DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–118250–20]

RIN 1545–BP94

Guidance on Passive Foreign Investment Companies and Controlled Foreign Corporations Held by Domestic Partnerships and S Corporations and Related Person Insurance Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the treatment of domestic partnerships and S corporations that own stock of passive foreign investment companies (''PFICs'') and their domestic partners and shareholders (the ''proposed regulations''). The proposed regulations also provide guidance regarding the determination of the controlling domestic shareholders of foreign corporations, the owner of a controlled foreign corporation (''CFC'') or qualified electing fund (''QEF'') that makes an election under section 1411, the treatment of S corporations with accumulated earnings and profits under subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code (''subpart F'' of the ''Code''), and the determination and inclusion of related person insurance income (''RPII'') under section 953(c). The proposed regulations affect United States persons that own, directly or indirectly, stock in certain foreign corporations.

DATES: Written or electronic comments and requests for a public hearing must be received by *April 25, 2022*. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–118250–20) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (''Treasury Department'') and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG–118250–20), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations under §§ 1.958–1(d), 1.964–1, 1.1291–1, 1.1291–9, 1.1293–1, 1.1295–1, 1.1296–1, 1.1297–0, 1.1297–3, 1.1298–1, 1.1298–3, and 1.1411–10, Edward Tracy at (202) 317–6934; concerning proposed regulation § 1.958–1(e), Jennifer N. Keeney at (202) 317–5045; concerning proposed regulation § 1.953–3, Raphael Cohen at (202) 317–3756 or Josephine Firehock at (202) 317–6938; concerning submissions of comments or requests for a public hearing, Regina Johnson at (202) 317–5177 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Regulations Addressing the Treatment of Domestic Partnerships for Purposes of Sections 951(a) and 951A

On October 10, 2018, the Treasury Department and the IRS published in the **Federal Register** proposed regulations under section 951A (REG–104390–18, 83 FR 51072) (''2018 proposed regulations''). The 2018 proposed regulations provided a hybrid approach to the treatment of a domestic partnership that is a United States shareholder, as defined in section 951(b) (''U.S. shareholder''), with respect to a CFC (''U.S. shareholder partnership''). Under the hybrid approach, a U.S. shareholder partnership would determine its section 951A inclusion, and the partners of the partnership that were not also U.S. shareholders of the CFC (''non-U.S. shareholder partners'') would take into account their distributive share of the inclusion. *See* proposed § 1.951A–5(b), 83 FR 51072, 51101. Partners that were themselves U.S. shareholders of a CFC (''U.S. shareholder partners'') would not take into account their distributive share of the partnership's global intangible low-taxed income (''GILTI'') inclusion amount and instead would be treated as proportionately owning the stock of the CFC within the meaning of section 958(a) as if the domestic partnership were a foreign partnership. *See* proposed § 1.951A–5(c), 83 FR 51072, 51101–51102.

On June 21, 2019, the Treasury Department and the IRS published final regulations (TD 9866) in the **Federal Register** (84 FR 29288, as corrected at 84 FR 44223, 84 FR 44693, and 84 FR 53052) under sections 951, 951A, 1502, and 6038 that include guidance with respect to the treatment of domestic partnerships that own stock in CFCs for purposes of section 951A (the ''final section 951A regulations''). The final section 951A regulations did not adopt the hybrid approach set forth in the 2018 proposed regulations and instead generally treat a domestic partnership as an aggregate of all of its partners for purposes of computing income inclusions under section 951A (and other provisions that apply by reference to section 951A). The final section 951A regulations apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end. § 1.951A–7. On the same date, the Treasury Department and the IRS published proposed regulations (REG–101828–19) in the **Federal Register** (84 FR 29114) that extended this aggregate treatment of domestic partnerships for purposes of computing subpart F inclusions under section 951 (the ''2019 proposed regulations'').

In the preamble to the 2019 proposed regulations, the Treasury Department and the IRS requested comments on the application of sections 1291 and 1293 through 1298 of the Code (the ''PFIC regime'') to domestic partnerships that directly or indirectly own PFIC stock and their domestic partners, including the operation of the PFIC regime with respect to non-U.S. shareholder partners of domestic partnerships under section 1297(d). 84 FR 29120. The 2019 proposed regulations are issued, with modifications, as final regulations in the Rules and Regulations section of this issue of the **Federal Register** (the ''final regulations'').

On August 22, 2019, the Treasury Department and the IRS released Notice 2019–46, 2019–37 I.R.B. 695, announcing the intention to issue regulations that will permit a domestic partnership or S corporation to apply the hybrid approach set forth in proposed § 1.951A–5 for taxable years ending before June 22, 2019 (that is, the hybrid approach set forth in the 2018 proposed regulations, which was revised in the 2019 final section 951A regulations to reflect an aggregate approach for purposes of section 951A). The notice also addressed the applicability of penalties in the case of a domestic partnership or S corporation that consistently applied proposed

§ 1.951A–5 on or before June 21, 2019, but filed a tax return consistent with the final section 951A regulations under § 1.951A–1(e). The notice was issued to address the compliance burden, and related penalty exposure, of domestic partnerships and S corporations that filed returns based on the hybrid approach set forth in the 2018 proposed regulations for taxable years ending before June 22, 2019, but later became subject to the aggregate approach of § 1.951A–1(e) for those years.

II. Treatment of Domestic Partnerships as Entities or Aggregates of their Partners—In General

For purposes of applying a particular provision of the Code, a partnership may be treated as either an entity separate from its partners or as an aggregate of its partners. Under the aggregate approach, the partners of a partnership, and not the partnership, are treated as owning the partnership's assets and conducting the partnership's operations. Under the entity approach, the partnership is respected as separate and distinct from its partners, and therefore the partnership, and not the partners, is treated as owning the partnership's assets and conducting the partnership's operations. Whether the aggregate or entity approach applies depends on which approach is more appropriate to carry out the scope and purpose of a particular Code provision. *See* H.R. Rep. No. 83–2543, at 59 (1954) (Conf. Rep.) (''Both the House provisions and the Senate amendment provide for the use of the 'entity' approach in the treatment of transactions between a partner and a partnership . . . . No inference is intended, however, that a partnership is to be considered as a separate entity for the purpose of applying other provisions of the internal revenue laws if the concept of the partnership as a collection of individuals is more appropriate for such provisions.''); *see also Holiday Village Shopping Center* v. *United States,* 5 Cl. Ct. 566, 570 (1984), aff'd 773 F.2d 276 (Fed. Cir. 1985) (''[T]he proper inquiry is not whether a partnership is an entity or an aggregate for purposes of applying the internal revenue laws generally, but rather which is the more appropriate and more consistent with Congressional intent with respect to the operation of the particular provision of the Internal Revenue Code at issue.''); *Casel* v. *Commissioner,* 79 T.C. 424, 433 (1982) (''When the 1954 Code was adopted by Congress, the conference report . . . clearly stated that whether an aggregate or entity theory of partnerships should be applied to a particular Code section depends upon which theory is more appropriate to such section.''); § 1.701–2(e)(1) (''The Commissioner can treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry out the purpose of any provision of the Internal Revenue Code or the regulations promulgated thereunder.'').

Consistent with this authority under subchapter K, the Treasury Department and the IRS have previously adopted the aggregate approach to partnerships to carry out the purpose of various provisions, including international provisions, of the Code. In addition to applying the aggregate approach for purposes of determining section 951 and section 951A inclusions in the final section 951A regulations and the final regulations, regulations under section 871 apply the aggregate approach in applying the 10 percent shareholder test of section 871(h)(3) to determine whether interest paid to a partnership would be considered portfolio interest under section 871(h)(2). § 1.871–14(g)(3)(i). The aggregate approach was also adopted in regulations issued under section 367(a) to address the transfer of property by a domestic or foreign partnership to a foreign corporation in an exchange described in section 367(a)(1). *See* § 1.367(a)–1T(c)(3)(i)(A). Similarly, the Treasury Department and the IRS adopted the aggregate approach for purposes of applying the regulations under section 367(b). *See* § 1.367(b)–2(k); *see also* §§ 1.367(e)–1(b)(2) (treating stock and securities of a distributing corporation owned by or for a partnership (domestic or foreign) as owned proportionately by its partners) and 1.861–9(e)(2) (requiring certain corporate partners to apportion interest expense, including the partner's distributive share of partnership interest expense, by reference to the partner's assets).

III. PFIC Rules

A. Section 1291

Under section 1291, a United States person (''U.S. person'') may be subject to ordinary income treatment and an interest charge when it receives an ''excess distribution'' from a PFIC or recognizes gain on the sale or disposition of PFIC stock (the ''excess distribution rules''). These charges are determined based on the person's holding period and the years in which the foreign corporation qualified as a PFIC. The excess distribution rules do not apply, however, if a shareholder makes certain elections with respect to the PFIC for its entire holding period of the PFIC stock.

The Treasury regulations under section 1291 apply the excess distribution rules to ''shareholders'' of a PFIC. *See* § 1.1291–1(b)(2)(v). Under § 1.1291–1(b)(7), a ''shareholder'' of a PFIC generally is defined as a U.S. person that owns PFIC stock directly or indirectly through certain corporations or pass-through entities (an ''indirect shareholder''), within the meaning of section 1298(a) and § 1.1291–1(b)(8) (collectively, a ''PFIC shareholder''). For purposes of sections 1291 and 1298, neither a domestic partnership nor an S corporation is treated as a PFIC shareholder except for purposes of any information reporting requirements (including the requirement to file an annual report under section 1298(f)) or where otherwise explicitly provided in regulations. Section 1.1291–1(b)(8)(iii)(A) and (B) provides that if a domestic partnership or S corporation owns PFIC stock, the partners or S corporation shareholders, respectively, are considered to own the PFIC stock proportionately in accordance with their ownership interests. As a result, if a domestic partnership or S corporation owns PFIC stock, the excess distribution rules apply at the partner or S corporation shareholder level.

B. Qualified Electing Funds

A PFIC shareholder may elect to treat the PFIC as a QEF (a ''QEF election'') under the rules in sections 1293 through 1295 (the ''QEF rules''). Under the QEF rules, provided the PFIC complies with certain information reporting requirements, the PFIC shareholder includes its pro rata share of the ordinary earnings and net capital gain generated by the QEF on a current basis under section 1293(a) (''QEF inclusions''), and any gain on a future disposition of the QEF shares may be treated as capital gain not subject to the excess distribution rules. Unlike for the excess distribution rules, under § 1.1295–1(j) domestic partnerships and S corporations are treated as PFIC shareholders for purposes of the QEF rules. A PFIC shareholder making a valid QEF election effective as of the beginning of its holding period in the PFIC stock is not subject to the excess distribution rules with respect to that PFIC (a ''pedigreed QEF''). Conversely, a PFIC shareholder that makes a QEF election effective after the beginning of its holding period in the PFIC stock is simultaneously subject to the excess distribution rules and the QEF rules with respect to that PFIC (an ''unpedigreed QEF'').

A domestic partnership or S corporation that owns PFIC stock generally makes the QEF election with respect to the PFIC under § 1.1295–1(d)(2)(i)(A) and (d)(2)(ii). Section 1.1293–1(c)(1) provides that the domestic partnership or S corporation recognizes any QEF inclusions at the entity level, and each U.S. person that is an interest holder in the domestic partnership or S corporation takes into account its pro rata share of the inclusions.

C. Mark-to-Market PFICs

Under section 1296 (the ''mark-to-market (MTM) rules''), if stock in a PFIC is marketable stock (''section 1296 stock''), a U.S. person owning that stock can make a mark-to-market election with respect to the PFIC (an ''MTM election''). For this purpose, pursuant to section 1296(g)(1), U.S. persons may be deemed to own certain marketable stock held by foreign partnerships, trusts, or estates. Section 1296(a) provides that if a U.S. person makes an MTM election with respect to a PFIC, the U.S. person is treated as if it sold the section 1296 stock at the end of each year, with any gain being recognized as ordinary income (''MTM gain'') and any loss potentially resulting in a deduction (''MTM loss,'' and together with MTM gains, ''MTM amounts'').

If a domestic partnership or an S corporation owns, or is treated as owning under § 1.1296–1(e) (providing ownership rules for PFIC stock owned through certain foreign entities), section 1296 stock, the domestic partnership or S corporation can make an MTM election with respect to the PFIC because the election is made by the U.S. person owning or treated as owning the stock. *See* § 1.1296–1(h)(1)(i). The domestic partnership or S corporation, by virtue of being a U.S. person, includes or deducts any MTM amounts at the entity level. *See* § 1.1296–1(c)(1) and (3).

D. CFC/PFIC Overlap

Section 957(a) defines a CFC as any foreign corporation in which U.S. shareholders own (within the meaning of section 958(a)), or are considered as owning by applying the ownership rules of section 958(b), more than 50 percent of the total combined voting power or value of the stock of the corporation on any day during the taxable year of the corporation. Under section 951(b), a U.S. shareholder is a U.S. person that owns (within the meaning of section 958(a)), or is considered as owning by applying the ownership rules of section 958(b), at least 10 percent of the total combined voting power of all classes of stock entitled to vote or at least 10 percent of the total value of all classes of stock of a foreign corporation. Section 957(c) defines a U.S. person by reference to section 7701(a)(30), which defines the term as a citizen or resident of the United States, a domestic partnership, a domestic corporation, and certain domestic estates and trusts.

Under section 1297(d), a foreign corporation that is both a CFC and a PFIC (a ''CFC/PFIC'') is not considered to be a PFIC with respect to a shareholder during the shareholder's qualified portion (as defined in section 1297(d)(2)) of its holding period (the ''CFC overlap rule''). The term ''qualified portion'' generally means the portion of the shareholder's holding period during which the shareholder is a U.S. shareholder with respect to the PFIC and during which the PFIC is also a CFC. Generally, this means that the PFIC regime should not apply to a U.S. person that is subject to the subpart F rules. The legislative history to the CFC overlap rule indicates that it was enacted due to concern about the simultaneous application of the subpart F and PFIC regimes to the same shareholders, explaining that ''a shareholder that is subject to current inclusion under the subpart F rules with respect to stock of a PFIC that is also a CFC generally is not subject also to the PFIC provisions with respect to the same stock.'' H.R. Rep. 105–148, at 534 (1997).

E. PFIC Purging Elections

1. Section 1291(d)(2) Purging Elections

Under section 1291(d)(2), a PFIC shareholder that owns, or is treated as owning, shares in an unpedigreed QEF may make certain elections to ''purge'' the PFIC taint and thereby no longer be subject simultaneously to the excess distribution and QEF rules with respect to that PFIC. Under section 1291(d)(2)(A) and § 1.1291–10, a PFIC shareholder may elect to recognize any gain on a deemed disposition of its PFIC stock with the gain being subject to the excess distribution rules. Alternatively, under section 1291(d)(2)(B) and § 1.1291–9, if the unpedigreed QEF is also a CFC (that is, it is a CFC/PFIC), the PFIC shareholder may elect to include its share of the CFC/PFIC's post-1986 accumulated earnings and profits (''E&P'') as a dividend subject to the excess distribution rules (together with the election described in the preceding sentence, the ''section 1291 purging elections''). The section 1291 purging elections are made by a PFIC ''shareholder'' as defined in § 1.1291–9(j)(3), which is a U.S. person that is a shareholder or indirect shareholder, as defined in § 1.1291–1(b)(7) or (8), respectively. If the PFIC shareholder makes one of the section 1291 purging elections, the QEF is a pedigreed QEF with respect to the shareholder.

2. Section 1298(b)(1) Purging Elections

Pursuant to section 1298(b)(1) and § 1.1298–3, a PFIC shareholder may make certain purging elections with respect to a foreign corporation that qualifies as a ''former PFIC'' or a ''section 1297(e) PFIC.'' These purging elections result in the foreign corporation no longer being treated as a PFIC as to the shareholder.

Under § 1.1291–9(j)(2)(iv), a ''former PFIC'' is a foreign corporation that satisfies neither the income test nor the asset test under section 1297(a), but its stock held by the PFIC shareholder is treated as stock of a PFIC as a result of section 1298(b)(1) (that is, the corporation was a PFIC that was not a QEF at some time during the PFIC shareholder's holding period). Pursuant to § 1.1291–9(j)(2)(v), a foreign corporation is a ''section 1297(e) PFIC'' [1] if it (i) qualifies as a PFIC under section 1297(a) on the first day on which the ''qualified portion'' (as defined in section 1297(d)(2)) of the PFIC shareholder's holding period in the foreign corporation begins (as determined under section 1297(e)(2)); and (ii) the stock of the foreign corporation held by the PFIC shareholder is treated as stock of a PFIC pursuant to section 1298(b)(1) because at any time during the PFIC shareholder's holding period of the stock, other than the qualified portion, the corporation was a PFIC that was not a QEF.

Similar to the section 1291 purging elections, under §§ 1.1297–3 and 1.1298–3, a PFIC shareholder can make either a deemed sale election or deemed dividend purging election with respect to either a former PFIC or section 1297(e) PFIC (the ''section 1298 purging elections'' and, together with the section 1291 purging elections, the ''PFIC purging elections''). The rules applicable to the section 1298 purging elections in §§ 1.1297–3(a) and 1.1298–3(a) are substantially the same as those applicable to the section 1291 purging elections, including that each section 1298 purging election is made by a PFIC ''shareholder'' as defined in § 1.1291–9(j)(3).

[1] Although the PFIC regulations use the term ''section 1297(e)'' PFIC, the term refers to CFC/PFICs under current section 1297(d). The regulations were issued before section 1297(e) was redesignated as section 1297(d) by the Tax Technical Corrections Act of 2007, Public Law 110–172, sec. 11(a)(24)(A), Dec. 29, 2007, 121 Stat 2473.

F. PFIC Information Reporting Requirements Under Section 1298(f)

Under section 1298(f), each U.S. person that is a PFIC shareholder as defined in § 1.1291–1(b)(7) must file an annual report with respect to the PFIC containing the information required by the IRS. Generally, pursuant to § 1.1298–1(b)(1), a U.S. person that is a PFIC shareholder must file Form 8621, ''Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund,'' if, during the shareholder's taxable year, it is (i) a direct PFIC shareholder; (ii) an indirect PFIC shareholder that holds any interest in the PFIC through one or more foreign entities; or (iii) an indirect PFIC shareholder that is treated as the owner of any portion of a domestic grantor trust that owns stock of a PFIC directly or through one or more foreign entities.

Certain other indirect PFIC shareholders are also required to file Form 8621. Specifically, under § 1.1298–1(b)(2)(i), an indirect PFIC shareholder that owns stock of a PFIC through one or more U.S. persons must file Form 8621 with respect to the PFIC if, during the indirect shareholder's taxable year, it is (i) treated as receiving an excess distribution with respect to the PFIC; (ii) treated as recognizing gain that is treated as an excess distribution as a result of a disposition of the PFIC; (iii) required to recognize QEF inclusions under section 1293(a); (iv) required to include or deduct MTM amounts under section 1296(a); or (v) required to report the status of an election under section 1294 with respect to the PFIC. However, under § 1.1298–1(b)(2)(ii), an indirect PFIC shareholder that is required to either recognize QEF inclusions under section 1293(a) or MTM amounts under section 1296(a) is generally not required to file Form 8621 if another PFIC shareholder through which the indirect PFIC shareholder owns its interest in the PFIC timely files Form 8621. Thus, if an indirect PFIC shareholder is treated as owning an interest in a PFIC by reason of an interest in a domestic partnership or S corporation and the domestic partnership or S corporation recognizes QEF inclusions or MTM amounts and timely files Form 8621, the indirect PFIC shareholder is generally not required to file Form 8621. Pursuant to § 1.1298–1(b)(2)(ii), this exception does not apply to a PFIC shareholder that transfers stock in a PFIC subject to a QEF election to a domestic partnership or S corporation if the domestic partnership or S corporation does not make a QEF election with respect to the PFIC after the transfer, in which case the transferor-PFIC shareholder is still required to file Form 8621.

G. Section 1298 Attribution of Ownership Provisions

For purposes of the entire PFIC regime, section 1298(a) contains various attribution rules that generally apply to treat stock of a PFIC as owned by a U.S. person. However, pursuant to section 1298(a)(1)(B), except as provided in regulations, section 1298(a) does not apply to treat stock owned (or treated as owned) by a U.S. person as owned by any other person. Under section 1298(a)(3), stock owned directly or indirectly by a partnership, estate, or trust is considered as being owned proportionately by its partners or beneficiaries.

