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Internal Revenue Code Section 1291(b)(2)

Interest on tax deferral

(a) Treatment of distributions and stock dispositions.

(1) Distributions.

If a United States person receives an excess distribution in respect of stock in a passive foreign investment company, then-

(A) the amount of the excess distribution shall be allocated ratably to each day in the taxpayer's holding period for the stock,

(B) with respect to such excess distribution, the taxpayer's gross income for the current year shall include (as ordinary income) only the amounts allocated under subparagraph (A) to-

(i) the current year, or

(ii) any period in the taxpayer's holding period before the 1st day of the 1st taxable year of the company which begins after December 31, 1986, and for which it was a passive foreign investment company, and

(C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under subsection (c)).

(2) Dispositions.

If the taxpayer disposes of stock in a passive foreign investment company, then the rules of paragraph (1) shall apply to any gain recognized on such disposition in the same manner as if such gain were an excess distribution.

(3) Definitions.

For purposes of this section -

(A) Holding period. The taxpayer's holding period shall be determined under section 1223 ; except that-

(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

(ii) if section 1296 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 so applied.

(B) Current year. The term "current year" means the taxable year in which the excess distribution or disposition occurs.

(b) Excess distribution.

(1) In general.

For purposes of this section , the term "excess distribution" means any distribution in respect of stock received during any taxable year to the extent such distribution does not exceed its ratable portion of the total excess distribution (if any) for such taxable year.

(2) Total excess distribution.

For purposes of this subsection -

(A) In general. The term "total excess distribution" means the excess (if any) of-

(i) the amount of the distributions in respect of the stock received by the taxpayer during the taxable year, over

(ii) 125 percent of the average amount received in respect of such stock by the taxpayer during the 3 preceding taxable years (or, if shorter, the portion of the taxpayer's holding period before the taxable year).

For purposes of clause (ii) , any excess distribution received during such 3-year period shall be taken into account only to the extent it was included in gross income under subsection (a)(1)(B) .

(B) No excess for 1st year. The total excess distributions with respect to any stock shall be zero for the taxable year in which the taxpayer's holding period in such stock begins.

(3) Adjustments.

Under regulations prescribed by the Secretary-

(A) determinations under this subsection shall be made on a share-by-share basis, except that shares with the same holding period may be aggregated,

(B) proper adjustments shall be made for stock splits and stock dividends,

(C) if the taxpayer does not hold the stock during the entire taxable year, distributions received during such year shall be annualized,

(D) if the taxpayer's holding period includes periods during which the stock was held by another person, distributions received by such other person shall be taken into account as if received by the taxpayer,

(E) if the distributions are received in a foreign currency, determinations under this subsection shall be made in such currency and the amount of any excess distribution determined in such currency shall be translated into dollars,

(F) proper adjustment shall be made for amounts not includible in gross income by reason of section 959(a) or 1293(c) , and

(G) if a charitable deduction was allowable under section 642(c) to a trust for any distribution of its income, proper adjustments shall be made for the deduction so



allowable to the extent allocable to distributions or gain in respect of stock in a passive foreign investment company.

(c) Deferred tax amount.

For purposes of this section -

(1) In general.

The term "deferred tax amount" means, with respect to any distribution or disposition to which subsection (a) applies, an amount equal to the sum of-

(A) the aggregate increases in taxes described in paragraph (2) , plus

(B) the aggregate amount of interest (determined in the manner provided under paragraph (3)) on such increases in tax.

Any increase in the tax imposed by this chapter for the current year under subsection (a) to the extent attributable to the amount referred to in subparagraph (B) shall be treated as interest paid under section 6601 on the due date for the current year.

(2) Aggregate increases in taxes.

For purposes of paragraph (1)(A) , the aggregate increases in taxes shall be determined by multiplying each amount allocated under subsection (a)(1)(A) to any taxable year (other than any taxable year referred to in subsection (a)(1)(B)) by the highest rate of tax in effect for such taxable year under section 1 or 11 , whichever applies.

(3) Computation of interest.

(A) In general. The amount of interest referred to in paragraph (1)(B) on any increase determined under paragraph (2) for any taxable year shall be determined for the period-

(i) beginning on the due date for such taxable year, and

(ii) ending on the due date for the taxable year with or within which the distribution or disposition occurs,

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

(B) Due date. For purposes of this subsection , the term "due date" means the date prescribed by law (determined without regard to extensions) for filing the return of the tax imposed by this chapter for the taxable year.

(d) Coordination with subparts B and C.

(1) In general.

This section shall not apply with respect to any distribution paid by a passive foreign investment company, or any disposition of stock in a passive foreign investment company, if such company is a qualified electing fund with respect to the taxpayer for each of its taxable years-

(A) which begins after December 31, 1986, and for which such company is a passive foreign investment company, and

(B) which includes any portion of the taxpayer's holding period.

