PART 171—[AMENDED]

■ 1. The authority citation for part 171 continues to read as follows:

Authority: 5 U.S.C. 552, 552a; 22 U.S.C. 2651a; Pub. L. 95–521, 92 Stat. 1824, as amended; E.O. 13526, 75 FR 707; E.O. 12600, 52 FR 23781, 3 CFR, 1987 Comp., p. 235.

§ 171.36 [Amended]

■ 2. Section 171.36 is amended by adding an entry, in alphabetical order, for ''Family Advocacy Case Records, State–75'' to the lists in paragraphs (b)(1) and (2)

Joyce A. Barr,

Assistant Secretary for Administration, U.S. Department of State.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9752]

RIN 1545–BM54

Reporting of Specified Foreign Financial Assets

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the requirements for certain domestic entities to report specified foreign financial assets to the Internal Revenue Service. These regulations set forth the conditions under which a domestic entity will be considered a specified domestic entity required to undertake such reporting. These regulations affect certain domestic corporations, partnerships, and trusts.

DATES: *Effective date:* These regulations are effective on February 23, 2016.

Applicability date: For dates of applicability, see §§ 1.6038D–2(g) and 1.6038D–6(e).

FOR FURTHER INFORMATION CONTACT: Joseph S. Henderson, (202) 317–6942 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 6038D was enacted by section 511 of the Hiring Incentives to Restore Employment (HIRE) Act, Public Law 111–147 (124 Stat. 71). Section 6038D(a) requires certain individuals to report information about specified foreign financial assets. Section 6038D(f) provides that, to the extent provided by the Secretary in regulations or other guidance, section 6038D shall apply to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if the entity were an individual.

On December 19, 2011, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published temporary regulations (the ''2011 temporary regulations'') (TD 9567) and a notice of proposed rulemaking by cross-reference to temporary regulations (REG–130302–10) in the **Federal Register** (76 FR 78553 and 76 FR 78594, respectively) addressing the reporting requirements under section 6038D. The notice of proposed rulemaking also included proposed § 1.6038D–6, which set forth the conditions under which a domestic entity will be considered a specified domestic entity and, therefore, required to report specified foreign financial assets in which it holds an interest. Corrections to the 2011 temporary regulations were published on February 21, 2012, in the **Federal Register** (77 FR 9845). Corrections to proposed § 1.6038D–6 were published on February 21, 2012, and February 22, 2012, in the **Federal Register** (77 FR 9877 and 77 FR 10422, respectively). The 2011 temporary regulations were issued as final regulations (TD 9706; 79 FR 73817) on December 12, 2014 (the ''2014 final regulations''). The Treasury Department and the IRS did not adopt proposed § 1.6038D–6 (REG–144339–14) as a final regulation at that time.

The Treasury Department and the IRS received written comments on proposed § 1.6038D–6. All comments are available at *www.regulations.gov* or upon request. Because no requests to speak were received, no public hearing was held. After consideration of the comments received, the Treasury Department and the IRS adopt proposed § 1.6038D–6 as a final regulation with the modifications described herein.

Summary of Comments and Explanation of Revisions

I. Organizational Changes Regarding the Reporting Threshold

Proposed §§ 1.6038D–6(b)(1)(i) and 1.6038D–6(c)(1) provide that, in order to be treated as a specified domestic entity, an entity must have an interest in specified foreign financial assets (excluding assets excepted under § 1.6038D–7T) that exceeds the reporting threshold in § 1.6038D–2T(a)(1). Under the proposed regulations, a domestic entity applies the reporting threshold in § 1.6038D–2T(a)(1) to determine whether it is a specified domestic entity. In making this determination, the proposed regulations require a corporation or partnership to take into account the aggregation rules in proposed § 1.6038D–6(b)(4)(i). Proposed §§ 1.6038D–6(b)(1)(i) and 1.6038D–6(c)(1), however, suggested that a specified domestic entity is required to again apply § 1.6038D–2T(a)(1) to determine whether it has a reporting requirement.