IV. Subpart F Rules

A. Controlling Domestic Shareholders

The controlling domestic shareholders of a foreign corporation take certain actions with respect to the foreign corporation, such as electing the method of calculating its E&P under section 964(a). *See* § 1.964–1(c)(3). Under § 1.964–1(c)(5)(i), the controlling domestic shareholders of a CFC are defined as the United States shareholders, within the meaning of section 951(b) or section 953(c), that, in the aggregate, own (within the meaning of section 958(a)) more than 50 percent of the total combined voting power of all classes of stock of the CFC entitled to vote and that undertake to act on the CFC's behalf. If the more than 50 percent ownership requirement is not satisfied, the controlling domestic shareholders of the CFC are all of the U.S. shareholders that own (within the meaning of section 958(a)) stock of the CFC. Under § 1.964–1(c)(5)(ii), with respect to a noncontrolled section 902 corporation (as defined in section 904(d)(2)(E)), the controlling domestic shareholders are the majority domestic corporate shareholders, which are those domestic corporations that meet certain ownership requirements under section 902(a) (as it existed before its repeal in 2017) and that own, directly or indirectly, more than 50 percent of the combined voting power of the stock of the noncontrolled section 902 corporation owned, directly or indirectly, by all domestic corporations. Under § 1.964–1(c)(3)(iii), a controlling domestic shareholder that takes actions with respect to a foreign corporation under § 1.964–1(c)(3) must provide notice of those actions to certain other domestic shareholders of the foreign corporation.

With respect to a U.S. shareholder partnership, the 2019 proposed regulations provided that aggregate treatment does not apply for purposes of determining whether any U.S. shareholder is a controlling domestic shareholder. Proposed § 1.958–1(d)(2). In response to a request for comments on this rule in the preamble to the 2019 proposed regulations, one comment was received. That comment recommended, on balance, that aggregate treatment should not apply for purposes of determining whether a U.S. shareholder is a controlling domestic shareholder for purposes of section 964.

The final regulations do not extend aggregate treatment for purposes of determining controlling domestic shareholders of foreign corporations and, thus, adopt the exception included in the 2019 proposed regulations. § 1.958–1(d)(2)(v).

B. Treatment of S Corporation Distributions Under Section 1368 and Treatment of S Corporations and S Corporation Shareholders Under Section 1373 and Subpart F

1. S Corporation Distributions

Section 1368(b) and (c) provides for the treatment of distributions made by an S corporation (as defined in section 1361(a)(1)) with respect to its stock to which section 301(c) would apply but for section 1368(a). Section 1368(b) addresses the treatment of those distributions by an S corporation that does not have accumulated E&P (''AE&P''). Section 1368(b)(1) provides that a distribution by an S corporation is not included in the gross income of an S corporation shareholder to the extent that the amount of the distribution does not exceed the shareholder's adjusted basis in its S corporation stock. Section 1368(b)(2) provides that, if the amount of the distribution exceeds the shareholder's adjusted basis in its S corporation stock, that excess is treated as gain from the sale or exchange of property.

Section 1368(c) addresses the treatment of distributions by an S corporation that has AE&P (for example, if the S corporation generated E&P in years before its election to be treated as an S corporation) and therefore has an accumulated adjustments account (''AAA''), as defined by section 1368(e)(1). AE&P does not include amounts that would increase an S corporation's AAA. *See* section 1371(c). Accordingly, an S corporation's AAA functions similarly to the stock basis adjustment rules of section 1367 and is increased to account for income taxed to its shareholders. *See* section

1368(e)(1)(A). AAA is limited to income generated by the corporation during its status as an S corporation and preserves the single-level-of-tax treatment to S corporation shareholders.

With regard to distributions by S corporations with AE&P, section 1368(c) first applies the distribution to the S corporation's AAA. Section 1368(c)(1) provides that the portion of the distribution that does not exceed the S corporation's AAA is governed by section 1368(b) and is either not included in a shareholder's gross income (if that amount does not exceed the shareholder's adjusted basis in its S corporation stock) or is treated as gain from the sale or exchange of property (if that amount does not exceed the S corporation's AAA but exceeds the shareholder's adjusted basis in its S corporation stock). After the application of section 1368(c)(1), section 1368(c)(2) provides that any remaining portion of the distribution that exceeds the amount of the S corporation's AAA is treated as a dividend (as defined in section 316) to the extent of the S corporation's remaining AE&P. Lastly, under section 1368(c)(3), the portion of the distribution remaining after the application of section 1368(c)(1) and (2) is governed by section 1368(b) and either not included in gross income or treated as gain, depending on the shareholder's adjusted basis in its S corporation stock.

2. Treatment of S Corporations for Purposes of Subpart F

Section 1373(a) provides that an S corporation is treated as a domestic partnership and its shareholders as partners of a domestic partnership for purposes of subpart F of the Code, which includes sections 951, 951A, and 958. Therefore, under § 1.958–1(d)(1) of the final regulations, for purposes of determining section 951 or section 951A inclusions with respect to a CFC owned by an S corporation, the S corporation is not treated as owning the CFC's stock within the meaning of section 958(a). Instead, the CFC stock is treated as owned by a foreign partnership for purposes of determining the U.S. person that owns the CFC stock within the meaning of section 958(a).

As a result, section 951 or section 951A inclusions with respect to CFC stock held by an S corporation are determined and taken into account at the S corporation shareholder level but only if the S corporation shareholder is a U.S shareholder of the CFC. With respect to S corporations with AE&P, this aggregate treatment does not increase the S corporation's AAA because any section 951 or section 951A inclusions are taken into account directly by the S corporation shareholders. An S corporation's AAA generally is increased, however, by dividends received by the S corporation from a foreign corporation even if the E&P from which the dividend distributions are made is attributable to amounts that are, or have been, included in gross income of one or more shareholders of the S corporation under section 951(a) or 951A(a). *See* section 1368(e)(1)(A). In contrast, if section 951 and 951A amounts were included by a S corporation, the S corporation's AAA would not be increased for distributions excluded from the S corporation's gross income pursuant to section 959(a).

3. Notice 2020–69

In response to the final section 951A regulations, a comment asserted that aggregate treatment for purposes of computing section 951A inclusions is inappropriate for S corporations, notwithstanding the language of section 1373(a) (treating an S corporation as a partnership and S corporation shareholders as partners of a partnership), particularly where an S corporation has AE&P. Specifically, the comment suggested that the aggregate approach creates a mismatch between when S corporation shareholders recognize income with respect to a CFC and the creation of AAA maintained by the S corporation. This mismatch can cause certain distributions out of AE&P made by an S corporation to be taxable to its shareholders despite the fact that the shareholders were already taxed on the CFC's earnings under the final section 951A regulations.

Notice 2020–69, 2020–39 I.R.B. 604, released on September 1, 2020, announced that the Treasury Department and the IRS intend to issue regulations under section 958 to ease the transition of S corporations with AE&P on September 1, 2020, from the historic entity treatment (and the hybrid treatment under proposed § 1.951A–5) to the aggregate treatment required under the final section 951A regulations (the ''S corporation transition approach''). Under the S corporation transition approach, an S corporation is subject to entity treatment with respect to a taxable year if (i) an election is made; (ii) the corporation has elected S corporation status before June 22, 2019; (iii) the S corporation would be treated as owning, within the meaning of section 958(a), stock of a CFC on June 22, 2019, if entity treatment applied; (iv) the S corporation has ''transition AE&P'' on September 1, 2020, or on the first day of any subsequent taxable year; and (v) the S corporation maintains records to support the determination of the transition AE&P amount. Under this entity treatment, an S corporation that owns stock of a CFC is treated as owning, within the meaning of section 958(a), the CFC stock for purposes of applying section 951A such that the S corporation determines its GILTI inclusion amount, and its shareholders take into account their distributive share of that amount. Generally, an electing S corporation is treated as an entity under the S corporation transition approach until the first taxable year for which it has no transition AE&P on the first day of that year, at which point it is treated as an aggregate of its shareholders for that year and each successive year.

C. Related Person Insurance Income

Section 952(a) provides that subpart F income includes insurance income, as defined in section 953. Under section 953(c)(2), RPII is any insurance income (as defined in section 953(a)) attributable to a policy of insurance or reinsurance that directly or indirectly insures a United States shareholder (as defined in section 953(c)(1)(A)) of the controlled foreign corporation (as defined in section 953(c)(1)(B)), or a person related to that shareholder. Under section 953(c)(1)(A), the term ''United States shareholder'' means, with respect to any foreign corporation, a U.S. person (as defined in section 957(c)) who owns (within the meaning of section 958(a)) any stock of the foreign corporation (''RPII U.S. shareholder''). Section 953(c)(1)(B) provides that the term ''controlled foreign corporation'' has the meaning given to such term by section 957(a) determined by substituting ''25 percent or more'' for ''more than 50 percent'' (''RPII CFC'').

On April 17, 1991, the Treasury Department and the IRS published in the **Federal Register** proposed regulations under section 953 (INTL–939–86, 56 FR 15540) (the ''1991 proposed regulations''). Section 1.953–3 of the 1991 proposed regulations contains, among other provisions, general rules for determining RPII and definitions that apply for RPII purposes. Section 1.953–3(b)(1) of the 1991 proposed regulations defines RPII as premium and investment income attributable to a policy of insurance or reinsurance that provides insurance coverage to a related insured on risks located outside the RPII CFC's country of incorporation and also provides an analogous rule for annuity contracts.

Section 1.953–3(b)(5) of the 1991 proposed regulations provides that insurance income attributable to a cross-insurance arrangement is treated as

RPII. In general, a cross-insurance arrangement is an arrangement in which a RPII CFC insures a person that is not a related insured and, as part of the same arrangement, another person insures a person that would be a related insured if insured by the RPII CFC.

The cross-insurance rule was issued pursuant to section 953(c)(8)(A), which as the Conference Report states, ''*requires* the Secretary to prescribe such regulations as may be necessary to carry out the purposes of the new sub-part F rules for captive insurers, including regulations preventing the avoidance of the new rules through cross-insurance arrangements or otherwise.'' H.R. Rep. No. 99–841 at II–620 (Sep. 18, 1986) (emphasis added). Congress recognized the need for regulations because cross-insurance can be used to replicate the economics and tax benefits of a captive insurance arrangement through cooperative risk sharing while improperly avoiding the application of section 953(c)(2). ''The conferees do not believe that U.S. shareholders should be able to obtain the deferral of U.S. tax on income attributable to insurance of risks of U.S. persons who are in turn insuring the risks of those shareholders. Accordingly, under the regulations, the income of the two companies in the example attributable to the insurance business described [in a cross-insurance arrangement] is to be treated as related person insurance income.'' *Id.* at II–621.

Regulatory activity on the 1991 proposed regulations was suspended in 1999 due to the temporary enactment of changes to the definition of insurance income under section 953 and the temporary enactment of section 954(i) (together, the ''Insurance Active Financing Exception''). *See* Unified Agenda, 64 FR 21831 (Apr. 26, 1999). These statutory changes were adopted on a permanent basis by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113 (Dec. 18, 2015). Although much of the 1991 proposed regulations requires modification to account for the Insurance Active Financing Exception, other provisions in the 1991 proposed regulations, including the cross-insurance rule, were not affected by the statutory changes.

V. Net Investment Income Tax

Section 1411 imposes a 3.8-percent tax on the net investment income of certain individuals, trusts, and estates. Under § 1.1411–10(g), an election can be made with respect to a CFC or PFIC that is a QEF to treat amounts included in income under section 951(a) or section 1293(a)(1)(A) with respect to the CFC or QEF as net investment income for purposes of § 1.1411–4(a)(1)(i), and to take amounts included in income under section 1293(a)(1)(B) into account for purposes of calculating the net gain attributable to dispositions of property under § 1.1411–4(a)(1)(iii). Pursuant to § 1.1411–10(g)(3), the election may be made by any individual, estate, trust, domestic partnership, S corporation, or common trust fund that owns the relevant CFC or QEF directly or indirectly through one or more foreign entities. In addition, if a domestic partnership, S corporation, estate, trust, or common trust fund that directly owns the CFC or QEF does not make the election, an individual, estate, trust, domestic partnership, S corporation, or common trust fund that owns the CFC or PFIC indirectly through the non-electing entity may itself make the election. § 1.1411–10(g)(3).

Explanation of Provisions

I. PFIC Rules

A. Definition of PFIC Shareholder

The Treasury Department and the IRS have concluded that, because domestic partnerships and S corporations should be treated as aggregates of their partners and shareholders, respectively, for purposes of the QEF and MTM rules (see parts I.B.1 and I.C.1 of this Explanation of Provisions), the definition of shareholder under § 1.1291–1(b)(7) should be updated to reflect aggregate treatment for purposes of the PFIC regime. Thus, under the proposed regulations, neither domestic partnerships nor S corporations are considered shareholders for purposes of making QEF or MTM elections, recognizing QEF inclusions or MTM amounts, making PFIC purging elections, or filing Forms 8621. Proposed §§ 1.1291–1(b)(7), 1.1295–1(j)(3), 1.1296–1(a)(4).

B. QEF Rules

1. Treatment of Pass-Through Entities for Purposes of Sections 1293 and 1295

Various comments in response to the 2019 proposed regulations addressed the treatment of domestic partnerships as aggregates of their partners for purposes of the QEF rules. Some comments requested that domestic partnerships continue to be treated as PFIC shareholders for purposes of making QEF elections and recognizing QEF inclusions based on administrability considerations (including reducing compliance burdens for small partners) and access to information. Other comments recommended an aggregate approach to QEFs, citing consistency with section 951, section 951A, and other aspects of the PFIC regime (specifically sections 1291, 1294, and 1297(d)). Additionally, comments recommended that, because QEF inclusions are taken into account in computing taxable income at the partner level, a partner should determine whether the QEF rules apply. One comment recommended a transition to an aggregate approach to QEFs with an alternative that would permit a domestic partnership to make a QEF election on behalf of its partners if permitted under the partnership agreement.

The Treasury Department and the IRS have concluded that it is more appropriate to treat domestic partnerships and S corporations as aggregates of their partners and shareholders, respectively, for purposes of sections 1293 and 1295. Aggregate treatment is consistent with the general treatment of partnerships for purposes of the PFIC regime under section 1298(a)(3) and aligns the QEF rules with the treatment of domestic partnerships and S corporations for purposes of the CFC overlap rule. It also provides partners and S corporation shareholders, the persons most affected by a QEF election, with the ability to decide whether to make the election. In addition, the new reporting by partnerships on Schedule K–2, ''Partners' Distributive Share Items—International,'' and Schedule K–3, ''Partner's Share of Income, Deductions, Credits, etc.—International'' is expected to facilitate a partner's ability to make the QEF election. The Treasury Department and the IRS are aware that in limited circumstances, as a result of certain nonconforming tax years between a partner and a partnership, the partner may be required to file its return on which it makes a QEF election (and includes its QEF inclusion) before the deadline for the partnership to provide it with Schedule K–3. In such a case, the Treasury Department and the IRS expect that a partner seeking to make a QEF election will make arrangements with the partnership to provide the partner with the necessary information in a timely fashion.

Accordingly, the proposed regulations provide that a partner or S corporation shareholder, rather than the domestic partnership or S corporation, respectively, makes a QEF election, and each electing partner or S corporation shareholder must notify the partnership or S corporation, respectively, of the election to assist the partnership or S corporation with information reporting and tracking basis in the QEF stock. Proposed § 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A). Similarly, partners and S corporation shareholders include their pro rata shares of ordinary earnings and net capital gain attributable to the QEF stock as if such shareholder owned its share of the QEF stock directly, and not as a share of the pass-through entity's income. *See* proposed § 1.1293–1(c)(1). Contrary to the current regulations, however, a QEF election made under proposed § 1.1295–1(d)(2)(i)(A) or (d)(2)(ii)(A) by a partner or S corporation shareholder with respect to PFIC stock held indirectly through a domestic partnership or S corporation applies to all stock of that PFIC owned by such partner or S corporation shareholder, even if owned outside of the partnership or S corporation.

In response to the comments' concerns regarding the administrability of partner-level QEF elections, the Treasury Department and the IRS request comments on whether final regulations should permit a domestic partnership- or S corporation-level QEF election on behalf of its partners or shareholders, respectively, in conjunction with the general rule requiring the partner or shareholder to make the election. Comments should specifically address (i) the legal mechanism by which the domestic partnership or S corporation would be delegated the ability to make a QEF election on behalf of its partners or shareholders; (ii) the standard of delegation that should be required, including whether delegation should be based on the partnership agreement or the S corporation's organizational documents, or some other instrument, and, if so, whether delegation should be explicit or implicit within the instrument; (iii) whether the domestic partnership or S corporation's election should be binding on all partners or shareholders, or only on certain partners or shareholders; (iv) if binding on all partners or shareholders, whether certain partners or shareholders should be allowed to opt out and whether an opt-out is consistent with the current rules; and (v) the timing, filing, and notification requirements that should apply to a domestic partnership- or S corporation-level QEF election, taking into account the possibility of nonconforming taxable years among the partners and partnership (or shareholders and S corporation) and the QEF.

2. Transfers of Stock to Domestic Pass-Through Entities

The current regulations include special rules that apply when stock of a PFIC subject to a QEF election is transferred to a domestic pass-through entity, depending on whether the transferee entity makes a QEF election with respect to the transferred PFIC. Under § 1.1293–1(c)(2)(i), if PFIC stock subject to a QEF election is transferred to a domestic pass-through entity of which the transferor is an interest holder, and the transferee pass-through entity makes a QEF election with respect to the PFIC, thereafter the transferor and other interest holders that become PFIC shareholders as a result of the transfer begin taking into account their pro rata shares of the pass-through entity's QEF inclusions. However, under § 1.1293–1(c)(2)(ii), if the transferee pass-through entity does not make a QEF election with respect to the transferred PFIC, the transferor-shareholder (but not other indirect shareholders resulting from the transfer) continues to be subject to QEF inclusions with respect to the PFIC.

To provide consistency with the aggregate treatment of domestic partnerships and S corporations under the QEF rules, the proposed regulations provide that, if a shareholder transfers stock of a PFIC with respect to which it has made a QEF election to a pass-through entity, the transferor continues to be subject to QEF inclusions with respect to the transferred stock, and the other interest holders of the pass-through entity are subject to QEF inclusions from the PFIC only if they make a QEF election with respect to the transferred stock. Proposed § 1.1293–1(c)(3)(i) and (ii). However, because domestic nongrantor trusts continue to be shareholders for purposes of the QEF rules, the proposed regulations retain the rule in current § 1.1293–1(c)(2)(i) but limit its application to domestic nongrantor trusts. Therefore, if stock of a PFIC subject to a QEF election is transferred to a domestic nongrantor trust, and the transferee trust makes a QEF election with respect to the stock, the electing trust includes its pro rata share of the QEF inclusions, and its beneficiaries account for such amounts according to the general rules applicable to inclusions of income from the trust. *See* proposed § 1.1293–1(c)(3)(iii). If the domestic nongrantor trust does not make a QEF election with respect to the transferred stock, only the transferor is subject to QEF inclusions with respect to the transferred stock. *Id.*

3. Continuation of Preexisting QEF Elections

The Treasury Department and the IRS have concluded that QEF elections made by a domestic partnership or S corporation that are effective for taxable years of a PFIC ending on or before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register** (such PFIC a ''preexisting QEF,'' and the election, a ''preexisting QEF election'') will continue for any partner or S corporation shareholder owning an interest in a preexisting QEF on that date. *See* proposed § 1.1295–1(d)(2)(i)(B), (d)(2)(ii)(B), and (f)(3). Treating the preexisting QEF elections as if they were effectively made by each partner or S corporation shareholder owning an interest in the preexisting QEF before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register** should minimize the number of additional QEF elections required by partners and S corporation shareholders, thus making the QEF rules more administrable for taxpayers and the IRS when transitioning from the historic entity approach to the aggregate approach of the proposed regulations. However, although a new election is not required to be made with respect to a preexisting QEF by partners or S corporation shareholders that indirectly owned the QEF before the finalization of the proposed regulations, they are subject to QEF inclusions under the new aggregate approach. *See* proposed § 1.1293–1(c)(1).

4. Additional Changes to QEF Rules

The proposed regulations make several modifications to the rules that characterize stock held through a pass-through entity under § 1.1295–1(b)(3)(iv). First, consistent with the general aggregate approach to domestic pass-through entities under the QEF rules (other than domestic nongrantor trusts and domestic estates), the rule now governs how stock of a PFIC will be treated as stock of a pedigreed QEF to a shareholder, as defined in proposed § 1.1295–1(j)(3), rather than all interest holders or beneficiaries of a pass-through entity as under the current provision. This paragraph is also modified to address both the treatment of PFICs as pedigreed QEFs to shareholders owning such PFICs through domestic partnerships and S corporations that have made preexisting QEF elections, and the treatment of PFICs owned through domestic pass-through entities (other than domestic nongrantor trusts and domestic estates) to shareholders making the QEF election. Further, the rule addresses the treatment of PFICs as pedigreed QEFs when PFIC stock is acquired by, or transferred to, pass-through entities. *See* proposed § 1.1295–1(b)(3)(iv)(A) through (C). Additionally, in order to ensure the proper application of proposed § 1.1295–1(b)(3)(iv), proposed § 1.1295–1(b)(3)(iv)(A) and (B) do not apply to transactions in which gain is not fully recognized.

