PFIC RULES
TAX POLICY GONE AWRY

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In this report, Dunn argues that the 1986 revisions of the U.S. tax on foreign corporations were without unifying theme except perhaps the raising of revenue. Although not restricted to passive income, prior law was largely focused on the taxation of passive income earned by foreign corporations with significant U.S. ownership. The 1986 Act changes are not so focused. First, the definition of a passive foreign investment company (PFIC) does not depend on the nationality or concentration of ownership. Rather, with some exceptions, a foreign corporation is PFIC if 75 percent of its gross income is passive income or 50 percent of its assets produce passive income. While United States shareholders are not taxed on undistributed income of a PFIC, there are harsh tax consequences attached when the corporation makes an "excess distribution," a term defined by reference to past distributions. These consequences can be avoided to some extent by the PFIC electing to be taxed as a qualified electing fund (QEF) that taxes shareholders in a manner similar to that accorded S corporations. Dunn also discusses the changes in taxing shareholders of PFICs that would be made by the Technical Corrections Bill. At the end, Dunn questions whether the tax policies supporting the PFIC legislation are sufficient to justify the tax results. He believes that the United States now is a tax shelter relative to much of the rest of the developed world and thus doubts that there is need to discourage U.S. investors from making passive foreign investments. He also notes that the tax consequences under PFICs can be more harsh than those imposed on 100 percent owned corporations, and he doubts whether that policy is wise. Finally, he believes that current taxation of passive income should be matched with passthrough of losses in the same way that S corporations pass through losses. He notes that the revenue gain from the PFIC legislation does not exceed $20 million per year even when fully implemented. He doubts that this amount of revenue is worth the effort. If there is need for PFIC legislation, he concludes with two suggestions for simplifying the tax regime for PFICs.

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The Tax Reform Act of 1986[1] enacted far-reaching tax policies intended to broaden the tax base and lower rates of tax. Related to these basic tax policies are major structural changes such as the elimination of the tax rate differential between capital gains and ordinary income and a multifaceted attack on passive loss tax shelters.

It is difficult to discern any policy that unifies most of [the 1986 Act]. . . foreign tax provisions.

The 1986 Act also contains some important changes in the taxation of foreign investments of United States persons and the taxation of United States investments by foreign persons. However, with certain exceptions, such as the new foreign currency rules,[2] it is difficult to rationalize these new foreign tax provisions[3] with the basic policies of the 1986 Act. To the contrary, it is difficult to discern any policy that unifies most of these foreign tax provisions, perhaps other than a desire to raise revenue without regard to the ensuing enormous complications and costs of compliance.

This article is addressed to one of these foreign tax provisions—the new passive foreign investment company

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[1]P.L. 99-514, 99th Cong., 2d Sess. 1986 (hereinafter cited as the 1986 Act).

[2]I.R.C. sections 985-989.

(PFIC) provisions. Commencing with the stated policy of the PFIC provisions, the article turns to a detailed analysis of the statutory provisions and then to the many changes proposed in the Technical Corrections Act (TCA).[4] With this policy and statutory background, the article then presents a critical analysis of the PFIC provisions and suggests that these provisions are not sound and that other policies should govern this matter. Even if the policies underlying the PFIC provisions are to be retained, such policies should be implemented by other means.

I. Policy Supporting PFIC Legislation

Prior to the 1986 Act, there was a host of statutory provisions that created exceptions to the general rule of United States tax policy that income of a foreign corporation is not taxed to its United States shareholders until such income is distributed to such United States shareholders. Most of these provisions related only to foreign companies with significant percentages of passive income. All such provisions were limited to situations in which United States persons had a controlling interest in the foreign corporation. These pre-1986 Act provisions[5] included the foreign personal holding company provisions[6]; the subpart F provisions[7]; section 1248, section 1247, and section 1246; and also two sets of provisions with domestic as well as foreign significance, i.e., the accumulated earnings tax[8] and the personal holding company provisions.[9] Some of these foreign oriented provisions sought to deny deferral of United States taxation with regard to undistributed earnings of foreign corporations,[10] while others sought to convert what would have otherwise been capital gain into ordinary income at the time of an actual or deemed sale or exchange of the shares in the foreign corporation.[11] Some of the provisions reached beyond passive income and were applicable to income from related persons[12] or even to income from any source, i.e., whether from active or passive sources or from related or unrelated persons.[13] Nevertheless, none of these provisions sought to reverse or modify the general deferral rule for undistributed income of foreign corporations unless United States shareholders or United States persons in the aggregate had a controlling interest, or at least a 50 percent interest in the foreign corporation.[14]

