Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

April 25, 2022

Via Electronic Submission:

Internal Revenue Service
CC:PA:LPD:PR (REG-118250-20)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Guidance on Passive Foreign Investment Companies and Controlled Foreign Corporations Held by Domestic Partnerships and S Corporations and Related Person Insurance Income [REG-118250-20]; RIN 1545-BP94[1]

Managed Funds Association[2] ("**MFA**") appreciates the opportunity to provide comments to the Treasury Department ("**Treasury**") and the Internal Revenue Service ("**IRS**") on the proposed passive foreign investment company ("**PFIC**") regulations.[3] MFA represents the global alternative investment industry and its investors. MFA's more than 150 member firms collectively manage nearly $1.6 trillion in assets across a diverse set of investment strategies. Our members' clients include a wide range of U.S. taxable investors for which Sections 1291 and 1293-1298 and the regulations thereunder ("**PFIC regime**") are directly relevant, including individuals, insurance companies, and regulated investment companies.

We understand that the policy rationale for the proposed regulations is to align the treatment of partnerships under the PFIC regime with the aggregate treatment which now applies to the global intangible low-taxed income ("**GILTI**") and Subpart F regimes and to permit elections to be made solely by the person whose tax liability is directly affected by the election. We believe that these are admirable goals. We nonetheless believe that the approach taken by the proposed regulations is flawed and would result in significantly increased compliance costs and an increased risk of non-compliance.

Under the proposed regulations, investors with small (or even fractional) interests in PFICs would be required to contend with complex computations and heightened compliance navigating Schedule K-3, notification of elections, and Form 8621 filings. At the same time, the proposed regulations do not offer partnerships the ability to relieve investors of this burden. In fact, the proposed regulations are in direct

[1] Unless otherwise indicated, all "Section" or "§" references are to the Internal Revenue Code of 1986, as amended (the "**Code**" or "**I.R.C.**"), and all "Treas. Reg. §," "Temp. Reg. §," or "Prop. Reg. §" references are to the final, temporary, or proposed regulations, respectively, promulgated under the Code.

[2] MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risks, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia.

[3] "Guidance on Passive Foreign Investment Companies and Controlled Foreign Corporations Held by Domestic Partnerships and S Corporations and Related Person Insurance Income," 87 Fed. Reg. 3,891 (Jan. 25, 2022) ("**2022 Proposed Regulations**").

conflict with what nearly every U.S. taxable investor requests when investing in an alternative investment fund—for the partnership to relieve the investor of the burden of making elections and filing tax forms.

We note that the complexity associated with exposure to a PFIC through an alternative investment fund is exponentially greater than the prototypical example of a PFIC investment—an investment in a single foreign mutual fund. Our members manage partnerships that, in a given year, may make hundreds or thousands of PFIC investments within complex investment structures. Rather than being responsible for one Form 8621 filing with respect to each foreign mutual fund in which an individual is invested, individuals invested in alternative investment funds would be responsible for potentially thousands of Form 8621 filings under the proposed regulations.

Polling of our membership reflects that the number of Form 8621 filings related to PFIC investments held directly by partnerships managed by our members under current law range from 10 to 3,000. Form 8621 filings would increase by orders of magnitude under the proposed regulations. Indeed, polling of our membership reflects that the number of Form 8621 filings related to PFIC investments held indirectly through partnerships managed by our members would range from 600 to 750,000, with median and average values of roughly 8,500 and 97,000, respectively, and, in sum, would total roughly 1,167,000. Investors prefer to rely on our members, which tend to be better situated in terms of sophistication, resources, and insight into PFIC investments, to service the compliance burden associated with their investment. In many cases, the intent of U.S. taxable investors and alternative investment funds are aligned in making a qualified electing fund ("**QEF**") or mark-to-market ("**MTM**") (as applicable) election in respect of a PFIC. As a principle, final regulations should facilitate QEF and MTM elections as a default, rather than impede them.

We set forth four principal recommendations in this letter:

I. Final regulations should permit domestic pass-through entity-level inclusions, elections, and filings pursuant to a delegation of authority from partners and shareholders to domestic pass-through entities.

II. If final regulations do not permit domestic pass-through entity-level inclusions, elections, and filings pursuant to a delegation of authority, then final regulations should permit entity-level elections on behalf of partners and shareholders.

III. In conjunction with final regulations, Treasury and the IRS should permit consolidated Form 8621 filings.

IV. Final regulations should not permit a U.S. person that is not a U.S. shareholder to rely on the CFC Overlap Rule to avoid the PFIC regime solely because the U.S. person owns its interest in the PFIC through a domestic pass-through entity.

We raise other technical areas for concern with the proposed regulations in **Appendix A**, including the administrative complexity of tracking basis separately by partner for Chapter 1 and net investment income tax ("**NIIT**") purposes; the true compliance costs and burdens of the proposed regulations as reflected in polling of our membership by comparison to estimates prepared by the Office of Management and Budget ("**OMB**"); and substantive elements of the proposed regulations which require additional clarification.

We include a case study in **Appendix B** to demonstrate the incremental change in size of a U.S. taxpayer's income tax return and the domestic partnership's Schedule K-3 package, which report thousands of PFIC investments held in a typical alternative investment fund, under the proposed regulations.

I. Final regulations should permit domestic pass-through entity-level inclusions, elections, and filings pursuant to a delegation of authority from partners and shareholders to domestic pass-through entities.

We applaud Treasury's and the IRS's efforts to design administrable regulations. In an acknowledgment of possible administrability concerns, the Preamble to the proposed regulations requested comments on whether final regulations should permit domestic pass-through entity-level QEF and MTM elections on behalf of partners and shareholders in conjunction with the general rule requiring partners and shareholders to make the elections. We believe that these administrability concerns are real and significant.[4] We respectfully submit that a well-designed delegation model could help mitigate administrative concerns while still furthering Treasury's and the IRS's stated policy goals. We address Treasury's and the IRS's specific questions in turn.

We focus our comments exclusively on domestic pass-through entities to be directly responsive to the prompts in the Preamble to the proposed regulations. However, we welcome the opportunity to discuss with Treasury and the IRS additional paths to increasing the uniformity and availability of a delegation model, such as permitting a foreign partnership to pursue a delegation of authority to make elections on behalf of its partners. A delegation model that applies equally to foreign partnerships would be more consistent with the aggregate treatment underlying the proposed regulations and the broader policy goal of facilitating QEF and MTM elections.