The proposed regulations also make several changes to conform § 1.1295–1 to the general aggregate treatment of domestic pass-through entities (other than domestic non-grantor trusts and domestic estates) under the QEF rules. These changes include (i) limiting the application of paragraphs (b)(3)(i) and (ii) to domestic nongrantor trusts and domestic estates, which are the only domestic pass-through entities that may make a QEF election under the proposed regulations; (ii) applying the partnership termination rule only with respect to partnerships that have made preexisting QEF elections and their partners; (iii) revising rules governing the treatment of PFIC stock distributed by a partnership as stock of a pedigreed QEF to transferee partners; and (iv) providing that shareholders owning QEF stock through a domestic partnership or S corporation that has made a preexisting QEF election are required to file Form 8621 for such QEFs. Proposed § 1.1295–1(b)(3)(i) through (iii) and (v) and (f)(2)(i). In addition, the proposed regulations remove the rule in § 1.1295–1(i)(1)(ii) that allows the Commissioner to invalidate a pass-through entity QEF election with respect to a shareholder if, as a result of nonconforming taxable years between the shareholder and a pass-through entity, the QEF inclusion is not included in income within two years of the PFIC's year end. The rule was removed because it specifically applies to pass-through entity QEF elections and inclusions, which, as a result of aggregate treatment, generally will only be relevant in limited circumstances involving domestic trusts. The Commissioner continues to have discretion to invalidate or terminate a shareholder's QEF election in appropriate circumstances if the requirements of section 1295 are not met by a shareholder, an intermediary, or the relevant PFIC. § 1.1295–1(i)(1)(i).

C. MTM Rules

1. Treatment of Pass-Through Entities for Purposes of Section 1296

The Treasury Department and the IRS received comments addressing the treatment of domestic partnerships as aggregates of their partners for purposes of the MTM rules, which generally were similar to the comments received with respect to QEFs. For reasons similar to those noted for QEFs, some comments recommended maintaining entity treatment of domestic partnerships under the MTM rules for administrability reasons, such as reduced compliance burdens for small partners and limited access to information. Other comments recommended an aggregate approach to maintain consistency with sections 951 and 951A and the PFIC regime (including the comments' proposed aggregate treatment of domestic partnerships for the QEF rules) and to allow the persons most affected by a MTM election, the partners, to determine whether the MTM rules apply. The comment discussed in part I.B.1 of this Explanation of Provisions that recommended an alternative that would permit a domestic partnership to make a QEF election on behalf of its partners made the same recommendation with respect to MTM elections.

For the reasons noted by the comments recommending an aggregate approach and to further consistency in the treatment of domestic partnerships and S corporations across the PFIC regime, the Treasury Department and the IRS have concluded that domestic partnerships and S corporations should also be treated as aggregates of their partners and shareholders, respectively, for purposes of the MTM rules. Accordingly, the proposed regulations extend aggregate treatment to domestic partnerships and S corporations for purposes of the MTM rules by providing that the MTM rules apply to PFIC shareholders, as defined in proposed § 1.1291–1(b)(7), which term does not include domestic partnerships or S corporations. *See* proposed § 1.1296–1(a)(4) and (e). As a result, partners of a domestic partnership or S corporation shareholders make an MTM election with respect to PFIC stock owned through the partnership or S corporation and determine their own MTM gain or loss, rather than taking into account their distributive share of the domestic partnership or S corporation's MTM gain or loss. *See* proposed § 1.1296–1(b)(1) and (c)(1) and (3). Partners and S corporation shareholders making an MTM election with respect to a PFIC held through a partnership or S corporation, respectively, must notify the partnership or S corporation of the election to assist the partnership or S corporation with information reporting and tracking basis in the PFIC stock. Proposed § 1.1296–1(h)(1)(i)(B). Incorporating the proposed § 1.1291–1(b)(7) definition of shareholder into § 1.1296–1 also clarifies that the MTM rules apply to grantors of domestic grantor trusts that own PFIC stock, and that domestic nongrantor trusts and domestic estates continue to be treated as entities for purposes of the MTM rules.

To reflect the transition to the aggregate treatment of domestic partnerships and S corporations for purposes of the MTM rules, various other conforming changes are made to apply the MTM rules to PFIC shareholders rather than U.S. persons. *See* proposed § 1.1296–1(b)(2) and (3); § 1.1296–1(c)(5); § 1.1296–1(d)(1) and (2); § 1.1296–1(e) and (f); § 1.1296–1(g)(1) and (2); § 1.1296–1(h)(1)(i) and (ii); § 1.1296–1(h)(2)(ii); § 1.1296–1(h)(3); and § 1.1296–1(i)(1). Additionally, the rule in § 1.1296–1(g)(3), providing that when an MTM PFIC is owned through certain foreign pass-through entities any MTM gain or loss is determined as of the end of the foreign pass-through entity's tax year, has been removed. Under the general aggregate treatment of pass-through entities (besides domestic nongrantor trusts and domestic estates) for purposes of the MTM rules, the appropriate taxable year with respect to which any MTM gain or loss is determined is the taxable year end of the shareholder that owns the MTM PFIC through a pass-through entity, not the pass-through entity's taxable year.

As in part I.B.1 of this Explanation of Provisions, the Treasury Department and the IRS request comments on whether a form of partnership- or S corporation-level MTM election could be accommodated in final regulations. Comments should address the same considerations noted in part I.B.1 of this Explanation of Provisions regarding the delegation of authority to make an MTM election to a domestic partnership or S corporation.

2. Continuation of Preexisting MTM Elections

The Treasury Department and the IRS have concluded that MTM elections made with respect to a PFIC by a domestic partnership or S corporation for taxable years of the PFIC ending on or before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register** (''preexisting MTM election'') should be treated as made by any partner or S corporation shareholder owning its interest on that date. This treatment should minimize the number of additional MTM elections that would be made by such partners or S corporation shareholders, thus making the MTM rules more administrable for taxpayers and the IRS as a result of the transition from the historic entity approach to the aggregate approach of the proposed regulations. Accordingly, MTM elections made by domestic partnerships and S corporations effective for taxable years of a PFIC ending on or before finalization of the proposed regulations under proposed § 1.1296–1(h)(1)(i)(A) continue to be valid and will be treated as made by the owners of such entities. As a result, going forward the owners of those entities will determine their MTM gain or loss as if they held the section 1296 stock directly.

3. Modifications to the MTM Coordination Rule

Under section 1296(j) and § 1.1296–1(i), if a taxpayer makes an MTM election with respect to a foreign corporation that was a PFIC (other than a QEF) before the first taxable year to which the MTM election was effective, the excess distribution rules apply to any (i) distributions by the PFIC with respect to the section 1296 stock; (ii) disposition of the section 1296 stock; and (iii) MTM gain recognized on the last day of the U.S. person's taxable year (the ''MTM coordination rule''). Before the proposed regulations, if section 1296 stock subject to the MTM coordination rule was held by a domestic partnership or S corporation, it may have been unclear how to apply the MTM coordination rule since the excess distribution rules are not applied at the domestic partnership or S corporation level.

Accordingly, to conform to the general transition to an aggregate approach under the MTM rules, the proposed regulations clarify that the MTM coordination rule is applied to a PFIC shareholder. *See* proposed § 1.1296–1(i)(2) introductory text and (i)(2)(ii). To coordinate with MTM rules other than those under section 1296, the proposed regulations also modify § 1.1291–1(c)(4)(ii) so that computations apply to PFIC shareholders.

D. CFC Overlap Rule

1. Application Based on Aggregate Treatment for Sections 951 and 951A

The CFC overlap rule provides that, for purposes of the PFIC regime, a corporation is not treated as a PFIC with respect to a shareholder during the qualified portion of the shareholder's holding period with respect to stock in the corporation. Section 1297(d)(1). Thus, this rule applies separately with respect to each shareholder of the foreign corporation, and the foreign corporation may be a PFIC with respect to one shareholder but not another. The CFC overlap rule was intended to eliminate the simultaneous application of the subpart F and PFIC regimes only for a shareholder that is ''subject to current inclusion under the subpart F rules.'' H.R. Rep. 105–148 at 534.

Under the final regulations (and § 1.951A–1(e) as applicable before the final regulations), domestic partnerships and S corporations do not have inclusions under section 951 or section 951A and, because the inclusions are instead determined directly and solely by the partners or S corporation shareholders that are U.S. shareholders, partners and S corporation shareholders that are not U.S. shareholders do not have section 951 or section 951A inclusions. *See* § 1.958–1(d)(1). Thus, a U.S. person that is not a U.S. shareholder of a foreign corporation that would otherwise be a PFIC with respect to that person if held directly should not be permitted to rely on the CFC overlap rule to avoid the PFIC regime simply because the U.S. person owns its interest in the foreign corporation indirectly through a domestic partnership or S corporation.

Although section 1297(d) does not define the term ''shareholder'' for this purpose, under § 1.1291–1(b)(7), a domestic partnership or S corporation is not a shareholder to which the CFC overlap rule applies.[2] Thus, this regulation sets forth an exception to the general rule in section 1298(a)(1)(B), which provides that a U.S. person is not treated as constructively owning stock that is owned by another U.S. person (including, for example, a domestic partnership). Accordingly, under the general rule of section 1298(a)(1)(A), constructive ownership of PFIC stock under section 1298(a) applies to the extent that the effect is to treat PFIC stock held by a domestic partnership or S corporation as owned by partners and shareholders of the entities that are U.S. persons. The ownership provisions of section 1298(a), in turn, apply for purposes of sections 1291 through 1298, including section 1297(d). Thus, neither a domestic partnership nor an S corporation is a shareholder for purposes of section 1297(d) by operation of § 1.1291–1(b)(7), notwithstanding that, under § 1.958–1(d)(2)(i), a domestic partnership or an S corporation may be a U.S. shareholder of the foreign corporation within the meaning of section 951(b). Consistent with this aggregate approach to section 951 and section 951A in applying the CFC overlap rule under the existing regulations, the proposed regulations confirm that for purposes of section 1297(d), the term ''qualified portion'' does not include any portion of a domestic partner or S corporation shareholder's holding period during which the partner or shareholder was not a U.S. shareholder with respect to the CFC/PFIC. Proposed § 1.1291–1(c)(5)(i).

2. Transition Rule for Entity Treatment

Although the CFC overlap rule, in conjunction with the shareholder definition in § 1.1291–1(b)(7), properly reflects the aggregate approach to subpart F (as discussed in part III.A of this Explanation of Provisions), the Treasury Department and the IRS have determined that the application of these rules could lead to inappropriate results under the entity approach to subpart F that applied under prior law. In particular, under entity treatment for subpart F, the CFC overlap rule would not apply with respect to partners or S corporation shareholders of the CFC/PFIC that were not U.S. shareholders even though they would take into account their share of inclusions of the domestic partnership or S corporation under section 951 and, as applicable, section 951A. Thus, the CFC/PFIC would be treated as a PFIC with respect to such partners or S corporation shareholders even though the partner or shareholder was subject to current inclusions under the subpart F regime.

Accordingly, the Treasury Department and the IRS have determined that it is appropriate to provide a transition rule that would apply to taxable years of shareholders beginning before the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**, or for taxable years of shareholders of an S corporation in which the S corporation elects to apply § 1.958–1(e). When this transition rule applies, the CFC overlap rule will benefit certain persons that are indirect PFIC shareholders, but not U.S. shareholders, due to owning stock of foreign corporations through domestic partnerships or S corporations, during periods when the shareholder was subject to current inclusions under section 951 or section 951A (for example, under the rules described in Notices 2019–46 and 2020–69) as a

[2] Section 1.1291–1(b)(7) provides that a PFIC shareholder is a U.S. person that directly owns PFIC stock or that is an indirect shareholder under § 1.1291–1(b)(8); further, it states that for purposes of sections 1291 and 1298, neither a domestic partnership nor an S corporation is treated as a PFIC shareholder, except for information reporting purposes. This definition of shareholder was first adopted as a temporary regulation, applicable to taxable years of shareholders ending on or after December 31, 2013 (T.D. 9650, 78 FR 79602, 79608 (Dec. 31, 2013)) and was subsequently issued as a final regulation without substantive change with the same applicability date (T.D. 9806, 81 FR 95459, 95465 (Dec. 28, 2016)). Both temporary and final § 1.1291–1(b)(7) were issued after several private letter rulings (''PLRs''), such as PLR 201108020 (Feb. 25, 2011) and PLR 200943004 (Oct. 23, 2009), which were issued with respect to the application of section 1297(d) to domestic partnerships.

share of a domestic partnership or S corporation's income inclusions. Proposed § 1.1291–1(c)(5)(ii).

E. PFIC Purging Elections

Under the current regulations, it may be unclear whether a domestic partnership or an S corporation that owns PFIC stock is eligible to make a PFIC purging election, particularly with respect to the section 1291 purging elections, both of which require simultaneous QEF elections that are generally made by domestic partnerships and S corporations.

Consistent with the aggregate treatment of domestic partnerships and S corporations for purposes of making elections and determining income inclusions within the PFIC regime, the Treasury Department and the IRS have determined that the PFIC purging elections with respect to PFICs owned by partnerships and S corporations should be made at the partner or shareholder level because each of the PFIC purging elections can result in the recognition of excess distributions under section 1291, and those inclusions are directly taken into account at the partner or shareholder level and rely on partner or shareholder specific tax attributes, such as holding period. Each PFIC purging election is made by a shareholder as defined in proposed § 1.1291–1(b)(7), which has been modified to make explicit that neither domestic partnerships nor S corporations are PFIC shareholders for any purpose. As a result, under the proposed regulations, PFIC purging elections are made at the partner or S corporation shareholder level.

F. PFIC Information Reporting

Consistent with the aggregate treatment of domestic partnerships and S corporations for purposes of the QEF and MTM rules, the Treasury Department and the IRS have concluded that domestic partnerships and S corporations should no longer be required to file an annual report (Form 8621) under section 1298(f) and § 1.1298–1. The requirement to file Form 8621 applies only to PFIC shareholders within the meaning of § 1.1291–1(b)(7), which includes, for example, partners or S corporation shareholders that indirectly own PFICs through domestic partnerships or S corporations. § 1.1298–1(a). Domestic partnerships and S corporations will not be subject to this filing obligation due to the revised definition of shareholder in proposed § 1.1291–1(b)(7), under which domestic partnerships and S corporations are not PFIC shareholders for any purpose.

To reflect this change, proposed § 1.1298–1(b)(1) revises the general rule requiring a PFIC shareholder to file Form 8621 to clarify that the requirement applies to PFIC shareholders as defined in § 1.1291–1(b)(7). Additionally, proposed § 1.1298–1(b)(1)(i) and (ii) provides that the general rule concerning who has to file Form 8621 with respect to a PFIC applies to a PFIC shareholder that is either (i) a direct PFIC shareholder or (ii) an indirect PFIC shareholder (within the meaning of § 1.1291–1(b)(8)) that holds an interest in a PFIC through one or more entities, each of which is not a PFIC shareholder within the meaning of § 1.1291–1(b)(7). As a result, because a domestic grantor trust is not a PFIC shareholder within the meaning of § 1.1291–1(b)(7), the proposed regulations remove § 1.1298–1(b)(1)(iii). Similarly, the proposed regulations remove § 1.1298–1(c)(6) because domestic partnerships are not PFIC shareholders under proposed § 1.1291–1(b)(7) and thus have no filing obligation under the proposed regulations.

These changes limit the application of § 1.1298–1(b)(2) (which currently requires certain indirect shareholders to file Form 8621 when those shareholders own an interest in a PFIC through one or more U.S. persons) to only beneficiaries of domestic estates and domestic nongrantor trusts, because an indirect PFIC shareholder owning stock in a PFIC through a domestic partnership, S corporation, or domestic grantor trust will be required to file a Form 8621 under proposed § 1.1298–1(b)(1)(ii). An indirect PFIC shareholder owning stock of a PFIC by reason of an interest in a domestic estate or domestic nongrantor trust that recognizes its share of the estate or trust's QEF inclusions or MTM amounts would continue to be able to rely on the exception of § 1.1298–1(b)(2)(ii) if the domestic estate or domestic nongrantor trust files Form 8621 with respect to the QEF or MTM PFIC. The proposed regulations remove the last sentence of § 1.1298–1(b)(2)(ii) regarding the inability to apply the exception with respect to stock in a QEF contributed to domestic partnerships or S corporations, because these entities cannot make a QEF election under the proposed regulations.

The changes to the section 1298(f) information reporting requirements in proposed § 1.1298–1 reflect the general shift in the treatment of domestic partnerships and S corporations as aggregates for purposes of the PFIC regime. While these changes represent a change in the PFIC shareholders required to file an annual report under section 1298(f), a domestic partnership or S corporation will continue to have a responsibility to report information with respect to the PFICs it owns to its interest holders on Schedule K–3, "Partner's Share of Income, Deductions, Credits, etc.—International," of Forms 1065, "U.S. Return of Partnership Income," and 1120–S, "U.S. Income Tax Return for an S Corporation," respectively, when required. The general information reporting obligations of domestic partnerships and S corporations with respect to their interest holders should result in the interest holders receiving the information required to satisfy their filing obligations under section 1298(f).

G. Other Changes

1. Section 1297(e) PFICs

The term "section 1297(e) PFIC" and other associated references to "section 1297(e)" related to section 1297(e) before it was re-designated as current section 1297(d) by the Tax Technical Corrections Act of 2007. Accordingly, the proposed regulations change the defined term "section 1297(e) PFIC" to "section 1297(d) PFIC" and replace references to "section 1297(e) PFICs" and "section 1297(e)(2)" with references to "section 1297(d) PFICs" and "section 1297(d)(2)," respectively.

2. Changes to Definition of Post-1986 Earnings and Profits

The term "post-1986 earnings and profits" is the basis upon which a deemed dividend under §§ 1.1291–9, 1.1297–3, and 1.1298–3 is determined, and each of those sections generally defines the term by reference to the definition of "undistributed earnings, within the meaning of section 902(c)." However, because section 902 was repealed by the Tax Cuts and Jobs Act, Public Law 115–97, December 22, 2017, 131 Stat 2054 ("TCJA"), the proposed regulations revise the definition of post-1986 earnings and profits in §§ 1.1291–9(a)(2)(i), 1.1297–3(c)(3)(i)(A), and 1.1298–3(c)(3)(i) to eliminate references to section 902(c) and to define the term by reference to earnings and profits computed in accordance with sections 964(a) and 986.

II. Subpart F Rules

A. Modifications to § 1.964–1(c), Including Determination of Controlling Domestic Shareholders

As discussed in part IV.A of the Background section of this preamble, the final regulations do not extend aggregate treatment for purposes of determining controlling domestic shareholders of foreign corporations. Nevertheless, the Treasury Department and the IRS have further considered the benefits of maintaining entity treatment of domestic partnerships for purposes of determining the controlling domestic shareholders of a CFC, including the administrative convenience of centralizing the various actions taken by controlling domestic shareholders, and have concluded that such actions should generally be taken by those persons whose tax liability is directly affected thereby. Accordingly, the Treasury Department and the IRS have concluded that domestic partnerships should be treated as aggregates for purposes of determining whether a U.S. shareholder is a controlling domestic shareholder of a CFC. This approach is consistent with the final regulations, which provide that neither section 951 nor section 951A inclusions arise at the U.S. shareholder partnership level but instead arise directly to U.S. shareholder partners. In other words, actions that affect the determination of inclusions under sections 951 and 951A are determined by the same persons that have the direct inclusions under those provisions.

Accordingly, proposed § 1.958–1(d)(1) provides that domestic partnerships are not considered to own stock of a foreign corporation under section 958(a) for purposes of § 1.964–1(c) as well as any provision that specifically applies by reference to § 1.964–1(c). As a result, domestic partnerships and S corporations (by virtue of section 1373(a)) would be treated as aggregates of their partners and shareholders, respectively, for purposes of determining the controlling domestic shareholders of foreign corporations under the proposed regulations.

In addition to applying for purposes of determining the controlling domestic shareholders of a foreign corporation, aggregate treatment also generally applies for purposes of the notice requirement of § 1.964–1(c)(3)(iii). Extending aggregate treatment to this notice requirement ensures that other persons known by the controlling domestic shareholders to be U.S. persons that own (within the meaning of section 958(a)) stock of a foreign corporation (''domestic shareholders'') through a domestic partnership (but that are not themselves controlling domestic shareholders) are made aware of any action undertaken by the controlling domestic shareholders under § 1.964–1(c)(3). However, proposed § 1.964–1(c)(3)(iii)(B) provides that a controlling domestic shareholder is deemed to satisfy the notice requirement with respect to domestic shareholders that are partners in a domestic partnership by providing the notice to the domestic partnership (known to the controlling domestic shareholder) through which the domestic shareholders own stock of the foreign corporation, which could then provide the notice to its partners that are domestic shareholders. Additionally, to help facilitate notice to the person that prepares and maintains the foreign corporation's books and records for U.S. federal income tax purposes, notice is also required to be provided to any U.S. person (such as a domestic partnership) that controls, within the meaning of section 6038(e), the foreign corporation (in other words, any U.S. person that is a Category 4 filer of Form 5471, ''Information Return of U.S. Persons With Respect to Certain Foreign Corporations,'' with respect to the foreign corporation).