The provision of the pre-1986 Act that was most specifically directed against minority shareholders in investment companies is section 1246. This section was enacted in 1962 and, in general, it converts capital gain into ordinary income on the sale or exchange of stock of a foreign investment company. However, the definition of a foreign investment company was and is restricted to a foreign corporation engaged primarily in investing in securities or commodities[15] and, most importantly, requires at least a 50 percent stock ownership, by vote or value, to be held by United States persons. Since the definition of a United States person,[16] unlike United States shareholders,[17] does not require the ownership of minimum share interest, section 1246 could and did apply if 50 percent or more of the stock of the foreign investment company was owned by United States citizens and residents, even if none of such United States persons held a sufficient stock ownership to have any influence over the foreign corporation or its investment policy. However, section 1246 never has proven to be very efficacious. In 25 years, no regulations were issued and very few rulings or cases interpreted or enforced this provision.[18]

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It was known that investors organized foreign companies that met the definition of section 1246(b) except that United States persons owned somewhat less than 50 percent of the vote and the value of the outstanding shares. These foreign investment companies thus circumvented section 1246 and the other provisions noted above because all of these provisions required a greater concentration of ownership in United States citizens or residents.[19] It is understood that there was also a concern with foreign corporations that operate in a similar manner to mutual funds, but it is not clear that non-dividend paying foreign mutual funds have attracted any significant investment from United States persons who collectively are minority shareholders in such foreign incorporated mutual funds.

It is with this background that the tax-writing committees and their staffs addressed this issue in the 1986 Act.

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[3]Title XII, the 1986 Act.

[4]Where appropriate, this article will also note certain relevant points: (a) under the recently issued temporary regulations under sections 1291, 1294, 1295, and 1297, which are principally concerned with elections under those sections, and (b) under Rev. Notice 88-22 and Rev. Notice 88-31.

[5]All of these provisions are continued by the 1986 Act, usually with some modifications. Since by some counts there are five principal provisions, these have sometimes been referred to as the pentapus provisions, although this word seems to have escaped the unabridged dictionaries. For a derivation of the term, see the excellent article of Rubenfeld & Rubin, *Passive Foreign Investment Companies: The Pentapus Becomes the Sextapus, Or Does It?*, 36 *Tax Notes* 199 (1987).

[6]I.R.C. sections 551 to 558.

[7]I.R.C. sections 951 to 964.

[8]I.R.C. sections 531 to 537. Commentators on U.S. taxation of foreign operation "love" to stress the importance of the applicability of the AET to foreign entities, but practical experience suggests that revenue agents have very rarely given any consideration to these provisions in the foreign context.

[9]I.R.C. sections 541 to 547.

[10]I.R.C. sections 951-964 (subpart F), I.R.C. sections 551-558 (foreign personal holding company), and I.R.C. section 1247.

[11]I.R.C. sections 1246 and 1248.

[12]I.R.C. sections 951-964 (subpart F).

[13]I.R.C. section 1248.

[14]*Compare* I.R.C. section 552 *with* I.R.C. sections 951(b), 957, *and* I.R.C. section 1248(a)(2) *with* I.R.C. section 1246(b).

[15]I.R.C. section 1246(b)—this included certain foreign corporations registered under the Investment Company Act of 1940.

[16]I.R.C. section 7701(a)(3).

[17]I.R.C. section 951(b).

[18]In fact, no significant cases or rulings can be cited.

[19]Section 551(a)(2) requires five or fewer individuals who are U.S. citizens or residents to own more than 50 percent of the value or vote of the stock of the foreign corporation while the other foreign provisions (e.g., subpart F and section 1248) require control in U.S. shareholders (e.g., 10 percent or greater shareholders).