(i) The legal mechanism by which the domestic partnership or S corporation would be delegated the ability to make a QEF or MTM election on behalf of its partners or shareholders;

We recommend that Treasury and the IRS permit partners and shareholders to delegate rights and obligations applicable to a shareholder of a PFIC, as defined in Prop. Reg. § 1.1291-1(b)(7), to domestic pass-through entities. A general power-of-attorney or other nonspecific provision authorizing the making of tax elections should serve as the legal mechanism by which domestic pass-through entities would be delegated the ability to make elections on behalf of partners and shareholders. Such provisions are market standard legal provisions widely used in the alternative investment industry and included in the partnership agreement or subscription documents of nearly every alternative investment fund. General power-of-attorney provisions allow fund managers to act on behalf of investors for a wide variety of purposes, including buying and selling securities, voting the fund's securities, admitting new limited

[4] *See* ABA Sec. Tax'n, *Comments on Proposed Regulations Under Sections 1291, 1297, and 1298 Regarding PFICs* (Oct. 9, 2019), https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2019/100919comments.pdf ("...we believe continuing to require QEF elections and inclusions at the partnership level is the better option for the practical reason of administrability. As a practical matter, it is often far more administratively feasible for a partnership to make the election on behalf of all partners…Placing the burden of making and reporting elections and inclusions on all partners of a domestic partnerships holding stock in a PFIC (except for the U.S. shareholder that would instead by subject to the CFC rules) could be avoided if a partnership were permitted to continue to make a QEF election (as well as presumably collateral purging elections or MTM elections) on behalf of its partners.").

partners, amending the fund's organizational documents, forming new vehicles (and admitting investors into those vehicles), managing FATCA compliance, filing treaty-based reclaims, and taking other actions necessary for the continued operation of the fund. Similarly, partnership agreements typically authorize the fund manager to make a variety of tax elections which may directly impact investors' tax liability.

We think it is natural to leverage these existing provisions to permit domestic pass-through entity-level elections. Under a delegation model, U.S. taxpayers remain ultimately responsible for making elections. However, this model would broaden the scope of persons making QEF and MTM elections and permit taxpayers to leverage the knowledge and skill of fund managers to properly account for income inclusions and service the compliance burdens associated with PFIC investments.

(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;

As discussed above, the standard of delegation should be a general or nonspecific grant of authority to act on behalf of partners and shareholders. We generally recommend that Treasury and the IRS avoid indirectly regulating in the area of contract, which would give the PFIC regime an inappropriate role in business negotiations among partners or shareholders of domestic pass-through entities.[5] For this reason, we are skeptical of any overly prescriptive model which would require an explicit delegation of authority or specific form. The grant of authority should be permitted to take any form of contract which is legally binding and agreed upon by both the affected partner or shareholder and the domestic pass-through entity (*e.g.*, a limited partnership agreement, subscription agreement, or side letter). We note that investors entrust fund managers to manage their capital (and the fund's affairs) in a manner that is in the best interests of the fund and its investors. Fund managers are already given the authority to make material decisions with respect to the fund's investments, including decisions that directly affect investors' tax liabilities. QEF and MTM elections should be treated no differently. At a minimum, *existing* domestic pass-through entities should be permitted to rely on such provisions, consistent with the rationale for *preexisting* QEF and MTM elections outlined by Treasury and the IRS in the Preamble to the proposed regulations.[6]

(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;

We recommend that an election pursuant to a delegation of authority be binding on all partners and shareholders, including indirect partners that invest through pass-through entities. An election made

[5] *See* N.Y. State Bar Ass'n Tax Sec., *Report on Proposed Regulations Section 1.1411-10* (May 22, 2013), https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Reports%202013/1285reportp.pdf ("Presumably, an S corporation or domestic partnership could address these problems by contractually obligating all its owners to make the G Election. But, this would potentially be problematic for S corporations and partnerships that are already in existence and could become a bargaining point in setting up S corporations and partnerships going forward and in our view that would give this tax issue an inappropriate role in the business negotiations between the owners. We believe that it would be more appropriate and reasonable for regulations to provide that S corporations and domestic partnerships are permitted to make G Elections at the entity level and that those elections would bind their respective shareholders and direct and indirect partners with respect to income and gain derived from an electing S corporation's or domestic partnership's investments in CFCs and QEFs.").

[6] *See* 2022 Proposed Regulations, at 3,896-97.

by a partnership which is binding on all partners is consistent with the general grant of authority to the fund manager, including with respect to tax matters (*e.g.*, choice of Section 704 methodologies, Section 754 election, Section 475(f) election, etc.). An election which is binding on all partners and shareholders would be more administrable and would help to mitigate the risk that indirect partners or shareholders may inadvertently fail to make elections.

With respect to pass-through entity partners, it is critical to the effectiveness of the delegation model that the underlying pass-through entity be able to rely on each pass-through entity partner's ability to bind its own partners or shareholders. The underlying pass-through entity would be unable to diligence a delegation of authority in practice; it has no privity of contract with ultimate beneficial owners, and the necessary information is likely to be a trade secret, confidential, or otherwise unavailable to it. The underlying pass-through entity should be able to presume that each pass-through entity partner has the requisite authority to bind its own U.S. taxable partners and that it has received the necessary delegation of authority from those partners.

We considered the fact that an election binding on *all* partners (including pass-through entity partners and their partners or shareholders) may initially seem contrary to the stated goal of permitting elections to be made solely by the person whose tax liability is directly affected by the election. This policy goal is well-intentioned but, in our view, misplaced as applied to the alternative investment industry, including, for example, in the fund-of-funds context. We focus our comments on funds-of-funds but note that similar concerns arise in other tiered partnership structures common in the alternative investment industry, including general partner entities and employee investment vehicles, which are largely owned by U.S. taxable partners.

Funds-of-funds are generally the vehicle-of-choice for investors who cannot meet the initial capital requirements for all the underlying funds in which a fund-of-funds is invested. A fund-of-funds may aggregate the capital of hundreds of U.S. taxable investors and may own hundreds or thousands of PFIC investments through the fund-of-fund's interests in other alternative investment funds. The U.S. taxable investors of a fund-of-funds are generally fractional (in percentage) and nominal (in dollar amount) indirect owners of each underlying fund's PFIC investments. These investors typically do not have access to the same resources as the fund-of-funds and, therefore, prefer to rely on the fund-of-funds, which in turn generally relies on the underlying funds, to handle all investment-related tax compliance. We are not aware of any instance in which a fund-of-funds or its U.S. taxable investors would prefer to be responsible for additional tax compliance. We are similarly not aware of any instance where a U.S. taxable investor in an alternative investment fund would prefer *not* to make a QEF or MTM election (as applicable) in respect of a PFIC. At a minimum, the lesson of the fund-of-funds industry is that U.S. taxable investors prefer for QEF and MTM elections to be made *by default* or made by the underlying funds themselves.

In our view, the most administrable delegation model is one that permits *all* partners (including pass-through entity partners) to delegate their authority to a single pass-through entity, and that centralizes all PFIC tax compliance with that pass-through entity.

(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

We recommend that any delegation of authority not be subject to exception—partners and shareholders should not be allowed to opt out. Otherwise, as discussed in Appendix A, Parts I.B. and I.C., if even a single direct or indirect partner or shareholder (or future transferee) does not make consistent elections, domestic pass-through entities would be required to implement systems to separately track and report to partners or shareholders complex and burdensome computations. We further note that barring partners or shareholders from opting-out would make the PFIC regime far more administrable for Treasury and the IRS as there would be no need to track partners or shareholders with divergent elections.