Additionally, in light of the repeal of section 902 as part of the TCJA, the proposed regulations replace the term ''noncontrolled section 902 corporation'' in § 1.964–1(c)(5)(ii) with the term ''noncontrolled foreign corporation,'' which is defined as any foreign corporation (other than a CFC as defined in section 957 or section 953) as to which a U.S. shareholder owns stock within the meaning of section 958(a). Proposed § 1.964–1(c)(5)(ii). The proposed regulations similarly replace the term ''majority domestic corporate shareholders'' with the term ''majority domestic shareholders,'' to reflect the repeal of section 902. *Id.*

B. Treatment of S Corporations With AE&P

After the issuance of Notice 2020–69 (announcing an intent to issue regulations adopting the S corporation transition approach), a comment requested additional guidance on issues applicable to S corporations under sections 951 and 951A. Specifically, the comment requested (i) transition rules for taxpayers that elected into the S corporation transition approach; (ii) guidance on the aggregate treatment of S corporations for purposes of sections 951 and 951A; and (iii) the ability of all S corporations to elect entity treatment similar to the S corporation transition approach described in Notice 2020–69, regardless of whether the S corporation has AE&P.[3]

The proposed regulations adopt the S corporation transition approach, as described in Notice 2020–69. *See* proposed § 1.958–1(e). The Treasury Department and the IRS have concluded that the S corporation transition approach in the proposed regulations appropriately smooths the transition for S corporations to be on an equal footing with domestic partnerships. The S corporation transition approach ensures that amounts corresponding to income of a CFC already taxed to S corporation shareholders can, even without being distributed by the CFC, be distributed tax-free by the S corporation and have priority over distributions of C corporation AE&P, while the latter will continue to be taxed as dividends when distributed, consistent with section 1368. Because section 951 and section 951A inclusions at the entity level will generate AAA, S corporations with AE&P will be able to make distributions to shareholders with respect to those amounts rather than distributions of dividends out of AE&P.

The proposed regulations do not extend the S corporation transition approach to all S corporations, regardless of AE&P. The Treasury Department and the IRS believe that permitting all S corporations to elect to be treated as an entity for purposes of sections 951 and 951A is inconsistent with section 1373(a) and the aggregate approach adopted in the final section 951A regulations and the final regulations. Further, the Treasury Department and the IRS have determined that, in recognition of certain issues specific to S corporations with AE&P as of a certain date, the S corporation transition approach, with its conditions, sufficiently transitions those S corporations that elect entity treatment to the aggregate treatment provided in the final section 951A regulations and the final regulations. Accordingly, this comment is not adopted.

C. Entity Treatment Under Section 951A and Inapplicability of Penalties

The proposed regulations include the rules announced in Notice 2019–46 that permit domestic partnerships and S

[3] This comment also requested guidance to (i) clarify the determination of a partner's proportionate share of CFC stock in accordance with the allocation of tested items under section 951A to a U.S. shareholder that owns stock in a CFC through an interest in a partnership and (ii) provide rules on the allocation of tested items under section 951A and on the maintenance of previously-taxed earnings and profits (''PTEP'') accounts. The long-standing issues of measuring a partner's proportionate share of income under subpart F as well as the treatment of targeted capital accounts are outside the scope of these proposed regulations and therefore are not addressed. With respect to the request for guidance related to PTEP, the Treasury Department and the IRS intend to separately address certain issues pertaining to partnerships and S corporations. In particular, this guidance will include rules to address the transition of S corporations from entity treatment to aggregate treatment as noted in section 3.04 of Notice 2020–69.

corporations to apply the hybrid approach for taxable years ending before June 22, 2019. Consistent with Notice 2019–46, to apply the hybrid approach, domestic partnerships and S corporations must satisfy certain notice requirements. Proposed § 1.951A–1(e)(2)(i) and (iii). In addition, if the domestic partnership or S corporation satisfies these notification requirements it will not be subject to certain penalties for failures to file or furnish statements to the extent such failures arise from acting consistently with the 2018 proposed regulations before June 22, 2019. Proposed § 1.951A–1(e)(2)(ii).

D. Related Person Insurance Income

1. Aggregate Treatment of Partnerships

A comment in response to the 2019 proposed regulations requested that aggregate treatment be applied to domestic partnerships for purposes of determining RPII and that domestic partnerships be treated the same way as foreign partnerships for this purpose. In addition, the Treasury Department and the IRS recognize that treating a domestic partnership as an entity for purposes of section 953(c) could produce disproportionate RPII inclusions in light of the special rules contained in section 953(c)(5). Therefore, proposed § 1.958–1(d)(1) modifies the list of provisions subject to aggregate treatment to include section 953(c), and a domestic partnership is not treated as a RPII U.S. shareholder for the purpose of characterizing income as RPII. The proposed regulations, however, provide that § 1.958–1(d)(1) does not apply for purposes of section 953(c)(1)(A) in determining whether any foreign corporation is a controlled foreign corporation as defined in section 953(c)(1)(B), 953(c)(3)(E), or 953(d)(1)(A). Proposed § 1.958–1(d)(2)(v). This approach is consistent with § 1.958–1(d)(2)(ii) (providing that § 1.958–1(d)(1) does not apply for purposes of determining whether a foreign corporation is a controlled foreign corporation as defined in section 957).

Corresponding changes are made to the definition of RPII under proposed § 1.953–3 to conform with the aggregate treatment of partnerships under proposed § 1.958–1(d)(1). RPII is generally defined as premium and investment income attributable to an annuity, insurance, or reinsurance policy that directly or indirectly provides coverage to a related insured. Proposed § 1.953–3(b)(1)(i). The new definition of RPII is modeled on the 1991 proposed regulations but has been modified to account for the aggregate treatment of partnerships and the Insurance Active Financing Exception. Section 1.953–3(b)(1) of the 1991 proposed regulations is withdrawn.

A related insured is defined to include a RPII U.S. shareholder or a person related to a RPII U.S. shareholder. Proposed § 1.953–3(b)(1)(ii)(A) and (B). In addition, if a related insured indirectly owns stock in a RPII CFC through a partnership, the partnership is treated as a related insured. Proposed § 1.953–3(b)(1)(ii)(C). This rule applies to foreign and domestic partnerships (other than publicly traded partnerships) and to S corporations.

Proposed § 1.953–3(b)(1)(ii)(D) also provides that a person (other than a publicly traded corporation or partnership) is treated as a related insured if it is more than 50 percent owned (directly, indirectly, or constructively) by RPII U.S. shareholders. This rule is intended to prevent the avoidance of RPII when the insured is held by multiple RPII U.S. shareholders (or their affiliates) and is issued pursuant to the authority granted in section 953(c)(8)(A). The Treasury Department and the IRS request comments on whether the final regulations should include a rule under which a U.S. person that holds an option to acquire stock (or another non-stock interest) in a RPII CFC also should be treated as a related insured.

The term ''related insured'' describes those persons who, if insured, would cause a RPII CFC's income to be characterized as RPII. A person who is not actually insured by a RPII CFC can meet the definition of a related insured for purposes of the proposed regulations (though a RPII CFC's income will not be characterized as RPII unless it is attributable to a policy that provides coverage to a related insured). No inference is intended concerning the standard for determining whether a person is characterized as being insured for other tax purposes.

When a partnership is insured by a RPII CFC, the amount of RPII is determined based on the portion of the premium that is allocated to related insureds (other than partnerships or S corporations). Proposed § 1.953–3(b)(1)(iii). In the case of tiered partnerships, the proposed regulations take into account the portion of the premium that is allocated to a partner who indirectly owns a partnership through one or more upper-tier partnerships. The proposed regulations provide that the premium allocated to the relevant partner is determined based on the partnership agreement and section 704(b). Proposed § 1.953–3(b)(1)(iii)(C)(*1*). The Treasury Department and the IRS are also considering whether, solely for purposes of determining the amount of RPII, another method of allocating the premium payments should be required under the authority provided in section 953(c)(8). One potential method includes allocating the premium payments in proportion to each partner's nonseparately stated share of partnership income or loss. Comments are requested on whether this or another alternative would be more appropriate.

The Treasury Department and the IRS request comments on the appropriate application of aggregate principles to RPII. The Treasury Department and the IRS also are considering revising forms and instructions to facilitate information sharing and reporting between RPII U.S. shareholders, RPII CFCs, and partnerships and request comments in this regard.

2. Cross-Insurance Rule

The Treasury Department and IRS are aware of abusive marketed offshore captive insurance arrangements that, notwithstanding the directive in section 953(c)(8)(A) and legislative history described in part IV.C of the Background section of this preamble and the 1991 proposed regulations, attempt to avoid the RPII rules through the use of cross-insurance. Consistent with the Congressional directive, the proposed regulations contain a special rule to address cross-insurance arrangements, which replaces the cross-insurance rule contained in the 1991 proposed regulations. Proposed § 1.953–3(b)(5) provides that insurance income is treated as RPII if it is attributable to an arrangement in which a RPII CFC insures a person that is not a related insured and, as part of the same arrangement, another person insures a related insured of the RPII CFC. This rule applies to direct or indirect arrangements involving two or more insurance companies, and also covers other arrangements with a similar degree of cooperative risk sharing and applies regardless of whether the shareholders of each RPII CFC are engaged in a similar line of business. Section 1.953–3(b)(5) of the 1991 proposed regulations is withdrawn.

The Treasury Department and the IRS request comments with respect to other parts of the 1991 proposed regulations relating to RPII, including whether other parts should be reproposed, such as the exception for indirect ownership through publicly traded corporations under § 1.953–3(b)(2)(iii) of the 1991 proposed regulations.

III. Net Investment Income Tax

As discussed in part V of the Background section of this preamble, a domestic partnership or S corporation that directly or indirectly (through one or more foreign entities) owns a CFC or QEF may make an election under § 1.1411–10(g) with respect to the CFC or QEF, and certain persons that own a CFC or QEF indirectly through a domestic partnership or S corporation may also make such an election, but only if the domestic partnership or S corporation does not make the election.

Consistent with the transition to aggregate treatment and provisions in this rulemaking requiring QEF elections to be made (and QEF inclusions to arise) at the partner or S corporation shareholder level, the Treasury Department and the IRS have determined that elections under § 1.1411–10(g) should no longer be permitted to be made by a domestic pass-through entity, but instead should be made only by an individual, estate, or trust that holds the CFC or QEF indirectly through the domestic pass-through entity. This rule permits the election to be made solely by the person whose tax liability is directly affected by the election. Accordingly, proposed § 1.1411–10(g)(3)(i) generally requires the election to be made by an individual, estate, or trust that indirectly holds the relevant CFC or QEF indirectly through a partnership or S corporation. However, for taxable years that an S corporation elects to be treated as an entity under proposed § 1.958–1(e), the S corporation may make the election under § 1.1411–10(g) with respect to CFCs it owns, directly or indirectly; if the S corporation does not make the election under § 1.1411–10(g), its shareholders that are individuals, estates, or trusts may make it instead. Proposed § 1.1411–10(g)(3)(ii).

The proposed regulations also remove § 1.1411–10(g)(2)(iii), which provided rules applicable when a partnership terminated under section 708(b)(1)(B), because section 708(b)(1)(B) was repealed as part of the TCJA.

Finally, the Treasury Department and the IRS are considering providing additional guidance (perhaps in the finalization of these proposed regulations) under section 1411 on the calculation of net gain for indirect shareholders when, for example, PFIC stock is sold by a foreign partnership through which the indirect shareholder owns the PFIC stock in a year after the indirect shareholder includes MTM gain. *Compare* section 1296(b)(1)(A) (providing an increase to the basis of PFIC stock held by a direct shareholder), *with* section 1296(b)(2)(A) and proposed § 1.1296–1(d)(2)(i) (providing, for purposes of chapter 1 of the Code, an increase to the basis of PFIC stock indirectly held). In light of this difference in wording, and the placement of section 1411 in chapter 2A of the Code, the question arises whether net gain under section 1411 could be overstated. *But see* section 1411(c)(1)(A)(iii) and § 1.1411–4(a)(1)(iii) (providing that net investment income includes net gain attributable to the disposition of property but only ''to the extent taken into account in computing taxable income.'') Comments are requested on this issue.

IV. Applicability Dates

A. In General

The regulations under sections 964, 1291, 1293, 1295, 1296, 1298, and 1411 and § 1.958–1(d) are proposed to apply to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

B. Entity Treatment of Certain Domestic Partnerships and S Corporations

With respect to the rules relating to domestic partnerships and S corporations that applied the hybrid approach to determining section 951A inclusions contained in previously proposed § 1.951A–5 (83 FR 51072, 51101–51104), proposed § 1.951A–1(e)(2) is proposed to apply to taxable years of foreign corporations ending before June 22, 2019, and to taxable years of U.S. shareholders in which or with which such taxable years end. Taxpayers may continue to rely on Notice 2019–46 until these regulations are finalized.

C. Elective Entity Treatment for Certain S Corporations

With respect to the rules relating to S corporations with AE&P, proposed § 1.958–1(e) is proposed to apply to taxable years of S corporations ending on after September 1, 2020. However, taxpayers may rely on proposed § 1.958–1(e) for taxable years of S corporations ending on or after June 22, 2019, and ending before September 1, 2020, provided that the S corporation and its shareholders that are U.S. shareholders consistently apply those rules with respect to all CFCs whose stock the S corporation owns with the meaning of section 958(a).

D. RPII Provisions

The general RPII rules in proposed § 1.953–3(b)(1) apply to taxable years of foreign corporations beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**, and to taxable years of United States persons in which or with which such taxable years of foreign corporations end.

The cross-insurance rule in proposed § 1.953–3(b)(5) applies to taxable years of foreign corporations ending on or after January 24, 2022, and to taxable years of United States persons in which or with which such taxable years of foreign corporations end. As noted in part IV.C of the Background section of this preamble, section 953(c)(8)(A) and the legislative history refer to cross insurance in offshore captive insurance arrangements as avoidance transactions, and the legislative history states that deferral is not intended for such cases. The applicability date of the final regulations is not intended to address the effect of the statute and legislative history on taxpayers who participated in cross-insurance arrangements in years ending before January 24, 2022.

Special Analyses

I. Regulatory Planning and Review—Economic Analysis

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (''OMB'') regarding review of tax regulations.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (''PRA'') generally requires that a federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit.

The collections of information included in these proposed regulations are in proposed § 1.951A–1(e)(2)(iii); proposed § 1.958–1(e)(1)(v) and (e)(2); proposed § 1.964–1(c)(3)(ii) and (iii); proposed § 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A); proposed § 1.1296–1(h)(1)(i) introductory text and (h)(1)(i)(B); and proposed § 1.1298–1(b)(1) and (2). The information in the collections of information provided will generally be used by the IRS for tax compliance purposes or by taxpayers to facilitate proper reporting and compliance.

A. Collections of Information Under Existing Tax Forms

1. Collections of Information in Proposed § 1.951A–1

The collections of information in proposed § 1.951A–1(e)(2)(iii) are required to be provided by domestic partnerships and S corporations that elect to apply the rules in proposed § 1.951A–5, as contained in the 2018 proposed regulations (83 FR 51072, 51101–51104), for taxable years ending before June 22, 2019. These collections of information are satisfied by the domestic partnership or S corporation attaching a statement to its return. In certain instances, the domestic partnership or S corporation must also file Form 8992, ''U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI),'' with its return and separately state each partner's or shareholder's share of any distributions of E&P received by the domestic partnership or S corporation that relate to the GILTI inclusion amount reflected on its Schedules K–1, ''Partner's Share of Income, Deductions, Credits, etc.'' or Schedules K–1, ''Shareholder's Share of Income, Deductions, Credits, etc.,'' as applicable.

For purposes of the PRA, the reporting burden associated with the collections of information in proposed § 1.951A–1(e)(2)(iii) will be reflected in the Paperwork Reduction Act Submissions associated with Forms 1065 and 1120–S (OMB control number 1545–0123).

2. Collections of Information in Proposed § 1.958–1

The collection of information in proposed § 1.958–1(e)(2) is a statement attached to Form 1120–S that identifies that the S corporation and its shareholders (where applicable) are electing for the S corporation to be treated as an entity for purposes of determining who is subject to income inclusions under sections 951 and 951A for the first taxable year ending on or after September 1, 2020, states the amount of the S corporation's AE&P, and is signed (where applicable) by a person authorized to sign the S corporation's Form 1120–S. A similar collection of information is required for taxpayers (certain S corporations and their shareholders) that elect for the S corporation to be treated as an entity for purposes of sections 951 and 951A for taxable years ending before September 1, 2020, and after June 21, 2019.

For purposes of the PRA, the reporting burden associated with the collection of information in proposed § 1.958–1(e)(2) will be reflected in the Paperwork Reduction Act Submissions associated with Form 1120–S (OMB control number 1545–0123). Additionally, where an S corporation and its shareholders elect for the S corporation to be treated as an entity for taxable years ending before September 1, 2020, and after June 21, 2019, the reporting burden associated with the collection of information in proposed § 1.958–1(e)(2) will be reflected in the Paperwork Reduction Act Submissions associated with Form 1120–S (OMB control number 1545–0123), the Form 1040 series (OMB control number 1545–0074), and the Form 1041 series (OMB control number 1545–0092).

3. Collections of Information in § 1.964–1 and Proposed § 1.964–1

The collection of information in proposed § 1.964–1(c)(3)(ii) applies to taxpayers that are controlling domestic shareholders of foreign corporations (as defined in § 1.964–1(c)(5)) and that make certain elections with respect to, or adopt or change methods of accounting or taxable years for, the foreign corporations. This collection of information is satisfied by the controlling domestic shareholder filing a statement containing certain prescribed information with its own tax return (or information return, if applicable) for its taxable year in which or within which the affected taxable year of the foreign corporation ends. The collection of information in proposed § 1.964–1(c)(3)(ii) applies to U.S. shareholder partners (and not to U.S. shareholder partnerships) as a result of proposed § 1.958–1(d)(1).

The collection of information in proposed § 1.964–1(c)(3)(iii) requires controlling domestic shareholders of foreign corporations to notify certain U.S. persons known to them of actions taken with respect to the foreign corporation, such as certain tax elections and adoptions of or changes to the foreign corporation's accounting methods or tax years. Under proposed § 1.964–1(c)(3)(iii)(A), this collection of information is satisfied by the controlling domestic shareholder providing notice to prescribed U.S. persons known to the controlling domestic shareholder setting forth the name, country of organization, and U.S. employer identification number (if applicable) of the foreign corporation; providing the names, addresses, and stock interests of the controlling domestic shareholders of the foreign corporation; describing the nature of the action taken on behalf of the foreign corporation and the taxable year for which the action was taken; and identifying a designated shareholder that retains a jointly executed consent confirming that such action has been approved by all of the controlling domestic shareholders and containing the signature of a principal officer of each such shareholder (or its common parent). Proposed § 1.964–1(c)(3)(iii)(B) provides that a controlling domestic shareholder will be deemed to satisfy the general notice requirement with respect to U.S. persons known to the controlling domestic shareholder that own stock in the foreign corporation through a domestic partnership by providing the notice containing the same information to the partnership instead of to each U.S. person.

For purposes of the PRA, the reporting burden associated with the collections of information in proposed § 1.964–1(c)(3)(ii) and (iii) will be reflected in the Paperwork Reduction Act Submissions associated with the Forms for persons which can be considered controlling domestic shareholders under the proposed regulations, including individuals and certain domestic trusts, domestic estates, domestic corporations, certain tax-exempt entities. Thus, the reporting burden associated with these collections of information will be reflected in the Paperwork Reduction Act Submissions associated with the Form 990 series (OMB control number 1545–0047), the Form 1040 series (OMB control number 1545–0074), the Form 1041 series (OMB control number 1545–0092), and the Form 1120 series (OMB control number 1545–0123).

4. Collections of Information in Proposed § 1.1295–1

The collections of information in proposed § 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A) apply to partners in partnerships and S corporation shareholders that make QEF elections with respect to a PFIC held through a partnership or S corporation. The collections of information in these sections are satisfied, in part, by the partners and S corporation shareholders filing Form 8621 to make the QEF election. For purposes of the PRA, the reporting burden associated with the collection of information in the Form 8621 will be reflected in the Paperwork Reduction Act Submissions associated with Form 8621 (OMB control number 1545–1002).

5. Collection of Information in Proposed § 1.1296–1

The collections of information in proposed § 1.1296–1(h)(1)(i) apply to partners in partnerships and S corporation shareholders that make MTM elections with respect to PFICs held through a partnership or S corporation. These collections of information are satisfied, in part, by the partners and S corporation shareholders filing Form 8621 to make the MTM election. For purposes of the PRA, the reporting burden associated with the collections of information in the Form 8621 will be reflected in the Paperwork Reduction Act Submissions associated with Form 8621 (OMB control number 1545–1002).

6. Collections of Information in Proposed § 1.1298–1

The collections of information in proposed § 1.1298–1(b)(1) apply to partners in partnerships and S corporation shareholders that own PFICs indirectly through partnerships and S corporations with respect to which they are required to file an annual report in their capacity as PFIC shareholders, as defined in proposed § 1.1291–1(b)(7). The collections of information in proposed § 1.1298–1(b)(2) apply to certain beneficiaries of domestic estates and domestic nongrantor trusts that own PFICs indirectly through the domestic estate or domestic nongrantor trust. These collections of information are satisfied by annually filing Form 8621. For purposes of the PRA, the reporting burden associated with the collections of information in the Form 8621 will be reflected in the Paperwork Reduction Act Submissions associated with Form 8621 (OMB control number 1545–1002).