The committee reports[20] state three interrelated policies to support the new PFIC provisions. First, the United States tax rules should not effectively operate to provide United States investors tax incentives to make investments outside the United States rather than inside the United States. Since current taxation generally is required for passive investment in the United States, the United States persons who invest in passive assets should not avoid the economic equivalent of current taxation merely because they invest in those assets indirectly through a foreign corporation. Second, the nationality of the owners of the controlling interest in a foreign corporation should not necessarily determine the United States tax treatment of its United States owners. Third, United States persons who invest in passive assets through a foreign corporation have tax advantages *vis-a-vis* United States investors in domestic investment companies because they would be able to convert income that would be ordinary income if received directly or received from a domestic investment company into capital gain income. The soundness of these three interrelated policy points will be analyzed in Part IV, *infra*, but first we must consider how the legislation operates to implement these policies.

II. The PFIC Rules Under the 1986 Act

The PFIC rules are in part VI of subchapter P (sections 1291 to 1297) and are divided into three subparts: the definition of a PFIC, the taxation of shareholders of a nonqualified electing fund and the taxation of shareholders of a qualified electing fund.

A. Definition of a PFIC

Any company which meets only two requirements is a PFIC. First, the company must be a foreign corporation.[21] Second, the corporation must have *either* 75 percent or more of its annual gross income from passive income *or* at least 50 percent of the assets produced, or are held for the production of, passive income. The nationality or concentration of the shareholders is immaterial. A German corporation which meets either the passive income or passive asset test is a PFIC even if all of its shares are owned by Germans, none of whom owns more than a nominal percentage of the outstanding shares. The source of income is immaterial. A United Kingdom corporation with a permanent establishment in the United States whose only asset is a $10,000 United States Treasury note is a PFIC.

This broad and relatively straightforward definition of a PFIC in section 1296(a) gives way, however, to various statutory exceptions[22] and several questions of interpretation. Considering first the PFIC definition itself in section 1296(a), it would seem that only in rare circumstances will the 75 percent income test be relevant. Since this income test is measured by gross income and since nonpassive assets will normally earn a higher amount of gross income than passive assets of comparable value,[23] it would be unusual for a foreign corporation to earn 75 percent or more of its gross income from less than 50 percent of its assets. In fact, there are serious questions whether the 75 percent income test will only produce unintended and harsh results in those cases in which it is met but the 50 percent asset test is not met.

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For example, foreign corporation X has been engaged throughout its history in manufacturing and selling steel. Ninety-nine percent of its assets are solely devoted to its steel business. X has the balance of its assets in an unrelated portfolio of shares of publicly held companies. In 1988, X's steel business operates at a net loss and generates zero gross income from such business. However, it receives a minor amount of gross income in dividends from its portfolio of unrelated securities. Apparently, X is a PFIC in 1988 and, except as developed below, its shareholders will be taxed as shareholders in a PFIC in every subsequent year.

The potential reach of the gross income percentage test can be illustrated by other examples. Foreign corporation Y has substantially all of its assets in an active service business but also owns unrelated real estate which was acquired as a passive investment. In 1988, Y's business is slow so it decides to sell its real estate to bolster annual profits. The gain from the sale of this real estate is 75 percent or more of annual gross income even though the value of the real property is substantially less than 50 percent of value of the Y's assets.

As one reflects on these two alternative percentage tests, it is difficult to see realistic situations in which the stated policies underlying the PFIC rules should apply to a foreign corporation that meets the 75 percent gross income test but does not meet the 50 percent asset test.

The asset test also raises a number of problems. The 1986 Act bases this test solely on the value of the assets.[24] Many assets are difficult to value and valuations are subject to almost unlimited factual and judgmental dis-

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[20]House Ways and Means Committee, Tax Reform Act of 1985, H. Rep. No. 426, 99th Cong., 1st Sess. 406-12 (1985); Senate Comm. on Finance, Tax Reform Act of 1986, S. Rep. No. 313, 99th Cong., 2d Sess. 392-99 (1986); Conference Comm., Tax Reform Act of 1986, Conf. Rep. No. 841, 99th Cong., 2d Sess. II640-45 (1986); Staff of Joint Comm. on Taxation, General Explanation of the Tax Reform Act of 1986, 1021-34 (Jt. Comm. Print 1987) [hereinafter General Explanation].