(v) The timing, filing, and notification requirements that should apply to a domestic partnership- or S corporation-level QEF or MTM election, taking into account the possibility of nonconforming taxable years among the partners and partnership (or shareholders and S corporation) and the PFIC.

We recommend that Treasury and the IRS provide that a domestic pass-through entity makes an election pursuant to a delegation of authority on or before the due date (including extensions) for filing the domestic pass-through entity's return for the first taxable year to which the election will apply. The election would be made on Form 8621 (or successor form) and this filing would relieve a domestic pass-through entity's partners or shareholders of any filing obligation under Section 1298(f) unless its partners or shareholders are subject to the excess distribution regime, *e.g.*, with respect to an unpedigreed QEF.[7]

We further recommend that Treasury and the IRS adopt a similar notification requirement whereby the domestic pass-through entity is required to notify its partners or shareholders of its elections no later than 30 days after filing the return in which the elections are made. An informational item on Schedule K-3 indicating that a domestic pass-through entity which directly holds PFIC stock made such elections pursuant to a delegation of authority should satisfy this notice requirement.

In the case of nonconforming taxable years among partners or shareholders and the domestic pass-through entity, the domestic pass-through entity should be required to notify its partners or shareholders no later than the due date (including extensions) of its partners' or shareholders' return for the taxable year ending within the domestic pass-through entity's election year.[8] The domestic pass-through entity should be permitted to notify its partner or shareholders in any reasonable manner, including via mail, email, or posting on a website through which the domestic pass-through entity would ordinarily disseminate tax information to its partners or shareholders. The failure of the domestic pass-through entity to notify its partners or shareholders should not invalidate an otherwise valid election.

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[7] For this purpose, Prop. Reg. § 1.1298-1(b)(2) should be modified to provide that there is no requirement to file for an indirect shareholder that owns a PFIC through a domestic pass-through entity if the domestic pass-through entity makes a QEF election with respect to the PFIC pursuant to a delegation of authority and files Form 8621.

We note that simply requiring a domestic pass-through entity to file Form 8621 with respect to each of its direct and, of particular concern, indirect U.S. taxable partners raises serious concerns regarding the confidentiality of investor information. An alternative investment fund should not be compelled to share its investor lists with the fund managers of other funds in which it invests.

[8] Treasury and the IRS may consider permitting domestic pass-through entities to transmit an early QEF or MTM election to their partners or shareholders in the form of a "disembodied" Form 8621, with only the election checked and the identifying information for the U.S. person and foreign corporation completed, which partners or shareholders may attach to their return.

II. If final regulations do not permit domestic pass-through entity-level inclusions, elections, and filings pursuant to a delegation of authority, then final regulations should permit entity-level elections on behalf of partners and shareholders.

If a delegation model is not adopted, we recommend that Treasury and the IRS permit domestic pass-through entities to make an "overriding" QEF or MTM election on behalf of partners and shareholders. The concept of a domestic pass-through entity-level election which would obviate the need for partner- or shareholder-level elections is not foreign to the PFIC regime. Treas. Reg. § 1.1291-1(c)(4)(i) provides that a Section 475(f) election operates to override the application of Section 1291 and the regulations thereunder to any distributions with respect to PFIC stock or to any disposition of PFIC stock. An entity-level election would also be more consistent with the longstanding rule under Subchapter K that any election affecting the computation of taxable income derived from a partnership must be made by the partnership, other than those specified in Section 703(b).

We acknowledge that an election model may seem contrary to the stated goal of permitting elections to be made solely by the person whose tax liability is directly affected by the election. However, we firmly believe that an overriding election is more consistent with the preferences of U.S. taxable investors in alternative investment funds than the approach taken in the proposed regulations. A typical U.S. individual investor in an alternative investment fund is a passive investor who may own a fractional interest in the fund. In our experience, U.S. individual investors uniformly prefer the *opposite* of the approach set out in the proposed regulations and generally prefer to push elections and filing obligations to the fund manager (on the theory that the fund manager is being paid to manage the investment, including related compliance, and is best positioned to streamline reporting and reduce costs). In fact, alternative investment funds already face significant resistance from U.S. taxable investors with respect to increasingly complex investor-level tax compliance obligations. We are concerned that the proposed regulations may have a severe chilling effect on the alternative investment industry. U.S. taxable investors may be unwilling (or, due to increased compliance costs, unable) to invest in these products, which would run counter to ongoing efforts to democratize investment opportunity in the industry.

We believe that an entity-level election would greatly simplify the administration of the PFIC regime and be more reflective of the reality of the alternative investment industry. We are not aware of a single U.S. taxable investor across our members' managed funds that would prefer to make thousands of QEF or MTM elections in a given year, particularly when there is a party that already has all of the resources necessary to make such elections—the partnership.

III. In conjunction with final regulations, Treasury and the IRS should permit consolidated Form 8621 filings.

We recommend that, notwithstanding the adoption of a delegation or election model, Treasury and the IRS re-design Form 8621 to allow for disclosure of more than one PFIC and the relevant elections in respect of the PFICs.[9] The proposed regulations would result in an exponential increase in Form 8621

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[9] To our knowledge, the American Institute of Certified Public Accountants ("**AICPA**") has requested a consolidated Form 8621 as recently as last year and as early as 2014. *See* AICPA, *RE: Recommendations for the 2021-2022 Guidance Priority List (Notice 2021-28)* (May 24, 2021), https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/aicpas-2021-2022-priority-guidance-plan-list.pdf; AICPA, *RE: Treatment of Shareholders of Certain Passive Foreign Investment Companies* (May 12, 2014),

filings for the alternative investment industry, in a volume which would be unprecedented and likely to overwhelm U.S. taxpayers. The increase in the size of a U.S. taxpayer's income tax return would be substantial. Commercial return preparation software may not support electronic filing beyond a limited number of Form 8621 filings, which could contribute to paper-filed return backlog.

We reasonably foresee the number of Form 8621 filings continuing to increase in the years to come. Anti-hybrid rules in non-U.S. jurisdictions (*e.g.*, Anti-Tax Avoidance Directive II) have generally led to an increased number of PFICs in foreign investment structures. Entities are frequently "checked close" for U.S. income tax purposes to remove hybridity concerns in non-U.S. jurisdictions. A consolidated Form 8621 with a landscape, or horizontal, supporting schedule which lists the relevant information for each PFIC could alleviate some of the compliance burden associated with PFIC investments. Where detailed computations related to Section 1291 are required, separate supporting schedules could satisfy the reporting requirements. A consolidated Form 8621 also seems consistent with the shift towards centralized and uniform reporting in Schedules K-2 and K-3.

IV. Final regulations should not permit a U.S. person that is not a U.S. shareholder to rely on the CFC Overlap Rule to avoid the PFIC regime solely because the U.S. person owns its interest in the PFIC through a domestic pass-through entity.

