

## Federal Tax Regulations, Regulation, §1.6038D-6, Internal Revenue Service, Specified domestic entities

**(a) Specified domestic entity.**— A specified domestic entity is a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E), if such corporation, partnership, or trust is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets. Whether a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E) is a specified domestic entity is determined annually.

### **(b) Corporations and partnerships**

**(1) Formed or availed of.**— Except as otherwise provided in paragraph (d) of this section, a domestic corporation or a domestic partnership is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if—

**(i)** The corporation or partnership is closely held by a specified individual as determined under paragraph (b)(2) of this section; and

**(ii)** At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership for the taxable year are assets that produce or are held for the production of passive income as determined under paragraph (b)(3) of this section (passive assets). For purposes of this paragraph (b)(1)(ii), the percentage of passive assets held by a corporation or partnership for a taxable year is the weighted average percentage of passive assets (weighted by total assets and measured quarterly), and the value of assets of a corporation or partnership is the fair market value of the assets or the book value of the assets that is reflected on the corporation's or partnership's balance sheet (as determined under either a U.S. or an international financial accounting standard).

### **(2) Closely held**

**(i) Domestic corporation.**— A domestic corporation is closely held by a specified individual if at least 80 percent of the total combined voting power of all classes of stock of the corporation entitled to vote, or at least 80 percent of the total value of the stock of the corporation, is owned, directly, indirectly, or constructively, by a specified individual on the last day of the corporation's taxable year.

**(ii) Domestic partnership.**— A partnership is closely held by a specified individual if at least 80 percent of the capital or profits interest in the partnership is held, directly, indirectly, or constructively, by a specified individual on the last day of the partnership's taxable year.

**(iii) Constructive ownership.**— For purposes of this paragraph (b)(2), sections 267(c) and (e) (3) apply for the purpose of determining the constructive ownership of a specified individual in a corporation or partnership, except that section 267(c)(4) is applied as if the family of an individual includes the spouses of the individual's family members.

### **(3) Determination of passive income and assets**

**(i) Definition of passive income.**— Except as provided in paragraph (b)(3)(ii) of this section, for purposes of paragraph (b)(1)(ii) of this section, passive income means the portion of gross income that consists of—

**(A)** Dividends, including substitute dividends;

**(B)** Interest;

- (C) Income equivalent to interest, including substitute interest;
- (D) Rents and royalties, other than rents and royalties derived in the active conduct of a trade or business conducted, at least in part, by employees of the corporation or partnership;
- (E) Annuities;
- (F) The excess of gains over losses from the sale or exchange of property that gives rise to passive income described in paragraphs (b)(3)(i)(A) through (b)(3)(i)(E) of this section;
- (G) The excess of gains over losses from transactions (including futures, forwards, and similar transactions) in any commodity, but not including—
  - (1) Any commodity hedging transaction described in section 954(c)(5)(A), determined by treating the corporation or partnership as a controlled foreign corporation; or
  - (2) Active business gains or losses from the sale of commodities, but only if substantially all the corporation or partnership's commodities are property described in paragraph (1), (2), or (8) of section 1221(a);
- (H) The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transaction; and
- (I) Net income from notional principal contracts as defined in §1.446-3(c)(1).

**(ii) Exception from passive income treatment for dealers.**— Notwithstanding paragraph (b)(3)(i) of this section, in the case of a corporation or partnership that regularly acts as a dealer in property described in paragraph (b)(3)(i)(F) of this section (referring to the sale or exchange of property that gives rise to passive income), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), the term passive income does not include—

- (A) Any item of income or gain (other than any dividends or interest) from any transaction (including hedging transactions and transactions involving physical settlement) entered into in the ordinary course of such dealer's trade or business as such a dealer; and
- (B) If such dealer is a dealer in securities (within the meaning of section 475(c)(2)), any income from any transaction entered into in the ordinary course of such trade or business as a dealer in securities.