[21]See. Rev. Rul. 88-8 for the point that an entity considered to be a corporation under foreign law may not be a foreign corporation under the governing United States tax principles.

[22]I.R.C. sections 1296(b)(2), (c), (d), 1297(b)(2), (b)(3).

[23]This is generally so because a greater amount of costs (over and above cost of goods sold) is associated with earning active income rather than passive income so that, if the net return is to be equal from passive and active assets of equal value, the gross income from active assets will be higher.

[24]While the TCA would introduce the alternative of adjusted basis, many foreign corporations may need to or wish to rely on value.

putes.[25] In addition, one must calculate the average annual percentage where unexpected upturns or downturns in values could dramatically alter reasonable expectations. While these problems of valuing assets are often found in the United States tax law,[26] here the issue of valuation is not one of degree but of PFIC or non-PFIC status. A foreign corporation may conclude that it does not meet the 50 percent asset test but then finds that it is challenged by the Internal Revenue Service when it is too late to make the election to be a qualified electing fund.[27] Furthermore, if a foreign corporation fails the asset test for any year, its shareholders may well remain subject to the PFIC regime for all later years even though the corporation never again fails either test.

The definition of passive income under the 1986 Act[28] has the meaning given such term by section 904(d)(2)(A) without regard to the four exceptions of clause (iii) thereof. Section 904(d)(2)(A) defines passive income as foreign personal holding company income as defined in section 954(c), plus any amount included in gross income under section 551 or section 1293.[29] This is a much broader definition of investment income than is found in section 1246(b) which only applies to foreign corporations engaged primarily in the business of investing, reinvesting, or trading in securities, commodities or interests in securities or commodities. The definition of passive income of PFICs under the Act includes rents, royalties, gains from the sale of real estate, and personal service contracts which are not covered under section 1246(b).

[25]Rev. Notice 88-22 addresses several issues concerning the asset test, including the following points. The asset test will be applied on a gross basis and no liabilities, including secured loans, will be taken into consideration; a section 1231(b) asset will be considered to be a nonpassive asset; incidental interest received on business receivables will not change the nonpassive character of such receivables; intangible assets will be considered as assets in applying the asset test; cash and other working capital will be treated as passive assets; and tax-exempt securities generally will be treated as passive assets. The last two provisions are very difficult to support under the statute or the reasoning presented; treating working capital as a passive asset seems to be in conflict with the stated policy support for considering tax-exempt securities to be passive assets. On the other hand, the gross asset approach may offer a means for avoiding PFIC status to a foreign corporation that now has only passive assets and income if such corporation undertakes a highly leveraged purchase of an active business.

[26]E.g., Chapter 11 (estate tax), Chapter 12 (gift tax), Chapter 13 (generation-skipping transfer tax), and section 170 (charitable contributions).

[27]Section 1295(b)(2) requires an election before the 15th day of the third month of the following year and the temporary regulations offer no help in this area. However, in a special transition rule, Notice 88-31 allows the shareholder of a PFIC the opportunity to elect QEF status on behalf of the PFIC by the appropriate date provided the foreign corporation ratifies such election on or before December 15, 1988.

[28]*See* discussion below of the restriction of this definition under the TCA.

[29]In view of the proposed cutback in this definition by the TCA, there is no need to discuss some of the technical problems in this definition such as the circular reference to section 1293.

While stated in various ways in sections 1296 and 1297, there are in substance six separate exceptions from PFIC status for foreign corporations which meet either the asset test or the income test of section 1296(a). The first two are structured as exceptions to the definition of passive income for passive income derived in the active conduct of banking or insurance businesses. The banking exception requires that the foreign corporation be licensed to do business as a bank in the United States, although the Secretary is given authority to broaden this exception in regulations, presumably to allow certain foreign licensed banks to avoid PFIC status. There is no requirement that there be any United States nexus in the insurance company exception. Both of these exceptions are subject to regulatory authority to restrict these exceptions to income derived by bona fide banks and insurance companies where it is necessary to prevent United States persons from earning what is essentially investment income in a tax deferred entity. The Joint Committee General Explanation lists various examples, none of which seem to be exceptions to bona fide banks and insurance companies but rather situations in which the entity is not operating as bona fide bank or insurance company.[30]

There are in substance six separate exceptions from PFIC status for foreign corporations. . . .