We understand that Treasury and the IRS are concerned that an entity approach may inappropriately allow,

> a U.S. person that is not a U.S. shareholder [as defined in Section 951(b)] of a foreign corporation that would otherwise be a PFIC with respect to that person if held directly…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 through a domestic partnership or S corporation.[10]

We appreciate this concern and recommend that, notwithstanding the adoption of a delegation or election model, a domestic pass-through entity not be treated as a shareholder of a PFIC for purposes of Section 1297(d) ("**CFC Overlap Rule**"). For this limited purpose, Prop. Reg. § 1.1291-1(b)(7) would operate as an exception to the general rule in Section 1298(a)(1)(B), which provides that partners or shareholders are not treated as constructively owning stock that is owned by domestic pass-through entities.

Domestic pass-through entities would allocate QEF or MTM inclusions at the domestic pass-through entity-level and separately provide U.S. Shareholders with Subpart F inclusions and items necessary to calculate their GILTI inclusions. We note that the population of U.S. Shareholders in alternative investment funds is likely small and easily identifiable, and, by comparison to separately tracking elections by partner, this exercise is far more administrable. Treasury and the IRS may consider modifying Schedule K-3 to include a checkbox or legend indicating that partners or shareholders have delegated the rights and obligations under the PFIC regime or the domestic pass-through entity has made

https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/2014.0.12_comments_on_pfics_treatment_of_shareholders.pdf.

[10] 2022 Proposed Regulations, at 3,898.

an overriding election, which would serve as notice to all partners or shareholders (including any pass-through entity partner and its partners or shareholders).[11]

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We appreciate the opportunity to provide our comments to Treasury and the IRS on the proposed regulations, and we would be pleased to meet with Treasury and the IRS to discuss our comments. If Treasury and the IRS have questions or comments, please do not hesitate to contact Joseph Schwartz, Director and Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

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[11] Treasury and the IRS may further consider adding a legend or other additional language to put partners or shareholders which are U.S. Shareholders on notice that such delegation or election does not apply to them because they are subject to the Subpart F and GILTI regimes.

Appendix A: Supplemental Technical Comments on the Proposed Regulations

The following is a summary of other technical areas for concern with the proposed regulations, which are explained in more detail below.

I. The proposed regulations increase compliance costs and burdens to partners and shareholders and domestic pass-through entities through which PFIC stock is held with no corresponding benefit to PFIC tax compliance and enforcement.

   A. Partner- and shareholder-level QEF and MTM elections require the separate tracking of partners' basis in PFIC stock.

   B. Partner- and shareholder-level G Elections require the separate tracking of partners' basis in PFIC stock for Chapter 1 and NIIT purposes.

   C. The proposed notification-of-election rules involve unnecessary legal and administrative costs.

   D. The true compliance costs and burdens of partner- and shareholder-level inclusions, elections, and filings are not reflected in OMB estimates.

II. Without further clarification, the proposed non-Section 1296 mark-to-market regulation is unclear and potentially overbroad.

I. The proposed regulations increase compliance costs and burdens to partners and shareholders and domestic pass-through entities through which PFIC stock is held with no corresponding benefit to PFIC tax compliance and enforcement.

The proposed regulations represent a material increase in information reporting and collection burdens relative to current law. Although some information reporting burdens fall squarely on partners or shareholders that own PFIC stock indirectly through domestic pass-through entities with respect to which they are required to file annual reports and provide notice of elections, the bulk of the information collection burdens, and associated costs, are borne by domestic pass-through entities.

Historically, Treasury and the IRS have taken "the view that multiple elections by partners or S corporation shareholders would be more burdensome than the single entity-level election."[12] More recently, Treasury and the IRS have framed the decision whether to require additional reporting as a balance between "undue compliance costs and burdens" and "PFIC tax compliance and enforcement."[13] We encourage

[12] "General Rules for Making and Maintaining Qualified Electing Fund Elections," 63 Fed. Reg. 6,9 (Jan. 2, 1998) ("**1998 Temporary Regulations**").

[13] "Definitions and Reporting Requirements for Shareholders of Passive Foreign Investment Companies," 81 Fed. Reg. 95,459,95,461 (Dec. 28, 2016) ("**2016 Final Regulations**") ("Requiring reporting under section 1298(f) by a domestic partnership when none of its direct and indirect owners are subject to the PFIC rules may result in *undue compliance costs and burdens*…In contrast, a domestic partnership is not exempt from filing Form 8621 under § 1.1298-1(c)(6) with respect to stock it holds in a section 1291 fund when some or all of its partners are exempt from filing Form 8621 with respect to that stock but otherwise would be subject to tax on distributions on, or dispositions of, that stock. PFIC information reporting by the domestic partnership in these circumstances is appropriate because it furthers *PFIC tax compliance and enforcement*.") (emphasis added).

Treasury and the IRS to approach final regulations with the same thoughtfulness towards costs and burdens which has informed prior regulations.[14] In doing so, we respectfully submit that the following increased compliance costs and burdens outweigh any purported benefits of aligning the treatment of partnerships under the PFIC regime with the aggregate treatment which now applies to the GILTI and Subpart F regimes.

A. Partner- and shareholder-level QEF and MTM elections require the separate tracking of partners' basis in PFIC stock.

Prop. Reg. §§ 1.1295-1(d)(2)(i)(A), (ii)(A) and 1.1296-1(h)(1)(i) provide that a QEF or MTM election with respect to PFIC stock is made by a partner or shareholder indirectly owning PFIC stock by reason of its interest in a domestic pass-through entity. The partner or shareholder includes the QEF or MTM inclusion in income as if the partner or shareholder directly owned its share of the PFIC stock held by the domestic pass-through entity.[15] We are concerned that these proposed regulations would require domestic pass-through entities to track basis in PFIC stock by lot and by partner, which would multiply compliance costs and burdens with no demonstrable benefit to PFIC tax compliance or enforcement.

Under current law, the administrative complexity of tracking basis in PFIC stock with respect to which a domestic pass-through entity makes a QEF or MTM election is relatively low. Basis in PFIC stock held directly by a domestic pass-through entity is tracked by lot and adjusted for income inclusions and, with respect to QEF stock, distributions of previously taxed earnings and profits ("**PTEP**").[16] Under the proposed regulations, the administrative complexity of tracking basis in PFIC stock by lot and by partner is substantially greater. The variety of elections and transactions effected by partners or shareholders with respect to PFIC stock, which could multiply the efforts required to track basis by partner or shareholder, makes quantifying the compliance costs and burdens of the proposed regulations difficult, if not impossible.