The Treasury Department and the IRS did not intend for domestic entities to apply the reporting threshold described in § 1.6038D–2(a)(1) twice in order to determine their section 6038D reporting responsibilities. Therefore, these final regulations eliminate the requirement to apply § 1.6038D–2(a)(1) as part of determining whether an entity is a specified domestic entity. Instead, a domestic entity that meets the definition of a specified domestic entity, which under these final regulations is determined without regard to whether the reporting threshold in § 1.6038D–2(a)(1) is met, applies the reporting threshold under § 1.6038D–2(a)(1) once, as part of determining whether it has a filing obligation. The aggregation rule for corporations and partnerships and the rule excluding assets excepted under § 1.6038D–7 from the reporting threshold have been moved to § 1.6038D–2(a)(6). These changes are organizational and no change is intended to the substantive reporting requirements for a specified domestic entity.

II. Elimination of Principal Purpose Test

Proposed § 1.6038D–6(b)(1)(iii) provides that a corporation or partnership is treated as formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if either: (1) At least 50 percent of the corporation or partnership's gross income or assets is passive; or (2) at least 10 percent of the corporation or partnership's gross income or assets is passive and the corporation or partnership is formed or availed of by a specified individual with a principal purpose of avoiding section 6038D (the principal purpose test). Under proposed § 1.6038D–6(b)(1)(iii), all facts and circumstances are taken into account to determine whether a specified individual has a principal purpose of avoiding section 6038D.

The Treasury Department and the IRS believe that a 50-percent passive assets or income threshold appropriately captures situations in which specified individuals may use a domestic

corporation or partnership to circumvent the reporting requirements of section 6038D. Furthermore, the Treasury Department and the IRS have concluded that taxpayers should be able to determine their reporting requirements under section 6038D based on objective requirements rather than a subjective principal purpose test. Therefore, these final regulations eliminate the principal purpose test for determining whether a corporation or partnership is a specified domestic entity. However, the Treasury Department and the IRS will continue to monitor whether domestic corporations and partnerships not required to report under these final regulations are being used inappropriately by specified individuals to avoid reporting under section 6038D. If needed, the Treasury Department and the IRS may expand the definition of a specified domestic entity in future guidance.

III. Definition of Passive Income

Proposed § 1.6038D–6(b)(2) defines ''passive income'' by listing specific items of income that are treated as passive. Following the issuance of proposed § 1.6038D–6(b)(2), on February 15, 2012, comprehensive regulations (77 FR 9022 (REG–121647–10)) were proposed under sections 1471 through 1474, which were also enacted as part of the HIRE Act that enacted section 6038D. A definition of passive income was included in the proposed regulations under section 1472 for purposes of identifying certain active nonfinancial foreign entities (NFFEs), which are excepted from withholding under section 1472(a) and therefore do not have to report their substantial U.S. owners in order to avoid withholding. The definition of passive income in proposed § 1.1472–1(c)(1)(v) contained a list of items that was similar, although not identical, to the list contained in proposed § 1.6038D–6(b)(2). On January 28, 2013, the proposed regulations under sections 1471 through 1474 were finalized (78 FR 5874, TD 9610). In the final regulations, the Treasury Department and the IRS clarified the scope of the definition of passive income, made modifications in response to comments received, and moved the provision to § 1.1472–1(c)(1)(iv)(A). In addition, exceptions for look-through payments and dealers were added in § 1.1472–1(c)(1)(iv)(B).

The definitions of passive income under sections 1472 and 6038D serve a similar function, which is to identify entities that have a high risk of being used for tax evasion and to reduce compliance burdens for active entities. Therefore, these final regulations in § 1.6038D–6(b)(2) adopt several of the modifications to the term ''passive income'' that were included in § 1.1472–1(c)(1)(iv)(A). Specifically, these modifications: (1) Clarify that ''dividends'' includes substitute dividends and expand ''interest'' to cover income equivalent to interest, including substitute interest, (2) add a new exception for certain active business gains or losses from the sale of commodities, and (3) define notional principal contracts by adding a reference to § 1.446–3(c)(1). In addition, these final regulations add the exception for dealers that is described in § 1.1472–1(c)(1)(iv)(B)(*2*).