Sections 1297(b)(2) and (3) provide two exceptions which are so narrowly drawn that they are not likely to be of much practicality. The first provides an exception for the start-up year of a foreign corporation. Such a corporation will not be a PFIC for the first year in which it has gross income provided no predecessor of such corporation was a PFIC, the corporation establishes to the satisfaction of the Secretary that it will not be a PFIC in either of the next two years and the corporation is not a PFIC in either of such two succeeding years. The other provides a one-year exception to the PFIC rules for a foreign corporation which has sold one or more active businesses and has passive income from temporarily reinvesting the proceeds of such a sale or sales. Again, the foreign corporation must not have been a PFIC in any earlier year, must establish to the satisfaction of the Secretary that its passive income is from the investment of proceeds from the disposition of an active business and that such corporation will not be a PFIC in either of the next two years, and the foreign corporation is not a PFIC in either of the next two years. One wonders under what circumstances a foreign corporation will be unable to convince the Secretary prospectively that it will not be a PFIC in the two succeeding years and thus fail section 1297(b)(2)(B) or section 1297(b)(3)(B)(ii) even though the corporation meets the separate requirement of section 1297(b)(2)(C) and section 1297(b)(3)(C) that it is not a PFIC in either of such two succeeding years.

These two limited exceptions for a start-up year and a change in business might be of some greater vitality if these provisions allowed exceptions for two or more years. Actually, such a broader scope can be read into

[30]General Explanation, *supra* note 20, at 1025-26.

the existing statutory language of the transition exception (section 1297(b)(3)). However, the legislative history seems to interpret each of these exceptions as limited to a single year.[31]

The fifth statutory exception also is likely to have very little practical relevance. This is the exception for any foreign investment company to which section 1247 applies.[32]

By far the most important exception...is the look-through rule of section 1296(c).

By far the most important exception, if it can be correctly viewed as an exception, is the look-through[33] rule of section 1296(c). For PFIC purposes, if a foreign corporation owns at least 25 percent (by value) of the stock of another foreign or domestic corporation, such shareholder foreign corporation will be treated as owning its proportional share of the assets and income of the corporation in which it holds such share interest.[34] The legislative history makes it clear that the value of the shares held by a foreign corporation holding shares in a second foreign corporation, and the income received from such second corporation, will be ignored in applying the percentage test of section 1296(a) to the first foreign corporation. This look-through rule can readily lead to a foreign corporation being or not being a PFIC even though the opposite result would be reached in the absence of the look-through rule. For example, a first-tier foreign subsidiary of a United States operating company which is a holding company owning all the shares of foreign operating corporations incorporated in other countries, avoids PFIC status only by the look-through rules.[35] On the other hand, an Irish manufacturing subsidiary of a United States parent corporation, which has no passive income of its own, may be a PFIC if it has placed a large enough amount of passive assets into its Bermuda subsidiary.

It is important to note that the look-through rules are somewhat of a one-way street. A second-tier foreign corporation cannot avoid PFIC status by looking through to its foreign parent. While a first-tier holding company of one or more foreign operating subsidiaries will not be a PFIC because of the look-through rule, a foreign second-tier subsidiary meeting either of the section 1296(a) asset or income tests will be a PFIC, and its stock will be attributed to the United States parent, even though there would be no problems under the PFIC rules if the first-tier foreign corporation had held such passive assets directly rather than through a subsidiary.