To be sure, a partner or shareholder may be subject to the excess distribution regime of Section 1291 and/or, at various times, make a QEF or MTM election (as applicable) in respect of a PFIC, be subject to a termination of an election, seek consent to revoke a prior election, and make purging elections. Similarly, transfers of interests in domestic pass-through entities directly holding PFIC stock (or transfers of PFIC stock itself) to other domestic pass-through entities, which cause partners or shareholders other than the transferor to become PFIC shareholders without a preexisting QEF or MTM election, would impose additional information collection burdens on domestic pass-through entities related to the elections of new partners or shareholders.[17]

We polled our members to understand the compliance costs and burdens associated with tracking basis by partner. Respondents indicated that no current accounting system can accommodate tracking basis by lot and by partner. With respect to domestic partnerships which allocate tax items using an aggregation

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[14] *See* N.Y. State Bar Ass'n Tax Sec., *Report on June 2019 GILTI and Subpart F Regulations* (Sep. 18, 2019), https://archive.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Section_Reports_2019/Report_1423.html ("...Section 1291 calculations are based on notional inclusions of income on the partners' own tax returns and interest on the resulting marginal tax liability to the partners. These calculations could not be made at the partnership level unless the partners reported significant information about their own individual tax positions to the partnership. There is no comparable compelling reason to so move QEF and MTM inclusions to the partner level.").

[15] Prop. Reg. §§ 1.1293-1(c)(1), 1.1296-19(a)(4), (e)(1).

[16] I.R.C. §§ 1293(b), 1296(b).

[17] *See* Prop. Reg. §§ 1.1293-1(c)(3)(ii), 1.1296-1(h)(1)(i)(A).

method,[18] these computations are not made on a lot-by-lot basis in the first instance. Rather, tax items are allocated among the partners based on the partners' relative participation in the domestic partnership's cumulative gains or losses. In such case, the need to track basis by lot and by partner would require that these computations be performed manually in a spreadsheet. Domestic pass-through entities would have to invest significant, and currently unquantifiable, time and resources to comply with the proposed regulations. We reasonably expect the IRS to incur similarly multiplied enforcement costs to train personnel and conduct audits in this area.

B. Partner- and shareholder-level G Elections require the separate tracking of partners' basis in PFIC stock for Chapter 1 and NIIT purposes.

Prop. Reg. § 1.1411-10(g)(3)(i) provides that only an individual, estate, or trust may make a Treas. Reg. § 1.1411-10(g) election ("**G Election**") in respect of a QEF that it holds directly or indirectly through one or more entities, each of which is foreign or a domestic pass-through entity. We are concerned that this proposed regulation would require domestic pass-through entities to maintain two sets of records to account for differences in treatment for Chapter 1 and NIIT purposes to the extent at least one partner or shareholder (or future transferee, as discussed in Part I.D) does not make a G Election.

For Chapter 1 purposes, a QEF shareholder currently includes in gross income its pro rata share of ordinary earnings and net capital gain as if the QEF had distributed such income,[19] and the QEF shareholder increases its basis in a corresponding amount.[20] When the QEF actually distributes such income, the QEF shareholder excludes the distribution from gross income as PTEP,[21] and the QEF shareholder decreases its basis in a corresponding amount.[22]

For NIIT purposes, QEF inclusions are not treated as dividends and, therefore, are not included in net investment income ("**NII**").[23] The basis adjustments made for Chapter 1 purposes are not taken into account for NIIT purposes.[24] Rather, distributions of PTEP attributable to QEF inclusions are treated as dividends and included in NII.[25] As a result, shareholders may have different basis in QEF stock for Chapter 1 and NIIT purposes. In recognition of the burden of tracking basis separately for both purposes, Treasury and the IRS instituted the G Election "to minimize complexity arising from the different treatment."[26]

However, as originally proposed, only an individual, estate, or trust may have made the G Election in respect of a QEF held directly or indirectly through one or more entities.[27] Commentators to the 2012 Proposed Regulations suggested that the obligation to provide partners and shareholders with information

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[18] *See*, *e.g.*, Treas. Reg. § 1.704-3(e)(3).

[19] I.R.C. § 1293(a)(1), (b).

[20] I.R.C. § 1293(d)(1).

[21] I.R.C. § 1293(c).

[22] I.R.C. 1293(d)(2).

[23] "Net Investment Income Tax," 78 Fed. Reg. 72,394,72,418 (Dec. 2, 2013) ("**2013 Final Regulations**").

[24] Treas. Reg. § 1.1411-10(d)(1).

[25] Treas. Reg. § 1.1411-10(c)(1)(i)(A)(1).

[26] "Net Investment Income Tax," 77 Fed. Reg. 72,612,72,630 (Dec. 5, 2012) ("**2012 Proposed Regulations**").

[27] *Id*. at 72,650.

under both the default and elective regimes would significantly increase compliance burdens, and, on exam, IRS personnel would need to apply dual proceedings to meet its enforcement obligations.[28] Notably, this would be the result under the proposed regulations.

In response to these and similar comments,[29] Treasury and the IRS modified the 2012 Proposed Regulations to allow domestic pass-through entities to make the G Election on the basis that,

> the partner (or shareholder) level election would create an administrative burden for the partnership (or S corporation) because it would require the partnership (or S corporation) to maintain two sets of records with respect to its CFC and QEF investments: one for chapter 1 purposes and one for section 1411 purposes.[30]

Partners and shareholders would need to separately track PTEP to determine the amount of gain or loss subject to NIIT on disposition of QEF stock. Domestic pass-through entities would need to track whether their partners or shareholders made G Elections and, if not, provide information regarding PTEP distributions. If even a single direct or indirect partner or shareholder did not make a G Election, the domestic pass-through entity would be required to implement systems to separately track both the Chapter 1 and NIIT computations of basis and PTEP by partner or shareholder. These information reporting and collection burdens are complicated by the fact that the proposed regulations do not include a notification requirement with respect to partner- or shareholder-level G Elections (as discussed in Part I.C).[31]

C. The proposed notification-of-election rules involve unnecessary legal and administrative costs.

Prop. Reg. §§ 1.1295-1(d)(2)(i)(A), (ii)(A) and 1.1296-1(h)(1)(i)(B) (collectively, the "**proposed notification-of-election rules**") provide that a partner or shareholder indirectly owning PFIC stock by reason of its interest in a domestic pass-through entity must notify the domestic pass-through entity of any QEF or MTM election no later than 30 days after filing the return in which the election is made. There is no formal notification procedure – the partner or shareholder may notify the domestic pass-through entity "in any reasonable manner"[32] – and there is no notification requirement for G Elections. We are concerned

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[28] *See* AICPA, *Re: Comments on REG-130507-11 relating to guidance under section 1411, as added by the Health Care and Education Reconciliation Act of 2010, regarding net investment income tax as relevant to international entities (controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs)) (12/5/2012)* (Aug. 5, 2013), https://downloads.regulations.gov/IRS-2012-0049-0084/attachment_1.pdf ("This requirement vastly increases the complexity of the compliance for partnerships, S corporations, their respective owners and for the IRS exam personnel. The proposed regulation puts domestic partnerships and S corporations in a situation where they will be required to provide information to their partners and shareholders under both the default and elective regimes, significantly increasing the compliance burden for the partnership or S corporation. On exam, IRS personnel will need to investigate at the partner or shareholder level, rather than streamlining exam efforts at the entity level.").