**(iii) Related entities.**— For purposes of applying the passive income and asset thresholds of paragraph (b)(1)(ii) of this section, all domestic corporations and domestic partnerships that are closely held by the same specified individual as determined under paragraph (b)(2) of this section and that are connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as owning the combined assets and receiving the combined income of all members of that group. For purposes of the preceding sentence, assets relating to any contract, equity, or debt existing between members of such a group, as well as any items of gross income arising under or from such contract, equity, or debt, are eliminated. A domestic corporation or a domestic partnership is considered connected through stock or partnership interest ownership with a common parent corporation or partnership if stock representing at least 80 percent of the total combined voting power of all classes of stock of the corporation entitled to vote or of the value of such corporation, or partnership interests representing at least 80 percent of the profits interests or capital interests of such

partnership, in each case other than stock of or partnership interests in the common parent, is owned by one or more of the other connected corporations, connected partnerships, or the common parent.

**(4) Examples.**— The following examples illustrate the application of this section:

*Example 1. Closely held and constructive ownership.* (i) *Facts.* DC1 is a domestic corporation the total value of the stock of which is owned 60% by A, a specified individual, 30% by B, a member of A's family for purposes of section 267(c)(2) who is not a specified individual, and 10% by FC1, a foreign corporation. DC1 owns 90% of the total value of the stock of DC2, a domestic corporation. FC2, a foreign corporation, owns 10% of DC2. Neither A nor B owns, directly, indirectly, or constructively, any stock in FC1 or FC2.

(ii) *Closely held ownership determination.* A is considered to own 90% and 81% of the total value of DC1 and DC2, respectively, by application of the rules of section 267(c) and this section. DC1 and DC2 are closely held by A within the meaning of paragraph (b)(2) of this section because A, a specified individual, is considered to own more than 80% of their total value.

*Example 2. Application of aggregation rule and reporting threshold.* (i) *Facts.* L is a specified individual. In Year X, L wholly owns DC1, a domestic corporation, and also owns a 90% capital interest in DP, a domestic partnership. DC1 owns 80% of the sole class of stock of DC2, a domestic corporation. DC1 has no assets other than its interest in DC2. DC2's only assets are assets that produce passive income, with a maximum value in Year X of \$40,000 on October 12. DC2's assets are comprised in relevant part of specified foreign financial assets with a maximum value in Year X of \$15,000 on October 12. DP's only assets are assets that produce passive income and that are specified foreign financial assets with a maximum value of \$90,000 in Year X on October 12.

(ii) *Specified domestic entity status—(A) DC1 and DC2.* DC1 and DC2 are closely held by a specified individual for purposes of paragraph (b)(2) of this section. DC1 and DC2 are considered related entities that are connected through stock ownership with a common parent corporation under paragraph (b)(3)(iii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 through DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, for purposes of applying paragraph (b)(1)(ii) of this section, each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2; however, DC1's equity interest in DC2 is disregarded for this purpose under paragraph (b)(3)(iii) of this section. Therefore, DC1 and DC2 each satisfies the passive asset threshold of paragraph (b)(1)(ii) of this section, because 100 percent of each company's assets is passive. DC1 and DC2 are specified domestic entities for Year X.

(B) *DP.* DP is closely held by a specified individual for purposes of paragraph (b)(2) of this section. DP is not considered a related entity with DC1 and DC2 under paragraph (b)(3)(iii) of this section, because DC1 and DP are not owned by a common parent corporation or partnership. As a result, whether the passive income or passive asset threshold of paragraph (b)(1)(ii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP holds only passive assets during Year X and therefore satisfies paragraph (b)(1)(ii) of this section. DP is a specified domestic entity for Year X.

(iii) *Reporting requirements—(A) DC1.* Under §1.6038D-2(a)(6)(ii), DC1 is not treated as owning the specified foreign financial assets held by DC2 and DP for purposes of applying the reporting threshold of §1.6038D-2(a)(1), because DC1 does not have an interest in any specified foreign financial assets. DC1 is not required to file Form 8938 because DC1 does not satisfy the reporting threshold of §1.6038D-2(a)(1).

(B) *DC2 and DP.* Under §1.6038D-3, DC2 and DP each has an interest in specified foreign financial assets. For purposes of applying the reporting threshold of §1.6038D-2(a)(1), §1.6038D-2(a)(6)(ii) provides that DC2 is treated as owning in addition to its own assets the assets of DP, and DP is treated as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of §1.6038D-2(a)(1), because the value of the specified foreign financial assets each

is considered as owning for purposes of §1.6038D-2(a)(1) is \$105,000 on October 12, Year X, which exceeds DC2's and DP's \$75,000 reporting threshold. DC2 and DP must each file Form 8938 for Year X to report their respective specified foreign financial assets in which they have an interest and disclose their maximum values as provided in §1.6038D-4 (\$15,000 in the case of DC2 and \$90,000 in the case of DP).