In determining whether a United States person is a shareholder in a PFIC, PFIC shares held by a corporation will be proportionately attributed to any United States persons who control 50 percent or more in value of the stock of such corporation. Furthermore, if such corporation is itself a PFIC, shares held by it are proportionately attributed to its shareholders who are United States persons without regard to the 50 percent limitation. Also, PFIC shares held by a partnership, trust or estate are proportionately attributed to its partners or beneficiaries.[36] There is no specific family attribution rule, so, subject to the Secretary's broad regulatory authority and general principles of tax law, PFIC shares held by a person who is not a United States person would not be attributed to a spouse, child, or other family member who is a United States person.

The look-through rules are somewhat of a one-way street.

As noted above, if a foreign corporation is a PFIC for any year during a shareholder's ownership of shares in such foreign corporation, the foreign corporation is considered to be a PFIC for every year in which the stock is held by such shareholder, unless the shareholder makes an election to recognize gain effective as of the last day of the last taxable year for which the foreign company was a PFIC.[37] This election is to be made under rules similar to the rules of section 1291(d)(2) for making a somewhat comparable election, which is discussed below. Since a shareholder will frequently not know which will be the last year of PFIC status until long after the end of such year, often not until several years later when this issue is raised on audit, the temporary regulations quite appropriately allow this election to be made at any time within three years of the due date, as extended, for the shareholder's tax return for such taxable year.[38]

B. Shareholders of a Nonqualified Fund

If a foreign corporation is a PFIC under the rules explained above and such corporation has not elected qualified electing fund status, its shareholders who are United States persons are subject to a very harsh tax regime. Although the taxation of the undistributed income of the PFIC is deferred until there is an excess distribution, there are several adverse tax consequences that attend an excess distribution which would not apply to a normal distribution from a foreign corporation to its United States shareholders. In general terms these adverse consequences are: (1) an excess distribution is tax-

[31] *Id.* at 1026.

[32] Section 1247 requires that an election was made on or before December 31, *1962*. There are very few, if any, companies to which section 1247 applies.

[33] The statute spells through as "thru."

[34] According to Rev. Notice 88-22, the regulation will provide that the look-through rules of section 904(d)(3) and the regulations issued under that section and section 904(d)(5) will apply to characterize payments received or accrued by foreign corporations from related controlled foreign corporations and certain related U.S. corporations.

[35] If the second-tier operating subsidiaries are in the same country as the operating company, dividends and interest from such second-tier would be excluded from passive income under section 954(c)(3) and section 552(c). *See*, however, note 54.

[36] Section 1297(a)(4) provides that stock owned by a person under the specific attribution rules shall be considered as actually owned for reattribution purposes.

[37] I.R.C. section 1297(b)(1).

[38] Temp. Reg. section 1.297-3T(b)(1).

able even though it exceeds the earnings and profits of the PFIC; (2) an interest charge is imposed on income allocated to PFIC years to offset the deferral benefits; (3) taxation of the deferred tax amount at the highest statutory rates for the years involved regardless of the taxpayer's actual tax bracket during such years; (4) a denial of any capital gain benefits; (5) the denial of a basis adjustment at death and under some other circumstances; (6) denial of tax-free exchange benefits and other nonrecognition rules; and (7) a denial of section 902 credits.[39]

An excess distribution...need not be from earnings and profits of the distributor.

Technically these results flow initially from the definition of excess distributions in section 1291(b) and the operational rules of section 1291(a). An excess distribution is a distribution from total excess distributions and need not be from earnings and profits of the distributor. Total excess distribution is the amount, if any, of distributions received by the taxpayer during the current year which is in excess of 125 percent of the average amount received in respect of such stock by the taxpayer during the three preceding taxable years (or, if shorter, during the taxpayer's holding period prior to the current year). Obviously, if a PFIC makes distributions of constant amounts, or gradually increasing amounts, to its shareholders, there will be no excess distributions.[40] In such cases the PFIC provisions will have no consequences for shareholders of a nonqualified electing fund PFIC and the normal rules will apply to such nonexcess distributions. In defining and calculating excess distributions, the Secretary is given regulatory authority to prescribe rules on several practical points.[41]

If a United States person does receive an excess distribution, the amount of such excess distribution is allocated ratably to each day in the taxpayer's holding period for the stock. In the simplest of cases, a taxpayer reduces the distribution received in a given year by the amount, if any, that is not an excess distribution and then divides the remainder by the number of days he has held the shares.[42] This per-day allocation is then totaled to arrive at annual allocations throughout the taxpayer's holding period. The calculation becomes more complicated if a United States person holds shares acquired at various times, if the PFIC has made distributions during the preceding three years and/or if the PFIC has had stock distributions or undertaken corporate restructuring during the holding period of the United States shareholder.