In addition, the proposed regulations under both sections 1472 and 6038D excluded from the definition of passive income rents or royalties derived in the active conduct of a trade or business conducted by employees of the relevant entity. A comment submitted in response to proposed § 1.6038D–6(b)(2)(iii) expressed concern that the exception applies only to rents and royalties derived in an active trade or business conducted exclusively by a corporation's or partnership's employees, and noted that it is difficult to find a trade or business that is conducted solely by a business's employees. These final regulations provide, consistent with § 1.1472–1(c)(1)(iv)(A)(*4*), that 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 will not be considered passive income.

The exception for certain look-through income from related persons in § 1.1472–1(c)(1)(iv)(B)(*1*) is not adopted in these final regulations because § 1.6038D–6(b)(3)(ii) already eliminates passive income or assets arising from related party transactions for purposes of applying the passive income and asset thresholds to a corporation or partnership with related entities.

Finally, the proposed regulations did not specify how to determine whether 50 percent of a corporation's or partnership's assets are passive assets. The Treasury Department and the IRS believe that the weighted average test for active NFFEs in the regulations under section 1472 provides an administrable way to determine the passive asset percentage. Therefore, these final regulations provide that the passive asset percentage is determined based on a weighted average approach similar to the rule in § 1.1472–1(c)(1)(iv). Under this test, corporations or partnerships may use either fair market value or book value (as reflected on the entity's balance sheet and as determined under either a U.S. or an international financial accounting standard) to determine the value of their assets. Corporations or partnerships may be required to substantiate their determination of the passive asset percentage upon request by the IRS. *See* section 6001.

IV. Annual Determination of Specified Person's Interest in a Domestic Partnership

Proposed § 1.6038D–6(a) provides that whether a domestic partnership is a specified domestic entity is determined annually, and proposed § 1.6038D–6(b)(3)(ii) provides that a partnership is closely held 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.

A commenter recommended that a partner's interest in a partnership should be calculated on a year-by-year basis for purposes of determining whether a domestic partnership is a specified domestic entity. The comment noted that it is often difficult to determine the precise capital or profits interest of a partner because it may shift depending on the performance of the partnership.

The requirement to determine a partner's capital or profits interest on a particular day is present in other provisions of the Internal Revenue Code, Treasury regulations, and published guidance, and the Treasury Department and the IRS believe it is an appropriate measure of an individual's economic interest in a partnership and, in general, is not overly complex. Accordingly, these final regulations retain the rule in the proposed regulations for determining if a domestic partnership is closely held.

V. Clarification to Aggregation Rules

Proposed § 1.6038D–6(b)(4) provides aggregation rules for purposes of applying proposed § 1.6038D–6(b)(1)(i), the § 1.6038D–2(a)(1) reporting threshold, and the passive income and asset thresholds under proposed § 1.6038D–6(b)(1)(iii). The proposed regulations provide that, for purposes of applying proposed § 1.6038D–6(b)(1)(i) and the reporting threshold, all domestic corporations and domestic partnerships that have an interest in specified foreign financial assets and are closely held by the same specified individual are treated as a single entity, and each such related corporation or partnership is treated as owning the specified foreign financial assets held by all such related corporations or

partnerships. Similarly, the proposed regulations provide that, for purposes of applying the passive income and asset thresholds, all domestic corporations and domestic partnerships that are closely held by the same specified individual and connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as a single entity, and each member of such a group is treated as owning the combined assets and receiving the combined income of all members of that group.

The Treasury Department and the IRS have determined that it is not necessary both to treat a group as a single entity and to attribute the assets or income of members of the group to an entity. Therefore, these final regulations simplify the aggregation rules by eliminating the reference to treating all domestic corporations and partnerships as a single entity.

VI. Domestic Trusts

Proposed § 1.6038D–6(c) provides that a trust described in section 7701(a)(30)(E) is a specified domestic entity 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 Treasury Department and the IRS intend that a specified domestic entity include a trust whereby a specified person has an immediately exercisable general power of appointment, even if such specified person is not technically a beneficiary. Therefore, these final regulations clarify that 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.