7. Estimated Number of Respondents

The following table displays the number of respondents estimated to be required to satisfy the collections of information described in this part II.A of the Special Analysis. The ranges in the following table may be overstated in some cases for various reasons, including overcounting domestic partnerships or S corporations that are themselves partners in domestic partnerships and overestimating the number of taxpayers who will make an election or take a relevant action.

TAX FORMS IMPACTED

Collection of information	Number of respondents (estimated)	Forms to which the information may be attached
Proposed § 1.951A–1(e) (2)(iii): Election for domestic partnerships to apply the hybrid approach in proposed § 1.951A–5 of the 2018 proposed regulations.	0–7,000	Form 1065.
Proposed § 1.951A–1(e)(2)(iii): Election for S corporations to apply the hybrid approach in proposed § 1.951A–5 of the 2018 proposed regulations.	0–4,000	Form 1120–S.
Proposed § 1.958–1(e)(2): Election for S corporations with AE&P to apply entity treatment for purposes of sections 951 and 951A.	2,300–4,300	Form 1120–S. Form 1040 series. Form 1041 series.
Proposed § 1.964–1(c)(3)(ii) and (iii): Statement attached to tax return of controlling domestic shareholders of certain foreign corporations and notification to certain other U.S. persons.	6,600–7,000	Form 990 series. Form 1040 series. Form 1041 series. Form 1120 series.
Proposed § 1.1295–1(d)(2)(i)(A): QEF election made by partner that indirectly owns stock of a PFIC through a partnership.	1,200,000–1,400,000.	Form 8621.
Proposed § 1.1295–1(d)(2)(ii)(A): QEF election made by shareholder of an S corporation that indirectly owns stock of a PFIC through the S corporation.	2,000	Form 8621.
Proposed § 1.1296–1(h)(1)(i): MTM election made by partner that indirectly owns stock of a PFIC through a partnership.	75,000–200,000	Form 8621.
Proposed § 1.1296–1(h)(1)(i): MTM election made by shareholder of an S corporation that indirectly owns stock of a PFIC through the S corporation.	200–300	Form 8621.
Proposed § 1.1298–1(b)(1): Annual report for partners that indirectly own stock of a PFIC through a partnership.	1,250,000–1,500,000.	Form 8621.
Proposed § 1.1298–1(b)(1): Annual report for shareholders of S corporations that indirectly own stock of a PFIC through the S corporation.	2,300–2,500	Form 8621.
Proposed § 1.1298–1(b)(2): Annual report for certain beneficiaries of domestic estates or domestic grantor trusts that indirectly own stock of a PFIC through the estate or grantor trust.	5,000	Form 8621.

Source: Research, Applied Analytics and Statistics division (RAAS) (IRS), Compliance Data Warehouse (CDW) (IRS).

8. Status of PRA Submissions

The current status of the PRA submissions related to the tax forms on which reporting under these regulations will be required is summarized in the following table. The burdens associated with the information collections in the forms are included in aggregated burden estimates for the OMB control numbers 1545–0047 (which represents a total estimated burden time for all forms and schedules for tax-exempt entities of 50.5 million hours and total estimated monetized costs of $3.59 billion ($2018)), 1545–0074 (which represents a total estimated burden time for all forms and schedules for individuals of 1.784 billion hours and total estimated monetized costs of $31.764 billion ($2017)), 1545–0092 (which represents a total estimated burden time for all forms and schedules for trusts and estates of 307.8 million hours and total estimated monetized costs of $9.95 billion ($2016)), and 1545–0123 (which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017)). The burden estimates provided in the OMB control numbers in the following table are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be revised as a result of the information collections in these proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by these proposed regulations. To guard against over-counting the burden that international tax provisions imposed prior to the Act, the Treasury Department and the IRS urge readers to recognize that these burden estimates have also been cited by regulations (such as the foreign tax credit regulations, 84 FR 69022) that rely on the applicable OMB control numbers in order to collect information from the applicable types of filers.

In 2018, the IRS released and invited comment on drafts of Forms 990–PF (Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation), 990–T (Exempt Organization Business Income Tax Return), 1040 (U.S. Individual Income Tax Return), (U.S. Income Tax Return for Estates and Trusts), 1065 (U.S. Return of Partnership Income), 1120 (U.S. Corporation Income Tax Return), and 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund). The IRS received comments only regarding Forms 1040, 1065, and 1120 during the comment period. After reviewing all such comments, the IRS made the forms available on December 21, 2018, for use by the public.

No burden estimates specific to the forms affected by the proposed regulations are currently available. The Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens for each relevant form and ways for the IRS to minimize the paperwork burden. In addition, drafts of IRS forms are posted for public review at *https://apps.irs.gov/app/picklist/list/draftTaxForms.htm.* Comments on these forms can be submitted at *https://www.irs.gov/forms-pubs/comment-on-tax-forms-and-publications.* These forms will not be finalized until after they have been approved by OMB under the PRA.

B. Collections of Information for Which New OMB Control Numbers Are Being Requested

1. Collection of Information in Proposed § 1.958–1

The collection of information in proposed § 1.958–1(e)(1)(v) is required for certain S corporations to make valid elections under proposed § 1.958–1(e)(1)(i) to apply entity treatment for purposes of determining income inclusions under sections 951 and 951A. This collection of information is satisfied by the S corporation maintaining sufficient records to support the determination of its AE&P amount.

Estimated annual reporting burden: 213.

Estimated total annual monetized cost burden: $20,188.

Estimated average annual burden hours per respondent: 0.5.

Estimated number of respondents: 425.

Estimated annual frequency of responses: Once.

2. Collections of Information in Proposed § 1.1295–1

Part of the collection of information in proposed § 1.1295–1(d)(2)(i)(A) is for a partner to notify the partnership that the partner has made a QEF election with respect to a PFIC it owns indirectly through the partnership. This collection of information is satisfied by the partner notifying the partnership of the election no later than 30 days after filing the return with which the election is made. The partner may notify the partnership in any reasonable manner.

Estimated annual reporting burden: 650,000.

Estimated total annual monetized cost burden: $61,750,000.

Estimated average annual burden hours per respondent: 0.5.

Estimated number of respondents: 1,300,000.

Estimated annual frequency of responses: One-time election.

Part of the collection of information in proposed § 1.1295–1(d)(2)(ii)(A) is for an S corporation shareholder to notify the S corporation that the shareholder has made a QEF election with respect to a PFIC it owns indirectly through the S corporation. This collection of information is satisfied by the shareholder notifying the S corporation of the election no later than 30 days after filing the return with which the election is made. The shareholder may notify the S corporation in any reasonable manner.

Estimated annual reporting burden: 1,000.

Estimated total annual monetized cost burden: $95,000.

Estimated average annual burden hours per respondent: 0.5.

Estimated number of respondents: 2,000.

Estimated annual frequency of responses: One-time election.

3. Collection of Information in Proposed § 1.1296–1

The collection of information in proposed § 1.1296–1(h)(1)(i)(B) is for a partner or an S corporation shareholder to notify the partnership or S corporation, respectively, that the partner or shareholder has made an MTM election with respect to a PFIC it owns indirectly through the partnership or S corporation. This collection of information is satisfied by the partner or shareholder notifying the partnership or S corporation of the election no later than 30 days after filing the return with which the election is made. The partner or shareholder may notify the partnership or S corporation in any reasonable manner.

Estimated annual reporting burden: 35,500.

Estimated total annual monetized cost burden: $3,372,500.

Estimated average annual burden hours per respondent: 0.5.

Estimated number of respondents: 71,000.

Estimated annual frequency of responses: One-time election.

4. Submission to OMB and Request for Comments

The collections of information contained in proposed §§ 1.958–1(e)(1)(v); 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A); and 1.1296–1(h)(1)(i)(B) are either general recordkeeping or notice requirements and cannot be associated with existing OMB control numbers. These collections of information will be submitted to the Office of Management and Budget for review and, if approved, assigned new OMB control numbers in accordance with the PRA. Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by March 28, 2022. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information for the collections discussed in part II.B of this Special Analyses.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the proposed regulations would not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (''small entities'').

The Small Business Administration establishes small business size standards (13 CFR part 121) by annual receipts or number of employees. There are several industries that may be identified as small even through their annual receipts are above $25 million or because of the number of employees. The Treasury Department and the IRS do not have data indicating the number of small entities that will be significantly impacted by the proposed regulations. Nevertheless, regardless of the number of small entities potentially impacted, the Treasury Department and the IRS have concluded that the proposed regulations will not have a significant economic impact on small entities.

First, the proposed regulations provide guidance with respect to domestic partnerships under the PFIC regime, which generally affects U.S. taxpayers that have ownership interests in certain foreign corporations that are not CFCs. To the extent that a foreign entity might be considered a small entity for purposes of the Regulatory Flexibility Act (because it has a place of business in the United States and makes a significant contribution to the U.S. economy, for example), because the proposed regulations would not affect foreign partnerships, foreign partners of the affected domestic partnerships, or the PFIC itself, there would be no economic impact on those foreign entities. Therefore, a small entity generally would not be affected by the proposed regulations unless it is a U.S. taxpayer that has an ownership interest in a foreign corporation. For purposes of the Regulatory Flexibility Act, natural persons are not considered small entities.

Although data on U.S. businesses that invest in a PFIC is limited, data available to the IRS shows that individuals (Form 1040 filers) make up approximately 70 percent of those who report PFIC income while U.S. businesses of all sizes make up approximately 20 percent of Form 8621 filers. To estimate the magnitude of the taxes currently collected as a result of U.S. businesses investing in PFICs, the Treasury Department and the IRS calculated the ratio of PFIC regime tax to (gross) total income for 2013 through 2018 for corporations that filed Form 1120 (''C corporations'') with a Form 8621 attached. Total income was determined by matching each C corporation filing Form 8621 to its Form 1120. Ordinary QEF income, QEF capital gains, and MTM income were assumed to be taxed at 35 percent (21 percent for 2018), and the section 1291 tax and interest charge tax were included as reported. Only those corporations where a match was found and that had positive total income were included in the analysis. For the approximately 150 to 300 C corporations for which a match was available in a given year, the average annual ratio of the calculated tax to total income was never greater than 0.00035 percent. For the approximately 60 to 200 C corporations per year with $25 million or less for which a match was available, the average annual ratio was never greater than 1.068 percent.

	2013 ($ millions)	2014 ($ millions)	2015 ($ millions)	2016 ($ millions)	2017 ($ millions)	2018 ($ millions)
All C corporations						
Tax	5	12	14	8	22	42
Total Income	4,204,795	10,154,520	19,935,845	20,076,876	21,625,159	13,317,244
Tax to Total Income	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%
C corporations with total income of $25 million or less						
Tax	(*)	(*)	4	4	5	3
Total Income	463	563	627	573	460	741
Tax to Total Income	0.060%	0.014%	0.576%	0.689%	1.068%	0.400%

Source: RAAS, CDW. * indicates less than $1 million.

Thus, even if the economic impact of the proposed regulations is interpreted broadly to include the tax liability due under the PFIC regime, which small entities would be required to pay even if the proposed regulations were not issued, the tax-related economic impact should not be regarded as significant under the Regulatory Flexibility Act.

A portion of the economic impact of the proposed regulations derives from the administration of the new rules and the collection of information requirements imposed by the PFIC-related provisions in proposed §§ 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A), 1.1296–1(h)(1)(i), and 1.1298–1(b)(1) and (2). For the collections of information in proposed §§ 1.1295–1(d)(2)(i)(A) and (d)(2)(ii)(A) and 1.1296–1(h)(1)(i), the Treasury Department and the IRS have determined that the average burden is approximately half an hour per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for this set of taxpayers is $95 per hour. Thus, the annual burden per taxpayer from the collection of information requirement for each of these provisions is approximately $48. Additionally, these requirements apply only if a taxpayer chooses to make an election. For the collections of information in proposed § 1.1298–1(b)(1) and (2), the Treasury Department and the IRS have determined that the average burden is approximately 49 hours per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for this set of taxpayers is $95 per hour. Thus, the annual burden per taxpayer from the collection of information requirement in this provision is approximately $4,655. This requirement applies to taxpayers required to file Form 8621 with respect to a PFIC. In each case, the compliance burden associated with the PFIC-related provisions in the proposed regulations is generally shifted from the entity level to the owner level. For example, under proposed §§ 1.1295–1(d)(2)(i)(A) and 1.1298–1(b)(1), a domestic partnership no longer makes a QEF election with respect to, and no longer files Form

8621 for, PFICs it owns; rather, the election and associated Form 8621 will be made and filed, respectively, by the partners. While this shift could result in some duplication of the overall compliance burden associated with the PFIC-related provisions in the proposed regulations, the Treasury Department and the IRS do not believe this shift should have a significant economic impact on taxpayers.

Additionally, the proposed regulations provide guidance with respect to several statutory provisions within subpart F, which generally affect U.S. shareholders of CFCs. To estimate the magnitude of the tax impact of these provisions on small entities, the Treasury Department and the IRS examined the gross receipts of all taxpayers that e-filed Forms 5471 as a Category 4 or 5 filer for 2015 and 2016, which amounted to approximately 25,000 to 35,000 taxpayers in each year. The Treasury Department and the IRS then determined the tax revenue generated from the approximately 25,000 to 35,000 taxpayers' section 951A inclusions [4] estimated by the Joint Committee on Taxation for businesses of all sizes is less than 0.3 percent of gross receipts, as shown in the table that follows. Based on data for 2015 and 2016, total gross receipts for all businesses with gross receipts under $25 million is $60 billion while those over $25 million is $49.1 trillion. Given that tax on section 951A inclusions is generally correlated with gross receipts, this results in businesses with less than $25 million in gross receipts accounting for approximately 0.01 percent of the tax revenue. Additionally, although data are generally not readily available to determine the sectoral breakdown of these entities, the number of domestic partnerships and S corporations subject to these provisions under the proposed regulations should make up only a portion of the totals. For example, the Treasury Department and the IRS estimate that there were approximately 7,000 domestic partnerships that e-filed at least one Form 5471 as a Category 4 or 5 filer in each of 2015 and 2016, amounting to 28 percent of the low-end estimate of all taxpayers filing Form 5471 as a Category 4 or 5 filer and 20 percent of the high-end estimate. Based on this analysis, the proposed regulations do not impose a significant economic impact on smaller businesses, in particular domestic partnerships and S corporations.

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Joint Committee on Taxation (JCT) tax revenue.	7.7 billion	12.5 billion.	9.6 billion	9.5 billion	9.3 billion	9.0 billion	9.2 billion	9.3 billion	15.1 billion.	21.2 billion.
Total gross receipts	30727 billion.	53870 billion.	566676 billion.	59644 billion.	62684 billion.	65865 billion.	69201 billion.	72710 billion.	76348 billion.	80094 billion.
Percent	0.03	0.02	0.02	0.02	0.01	0.01	0.01	0.01	0.02	0.03.

Source: Research, Applied Analytics and Statistics division (IRS), Compliance Data Warehouse (IRS) (E-filed Form 5471, category 4 or 5, C and S corporations and partnerships); Conference Report, at 689.

Thus, even if the economic impact of the proposed regulations is interpreted broadly to include the tax liability due under subpart F, which small entities would be required to pay even if the proposed regulations were not issued, the tax-related economic impact should not be regarded as significant under the Regulatory Flexibility Act.

A portion of the economic impact of the proposed regulations derives from the collection of information requirements imposed by the provisions related to CFCs and other types of foreign corporations in proposed § 1.951A–1(e)(2)(iii), proposed § 1.958–1(e)(1)(v) and (e)(2), and proposed § 1.964–1(c)(3)(ii) and (iii). The Treasury Department and the IRS have determined that the average burden for each of these provisions is approximately half an hour per response. The IRS's Research, Applied Analytics, and Statistics division estimates that the appropriate wage rate for this set of taxpayers is $95 per hour. Thus, the annual burden per taxpayer from the collection of information requirement for each of these provisions is approximately $48. These requirements apply only if a taxpayer chooses to make an election with respect to the CFC or other foreign corporation. In the case of proposed § 1.964–1(c)(3)(ii) and (iii), the compliance burden is generally shifted from the U.S. shareholder partnership level to its U.S. shareholder partners. While this shift could result in some duplication of the overall compliance burden associated with these provisions, the Treasury Department and the IRS do not believe this shift should result in a significant economic impact on taxpayers.

Accordingly, it is hereby certified that the proposed regulations would not have a significant economic impact on a substantial number of small entities.

IV. Section 7805(f)

Pursuant to section 7805(f), the proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses. The Treasury Department and the IRS also request comments from the public on the analysis in part III of the Special Analyses.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance

[4] The Treasury Department and the IRS determined that using section 951A inclusions, rather than section 951 inclusions, would serve as a better indication of the potential tax impact of the proposed regulations on small entities that own CFCs because the base upon which a U.S. shareholder's section 951A inclusion is computed (a CFC's gross income—with certain exceptions—less allocable deductions) is generally broader than the base upon which its section 951 inclusion is computed (a CFC's income from specified transactions).

costs on state and local governments or preempt state law within the meaning of the Executive order.

Comments and Requests for Public Hearing

Before the proposed amendments are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. See also parts I.B.1 and I.C.1 of the Explanation of Provisions requesting comments related to the possibility of delegating authority to domestic partnerships and S corporations to make QEF and MTM elections on behalf of their owners; part II.D of the Explanation of Provisions requesting comments on (i) whether a U.S. person holding an option to acquire stock (or other non-stock interest) in a RPII CFC should be treated as a related insured, (ii) the allocation of premium payments made by a partnership, (iii) the general application of aggregate principles to RPII, (iv) necessary revisions to forms and instructions to facilitate information sharing and reporting for RPII purposes, and (v) other parts of the 1991 proposed regulations relating to RPII, including whether other parts should be reproposed (such as the exception for indirect ownership through publicly traded corporations); and part III of the Explanation of Provisions requesting comments on the calculation of indirect shareholders' net gain for purposes of section 1411. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020–4, 2020–17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of these regulations are Edward Tracy, Raphael Cohen, and Josephine Firehock of the Office of Associate Chief Counsel (International), and Caroline E. Hay and Jennifer N. Keeney of the Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *www.irs.gov.*

Partial Withdrawal of Proposed Regulations

Under the authority of 26 U.S.C. 7805, proposed § 1.953–3(b)(1) and (5) contained in the notice of proposed rulemaking that was published in the **Federal Register** on April 17, 1991 (56 FR 15540), is withdrawn.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.**The authority citation for part 1 is amended by:

■ 1. Adding a sectional authority for § 1.953–3 in numerical order;

■ 2. Revising the sectional authorities for §§ 1.1293–1, 1.1295–1, and 1.1296–1;

■ 3. Adding sectional authorities for §§ 1.1297–0 and 1.1297–3 in numerical order;

■ 4. Arranging the sectional authority for § 1.1298–1 in numerical order and revising the authority; and

■ 5. Adding a sectional authority for § 1.1298–3 in numerical order.

The additions and revisions read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.953–3 also issued under 26 U.S.C. 953(c)(8).

* * * * *

Section 1.1293–1 also issued under 26 U.S.C. 1298(g).

* * * * *

Section 1.1295–1 also issued under 26 U.S.C. 1295(b)(2) and 1298(g).

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Section 1.1296–1 also issued under 26 U.S.C. 1298(a)(1)(B) and (g).

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Section 1.1297–0 also issued under 26 U.S.C. 1298(g).

* * * * *

Section 1.1297–3 also issued under 26 U.S.C. 1298(g).

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Section 1.1298–1 also issued under 26 U.S.C. 1298(f) and (g).

* * * * *

Section 1.1298–3 also issued under 26 U.S.C. 1298(g).

* * * * *

■ **Par. 2.** Section 1.951A–1 is amended by revising paragraph (e) to read as follows:

§ 1.951A–1 General provisions.

* * * * *

(e) *Stock owned through domestic partnerships and S corporations*—(1) *Cross-references.* See § 1.958–1(d) for rules regarding the ownership of stock of a foreign corporation through a domestic partnership (or S corporation, as defined in section 1361(a)(1), by reason of section 1373(a)) for purposes of section 951A and for purposes of any provision that specifically applies by reference to section 951A or the section 951A regulations. See § 1.958–1(e) for rules regarding an election for certain S corporations to be treated as an entity for purposes of section 951A and the section 951A regulations.

(2) *Application of entity treatment for taxable years ending before June 22, 2019*—(i) *General rule.* If a domestic partnership or S corporation satisfies the notification and reporting requirements in paragraph (e)(2)(iii) of this section, the domestic partnership or S corporation may apply the rules in proposed § 1.951A–5 as if the amendments proposed on October 10, 2018, had been finalized in their entirety (*proposed GILTI rules*), for taxable years ending before June 22, 2019.

(ii) *Inapplicability of penalties.* If a domestic partnership or S corporation satisfies the requirements of paragraph (e)(2)(iii) of this section, penalties for failures described in sections 6698(a), 6699(a), 6722(a), or any similar provision will not apply to the domestic partnership or S corporation to the extent such failures arise from acting consistently with the proposed GILTI rules before June 22, 2019.