Generally, the United States person will benefit from a short holding period and by not tacking on the holding period of his predecessor in interest. However, section 1291(a)(3) adopts the holding period definition of section 1223. This results in the holding period of a donor being attributed to the donee, so that a person may not escape the consequences of section 1291 by a gift to a family member who then disposes of the PFIC shares with only his holding period coming within the scope of section 1291. This same tracking of holding period is applicable to any transaction in which the basis of the transferee is determined in whole or in part by the basis of the transferor or by the basis of the property exchanged by the transferee so as to characterize stock received as shares of a PFIC if the shares were transferred shares in a PFIC.[43]

Under section 1291(f) the Secretary is given authority to require recognition of gain on any disposition of stock in a PFIC. The committee reports suggest a limited role for this provision, but there is no statutory limit.[44] Consequently, section 1291(f) could be considered as providing regulatory support for treating a transfer at death, any gift or any tax-free reorganization as a taxable disposition for purposes of section 1291.

C. Shareholders of a Qualified Electing Fund

If a PFIC elects under section 1295 to be a qualified electing fund (QEF), section 1291 with its severe regime of taxation is inapplicable and the shareholder of the PFIC is taxed somewhat like a shareholder of an S corporation or a mutual fund, subject to a special deferral election under section 1294. Any PFIC may make an election prior to the 15th day of the third month following the end of any of its taxable years to be a qualified electing fund. While the statute requires the election to be made by the PFIC, the Service has announced a liberal interpretation of this for 1988.[45] Note that the election must be made by the PFIC and may not be made by its shareholders. An electing PFIC must provide the Service with certain prescribed information which includes the ordinary earnings and capital gain of the PFIC for the taxable year and the outstanding stock ownership of the PFIC.[46] Each United States person who is a shareholder of an electing PFIC must include in his gross income his pro rata share of the ordinary income and the long-term capital gain for the electing year. The pro rata share is the amount which would have been distributed to the shareholder if the QEF had made daily distributions of its

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[39]The denial of section 902 credits would be reversed by TCA.

[40]Note, however, that the TCA would place some limitation on this where equal annual distributions are from past accumulations and are distributed over more than three years.

[41]I.R.C. section 1291(b)(3). These are: make excess distributions on a share-by-share basis but aggregate shares where they have the same holding period, adjust for stock splits and stock dividends, annualize for partial years, tack holding period and distributions, and adjust for distributions in foreign currency.

[42]Note this includes periods prior to the effective date of the PFIC rules.

[43]I.R.C. section 1223(1), (2).

[44]General Explanation, *supra* note 20, at 1028 (refers to gifts of PFIC stock to charity or foreign person).

[45]Rev. Notice 83-31 advised that for elections required by March 14, 1988 for taxable years ended on or before December 31, 1987, the election may be made by the U.S. shareholder of the PFIC provided the election is ratified by the PFIC no later than December 15, 1988. Similar provisions will be made for PFICs for taxable years ending before October 1, 1988.

[46]*See* Temp. Reg. section 1.1295-1T for details about the information to be provided and the need for certification from U.S. persons who own stock, directly or indirectly, in the PFIC. An election under section 1295 may not be made by a PFIC that issues any of its shares in bearer form or is otherwise unable to identify its shareholders of record. However, the temporary regulations do not require the PFIC itself to go beyond identifying its shareholders of record.

ordinary earnings and net capital gain. Appropriate adjustments are made to exclude previously taxed income, for increases in basis for taxed but undistributed income, for decreases in basis for actual distributions of previously taxed income, for the allowance of foreign tax credits to direct corporate investors, and to limit ordinary income and net capital gains to current earnings and profits.[47]