VII. Expanding the Exceptions for Domestic Entities

Proposed § 1.6038D–6(d) excepts certain entities from being treated as a specified domestic entity. A commenter recommended that the final regulations expand proposed § 1.6038D–6(d) to also except certain domestic trusts that are not required to file a Form 1041, ''U.S. Fiduciary Income Tax Return,'' or any information returns. The Treasury Department and the IRS do not adopt this comment because the 2014 final regulations already address the commenter's concerns. The 2014 final regulations provide in § 1.6038D–2(a)(7) that a specified person, including a specified domestic entity, is not required to file Form 8938, ''Statement of Specified Foreign Financial Assets,'' with respect to a taxable year if the specified person is not required to file an annual return with the IRS with respect to that taxable year. In the case of a specified domestic entity, the term ''annual return'' means an annual federal income tax return or information return filed with the IRS, including returns required under section 6012. *See* § 1.6038D–1(a)(11). A Form 1041 is an annual return for purposes of § 1.6038D–1(a)(11) of the final regulations.

A commenter recommended that the final regulations except publicly traded partnerships from being specified domestic entities because they are similar to publicly traded corporations described in section 1473(3), which are excepted from the definition of specified domestic entity under proposed § 1.6038D–6(d)(1). The Treasury Department and the IRS do not adopt this comment. The requirement under proposed § 1.6038D–6(b) that to be a specified domestic entity at least 80 percent of the capital or profits interest in a partnership must be held by a specified individual on the last day of the partnership's taxable year establishes appropriate general criteria that, as a practical matter, should exempt most publicly traded partnerships from being specified domestic entities.

A commenter recommended that the final regulations except an employer trust established for the benefit of more than a minimum number of employees, such as 50, from being a specified domestic entity even if the employer trust holds stock of a foreign company. The Treasury Department and the IRS believe the exception under proposed § 1.6038D–6(d)(1) for domestic entities that are not ''specified United States persons'' pursuant to section 1473(3), together with the exception for trusts whose trustees satisfy the supervisory oversight requirements and the income tax and information return filing requirements under proposed § 1.6038D–6(d)(2), are sufficiently broad to except employer trusts that represent a low risk of tax avoidance from characterization as a specified domestic entity. Therefore, this comment is not adopted.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required.

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). In the case of domestic corporations and partnerships, these regulations apply only when two separate tests are met. The first requires that at least 80 percent of the entity must be owned, directly, indirectly, or constructively, by a specified individual, generally a U.S. citizen or resident. The second test compares the entity's business income and assets with its passive income and assets. If more than 50 percent of the entity's annual gross income for the year is active business income and more than 50 percent of its assets for the taxable year are assets that produce or are held for the production of active income, then the entity is not subject to the reporting requirements under section 6038D. This two-part test reduces the burden imposed by these final regulations on domestic small business entities because closely-held domestic corporations and partnerships that are predominantly engaged in an active business generally will be excluded from reporting. Furthermore, small not-for-profit organizations that are tax-exempt under section 501(a) of the Internal Revenue Code and small governmental jurisdictions are not subject to these regulations.

For closely-held domestic corporations and partnerships that meet both tests, these final regulations limit the burden imposed. First, reporting is required only when the aggregate value of the entity's interests in specified foreign financial assets exceeds the reporting threshold under § 1.6038D–2(a)(1). Second, the final regulations exclude the value of specified foreign financial assets reported on one or more of the following forms from being taken into consideration in determining whether the small entity satisfies the reporting threshold under § 1.6038D–2(a)(1): Form 3520, ''Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts''; Form 3520–A, ''Annual Information Return of Foreign Trust With a U.S. Owner''; Form 5471, ''Information Return of U.S. Persons

With Respect To Certain Foreign Corporations''; Form 8621, ''Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund''; or Form 8865, ''Return of U.S. Persons With Respect to Certain Foreign Partnerships.'' Third, small entities that hold specified foreign financial assets generally will be excepted from reporting such assets if the assets are reported on one or more of the these forms, thereby further limiting the burden imposed by the final regulations on small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Joseph S. Henderson, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry for § 1.6038D–6 in numerical order to read in part as follows:

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

Section 1.6038D–6 is also issued under 26 U.S.C. 6038D.