[29] *See* Managed Funds Assoc., *Re: MFA Comments on IRS REG-130507-11, Net Investment Income Tax* (March 5, 2013), https://downloads.regulations.gov/IRS-2012-0049-0038/attachment_1.pdf.

[30] 2013 Final Regulations, at 72,420.

[31] *Compare* Prop. Reg. §§ 1.1295-1(d)(2)(i)(A), (ii)(A) & 1.1296-1(h)(1)(i)(B) *with* Prop. Reg. § 1.1411-10(g).

[32] Prop. Reg. §§ 1.1295-1(d)(2)(i)(A), (ii)(A) & 1.1296-1(h)(1)(i)(B).

that the proposed notification-of-election rules would impose unnecessary legal and administrative costs on domestic pass-through entities with no guarantee of compliance.

The Preamble to the proposed regulations indicates that partners or shareholders and the domestic pass-through entities through which they hold PFIC stock would have to make arrangements to facilitate the sharing of elections and information necessary for partners or shareholders to make elections.[33] In the case of conforming tax years between domestic pass-through entities and partners or shareholders, partners or shareholders would be required to provide notice of elections prior to the 30-day post-filing regulatory deadline so that domestic pass-through entities could comply with their Schedules K-2 and K-3 filing obligations. In the case of nonconforming tax years, domestic pass-through entities would be required to provide information necessary for partners or shareholders to make elections prior to the statutory deadline for Schedules K-2 and K-3. In the case of G Elections, domestic pass-through entities would need to obtain information concerning elections despite the lack of a notification requirement.

In any case, domestic pass-through entities would have to develop a legal mechanism to require direct partners or shareholders to provide notice of QEF, MTM, and G Elections (*e.g.*, by the terms of the partnership agreement or organizational documents). Even if the legal mechanism is effective with respect to direct partners or shareholders, it is an imperfect solution: the direct partners may be other pass-through entities (*e.g.*, a fund-of-funds), the ultimate partners of which are not bound by the legal mechanism at the lower tier.[34] The legal mechanism is further jeopardized by a direct partner or shareholder which may sell its interest to a transferee that does not make similar elections. And, as a practical matter, the likelihood of both providing the relevant information for the ultimate partner to make elections and receiving timely notification of elections decreases at each tier.

We polled our members to understand the compliance costs and burdens associated with the proposed notification-of-election rules. Respondents indicated that the number of notifications which domestic pass-through entities in our members' organizational structures would receive ranged from 30 to 560,000, with median and average values of roughly 7,000 and 66,000, respectively, and, in sum, would total roughly 661,000. A significant number of respondents excluded direct partners which were other domestic pass-through entities because there was little to no transparency into the number of U.S. taxable partners at successive tiers.

By contrast, OMB estimated the annual reporting burden of the proposed notification-of-election rules in terms of number of respondents (*i.e.*, notifications provided to domestic pass-through entities) under

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[33] *See* 2022 Proposed Regulations, at 3,895.

[34] *See* N.Y. State Bar Ass'n Tax Sec., *Report on Proposed Regulations Section 1.1411-10* (May 22, 2013), https://nysba.org/NYSBA/Sections/Tax/Tax%20Section%20Reports/Tax%20Reports%202013/1285reportp.pdf ("...domestic partnerships will need to determine on a continuous basis whether they have indirect partners who are individuals, trusts or estates potentially subject to Section 1411 so that the necessary information can be provided to the entities through which the indirect partners hold their interests. It may be difficult (if not impossible in some cases, such as when a partner is a fund-of-funds) for partnerships to obtain this information. Consequently, in practice, any domestic partnership that has a passthrough entity as a partner, or that could in the future have a direct or indirect partner who is subject to Section 1411, will likely have to track and report these items for Section 1411 purposes (even if the entity currently has no direct or indirect partner who is subject to Section 1411 and has not made a G Election)."); *see also id*. at n.60 ("To further complicate this, the contractual obligation would be effective only if it obligated all partners that are themselves passthrough entities to have comparable contractual obligations with their owners. In the case of pre-existing partnerships and S corporations, it could [be] very difficult for them to ensure that the G Election was made all the way up the chain of indirect owners.").

Prop. Reg. § 1.1295-1(d)(2)(i)(A) (notice of QEF election to domestic partnership) as 1,300,000, under Prop. Reg. § 1.1295-1(d)(2)(ii)(A) (notice of QEF election to S corporation) as 2,000, and under Prop. Reg. § 1.1296-1(h)(1)(i)(B) (notice of MTM election) as 71,000.[35] If accurate, an organizational structure with a domestic pass-through entity which receives 66,000 notifications would represent roughly 4.8% of total estimated respondents. In total, our members which voluntarily responded to our polling would represent roughly 48% of total estimated respondents. The likelihood that the notifications received by any one domestic pass-through entity would constitute 4.8% of the notifications received by all domestic pass-through entities is low.[36] The likelihood that our members which voluntarily responded to our polling would account for 48% of the notifications received by all domestic pass-through entities is similarly low. On this basis, OMB estimates are likely understated as organizational structures which could receive thousands of notifications are far more commonplace than OMB expects.

D. The true compliance costs and burdens of partner- and shareholder-level inclusions, elections, and filings are not reflected in OMB estimates.

Treasury and the IRS have identified certain practical challenges in the Preamble to the proposed regulations: the number of additional Form 8621 filings required;[37] that a 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 as a result of nonconforming tax years between the partner and the partnership;[38] and that additional reporting on Schedules K-2 and K-3 will be required to facilitate a partner's ability to make a QEF election.[39] We are concerned that Treasury and the IRS significantly underestimated the compliance costs and burdens of partner- and shareholder-level filings.

We polled our members to understand the compliance costs and burdens associated with additional Form 8621 filings under the proposed regulations. Respondents indicated that the number of Form 8621 filings related to PFIC stock held indirectly through domestic pass-through entities in our members' organizational structures would range from 600 to 750,000, with median and average values of roughly 8,500 and 97,000, respectively, and, in sum, would total roughly 1,167,000.

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[35] 2022 Proposed Regulations, at 3,905. Although OMB counted only one notification from a PFIC shareholder, as defined in Prop. Reg. § 1.1291-1(b)(7), as the singular relevant action, *id*. at 3,904, the true costs and burdens of the notification-of-election rules should consider the cumulative impact of notifications across tiers of domestic pass-through entities. PFIC shareholders may notify domestic pass-through entities "in any reasonable manner," and we expect such notifications to be directed to the most immediate tier, with costs incurred and burdens imposed at each successively lower tier until the notification is made to the tier which directly holds PFIC stock.

[36] Roughly 20 similarly situated domestic pass-through entities would exceed OMB estimates.

[37] 2022 Proposed Regulations, at 3,899.

[38] 2022 Proposed Regulations, at 3,895; *see also* 2016 Final Regulations, at 95,464 ("One of the comments explained that foreign investment partnerships commonly hold multiple PFIC investments, and, in such cases, a United States person who is a partner in the foreign partnership is required to file multiple Forms 8621 to report each underlying PFIC. This comment further noted that at least two commonly used commercial tax preparation products, as of 2012, did not allow for electronic filing of a Form 1040 containing more than five Forms 8621, which is contrary to the IRS's goal of increasing e-filings of tax returns.").