(iii) *Notification and reporting requirements*—(A) *Notification.* To be eligible for the rules described in paragraphs (e)(2)(i) and (ii) of this section, a domestic partnership or S corporation must provide the notification described in paragraphs (e)(2)(iii)(A)(*1*) through (*3*) of this section to each partner of the partnership or shareholder of the S corporation. Such notification must be provided no later than the due date (taking into account extensions, if any, or any additional time that would have been granted if the domestic partnership or S corporation had made an extension request) of the domestic partnership's or S corporation's tax return for the last taxable year ending before June 22, 2019, and may be provided through any reasonable method, including via mail, email, or posting on a website through which the domestic partnership or S corporation would ordinarily disseminate tax information to its partners or shareholders. The domestic partnership or S corporation must also attach the notification described in this paragraph (e)(2)(iii)(A) and Form 8992, ''U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI),'' reflecting computations under the proposed GILTI rules to any tax return with respect to which the rules described in paragraph (e)(2)(i) or (ii) of this section are being applied if the tax return has not been filed as of September 9, 2019. The notification required under this paragraph (e)(2)(iii) must provide—

(*1*) That the Schedule K–1, ''Partner's Share of Income, Deductions, Credits, etc.,'' or the Schedule K–1, ''Shareholder's Share of Income, Deductions, Credits, etc.,'' provided to the partner or shareholder, respectively, is consistent with the proposed GILTI rules;

(*2*) Whether the domestic partnership or S corporation filed a Form 1065, ''U.S. Return of Partnership Income,'' or Form 1120–S, ''U.S. Income Tax Return for an S Corporation,'' consistent with the proposed GILTI rules or this paragraph (e); and

(*3*) That the notification is provided in accordance with Notice 2019–46, 2019–37 I.R.B. 695.

(B) *Schedule K–1 distribution reporting.* If a domestic partnership or S corporation furnished a Schedule K–1 based on the proposed GILTI rules, the domestic partnership or S corporation must separately state on Schedules K–1 for subsequent taxable years the partner's or shareholder's distributive share or pro rata share of a foreign corporation's distributions to the domestic partnership or S corporation of earnings and profits that relate to the GILTI inclusion amount of the partnership or S corporation that was reflected on the initially provided Schedules K–1. This information must be provided for each taxable year of the domestic partnership or S corporation following the taxable year to which the first Schedule K–1 relates.

* * * * *

■ **Par. 3.** Section 1.951A–7 is amended by adding paragraph (e) to read as follows:

§ 1.951A–7 Applicability dates.

* * * * *

(e) *Entity treatment of domestic partnerships and S corporations.* Section 1.951A–1(e)(2) applies to taxable years of foreign corporations ending before June 22, 2019, and to taxable years of United States shareholders in which or with which such taxable years end.

■ **Par. 4.** Section 1.953–3 is revised to read as follows:

§ 1.953–3 Related person insurance income.

(a) [Reserved]

(b) *Related person insurance income*—(1) *Definition of related person insurance income*—(i) *In general.* Insurance income under section 953(a) includes related person insurance income under section 953(c)(2). Related person insurance income is premium and investment income attributable to an annuity, insurance, or reinsurance policy that directly or indirectly provides coverage to a related insured as defined in paragraph (b)(1)(ii) of this section. For purposes of this section, the terms *United States shareholder* and *controlled foreign corporation* have the meaning provided in section 953(c)(1).

(ii) *Related insured.* Except as provided in paragraph (b)(5)(ii) of this section, with respect to a foreign corporation, a related insured means any of the following—

(A) A United States shareholder of the foreign corporation;

(B) A person that is related to a United States shareholder within the meaning of section 953(c)(6);

(C) A pass-through entity, if a related insured (other than a pass-through entity) owns stock in the foreign corporation indirectly (within the meaning of section 958(a)) through the pass-through entity; or

(D) A person (other than a publicly traded corporation or publicly traded partnership) that is more than 50 percent owned by United States shareholders of the foreign corporation as described in paragraph (b)(1)(v) of this section.

(iii) *Amount treated as related person insurance income with respect to a pass-through entity*—(A) *In general.* In the case of a pass-through entity that is a related insured, the amount treated as related person insurance income is equal to the insurance income attributable to the policy that directly or indirectly provides coverage to the pass-through entity multiplied by the fraction described in paragraph (b)(1)(iii)(B) of this section.

(B) *Fraction.* The fraction described in this paragraph (b)(1)(iii)(B) is equal to—

(*1*) The total amount of premiums paid or accrued by the pass-through entity for the policy that is allocated (directly or indirectly, through one or more pass-through entities) to all related insureds (other than pass-through entities); divided by

(*2*) The total amount of premiums paid or accrued by the pass-through entity for the policy.

(C) *Allocation*—(*1*) *Partnerships.* For purposes of paragraph (b)(1)(iii)(B) of this section, the total amount of premiums paid or accrued by a partnership that is allocated to the related insureds is determined in accordance with the partnership agreement and section 704(b).

(*2*) *S corporations.* For purposes of paragraph (b)(1)(iii)(B) of this section, the total amount of premiums paid or accrued by an S corporation that is allocated to the related insureds is determined on a pro rata basis.

(iv) *Pass-through entities.* For purposes of paragraph (b)(1) of this section, a pass-through entity is an S corporation or a domestic or foreign partnership (other than a publicly traded partnership).

(v) *Ownership.* The ownership threshold described in paragraph (b)(1)(ii)(D) of this section is met if United States shareholders collectively own (after applying the principles of section 958(a) and (b)) more than 50 percent of the stock in a corporation (by vote or value), more than 50 percent of the capital or profits interests in a partnership, or more than 50 percent of the interests in a trust or estate.

(vi) *Stock owned through domestic partnerships or S corporations.* See § 1.958–1(d) for rules regarding the ownership of stock of a foreign corporation through a domestic partnership or S corporation for purposes of section 953(c) and for purposes of any provision that specifically applies by reference to section 953(c) or the regulations in this part under section 953 that relate to section 953(c).

(vii) *Examples.* The following examples illustrate the rules of paragraph (b)(1) of this section.

(A) *Example 1*—(*1*) *Facts.* FC is a foreign corporation engaged in the insurance business. FC is wholly owned by FP, a foreign partnership. DC, a domestic corporation, owns 25% of the interests in FP. The remaining interests in FP are held by unrelated foreign corporations. Under the partnership agreement, all items of income, gain, loss, deduction, and credit are allocated 25% to DC and 75% to the other partners. In Year 1, FC issues the FP policy, under which FP is insured. FP pays a premium of $80 for the FP policy. The insurance income attributable to the FP policy (including both premium and investment income) is $100. FC earns an additional $1,000 of income that is treated as related person insurance income. Under section 704(b), DC would be allocated $20 (25%) of the premium paid or accrued by FP.

(*2*) *Result.* Under paragraph (b)(1)(ii)(C) of this section, FP is treated as a related insured with respect to FC because it is a pass-through entity through which DC indirectly owns stock in FC. Therefore, under paragraph (b)(1)(i) of this section, a portion of the insurance income attributable to the FP policy is treated as related person insurance income. Under paragraph (b)(1)(iii)(A) of this section, the amount of related person insurance income with respect to FP is equal to the insurance income attributable to the FP policy ($100) multiplied by the fraction described in paragraph (b)(1)(iii)(B) of this section. That fraction is equal to the portion of the premium paid by FP that is allocable to DC ($20) divided by the total premium paid by FP ($80), or 25%. Therefore, FC has $25 of related person insurance income under section 953(c)(2) attributable to the FP policy in Year 1.

(B) *Example 2*—(*1*) *Facts.* FC is a foreign corporation engaged in the insurance business. Two domestic corporations, DC1 and DC2, each own 50% of the stock of FC. In addition, DC1 and DC2 each own 50% of the stock in DC3, a domestic corporation. In Year 1, FC issues the DC3 policy, under which DC3 is insured. The insurance income attributable to the DC3 policy is $100. FC earns an additional $1,000 of income that is treated as related person insurance income.

(*2*) *Result.* DC3 meets the requirements of paragraph (b)(1)(v) of this section because United States shareholders of FC (DC1 and DC2) collectively own all the stock of DC3. Therefore, under paragraph (b)(1)(ii)(D) of this section, DC3 is treated as a related insured with respect to FC. Consequently, under paragraph (b)(1)(i) of this section, all of FC's $100 of insurance income attributable to the DC3 policy is treated as related person insurance income under section 953(c)(2).

(2) through (4) [Reserved]

(5) *Cross-insurance arrangements*—(i) *In general.* Related person insurance income includes insurance income attributable to an arrangement (or a substantially similar arrangement with a similar degree of cooperative risk sharing) whereby a foreign corporation issues an insurance, reinsurance, or annuity contract to a person other than a related insured and, as part of the arrangement (involving one or more other persons), another person issues an insurance, reinsurance, or annuity contract to a related insured of the foreign corporation.

(ii) *Related insured.* For purposes of applying paragraph (b)(5)(i) of this section before the applicability date described in paragraph (c)(1) of this section, the term *related insured* means, with respect to a foreign corporation, a United States shareholder of the foreign corporation or a person that is related to a United States shareholder within the meaning of section 953(c)(6).

(iii) *Example.* Controlled foreign corporation X is owned by 30 unrelated United States shareholders. Controlled foreign corporation Y is owned by 30 unrelated United States shareholders (that is, unrelated to X and Y and the shareholders of X and Y). X agrees to provide insurance protection to Y's shareholders, and Y agrees to provide insurance to X's shareholders. The insurance income of both X and Y that is attributable to insuring the shareholders of the other corporation constitutes related person insurance income.

(c) *Applicability date*—(1) *In general.* Paragraph (b)(1) of this section applies to taxable years of foreign corporations beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], and to taxable years of United States persons in which or with which such taxable years of foreign corporations end.

(2) *Cross-insurance rule.* Paragraph (b)(5) of this section applies to taxable years of foreign corporations ending on or after January 24, 2022, and to taxable years of United States persons in which or with which such taxable years of foreign corporations end (in each case without regard to when the arrangement was entered into).

■ **Par. 5.** Section 1.958–1, as amended in a final rule published elsewhere in this issue of the **Federal Register**, effective January 25, 2022, is amended by:

■ 1. Revising the first sentence of paragraph (d)(1);

■ 2. Revising paragraph (d)(2)(v);

■ 3. Adding a sentence to the end of paragraph (d)(4)(i); and

■ 4. Adding paragraph (e).

The revisions and addition read as follows:

§ 1.958–1 Direct and indirect ownership of stock.

* * * * *

(d) * * * (1) * * * Except as otherwise provided in paragraph (d)(2) of this section, for purposes of sections 951, 951A, 953(c), and 956(a) and § 1.964–1(c), and for purposes of any provision that specifically applies by reference to any of such sections or the regulations in this part under section 951, 951A, 953, or 956 (but only as the regulations in this part under section 953 or section 956 relate to section 953(c) or section 956(a), respectively), a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of section 958(a). * * *

(2) * * *

(v) Applying section 953(c)(1)(A) for purposes of determining whether any foreign corporation is a controlled foreign corporation as defined in sections 953(c)(1)(B), 953(c)(3)(E), or 953(d)(1)(A).

* * * * *

(4) * * *

(i) * * * Notwithstanding the prior sentences, paragraph (d)(2)(v) of this section and the inclusion of the references to section 953(c) and § 1.964–1(c) in paragraph (d)(1) of this section apply to taxable years of foreign corporations beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], and to taxable years of United States persons in which or with which such taxable years of foreign corporations end.

* * * * *

(e) *Elective entity treatment for certain S corporations*—(1) *In general.* Except as otherwise provided in this paragraph (e), with respect to an S corporation (as defined in section 1361(a)(1)), paragraph (d)(1) of this section shall not apply, and such S corporation shall be treated as owning stock of a foreign corporation within the meaning of section 958(a), if—

(i) The S corporation and its shareholders (where applicable) make the election described in paragraph (e)(2) of this section;

(ii) The S corporation made its election under section 1362(a) before June 22, 2019;

(iii) The S corporation would have been treated as owning stock of a controlled foreign corporation within the meaning of section 958(a) on June 22, 2019, if § 1.951A–1(e) (as in effect and contained in 26 CFR part 1, as revised April 1, 2021) did not apply to it;

(iv) The S corporation had transition accumulated earnings and profits (as defined in paragraph (e)(3) of this section) on September 1, 2020, or on the first day of any subsequent taxable year; and

(v) The S corporation maintains sufficient records to support the determination of the transition accumulated earnings and profits amount.

(2) *Election*—(i) *Time and manner of making election.* With respect to the first taxable year ending on or after September 1, 2020, an S corporation may irrevocably elect to apply the provisions of paragraph (e)(1) of this section on a timely-filed (including extensions) original Form 1120–S, ''U.S. Income Tax Return for an S Corporation,'' by attaching a statement to such return including the contents of paragraph (e)(2)(ii) of this section. For taxable years of an S corporation ending before September 1, 2020, and after June 21, 2019, the S corporation and all of its shareholders may irrevocably elect to apply the provisions of paragraph (e)(1) of this section on timely-filed (including extensions) original returns or on amended returns filed by March 15, 2021, by attaching a statement including the contents of paragraph (e)(2)(ii) of this section thereto. An election described in Section 3.02 of Notice 2020–69, 2020–39 I.R.B. 604 that is filed (in the time and manner specified in Section 3.02 of Notice 2020–69) on or before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] is deemed to satisfy the election requirement of this paragraph (e)(2).

(ii) *Contents of election statement.* The statement described in paragraph (e)(2)(i) of this section must:

(A) Identify that the S corporation and its shareholders (where applicable) are electing for the S corporation to be treated as owning stock of a foreign corporation within the meaning of section 958(a) under paragraph (e)(2) of this section;

(B) Include the amount of transition accumulated earnings and profits (as defined in paragraph (e)(3) of this section); and

(C) Where applicable, be signed by a person authorized to sign the S corporation's return that is required to be filed under section 6037.

(3) *Transition accumulated earnings and profits*—(i) *In general.* For purposes of this section, the term *transition accumulated earnings and profits* means, with respect to an S corporation and its shareholders, the amount of accumulated earnings and profits of the S corporation calculated as of September 1, 2020, reduced as described in paragraph (e)(3)(ii) of this section. Transition accumulated earnings and profits are not increased as a result of transactions occurring (or entity classification elections described in § 301.7701–3 of this chapter filed) after September 1, 2020. For purposes of this section, transition accumulated earnings and profits are not transferable to another person under any provision of the Code.

(ii) *Reduction solely by distributions.* An S corporation with transition accumulated earnings and profits is treated as having no transition accumulated earnings and profits if, beginning after September 1, 2020, the S corporation distributes in one or more distributions a cumulative amount of accumulated earnings and profits equal to or greater than the amount of the S corporation's transition accumulated earnings and profits as of September 1, 2020.

(4) *Required aggregate treatment.* In the case of an S corporation that has made an election under paragraph (e)(2) of this section and which satisfies the additional requirements of paragraph (e)(1) of this section, paragraph (d) of this section shall apply beginning with the S corporation's first taxable year for which the S corporation has no transition accumulated earnings and profits on the first day of that year, and to each subsequent taxable year of the S corporation.

(5) *Examples.* The following examples illustrate the application of paragraph (e).

(i) *Example 1*—(A) *Facts.* Individual A and Individual B, each a United States citizen, respectively own 5% and 95% of the single class of stock of SCX, an S corporation. SCX's sole asset is 100% of the single class of stock of FC, a controlled foreign corporation, which SCX has held since June 1, 2019. None of SCX, Individual A, or Individual B own shares, directly or indirectly, in any other controlled foreign corporation. Individual A, Individual B, SCX, and FC all use the calendar year as their taxable year. On January 1, 2021, SCX has transition accumulated earnings and profits of $100x and AAA of $0. SCX elects to apply the transition rules under paragraph (e)(1) of this section. During the 2021 taxable year, FC has $200x of tested income (within the meaning of § 1.951A–2(b)(1)) and $0 of qualified business asset investment (QBAI) (within the meaning of § 1.951A–3(b)).

(B) *Analysis*—(*1*) *S corporation level.* As an electing S corporation with transition accumulated earnings and profits on the first day of the taxable year (January 1, 2021), SCX is treated as owning (within the meaning of section 958(a)) all the stock of FC for purposes of applying sections 951 and 951A and any provision that applies specifically by reference thereto. Accordingly, SCX, a United States shareholder of FC, determines its GILTI inclusion amount under § 1.951A–1(c)(1) for its 2021 taxable year. SCX's pro rata share of FC's tested income is $200x, and its pro rata share of FC's QBAI is $0. SCX's net CFC tested income (within the meaning of § 1.951A–1(c)(2)) is $200x, and its net deemed tangible income return (within the meaning of § 1.951A–1(c)(3)) is $0. As a result, SCX's GILTI inclusion amount for 2021 is $200x. At the end of 2021, SCX increases its AAA by $200x to reflect the GILTI inclusion amount. Because SCX computes its income as an individual under section 1363(b), it cannot take a section 250 deduction for any GILTI inclusion amount. See § 1.250(a)–1(c)(1).

(*2*) *S corporation shareholder level.* Neither Individual A nor Individual B is treated as owning the stock in FC within the meaning of section 958(a). Accordingly, Individual A and Individual B include in gross income their pro rata shares of SCX's GILTI inclusion amount as described in section 1366(a), which is $10x ($200x × 5%) for Individual A and $190x ($200x × 95%) for Individual B.

(ii) *Example 2*—(A) *Facts.* The facts are the same as in paragraph (e)(5)(i) of this section, except that, on December 31, 2021, SCX distributes $300x to its shareholders. In addition, FC has an additional $200x of tested income (within the meaning of § 1.951A–2(b)(1)) and $0 of QBAI (within the meaning of § 1.951A–3(b)) during the 2022 taxable year.

(B) *Analysis*—(*1*) *Determination of transition accumulated earnings and profits.* Before taking into account the distribution on December 31, 2021, the results for taxable year 2021 are the same as in paragraph (e)(5)(i)(B) of this section. For 2021, $200x, the portion of SCX's $300x distribution that does not exceed AAA, is subject to section 1368(c)(1). The remaining distribution of $100x is treated as a dividend under section 316 to the extent of SCX's accumulated earnings and profits. As of January 1, 2022, SCX has $0 of transition accumulated earnings and profits under paragraph (e)(3) of this section because the cumulative amount of SCX's distributions out of accumulated earnings and profits after

September 1, 2020, equals or exceeds the amount of SCX's transition accumulated earnings and profits as of September 1, 2020.

(*2*) *S corporation level.* Because SCX has no transition accumulated earnings and profits as of January 1, 2022, paragraph (d) of this section applies to SCX for its taxable year 2022 and for each subsequent taxable year. As a result, for purposes of determining a GILTI inclusion amount in its taxable year 2022, SCX is not treated as owning (within the meaning of section 958(a)) the FC stock; instead, SCX is treated in the same manner as a foreign partnership for purposes of determining the FC stock owned by Individual A and Individual B under section 958(a)(2). Accordingly, SCX does not have a GILTI inclusion amount for its 2022 taxable year (or for any subsequent taxable year) and therefore will not increase its AAA as a result of GILTI inclusion amounts attributable to FC stock for its taxable year 2022 (or for any subsequent taxable year).

(*3*) *S corporation shareholder level.* With respect to Individual A, for purposes of determining the GILTI inclusion amount for taxable year 2022, Individual A is treated as owning 5% of the FC stock under section 958(a). Individual A is not a United States shareholder of FC because Individual A owns (within the meaning of section 958(a) and (b)) less than 10% of the FC stock. Accordingly, Individual A does not have a GILTI inclusion amount for taxable year 2022. With respect to Individual B, for purposes of determining the GILTI inclusion amount for taxable year 2022, Individual B is treated as owning 95% of the FC stock under section 958(a). In addition, Individual B is a United States shareholder of FC because Individual B owns (within the meaning of section 958(a) and (b)) at least 10% of the FC stock. Accordingly, Individual B's pro rata share of FC's tested income is $190x ($200x × 95%), and Individual B's pro rata share of FC's QBAI is $0. Individual B's net CFC tested income is $190x, and Individual B's net deemed tangible income return is $0. As a result, Individual B's GILTI inclusion amount for taxable year 2022 is $190x.

(6) *Applicability date.* This paragraph (e) applies to taxable years of S corporations ending on or after September 1, 2020. Taxpayers may choose to apply this paragraph (e) to taxable years of S corporations ending on or after June 22, 2019, provided that the S corporation and its shareholders that are United States shareholders consistently apply the rules set forth in this paragraph (e) with respect to all controlled foreign corporations whose stock the S corporation owns within the meaning of section 958(a).