Except as provided in section 1296(j) , this section also shall not apply if an election under section 1296(k) is in effect for the taxpayer's taxable year. In the case of stock which is marked to market under section 475 or any other provision of this chapter, this section shall not apply, except that rules similar to the rules of section 1296(j) shall apply.

(2) Election to recognize gain where company becomes qualified electing fund.

(A) In general. If-

(i) a passive foreign investment company becomes a qualified electing fund with respect to the taxpayer for a taxable year which begins after December 31, 1986,

(ii) the taxpayer holds stock in such company on the first day of such taxable year, and

(iii) the taxpayer establishes to the satisfaction of the Secretary the fair market value of such stock on such first day,

the taxpayer may elect to recognize gain as if he sold such stock on such first day for such fair market value.

(B) Additional election for shareholder of controlled foreign corporations.

(i) In general. If-

(I) a passive foreign investment company becomes a qualified electing fund with respect to the taxpayer for a taxable year which begins after December 31, 1986,

(II) the taxpayer holds stock in such company on the first day of such taxable year, and

(III) such company is a controlled foreign corporation (as defined in section 957(a)),

the taxpayer may elect to include in gross income as a dividend received on such first day an amount equal to the portion of the post-1986 earnings and profits of such company attributable (under regulations prescribed by the Secretary) to the stock in such company held by the taxpayer on such first day. The amount treated as a dividend under the preceding sentence shall be treated as an excess distribution and shall be allocated under subsection (a)(1)(A) only to days during periods taken into account in determining the post-1986 earnings and profits so attributable.

(ii) Post-1986 earnings and profits. For purposes of clause (i) , the term "post-1986 earnings and profits" means earnings and profits which were accumulated in taxable years of such company beginning after December 31, 1986, and during the period or periods the stock was held by the taxpayer while the company was a passive foreign investment company.

(iii) Coordination with section 959(e) . For purposes of section 959(e) , any amount included in gross income under this subparagraph shall be treated as included in gross income under section 1248(a) .

(C) Adjustments. In the case of any stock to which subparagraph (A) or (B) applies-

(i) the adjusted basis of such stock shall be increased by the gain recognized under subparagraph (A) or the amount treated as a dividend under subparagraph (B) , as the case may be, and

(ii) the taxpayer's holding period in such stock shall be treated as beginning on the first day referred to in such subparagraph.

(e) Certain basis, etc., rules made applicable.

Except to the extent inconsistent with the regulations prescribed under subsection (f) , rules similar to the rules of subsections (c) , (d), and (e) of section 1246 shall apply for purposes of this section ; except that-

(1) the reduction under subsection (e) of such section shall be the excess of the basis determined under section 1014 over the adjusted basis of the stock immediately before the decedent's death, and

(2) such a reduction shall not apply in the case of a decedent who was a nonresident alien at all times during his holding period in the stock.

(f) Recognition of gain.

To the extent provided in regulations, in the case of any transfer of stock in a passive foreign investment company where (but for this subsection) there is not full recognition of gain, the excess (if any) of-

(1) the fair market value of such stock, over

(2) its adjusted basis,

shall be treated as gain from the sale or exchange of such stock and shall be recognized notwithstanding any provision of law. Proper adjustment shall be made to the basis of any such stock for gain recognized under the preceding sentence.

(g) Coordination with foreign tax credit rules.

(1) In general.

If there are creditable foreign taxes with respect to any distribution in respect of stock in a passive foreign investment company-

(A) the amount of such distribution shall be determined for purposes of this section with regard to section 78 ,

(B) the excess distribution taxes shall be allocated ratably to each day in the taxpayer's holding period for the stock, and

(C) to the extent-

(i) that such excess distribution taxes are allocated to a taxable year referred to in subsection (a)(1)(B) , such taxes shall be taken into account under section 901 for the current year, and

(ii) that such excess distribution taxes are allocated to any other taxable year, such taxes shall reduce (subject to the principles of section 904(d) and not below zero) the increase in tax determined under subsection (c)(2) for such taxable year by reason of such distribution (but such taxes shall not be taken into account under section 901).

(2) Definitions.

For purposes of this subsection -

(A) Creditable foreign taxes. The term "creditable foreign taxes" means, with respect to any distribution, any withholding tax imposed with respect to such distribution, but only if the taxpayer chooses the benefits of section 901 and such taxes are creditable under section 901 (determined without regard to paragraph (1)(C)(ii)).

(B) Excess distribution taxes. The term "excess distribution taxes" means, with respect to any distribution, the portion of the creditable foreign taxes with respect to such distribution which is attributable (on a pro rata basis) to the portion of such distribution which is an excess distribution.

(C) Section 1248 gain. The rules of this subsection also shall apply in the case of any gain which but for this section would be includible in gross income as a dividend under section 1248 .