[39] Under current law, a domestic partnership that has elected to treat a PFIC as a pedigreed QEF or made an MTM election is not required to complete Part VII, "Information to Complete Form 8621," of Schedules K-2 and K-3 if the partnership files Form 8621 for that PFIC. *See* 2021 Instructions for Schedules K-2 and K-3 (Form 1065) (Aug. 25, 2021), https://www.irs.gov/pub/irs-pdf/i1065s23.pdf.

By contrast, OMB estimated the annual reporting burden of Form 8621 filings in terms of number of respondents (*i.e.*, Form 8621 filings) under Prop. Reg. § 1.1298-1(b)(1) (annual reports of partners in partnerships) as 1,250,000 – 1,500,000, under Prop. Reg. § 1.1298-1(b)(1) (annual reports of shareholders in S corporations) as 2,300 – 2,500, and under Prop. Reg. § 1.1298-1(b)(2) (annual reports of beneficiaries of estates and grantor trusts) as 5,000.[40] If accurate, an organizational structure with a domestic pass-through entity which is the "source" of 97,000 Form 8621 filings would represent roughly 6.5% of total estimated respondents at the uppermost range. In total, our members which voluntarily responded to our polling would represent roughly 77% of total estimated respondents at the uppermost range. The likelihood that Form 8621 filings related to PFIC stock held indirectly through any one domestic pass-through entity would constitute 6.5% of Form 8621 filings related to PFIC stock held indirectly through all domestic pass-through entities is low.[41] The likelihood that our members which voluntarily responded to our polling would account for 77% of Form 8621 filings related to PFIC stock held indirectly through all domestic pass-through entities is similarly low. Again, OMB estimates are likely understated as organizational structures which could be the "source" of thousands of Form 8621 filings are far more commonplace than OMB expects.

Treasury and the IRS have recognized that the PFIC regime is complex and, in many cases, difficult for shareholders to apply.[42] The PFIC regime presents a steep learning curve for seasoned tax professionals. We are concerned that the limited availability of sophisticated tax return preparers would be magnified when individuals filing in their own capacity are required to contend with the PFIC regime. In this respect, individuals rely on domestic pass-through entities to fulfill essential compliance functions related to the PFIC regime. Domestic pass-through entities tend to be better situated in terms of sophistication, resources, and insight into PFIC investments to contend with this degree of complexity, particularly with respect to novel compliance burdens.

Under the proposed regulations, even individuals with minimal ownership of PFICs, or their tax return preparers, would be exposed, possibly for the first time, to the foreign corporations underlying their investments and incur significant costs to rationalize their elections. The Preamble to the proposed regulations indicates that "such actions should generally be taken by those persons whose tax liability is directly affected thereby."[43] However, Treasury and the IRS fail to consider compliance costs and burdens in terms of *ability* and *availability* of resources and largely ignore that tax complexity concerns are more acute depending on the type of taxpayer. We reasonably expect that the level of complexity, coupled with the inexperience and limited resources of taxpayers and tax return preparers, would result in inadvertent non-compliance and decreased revenue collections. Accordingly, we recommend that Treasury and the IRS further consider the costs of requiring individuals to service the role that dedicated compliance functions of domestic pass-through entities currently fill and the costs of educating the broader public of their compliance obligations under the proposed regulations.

We are similarly concerned that Treasury and the IRS did not adequately consider additional costs and burdens to domestic pass-through entities. First, additional information currently not furnished to partners and shareholders receiving Schedule K-3 which is either uncertain or difficult to track would need

[40] 2022 Proposed Regulations, at 3,904.

[41] Roughly 15 similarly situated domestic pass-through entities would exceed OMB estimates.

[42] *See* 1998 Temporary Regulations, at 12 (discussing the rationale for providing shareholders with the ability to make retroactive elections).

[43] 2022 Proposed Regulations, at 3,900.

to be provided to partners and shareholders, including the partners' pro rata share of the purchase cost of PFIC stock and the percentage of PFIC stock disposed.

Second, partner- and shareholder-level elections and filing obligations would potentially subject a domestic pass-through entity, through no fault of its own, to various penalties related to Schedules K-2 and K-3 where a partner or shareholder provides an erroneous notification of election. [44] The domestic pass-through entity would be left with no means to discover the error prior to filing and be required to take corrective action. The partner or shareholder would not be accountable to the domestic pass-through entity or the IRS to the extent it timely files Form 8621 and accurately accounts for income inclusions described by its election because of the lack of a regulatory backstop (*i.e.*, the failure of the partner or shareholder to notify the domestic pass-through entity does not invalidate an otherwise valid election).[45] Further, the proposed regulations altogether fail to address whether and to what extent a domestic pass-through entity is required to take corrective action with respect to Schedule K-3 (and whether and to what extent penalties attach) where a partner or shareholder files an amended return to make a retroactive QEF election under Treas. Reg. § 1.1295-3. We note that much of Treas. Reg. § 1.1295-3 related to the obligations of domestic pass-through entities would be non-sensical in light of the proposed regulations.[46]

Third, given the scope of final and proposed regulations over the past year, the possibility of further legislative and regulatory change, and accounting for the IRS's and taxpayers' experience in administering and complying with Schedules K-2 and K-3, the development of new information reporting and collection obligations is likely to be an iterative process. The IRS and taxpayers will have to invest significant time and resources into enforcement and compliance. Accordingly, we encourage Treasury and the IRS to further study how new information reporting and collection obligations impact IRS and taxpayer resources prior to adopting regulations which may require material changes to compliance processes.

II. Without further clarification, the proposed non-Section 1296 mark-to-market regulation is unclear and potentially overbroad.

Treas. Reg. § 1.1291-1(c)(4)(i) provides that Section 1291 and the regulations thereunder do not apply to any distributions with respect to PFIC stock or to any disposition of PFIC stock if such PFIC stock is marked to market under Section 475 or any other provision of Chapter 1 other than Section 1296 ("**non-Section 1296 MTM regulation**"). The non-Section 1296 MTM regulation applies "regardless of whether the application of such provision is mandatory or results from an election by the taxpayer or another person…"[47] Prop. Reg. § 1.1291-1(c)(4)(i) revises this clause by substituting "*the shareholder (as defined in paragraph (b)(7) of this section)*" for "*the taxpayer*". We are concerned that this revision makes it unclear whether a dealer or electing trader under Section 475, classified as a domestic pass-

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[44] Penalties under I.R.C. §§ 6038(b) and (c), 6698, 6721, and 6722 may attach for failure to furnish complete and correct information on Schedules K-2 and K-3. *See* Notice 2021-39, 2021-27 I.R.B. 3. Our concern is amplified to the extent the statute of limitations does not begin to run until the date on which the IRS is furnished the information required to be reported. *See* I.R.C. § 6501(c)(8).