* * * * *

■ **Par. 6.** Section 1.964–1 is amended by:

■ 1. Revising the first sentence of paragraph (c)(2);

■ 2. Removing the language ''domestic shareholders'' in the first sentence of paragraph (c)(3)(ii) and adding ''United States persons'' in its place;

■ 3. Revising paragraph (c)(3)(iii);

■ 4. Removing the language ''noncontrolled section 902 corporation'' in paragraphs (c)(4)(i)(B) and (c)(4)(ii) and adding ''noncontrolled foreign corporation'' in its place;

■ 5. Revising paragraph (c)(5)(ii);

■ 6. Redesignating paragraph (c)(8) as paragraph (c)(9);

■ 7. Adding a new paragraph (c)(8); and

■ 8. In paragraph (d):

■ i. Revising the heading;

■ ii. Removing ''Paragraphs (c)(1)(v) through (c)(6),'' ''26 CFR 1.964–1T(c)(1)(v) through (c)(6),'' and ''paragraphs (c)(1)(v) through (c)(6)'' everywhere they appear and adding ''Paragraphs (c)(1)(v) and (vi) and (c)(2) through (6),'' ''26 CFR 1.964–1T(c)(1)(v) and (vi) and (c)(2) through (6),'' and ''paragraphs (c)(1)(v) and (vi) and (c)(2) through (6)'' in their places, respectively; and

■ iii. Adding two sentences to the end of the paragraph.

The revisions and additions read as follows:

§ 1.964–1 Determination of the earnings and profits of a foreign corporation.

* * * * *

(c) * * *

(2) * * * For the first taxable year of a foreign corporation in which such foreign corporation first qualifies as a controlled foreign corporation (as defined in section 957 or 953) or a foreign corporation (other than a controlled foreign corporation as defined in section 957 or 953) as to which a United States person that is a United States shareholder (within the meaning of section 951(b)) owns stock (within the meaning of section 958(a)) (such corporation, a ''noncontrolled foreign corporation''), any method of accounting or taxable year allowable under this section may be adopted, and any election allowable under this section may be made, by such foreign corporation or on its behalf notwithstanding that, in previous years, its books or financial statements were prepared on a different basis, and notwithstanding that such election is required by the Code or regulations in this chapter to be made in a prior taxable year. * * *

(3) * * *

(iii) *Notice*—(A) *In general.* Except as otherwise provided in paragraph (c)(3)(iii)(B) of this section, on or before the filing date described in paragraph (c)(3)(ii) of this section, the controlling domestic shareholders must provide written notice of the election made or the adoption or change of method or taxable year effected to all other persons known by them to be United States persons that own (within the meaning of section 958(a)) stock of the foreign corporation (*domestic shareholders*) and to any other United States person that is a ''Category 4 filer'' of Form 5471, ''Information Return of U.S. Persons With Respect to Certain Foreign Corporations,'' with respect to the foreign corporation (that is, certain United States persons that control, within the meaning of section 6038(e), the foreign corporation). Thus, for example, this notice is required to be provided to domestic shareholders that own (within the meaning of section 958(a)) stock in the foreign corporation through one or more domestic partnerships. The notice required in this paragraph (c)(3)(iii)(A) must set forth the name, country of organization, and U.S. employer identification number (if applicable) of the foreign corporation, and the names, addresses, and stock interests of the controlling domestic shareholders. Such notice must also describe the nature of the action taken on behalf of the foreign corporation and the taxable year for which made, and identify a designated shareholder that retains a jointly executed consent confirming that such action has been approved by all of the controlling domestic shareholders and containing the signature of a principal officer of each such shareholder (or its common parent). However, the failure of the controlling domestic shareholders to provide such notice to a person required to be notified does not invalidate the election made or the adoption or change of method or taxable year effected.

(B) *Special rule for domestic partnerships.* A controlling domestic shareholder will be deemed to satisfy the notice requirement of paragraph (c)(3)(iii)(A) of this section with respect to any domestic shareholder that is a partner in a domestic partnership by providing notice to a domestic partnership (known to the controlling domestic shareholder) through which the domestic shareholder owns stock of the foreign corporation, instead of to the domestic shareholder.

* * * * *

(5) * * *

(ii) *Noncontrolled foreign corporations.* For purposes of this paragraph (c), the controlling domestic shareholders of a noncontrolled foreign corporation are its majority domestic shareholders. The majority domestic shareholders of a noncontrolled foreign corporation are those United States shareholders (within the meaning of section 951(b)) that own (within the meaning of section 958(a)) stock in the noncontrolled foreign corporation and that, in the aggregate, own (within the meaning of section 958(a)), or are considered as owning by applying the rules of section 958(b), more than 50 percent of the combined voting power of all of the voting stock of the noncontrolled foreign corporation that is owned by all United States shareholders that own (within the meaning of section 958(a)), or are considered as owning by applying the rules of section 958(b), stock of the noncontrolled foreign corporation.

* * * * *

(8) *Stock owned through domestic partnerships.* See § 1.958–1(d) for rules regarding the ownership of stock of a foreign corporation through a domestic partnership for purposes of paragraph (c) of this section and for purposes of any provision that specifically applies by reference to paragraph (c) of this section.

* * * * *

(d) *Applicability dates.* * * * Notwithstanding the preceding sentences in this paragraph (d), paragraphs (c)(2), (c)(3)(ii) and (iii), (c)(4)(i)(B), (c)(4)(ii), (c)(5)(ii), and (c)(8) of this section apply to taxable years of foreign corporations beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], and to taxable years of United States persons in which or with which such taxable years end. For taxable years of foreign corporations beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], and to taxable years of foreign United States persons in which or with which such taxable years end, see § 1.964–1(c)(2), (c)(3)(ii) and (iii), (c)(4)(i)(B), (c)(4)(ii), and (c)(5)(ii) as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

■ **Par. 7.** Section 1.1291–1 is amended by:

■ 1. Revising paragraphs (b)(7), (c)(4)(i), and (c)(4)(ii)(A) and (B);

■ 2. Adding paragraph (c)(5);

■ 3. Removing the language ''Paragraphs (c)(3) and (4)'' in paragraph (j)(1) and adding ''Paragraph (c)(3)'' in its place;

■ 4. Removing the language ''paragraphs (b)(2)(ii) and (v), (b)(7) and (8), and (e)(2) of this section'' in paragraph (j)(3) and adding ''paragraphs (b)(2)(ii) and (v), (b)(8), and (e)(2) of this section'' in its place; and

■ 5. Adding paragraph (j)(5).

The revisions and additions read as follows:

§ 1.1291–1 Taxation of U.S. persons that are shareholders of section 1291 funds.

* * * * *

(b) * * *

(7) *Shareholder.* Except as otherwise provided in this paragraph (b)(7) or paragraph (e) of this section, a shareholder of a PFIC is a United States person that directly owns stock of a PFIC (a direct shareholder), or that is an indirect shareholder (as defined in paragraph (b)(8) of this section). Notwithstanding the previous sentence, neither a domestic partnership nor an S corporation (as defined in section 1361(a)(1)) is treated as a shareholder of a PFIC. In addition, to the extent that a person is treated under sections 671 through 678 as the owner of a portion of a domestic trust, the trust is not treated as a shareholder of a PFIC with respect to PFIC stock held by that portion of the trust, except for purposes of the information reporting requirements of § 1.1298–1(b)(3)(i) (imposing an information reporting requirement on domestic liquidating trusts and fixed investment trusts).

* * * * *

(c) * * *

(4) * * * (i) *In general.* If PFIC stock is marked to market for any taxable year under section 475 or any other provision of chapter 1 of the Internal Revenue Code, other than section 1296, regardless of whether the application of such provision is mandatory or results from an election by the shareholder (as defined in paragraph (b)(7) of this section) or another person, then, except as provided in paragraph (c)(4)(ii) of this section, section 1291 and the regulations in this part thereunder do not apply to any distribution with respect to such PFIC stock or to any disposition of such PFIC stock for such taxable year. See §§ 1.1295–1(i)(3) and 1.1296–1(h)(3)(i) for rules regarding the automatic termination of an existing election under section 1295 or section 1296 when a shareholder marks to market PFIC stock under section 475 or any other provision of chapter 1 of the Internal Revenue Code.

(ii) * * * (A) Notwithstanding any provision in this section to the contrary, with respect to a shareholder (as defined in paragraph (b)(7) of this section), the rule of paragraph (c)(4)(ii)(B) of this section applies to the first taxable year in which the shareholder's PFIC stock is marked to market under a provision of chapter 1 of the Internal Revenue Code, other than section 1296, if such foreign corporation was a PFIC for any taxable year before the taxable year in which the PFIC stock is marked to market, which is during the shareholder's holding period (as defined in section 1291(a)(3)(A) and § 1.1296–1(f)) in such stock, and for which such corporation was not treated as a QEF with respect to such shareholder.

(B) For the first taxable year of a shareholder in which the shareholder's PFIC stock is marked to market under any provision of chapter 1 of the Internal Revenue Code, other than section 1296, such shareholder, in lieu of the rules under which the stock is marked to market, applies the rules of § 1.1296–1(i)(2) and (3) as if an election had been made under section 1296 for such first taxable year.

(5) *Coordination with section 1297(d)*—(i) *In general.* For purposes of section 1297(d), with respect to a partner or S corporation shareholder that would be considered an indirect shareholder, through its ownership in a domestic partnership or S corporation, with respect to a foreign corporation that is a PFIC and a controlled foreign corporation (as defined in section 957), the term ''qualified portion'' does not include any portion of such indirect shareholder's holding period during which it was not a United States shareholder (as defined in section 951(b)) with respect to the foreign corporation.

(ii) *Transition rule.* For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], or for taxable years of shareholders of an S corporation in which the S corporation elects to apply § 1.958–1(e), for purposes of section 1297(d), a partner's or S corporation shareholder's qualified portion with respect to the foreign corporation includes the portion of its holding period during which it—

(A) Is an indirect shareholder under paragraph (b)(8)(iii)(A) or (B) of this section with respect to the foreign corporation; and

(B) Included in gross income its distributive or pro rata share of any amount that the domestic partnership or S corporation, respectively, included under sections 951(a)(1) and 951A(a) with respect to stock in the foreign corporation (treating the requirement in this paragraph (c)(5)(ii)(B) as not satisfied to the extent § 1.958–1(d)(1) through (3) is applied with respect to the domestic partnership or S corporation before their general applicability date under § 1.958–1(d)(4) or the domestic partnership or S corporation relied on the earlier proposed version of such provisions). See, for example, § 1.951A–1(e)(2).

* * * * *

(j) * * *

(5) Paragraphs (b)(7), (c)(4)(i), (c)(4)(ii)(A) and (B), and (c)(5) of this section apply to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see § 1.1291–1(b)(7), (c)(4)(i), and (c)(4)(ii)(A) and (B) as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

§ 1.1291–9 [Amended]

■ **Par. 8.** Section 1.1291–9 is amended by:

■ 1. Removing the language ''the undistributed earnings and profits, within the meaning of section 902(c)(1)'' in paragraph (a)(2)(i) and adding ''the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986)'' in its place;

■ 2. Removing the language ''section 1297(e) PFIC'' in paragraphs (i) and (j)(2)(v) introductory text and adding ''section 1297(d) PFIC'' in its place wherever it appears; and

■ 3. Removing the language ''section 1297(e)(2)'' in paragraph (j)(2)(v)(A) and adding ''section 1297(d)(2)'' in its place.

■ **Par. 9.** Section 1.1293–1 is amended by:

■ 1. Adding paragraphs (a)(3) and (4);

■ 2. Revising paragraphs (c)(1) and (2);

■ 3. Redesignating paragraph (c)(3) as paragraph (c)(4);

■ 4. Adding a new paragraph (c)(3); and

■ 5. Revising newly redesignated paragraph (c)(4).

The additions and revisions read as follows:

§ 1.1293–1 Current taxation of income from qualified electing funds.

(a) * * *

(3) *Pass-through entity defined.* For purposes of this section, the term *pass-through entity* has the meaning provided in § 1.1295–1(j)(2).

(4) *Applicability dates.* Paragraph (a)(3) of this section applies to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**].

* * * * *

(c) * * * (1) *In general.* Except as otherwise provided in this paragraph (c), a shareholder that makes a section 1295 election as provided in § 1.1295–1(d)(2) with respect to stock in a PFIC that it is treated as owning by reason of an interest in a pass-through entity, or a shareholder that is treated as owning stock in a QEF by reason of an interest in a domestic partnership that has made a preexisting partnership section 1295 election (within the meaning of § 1.1295–1(d)(2)(i)(B)) or in an S corporation that has made a preexisting S corporation section 1295 election (within the meaning of § 1.1295–1(d)(2)(ii)(B)), includes in income its pro rata share of ordinary earnings and net capital gain attributable to the QEF stock as if the shareholder directly owned its share of the QEF stock held by the pass-through entity.

(2) *Section 1295 election made by domestic nongrantor trust or domestic estate.* Notwithstanding paragraph (c)(1) of this section, if a domestic nongrantor trust or domestic estate makes a section 1295 election as provided in § 1.1295–1(d)(2)(iii)(A)(*1*) with respect to PFIC stock that it owns, the domestic nongrantor trust or domestic estate includes in income its pro rata share of ordinary earnings and net capital gain attributable to the QEF stock. A shareholder that is treated as owning such QEF stock by reason of an interest in the domestic nongrantor trust or domestic estate accounts for its pro rata share of ordinary earnings and net capital gain attributable to such stock according to the general rules applicable to inclusions of income from the domestic nongrantor trust or domestic estate.

(3) *QEF stock transferred to a pass-through entity*—(i) *In general.* Except as otherwise provided in this paragraph (c)(3), if a shareholder transfers stock in a PFIC subject to a section 1295 election to a pass-through entity in which it is an interest holder, such shareholder continues to include in income its pro rata share of ordinary earnings and net capital gain attributable to the QEF stock held by the transferee pass-through entity, under paragraph (c)(1) of this section. Proper adjustments to reflect an inclusion in income under section 1293 by the indirect shareholder must be made, under the principles of § 1.1291–9(f), to the basis of the indirect shareholder's interest in the pass-through entity.

(ii) *Shareholders other than the transferor.* Except as otherwise provided in this paragraph (c)(3), if a shareholder transfers stock in a PFIC subject to a section 1295 election to a pass-through entity and such stock is not subject to a preexisting QEF election made by the pass-through entity, any other person that becomes a shareholder of such PFIC as a result of the transfer will be subject to the income inclusion rules of this section only if such person makes a section 1295 election with respect to the transferred PFIC stock under § 1.1295–1(d)(2).

(iii) *QEF stock transferred to domestic nongrantor trust.* Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, if a shareholder transfers stock in a PFIC subject to a section 1295 election to a domestic nongrantor trust in which it is a beneficiary, and the transferee domestic nongrantor trust makes a section 1295 election with respect to that stock pursuant to § 1.1295–1(d)(2)(iii)(A)(*1*), the domestic nongrantor trust, and the transferor and any person that becomes a shareholder of the QEF as a result of the transfer, take into account their share of ordinary earnings and net capital gain attributable to the QEF shares under paragraph (c)(2) of this section. If the transferee domestic nongrantor trust does not make a section 1295 election with respect to the transferred PFIC stock, the transferor continues to be subject, in its capacity as an indirect shareholder, to the income inclusion rules of paragraph (c)(1) of this section.

(4) *Applicability date.* Paragraph (c) of this section applies to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see § 1.1293–1(c), as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

■ **Par. 10.** Section 1.1295–1 is amended by:

■ 1. Revising paragraph (b)(3);

■ 2. Removing the language ''are defined in paragraph (j) of this section'' in paragraph (c)(1) and adding ''are defined in paragraphs (j)(3) and (4) of this section, respectively'' in its place;

■ 3. Removing the language ''(as defined in paragraph (j) of this section)'' in paragraph (c)(2)(iv) and adding ''(as defined in paragraph (j)(2) of this section)'' in its place;

■ 4. Revising paragraphs (d)(1), (d)(2)(i)(A) and (B), and (d)(2)(ii);

■ 5. In paragraph (d)(2)(iii)(A)(*1*):

■ i. Removing the language ''§ 1.1293–1(c)(1)'' and adding ''§ 1.1293–1(c)(2)'' in its place; and

■ ii. Removing the language ''domestic trust or estate'' and adding ''domestic nongrantor trust or domestic estate'' in its place;

■ 6. Revising paragraph (f)(2)(i) introductory text;

■ 7. Redesignating paragraph (f)(3) as paragraph (f)(5);

■ 8. Adding a new paragraph (f)(3) and paragraph (f)(4);

■ 9. Removing the language ''as defined in paragraph (j) of this section'' in paragraph (g)(3) and adding ''as defined in paragraph (j)(1) of this section'' in its place;

■ 10. Removing the language ''(as defined in paragraph (j) of this section)'' and ''§ 1.1295–1'' in paragraph (h) and adding ''(as defined in paragraph (j)(4) of this section)'' and ''this section'' in their places, respectively;

■ 11. Removing and reserving paragraph (i)(1)(ii);

■ 12. Revising paragraph (j); and

■ 13. In paragraph (k):

■ i. Revising the heading;

■ ii. Removing the language ''(b)(3),'' in the first sentence;

■ iii. Removing the language ''and (c) through (j) of this section'' in the first sentence and adding ''(c), (d)(2)(iv), (d)(3) through (d)(6), (e), (f)(1), (f)(2)(ii), (g), (h), (i)(1)(i) and (iii), and (i)(2) through (5) of this section'' in its place;

■ iv. Removing the language ''(f) and (g) of this section'' in the second sentence of and adding ''(f)(1), (f)(2)(ii), and (g) of this section'' in its place;

■ v. Removing the third sentence; and

■ vi. Adding two sentences at the end of the paragraph.

The revisions and additions read as follows:

§ 1.1295–1 Qualified electing funds.

* * * * *

(b) * * *

(3) *Application of general rules to stock held by a pass through entity*—(i) *Stock subject to a section 1295 election transferred to a domestic nongrantor trust or domestic estate.* A shareholder's section 1295 election will not apply to a domestic nongrantor trust or domestic estate to which the shareholder transfers stock subject to a section 1295 election, or to any other United States person that is a beneficiary of the domestic nongrantor trust or estate. However, as provided in paragraph (c)(2)(iv) of this section (relating to a transfer to a domestic pass through entity of stock subject to a section 1295 election), a shareholder that transfers stock subject to a section 1295 election to a domestic nongrantor trust or domestic estate will continue to be subject to the section 1295 election with respect to the stock indirectly owned through the domestic nongrantor trust or domestic estate and any other stock of that PFIC owned by the shareholder.

(ii) *Limitation on application of domestic nongrantor trust's or domestic estate's section 1295 election.* Except as provided in paragraph (c)(2)(iv) of this section, a section 1295 election made by a domestic nongrantor trust or domestic estate does not apply to other stock of the PFIC held directly or indirectly by the beneficiary.

(iii) *Effect of partnership termination on preexisting partnership section 1295 election.* The termination of a preexisting partnership section 1295 election (within the meaning of paragraph (d)(2)(i)(B) of this section) by reason of the termination of the partnership under section 708(b) will not terminate the section 1295 election with respect to partners of the terminated partnership that are partners of the new partnership (continuing partners). The stock of the PFIC of which a new partner (partners other than continuing partners) is an indirect shareholder will be treated as stock of a QEF with respect to such partner only if the new partner makes or has made a section 1295 election with respect to that stock under paragraph (d)(2)(i)(A) of this section.

(iv) *Characterization of stock held through a pass-through entity.* Stock of a PFIC held through a pass-through entity will be treated as stock of a pedigreed QEF with respect to a shareholder (as defined in paragraph (j)(3) of this section) that is treated as owning such stock by reason of an interest in the pass-through entity only if—

(A) In the case of PFIC stock acquired (other than in a transaction in which gain is not fully recognized, including pursuant to regulations in this part under section 1291(f)) and held by a domestic pass-through entity, the domestic pass-through entity has made a preexisting section 1295 election under paragraph (d)(2)(i)(B) or (d)(2)(ii)(B) of this section, or makes an election under paragraph (d)(2)(iii)(A)(*1*) of this section, and the PFIC has been a QEF with respect to the pass-through entity for all taxable years that are included in the pass-through entity's holding period of the PFIC stock and during which the foreign corporation was a PFIC within the meaning of § 1.1291–9(j)(1);

(B) In the case of PFIC stock acquired (other than in a transaction in which gain is not fully recognized, including pursuant to regulations in this part under section 1291(f)) and held by a domestic pass-through entity, other than PFIC stock described in paragraph (b)(3)(iv)(A) of this section, through which the shareholder is treated as owning such PFIC stock, the shareholder makes the section 1295 election under paragraph (d)(2)(i)(A), (d)(2)(ii)(A), (d)(2)(iii)(A)(*2*), or (d)(2)(iii)(B) of this section, and the PFIC has been a QEF with respect to the shareholder for all taxable years that are included in the shareholder's holding period for the PFIC stock, and during which the foreign corporation was a PFIC within the meaning of § 1.1291–9(j)(1); or

(C) In the case of PFIC stock transferred by an interest holder or beneficiary to a pass-through entity in a transaction in which gain is not fully recognized (including pursuant to regulations in this part under section 1291(f)), if the pass-through entity made a preexisting section 1295 election under paragraph (d)(2)(i)(B) or (d)(2)(ii)(B) of this section with respect to the PFIC stock, or the shareholder or pass-through entity, as applicable, makes a section 1295 election under paragraph (d)(2)(i)(A), (d)(2)(ii)(A), (d)(2)(iii)(A)(*1*) or (*2*), or (d)(2)(iii)(B) of this section, in each case for the taxable year in which the transfer was made, or the shareholder's section 1295 election continues pursuant to paragraph (c)(2)(iv) of this section. If the foreign corporation was a PFIC within the meaning of § 1.1291–9(j) at the time of the transfer, the PFIC stock transferred will be treated as stock of a pedigreed QEF with respect to a transferor, however, only if that stock was treated as stock of a pedigreed QEF with respect to the transferor at the time of the transfer. In all cases subject to this paragraph (b)(3)(iv)(C), the PFIC stock will be treated as stock of a pedigreed QEF only if the PFIC has been a QEF for all taxable years of the PFIC that are included wholly or partly in the shareholder's holding period of the PFIC stock during which the foreign corporation was a PFIC within the meaning of § 1.1291–9(j).