*Example 3. Application of aggregation rule and entity with an active trade or business.* (i) *Facts.* The facts are the same as in *Example 2*, except that DC2 also owns an active business. The assets attributable to the business are not passive assets and constitute at least 60% of the value of DC2's assets at all times during Year X. The income from the business is not passive income and constitutes at least 60% of the gross income generated by DC2 in Year X.

(ii) *Specified domestic entity status—(A) DC1 and DC2.* DC1 and DC2 are considered related entities that are connected through stock ownership with a common parent corporation under paragraph (b)(3)(iii) of this section because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 through DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, for purposes of applying paragraph (b)(1)(ii) of this section, each of DC1 and DC2 is treated as owning the combined assets, and receiving the combined income, of both DC1 and DC2; however, DC1's equity interest in DC2 is disregarded for this purpose under paragraph (b)(3)(iii) of this section. As a result, no more than 40 percent of the value of DC1's and DC2's assets at all times during Year X are passive and no more than 40 percent of DC1's and DC2's gross income for Year X is passive. DC1 and DC2 do not satisfy the passive income or passive asset threshold in paragraph (b)(1)(ii) of this section for Year X. DC1 and DC2 are not specified domestic entities for Year X.

(B) *DP.* For the reasons described in paragraph (ii)(B) of *Example 2*, DP is a specified domestic entity for Year X.

(iii) *Reporting requirements—(A) DC1 and DC2.* DC1 and DC2 are not specified domestic entities for Year X, and are not required to file Form 8938.

(B) *DP.* Under §1.6038D-3, DP has an interest in specified foreign financial assets. Under §1.6038D-2(a)(6)(ii), DP is treated as owning in addition to its own assets the assets of DC2. As a result, DP satisfies the reporting threshold of §1.6038D-2(a)(1) because the value of the specified foreign financial assets it is considered to own for purposes of §1.6038D-2(a)(1) is \$105,000 on October 12, Year X, which exceeds DP's \$75,000 reporting threshold. DP must file Form 8938 for Year X to report the specified foreign financial assets in which it has an interest and disclose their maximum values as provided in §1.6038D-4, which is \$90,000.

**(c) Domestic trusts.**— Except as otherwise provided in paragraph (d) of this section, a trust described in section 7701(a)(30)(E) is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if the trust has one or more specified persons as a current beneficiary. The term current beneficiary means, with respect to the taxable year, any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). The term current beneficiary also includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year, but does not include any holder of a general power of appointment that is exercisable only on the death of the holder.

**(d) Excepted domestic entities.**— An entity is not considered to be a specified domestic entity if the entity is—

**(1) Certain persons described in section 1473(3).**— An entity, except for a trust that is exempt from tax under section 664(c), that is excepted from the definition of the term "specified United States person" under section 1473(3) and the regulations issued under that section;

**(2) Certain domestic trusts.**— A trust described in section 7701(a)(30)(E) provided that the trustee of the trust—

(i) Has supervisory authority over or fiduciary obligations with regard to the specified foreign financial assets held by the trust;

(ii) Timely files (including any applicable extensions) annual returns and information returns on behalf of the trust; and

(iii) Is —

(A) A bank that is examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the National Credit Union Administration;

(B) A financial institution that is registered with and regulated or examined by the Securities and Exchange Commission; or

(C) A domestic corporation described in section 1473(3)(A) or (B), and the regulations issued with respect to those provisions.

**(3) Domestic trusts owned by one or more specified persons.**— A trust described in section 7701(a)(30)(E) to the extent such trust or any portion thereof is treated as owned by one or more specified persons under sections 671 through 678 and the regulations issued under those sections.

**(e) Effective/applicability dates.**— This section applies to taxable years beginning after December 31, 2015. [Reg. §1.6038D-6.]

□ [ T.D. 9706, 12-11-2014. Amended by T.D. 9752, 2-22-2016.]