[45] *See* Prop. Reg. §§ 1.1295-1(d)(2)(i)(A), (ii)(A) & 1.1296-1(h)(1)(i)(B).

[46] Although Treasury and the IRS have not quantified the costs associated with partner- or shareholder-level retroactive QEF elections, Treasury has recently observed that "there are large individual and administrative costs under current law for the existing special consent procedure. The existing procedure requires a taxpayer to file a ruling request with the IRS and pay a user fee that is currently several thousand dollars." Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals" (March 28, 2022).

[47] Treas. Reg. § 1.1291-1(c)(4)(i).

through entity, is "*another person*" within the meaning of the proposed regulation. We are similarly concerned that this revision is overbroad and requires a partner or shareholder which is subject to Section 475 to mark to market PFIC stock held indirectly through a domestic pass-through entity.

Congress has expressed its clear intent to except PFIC stock that is marked to market from Section 1291, reasoning that, in such case, an inappropriate deferral of tax is not a risk.[48] For this purpose, the flush language in Section 1291(d)(1) provides that Section 1291 does not apply to PFIC stock which is marked to market under Section 475 or any other provision of Chapter 1. Importantly, the statutory language does not refer to the operative person who may hold PFIC stock subject to a mark-to-market provision (*e.g.*, "*shareholder*" or "*U.S. person*"). Accordingly, Prop. Reg. § 1.1291-(c)(4)(i) should not, in effect, operate to "turn off" Section 475 at the domestic pass-through entity-level. Rather, whether PFIC stock is marked to market under Section 475 should be determined within the confines of Section 475 and the regulations thereunder.

Congress has expressed its clear intent that an entity approach apply to Section 475 by reason of its choice of the terms "*taxpayer*" or "*person*", which are understood to include domestic pass-through entities.[49] It would be inappropriate for Treasury and the IRS to apply an aggregate approach, in part, to Section 475 by providing that a domestic pass-through entity which directly holds PFIC stock subject to Section 475 may no longer mark to market such PFIC stock, subjecting its partners or shareholders to the PFIC regime. In the absence of Section 1291, partners or shareholders of a domestic pass-through entity which directly holds PFIC stock subject to Section 475 would not benefit from the tax deferral risk which Section 1291 was intended to address. To give effect to Congress's intent, it should be alone sufficient that PFIC stock is subject and meets no exception to Section 475, provided that partners or shareholders are subject to the coordination rules of Section 1296(j) and the regulations thereunder.

Conversely, PFIC stock held indirectly through a domestic pass-through entity, which is not subject to Section 475, may now be subject to Section 475 under the non-Section 1296 MTM regulation if its partners or shareholders are shareholders, as defined in Prop. Reg. § 1.1291-(b)(7), and dealers or electing traders under Section 475. Prop. Reg. § 1.1291-1(c)(4)(i) provides that the non-Section 1296 MTM regulation seemingly applies if a mark-to-market provision applies mandatorily or by election of *either* "the shareholder…*or* another person…" This revision makes it is unclear whether the application of Section 475 at the partner- or shareholder-level equally applies to PFIC stock indirectly held through a domestic pass-through entity. As discussed above, this result would run counter to Congress's clear intent to apply an entity approach to Section 475 by reason of its choice of the terms "*taxpayer*" and "*person*".

The Preamble to the proposed regulations fails to provide a reasoned explanation for either of these possible results.[50] In regard to whether Prop. Reg. § 1.1291-1(c)(4)(i) may alter the application of Section 475 to PFIC stock held directly by a domestic pass-through entity, we submit that Treasury and the IRS "may not…depart from a prior policy *sub silentio* or simply disregard rules that are still on the books."[51] If either of these results are intended, Treasury and the IRS are required to "provide a more

[48] S.R. Rep. No. 105-174 (1998) (Conf. Rep.); Staff of the Joint Comm. on Tax'n, 105th Cong., General Explanation of Tax Legislation Enacted in 1998 (1998).

[49] H.R. Rep. No. 105-220 (1997) (Conf. Rep.); Staff of the Joint Comm. on Tax'n, 105th Cong., General Explanation of Tax Legislation Enacted in 1997 (1997).

[50] *See* 2022 Proposed Regulations, at 3,898, 3,913.

[51] *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

detailed justification than what would suffice for a new policy created on a blank state…when…its prior policy has engendered serious reliance interests that must be taken into account."[52] To resolve any uncertainty, we recommend that Treasury and the IRS clarify that the non-Section 1296 MTM regulation applies only by reference to the application of Section 475 (or any other provision of Chapter 1 other than Section 1296 which would cause PFIC stock to be marked to market), notwithstanding the aggregate approach which applies elsewhere.

[52] *Id*. (citing *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 742 (1996)).

Appendix B: Case Study

The compliance burden associated with tracking basis separately for each partner is substantial under the proposed regulations. Suppose a domestic partnership with 200 U.S. taxable partners holds one or more lots of stock in three PFICs in respect of which the domestic partnership would make QEF elections under current law. Assuming the U.S. taxable partners would make similar elections, the number of basis calculations and Form 8621 filings would increase exponentially under the proposed regulations as reflected below.

			PFIC 1	PFIC 2	PFIC 3	Total
Facts:						
	Election		QEF	QEF	QEF	
	Number of Lots	**A**	1	2	3	
	Number of LPs in Fund	**B**	200	200	200	
Current:						
	Number of Cost Basis Calculations	**A**	1	2	3	**6**
	Number of Form 8621s		1	1	1	**3**
Proposed:						
	Number of Cost Basis Calculations	**A*B**	200	400	600	**1200**
	Number of Form 8621s	**B**	200	200	200	**600**

Suppose further that the domestic partnership described above holds stock in 3,000 PFICs.[53] Assuming again that 200 U.S. taxable investors indirectly own such PFIC stock by reason of their direct or indirect interest in the domestic partnership, the U.S. taxable investors would submit 600,000 Form 8621 filings. Under current law, the domestic partnership would submit 3,000 Form 8621 filings. The incremental change in number of Form 8621 filings would be 597,000 or 19,900%.

Assuming Schedule K-3, Part VII, retains its twelve-line format, the incremental change in size of the domestic partnership's Schedule K-3 package would be 100,000 pages.[54] Under current law, a domestic partnership that has elected to treat a PFIC as a pedigreed QEF or made an MTM election is *not* required to complete Schedule K-3, Part VII, if the domestic partnership files Form 8621 for that PFIC. The proposed regulations would result in substantially increased compliance costs for the alternative investment industry, in a volume which would be unprecedented and likely to overwhelm U.S. taxpayers.

[53] Polling of our membership reflects that the number of Form 8621 filings related to PFIC investments held directly by partnerships managed by our members under current law range from 10 to 3,000.

[54] [3,000 PFICs / 12 lines per Schedule K-3, Part VII, page * 2 pages per Schedule K-3, Part VII * 200 U.S. taxable investors]. This figure does not include additional reporting required in attached statements, *e.g.*, Tables 4 and 5.