(v) *Characterization of stock distributed by a partnership.* In the case of PFIC stock distributed by a partnership to one or more partners in a transaction in which gain is not fully recognized (including pursuant to regulations in this part under section 1291(f)), the PFIC stock will be treated as stock of a pedigreed QEF by a shareholder only if that stock was treated as stock of a pedigreed QEF with respect to the shareholder immediately before the distribution, or, in the case of a distribution of PFIC stock by a partnership to one or more partners in the first year of the distributee partner or partners' holding period of the PFIC stock, the distributee partner or partners make an election as provided in paragraph (d)(2) of this section.

* * * * *

(d) * * * (1) *General rule.* Except as otherwise provided in this paragraph (d), any shareholder (as defined in paragraph (j)(3) of this section) of a PFIC, including a shareholder that holds stock of a PFIC in bearer form, may make a section 1295 election with respect to that PFIC. The shareholder need not own directly or indirectly any stock of the PFIC when the shareholder makes the section 1295 election provided the shareholder is a shareholder of the PFIC during the taxable year of the PFIC that ends with or within the taxable year of the shareholder for which the section 1295 election is made.

(2) * * * (i) * * * (A) *In general.* If a partnership (domestic or foreign) holds stock of a PFIC, the section 1295 election with respect to such PFIC is made by a shareholder (as defined in paragraph (j)(3) of this section) indirectly owning the PFIC stock by reason of its interest in the partnership. A section 1295 election made by a shareholder under this paragraph (d)(2)(i)(A) applies to the stock of the PFIC indirectly owned by the shareholder by reason of its interest in the partnership and to any other stock of the PFIC owned by the shareholder. A shareholder making an election under this paragraph (d)(2)(i)(A) must do so in the form and manner provided in paragraph (f) of this section. The shareholder must also notify the partnership of the election no later than 30 days after filing the return in which the election is made; the shareholder may notify the partnership in any reasonable manner. However, the failure of the shareholder to notify the partnership of its election does not invalidate an otherwise valid election under this paragraph (d)(2)(i)(A). A shareholder making an election under this paragraph (d)(2)(i)(A) accounts for its pro rata share of ordinary earnings and net capital gain attributable to the QEF stock as provided in § 1.1293–1(c)(1).

(B) *Preexisting section 1295 election by domestic partnership.* Any section 1295 election made by a domestic partnership with respect to a PFIC effective for taxable years of the PFIC ending on or before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] (*preexisting partnership section 1295 election*) will be treated as if it were made by each shareholder that is treated as owning stock in the PFIC by reason of its interest in the domestic partnership on or before such date, and the stock in the PFIC will continue to be treated as stock in a QEF to such shareholder; any partner that becomes a shareholder of the PFIC by acquiring an interest in the domestic partnership after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] and wishes to have a section 1295 election applicable with respect to the PFIC may make a section 1295 election under paragraph (d)(2)(i)(A) of this section with respect to stock treated as owned by reason of its interest in the domestic partnership. A shareholder that is treated as owning stock of a QEF by reason of an interest in a domestic partnership that has made a preexisting partnership section 1295 election accounts for its pro rata share of the ordinary earnings and net capital gain attributable to such QEF stock as provided in § 1.1293–1(c)(1).

(ii) *S corporation*—(A) *In general.* If an S corporation holds stock of a PFIC, the section 1295 election with respect to such PFIC is made by a shareholder (as defined in paragraph (j)(3) of this section) indirectly owning the PFIC stock by reason of its interest in the S corporation. A section 1295 election made by a shareholder under this paragraph (d)(2)(ii)(A) applies to the stock of the PFIC held by the shareholder by reason of its interest in the S corporation and to any other stock of the PFIC held by the shareholder. A shareholder making an election under this paragraph (d)(2)(ii)(A) must do so in the form and manner provided in paragraph (f) of this section. The shareholder must also notify the S corporation of the election no later than 30 days after filing the return in which the election is made; the shareholder may notify the S corporation in any reasonable manner. However, the failure of the shareholder to notify the S corporation of its election does not invalidate an otherwise valid election under this paragraph (d)(2)(ii)(A). A shareholder making an election under this paragraph (d)(2)(ii)(A) accounts for its pro rata share of ordinary earnings and net capital gain attributable to the QEF stock as provided in § 1.1293–1(c)(1).

(B) *Preexisting section 1295 election by S corporation.* Any section 1295 election made by an S corporation with respect to a PFIC effective for taxable years of such PFIC ending on or before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] (*preexisting S corporation section 1295 election*) will be treated as if it were made by each shareholder that is treated as owning stock in the PFIC by reason of its interest in the S corporation on or before such date, and the stock in the PFIC will continue to be treated as stock in a QEF to such shareholder; any S corporation shareholder that becomes a shareholder of the PFIC by acquiring an interest in the S corporation after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] and wishes to have a section 1295 election applicable with respect to the PFIC may make a section 1295 election under paragraph (d)(2)(ii)(A) of this section with respect to stock treated as owned by reason of its interest in the S corporation. A shareholder that is treated as owning stock of a QEF by reason of an interest in an S corporation that has made a preexisting S corporation section 1295 election accounts for its pro rata share of the ordinary earnings and net capital gain attributable to the QEF stock as provided in § 1.1293–1(c)(1).

* * * * *

(f) * * *

(2) * * * (i) *In general.* A shareholder that makes a section 1295 election with respect to a PFIC, or a shareholder that is treated as owning stock in a QEF by reason of an interest in a domestic partnership that has made a preexisting partnership section 1295 election (within the meaning of paragraph (d)(2)(i)(B) of this section) or by reason of an interest in an S corporation that has made a preexisting S corporation section 1295 election (within the meaning of paragraph (d)(2)(ii)(B) of this section), for each taxable year to which the section 1295 election applies, must—

* * * * *

(3) *Preexisting partnership or S corporation section 1295 election.* A shareholder that is treated as owning stock in a QEF by reason of an interest in a domestic partnership that has made a preexisting partnership section 1295 election or by reason of an interest in an S corporation that has made a preexisting S corporation section 1295 election does not need to make a section 1295 election with respect to such QEF under the rules of paragraph (f)(1) of this section. However, such shareholder must comply with the annual election requirements as provided in paragraph (f)(2) of this section.

(4) *Notice requirement for partners and S corporation shareholders.* See paragraphs (d)(2)(i)(A) and (d)(2)(ii)(A) of this section for a notice requirement for partners and S corporation shareholders making a section 1295 election under this section.

* * * * *

(j) *Definitions.* For purposes of this section—

(1) *Intermediary.* The term *intermediary* means a nominee or shareholder of record that holds stock on behalf of the shareholder or on behalf of another person in a chain of ownership between the shareholder and the PFIC, and any direct or indirect beneficial owner of PFIC stock (including a beneficial owner that is a pass-through entity) in the chain of ownership between the shareholder and the PFIC.

(2) *Pass-through entity.* The term *pass-through entity* means a partnership, S corporation, trust, or estate.

(3) *Shareholder.* The term *shareholder* has the meaning provided in § 1.1291–1(b)(7).

(4) *Shareholder's election year.* The term *shareholder's election year* means the taxable year of the shareholder for which it makes the section 1295 election.

(k) *Applicability dates.* * * * Paragraphs (b)(3), (d)(1), (d)(2)(i) and (ii), (f)(2)(i), (f)(3) and (4), and (j) of this section apply to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see § 1.1295–1(b)(3), (d)(1), (d)(2)(i) and (ii), (f)(2)(i), (i)(1)(ii), and (j) as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

■ **Par. 11.** Section 1.1296–1 is amended by:

■ 1. Adding paragraph (a)(4);

■ 2. Revising paragraph (e)(1);

■ 3. Removing paragraph (g)(3);

■ 4. Revising paragraphs (h)(1)(i) and (j); and

■ 5. For each paragraph listed in the following table, removing the language in the ''Remove'' column and adding in its place the language in the ''Add'' column.

Paragraph	Remove	Add
(b)(1)	United States person	shareholder.
(b)(2), heading	United States person	shareholder.
(b)(2), first sentence	United States person	shareholder.
(b)(2), first sentence	U.S. person	shareholder.
(b)(2), second sentence	United States person's	shareholder's.
(b)(3), second sentence	United States person's	shareholder's.
(b)(3), second sentence	person owns directly	shareholder owns directly.
(c)(1)	United States person's	shareholder's.
(c)(1)	United States person	shareholder.
(c)(3)	United States person's	shareholder's.
(c)(3)	such person	such shareholder.
(c)(5)	United States person	shareholder.
(d)(1)	United States person	shareholder.
(d)(2), heading	certain foreign entities	pass-through entities.
(d)(2)(i), first and last sentences	United States person	shareholder.
(d)(2)(i), first sentence	certain foreign entities	pass-through entities.
(d)(2)(i), first sentence	foreign entity	entity.
(d)(2)(i), last sentence	United States person's	shareholder's.
(e), heading	foreign entities	pass-through entities.
(f)	taxpayer	shareholder.
(f)	taxpayer's	shareholder's.
(g)(1)	United States person	shareholder.
(g)(2), heading	United States person	shareholder.
(g)(2)(i)	United States person	shareholder.
(h)(1)(ii)	controlling United States shareholders	controlling domestic shareholders.
(h)(2)(ii), first sentence	United States person	shareholder.
(h)(2)(ii), last sentence	United States person's	shareholder's.
(h)(3)(i), first sentence	United States person's	shareholder's.
(h)(3)(i), first sentence	United States person	shareholder.
(h)(3)(ii), second sentence	United States person	shareholder.
(i)(1)	United States person's	shareholder's.
(i)(1)	United States person	shareholder.
(i)(2), introductory text	United States person	shareholder.
(i)(2)(ii)	United States person's	shareholder's.
(i)(2)(ii)	taxpayer's	shareholder's.

The addition and revisions read as follows:

§ 1.1296–1 Mark to market election for marketable stock.

(a) * * *

(4) *Shareholder.* The term *shareholder* has the meaning provided in § 1.1291–1(b)(7).

* * * * *

(e) * * * (1) *In general.* Except as provided in paragraph (e)(2) of this section, the following rules apply in determining stock ownership for purposes of this section. PFIC stock owned, directly or indirectly, by or for a partnership (domestic or foreign), S corporation, foreign trust (other than a foreign trust that is described in sections 671 through 679), or foreign estate is considered as being owned proportionately by its partners, shareholders, or beneficiaries, respectively. PFIC stock owned, directly or indirectly, by or for a trust (domestic or foreign) described in sections 671 through 679 is considered as being owned proportionately by its grantors or other persons treated as owners under sections 671 through 679 of any portion of the trust that includes the stock. The determination of a person's proportionate interest in a partnership, S corporation, trust, or estate will be made on the basis of all the facts and circumstances. Stock considered owned by a person by reason of this paragraph is treated as actually owned by such person for purposes of applying the rules of this section.

* * * * *

(h) * * * (1) * * * (i) *Shareholders.* Except as otherwise provided in this paragraph (h), a shareholder (as defined in paragraph (a)(4) of this section) that owns marketable stock in a PFIC, or is treated as owning marketable stock under paragraph (e) of this section, on the last day of the shareholder's taxable year, must make a section 1296 election for such taxable year on or before the due date (including extensions) of its income tax return for that year. The section 1296 election must be made on the Form 8621, ''Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund'' (or successor form), included with the original or superseding tax return of the shareholder for that year.

(A) *Preexisting section 1296 election.* Notwithstanding paragraph (h)(1)(i) of this section, any section 1296 election with respect to a PFIC made by a domestic partnership or S corporation effective for taxable years of the PFIC ending on or before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**] (*preexisting section 1296 election*) will continue to apply, and any stock in the PFIC that a shareholder is treated as owning by reason of its interest in the domestic partnership or S corporation on or before such date will continue to be treated as section 1296 stock to such shareholder; any person that becomes a shareholder of the PFIC by acquiring an interest in the domestic partnership or S corporation after such date that wishes for a section 1296 election to apply with respect to the PFIC may make a section 1296 election as provided in paragraphs (b)(1) and (h)(1)(i) of this section. A shareholder that is treated as owning section 1296 stock by reason of an interest in a domestic partnership or S corporation that has made a preexisting 1296 election under this paragraph (h)(1)(i)(A) accounts for its share, through its ownership in the domestic partnership or S corporation, of any mark to market gain recognized under paragraph (c)(1) of this section and any mark to market loss under paragraph (c)(3) of this section as if it owned the section 1296 stock directly.

(B) *Notice.* A shareholder that makes a section 1296 election with respect to section 1296 stock owned through a partnership or S corporation must notify the partnership or S corporation of the election no later than 30 days after filing the return in which the election is made; the shareholder may provide such notification in any reasonable manner. However, the failure of the shareholder to notify the partnership or S corporation of its election will not invalidate an otherwise valid section 1296 election.

* * * * *

(j) *Applicability date.* Except as otherwise provided in this paragraph (j), the provisions in this section apply to taxable years beginning on or after May 3, 2004. The provisions of paragraph (d)(4) of this section relating to section 1022 apply on and after January 19, 2017. The provisions of paragraphs (a)(4); (b)(1) through (3); (c)(1), (3), and (5); (d)(1) and (d)(2)(i); (e)(1); (f); (g)(1), (g)(2)(i), and (g)(3); (h)(1)(i) and (ii), (h)(2)(ii), and (h)(3)(i) and (ii); and (i)(1), (i)(2) introductory text, and (i)(2)(ii) apply to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see § 1.1296–1(b)(1) through (3); (c)(1), (3), and (5); (d)(1) and (d)(2)(i); (e)(1); (f); (g)(1), (g)(2)(i), and (g)(3); (h)(1)(i) and (ii), (h)(2)(ii), and (h)(3)(i) and (ii); and (i)(1), (i)(2) introductory text, and (i)(2)(ii) as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

§ 1.1297–0 [Amended]

■ **Par. 12.** Section 1.1297–0 is amended by removing the language ''section 1297(e) PFIC'' from the heading for the entry for § 1.1297–3 and adding ''section 1297(d) PFIC'' in its place.

■ **Par. 13.** Section 1.1297–3 is amended by:

■ 1. Revising the section heading;

■ 2. Removing the language ''section 1297(e)'' in paragraph (a) and adding ''section 1297(d)'' in its place;

■ 3. Removing the language ''section 1297(e) PFIC'' in paragraphs (b)(1) and (2) and adding ''section 1297(d) PFIC'' in its place;

■ 4. Removing the language ''section 1297(e)(2)'' in paragraph (b)(2) and adding ''section 1297(d)(2)'' in its place;

■ 5. Removing the language ''section 1297(e) PFIC'' in paragraphs (c)(1) and (2) and adding ''section 1297(d) PFIC'' in its place;

■ 6. Removing the language ''section 1297(e)(2)'' in paragraph (c)(2) and adding ''section 1297(d)(2)'' in its place;

■ 7. Removing the language ''the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3))'' in paragraphs (c)(3)(i)(A) and (B) and adding ''the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986)'' in its place; and

■ 8. Removing the language ''section 1297(e) PFIC'' in paragraphs (d) and (e)(1) and adding ''section 1297(d) PFIC'' in its place.

The revision reads as follows:

§ 1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(d) PFIC.

* * * * *

■ **Par. 14.** Section 1.1298–1 is amended by:

■ 1. Revising paragraphs (b)(1), (b)(2) heading, (b)(2)(i) introductory text, and (b)(2)(ii);

■ 2. Removing paragraph (c)(6);

■ 3. Redesignating paragraphs (c)(7) through (9) as paragraphs (c)(6) through (8), respectively;

■ 4. Removing the language ''Except as provided in paragraph (h)(2) of this section'' in paragraph (h)(1) and adding ''Except as provided in paragraph (h)(2) or (3) of this section'' in its place;

■ 5. Removing the language ''Paragraph (c)(9)'' in paragraph (h)(2) and adding ''Paragraph (c)(8)'' in its place; and

■ 6. Adding paragraph (h)(3).

The revisions and addition read as follows:

§ 1.1298–1 Section 1298(f) annual reporting requirements for United States persons that are shareholders of a passive foreign investment company.

* * * * *

(b) * * * (1) *General rule.* Except as otherwise provided in this section, a United States person that is a shareholder of a PFIC (as defined in § 1.1291–1(b)(7)) must complete and file Form 8621, ''Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund'' (or successor form), under section 1298(f) and this section for the PFIC if, during the shareholder's taxable year, the shareholder—

(i) Directly owns stock of the PFIC; or

(ii) Is an indirect shareholder under § 1.1291–1(b)(8) that holds any interest in the PFIC through one or more entities, domestic or foreign, each of which is not a shareholder of such PFIC within the meaning of § 1.1291–1(b)(7).

(2) *Additional requirement to file for certain beneficiaries of domestic estates and domestic nongrantor trusts*—(i) *General rule.* Except as otherwise provided in this section, an indirect shareholder that owns an interest in a PFIC by reason of an interest in a domestic estate or domestic nongrantor trust (as described in § 1.1291–

1(b)(8)(iii)(C)) also must file Form 8621 (or successor form) with respect to the PFIC under section 1298(f) and this section if, during the indirect shareholder's taxable year, the indirect shareholder is—

* * * * *

(ii) *Exception to indirect shareholder reporting for certain QEF inclusions and MTM inclusions.* The filing requirements under paragraph (b)(2)(i) of this section do not apply with respect to an interest in a PFIC owned by an indirect shareholder described in paragraph (b)(2)(i)(C) or (D) of this section if the domestic nongrantor trust or domestic estate through which the indirect shareholder owns such interest in the PFIC timely files Form 8621 (or successor form) with respect to the PFIC under paragraph (b)(1) of this section.

* * * * *

(h) * * *

(3) Paragraphs (b)(1) and (b)(2)(i) and (ii) of this section apply to taxable years of shareholders beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years of shareholders beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see § 1.1298–1(b)(1) and (b)(2)(i) and (ii) as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

§ 1.1298–3 [Amended]

■ **Par. 15.** Section 1.1298–3 is amended by removing the language ''the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3))'' in paragraph (c)(3)(i) and adding ''the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986)'' in its place.

■ **Par. 16.** Section 1.1411–10 is amended by:

■ 1. Removing paragraph (g)(2)(iii);

■ 2. Revising paragraph (g)(3);

■ 3. Removing paragraph (g)(4)(ii);

■ 4. Redesignating paragraphs (g)(4)(iii) and (iv) as paragraphs (g)(4)(ii) and (iii), respectively; and

■ 5. Revising newly redesignated paragraph (g)(4)(iii) and paragraph (i).

The revisions read as follows:

§ 1.1411–10 Controlled foreign corporations and passive foreign investment companies.

* * * * *

(g) * * *

(3) *Who may make the election*—(i) *In general.* An individual, estate, or trust may make an election under paragraph (g) of this section with respect to each CFC or QEF that it holds directly or indirectly through one or more entities, each of which is a foreign entity or a domestic pass-through entity. The election, if made, for an estate or trust must be made by the fiduciary of the estate or trust.

(ii) *Special rule for certain S corporations.* For taxable years in which an S corporation elects to apply § 1.958–1(e), the S corporation may make an election under this paragraph (g)(3)(ii) with respect to each CFC that it holds, directly or indirectly. If an S corporation does not make the election under this paragraph (g)(3)(ii), the election may be made by its shareholders that are individuals, estates, or trusts instead.

(4) * * *

(iii) *Time for making election.* The election under paragraph (g) of this section must be made in the manner prescribed by forms, instructions, or in other guidance on the individual's, estate's, or trust's original or amended return for the taxable year for which the election is made. An election can be made on an amended return only if the taxable year for which the election is made, and all taxable years that are affected by the election, are not closed by the period of limitations on assessments under section 6501. Extensions of time to make the election are not available under any other provision of the law, including § 301.9100 of this chapter.

* * * * *

(i) *Applicability dates.* Except as otherwise provided in this paragraph (i), this section applies to taxable years beginning after December 31, 2013. However, taxpayers may apply this section to taxable years beginning after December 31, 2012, in accordance with § 1.1411–1(f). Paragraphs (g)(3) and (g)(4)(iii) of this section apply to taxable years beginning on or after [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For taxable years beginning before [date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], see paragraphs (g)(3) and (g)(4)(iii) of this section as in effect and contained in 26 CFR part 1, as revised April 1, 2021.

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Deputy Commissioner for Services and Enforcement.

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