■ **Par. 2.** Section 1.6038D–0 is amended by:

■ 1. Revising the entry for § 1.6038D–1(a)(12).

■ 2. Adding entries for § 1.6038D–2(a)(6)(i) and (ii).

■ 3. Revising the entry for § 1.6038D–6.

The revisions and additions read as follows:

§ 1.6038D–0 Outline of regulation provisions

* * * * *

§ 1.6038D–1 Reporting with respect to specified foreign financial assets, definition of terms.

(a) * * *

* * * * *

(12) Specified domestic entity.

* * * * *

§ 1.6038D–2 Requirement to report specified foreign financial assets.

(a) * * *

* * * * *

(6) * * *

(i) Specified individual.

(ii) Specified domestic entity.

* * * * *

§ 1.6038D–6 Specified domestic entities.

(a) Specified domestic entity.

(b) Corporations and partnerships.

(1) Formed or availed of.

(2) Closely held.

(i) Domestic corporation.

(ii) Domestic partnership.

(iii) Constructive ownership.

(3) Determination of passive income and assets.

(i) Definition of passive income.

(ii) Exception from passive income treatment for dealers.

(iii) Related entities.

(4) Examples.

(c) Domestic trusts.

(d) Excepted domestic entities.

(1) Certain persons described in section 1473(3).

(2) Certain domestic trusts.

(3) Domestic trusts owned by one or more specified persons.

(e) Effective/applicability dates.

* * * * *

■ **Par. 3.** Section 1.6038D–1(a)(12) is revised to read as follows:

§ 1.6038D–1 Reporting with respect to specified foreign financial assets, definition of terms.

(a) * * *

* * * * *

(12) *Specified domestic entity.* The term *specified domestic entity* has the meaning set forth in § 1.6038D–6.

* * * * *

■ **Par. 4.** Section 1.6038D–2 is amended by:

■ 1. Redesignating the text of paragraph (a)(6) as paragraph (a)(6)(i) and adding a paragraph heading to newly redesignated paragraph (a)(6)(i).

■ 2. Adding paragraph (a)(6)(ii).

■ 3. Revising paragraph (g).

The additions and revision read as follows:

§ 1.6038D–2 Requirement to report specified foreign financial assets.

(a) * * *

(6) *Aggregate value calculation in case of specified foreign financial asset excluded from reporting*—(i) *Specified individual.* * * *

(ii) *Specified domestic entity.* The value of any specified foreign financial asset in which a specified domestic entity has an interest and that is excluded from reporting on Form 8938 pursuant to § 1.6038D–7(a) (concerning certain assets reported on another form) is excluded for purposes of determining the aggregate value of specified foreign financial assets. For purposes of determining the aggregate value of specified foreign financial assets, a specified domestic entity that is a corporation or partnership and that has an interest in any specified foreign financial asset is treated as owning all the specified foreign financial assets (excluding specified foreign financial assets excluded from reporting on Form 8938 pursuant to § 1.6038D–7(a)) held by all domestic corporations and domestic partnerships that are closely held by the same specified individual as determined under § 1.6038D–6(b)(2).

* * * * *

(g) *Effective/applicability dates.* This section, with the exception of § 1.6038D–2(a)(6)(ii), applies to taxable years ending after December 19, 2011. Section 1.6038D–2(a)(6)(ii) applies to taxable years beginning after December 31, 2015. Taxpayers may elect to apply the rules of this section, with the exception of § 1.6038D–2(a)(6)(ii), to taxable years ending on or prior to December 19, 2011.

■ **Par 5.** Section 1.6038D–6 is added to read as follows:

§ 1.6038D–6 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 though 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.

Karen M. Schiller,

Deputy Commissioner for Services and Enforcement.

Approved: January 19, 2016.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).

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