A crucial point, however, is that the consequences of section 1291 cannot be avoided simply by electing to be a QEF for the year in which the shareholder disposes of his PFIC shares. Section 1291(d), which coordinates the interrelationship of the taxation of shareholders of qualified and nonqualified PFICs, requires with respect to dispositions[48] that the PFIC have been a QEF for each year in which it was a PFIC that includes any portion of the particular shareholder's holding period in order to avoid nonqualified consequences for the shareholder on the disposition of his PFIC shares. Section 1291(d)(2) allows a PFIC shareholder to elect to recognize gain at the beginning of the year in which the PFIC first becomes a QEF.[49] Such gain is taxed under section 1291 as though the shareholder had sold his shares on such date at their fair market value. In beneficial consequence, his basis is increased by the amount of the gain and he receives a new holding period. Thus, section 1291(d) provides a mechanism, albeit costly, for a PFIC shareholder to purge himself (itself) of future section 1291 consequences once the PFIC has made a qualified election under section 1295(b).

The consequences of section 1291 cannot be avoided simply by electing to be a QEF [in the year of disposition]. . . .

Finally, the shareholder of a qualified PFIC is provided a separate election under section 1294 to extend the time for payment of taxes on undistributed income.[50] While not expressly covered in section 1294, since this is an extension of the time of payment, presumably the normal rules for extensions apply and the legislative history expressly states this includes the payment of interest.[51] Only the tax on the undistributed earnings of the PFIC is deferred and this deferral is terminated if the shareholder receives a distribution of previously undistributed income, the shareholder disposes of his shares,[52] or the PFIC ceases to be a QEF.

[47]I.R.C. sections 1293(c), (d), (e), (f).

[48]And under the TCA for distributions also.

[49]*See* Temp. Reg. section 1.1291-10T for details. As under section 1297(b), the temporary regulations permit this election to be made within three years of the due date of the return for the taxable year which includes the qualification date.

[50]*See* Temp. Reg. section 1.1294-1T for details.

[51]General Explanation, *supra* note 20, at 1029.

[52]Including nontaxable dispositions or dispositions at death. General Explanation, *id.* at 1029.

D. Coordination With Related Provisions

The 1986 Act provides an incomplete statutory correlation of the PFIC rules with overlapping and related provisions. The rules in the 1986 Act would be modified and supplemented by the TCA. However, the coordination under the 1986 Act is as follows:

1. As noted above, any foreign investment company which has elected to be covered by section 1247 is not a PFIC.
2. The PFIC rules govern in any case in which any foreign company which also might be covered under section 1246.
3. Section 551 (foreign personal holding company) shall govern when it overlaps with section 1293, but there is no coordination between sections 551 and section 1291.
4. Section 531 (accumulated earnings tax) does not apply to a PFIC.
5. Section 541 (personal holding company tax) does not apply to a PFIC.
6. If amounts would be includable under section 1293 and subpart F, the latter controls.

III. The Technical Corrections Act

The TCA would enact an extraordinarily large number of revisions in the PFIC rules.[53] While some are indeed technical corrections and, therefore, are not discussed in this article, others are revisions of substance. Although there is a probability that most of these changes will be enacted, it now appears there will be a delay of many months before the TCA becomes law, so there is a prospect that the proposed revisions could undergo changes before enactment, particularly as the Treasury and Hill staffs reevaluate the PFIC provisions of the 1986 Act.

The discussion of the significant TCA amendments is divided into the same four categories as are presented above in describing the PFIC provisions of the 1986 Act.

A. Definition of a PFIC

Under the 1986 Act, passive income is defined by a cross reference to section 904(d)(2)(A) which, in turn, incorporates all passive income as defined under section 954(c), section 551, and/or section 1293. The cross reference in the 1986 Act to section 954(c) incorporated and made available the exception under section 954(c)(3). While the 1986 Act also includes section 551 in defining passive income for purposes of section 1296(b)(1), since 1984 the foreign personal holding company provisions have had an exception similar to section 954(c)(3).[54]

Under the TCA the definition of passive income in section 1296(b)(1) would be restricted to foreign personal holding company income as defined under section 954(c), but without the benefit of the exception in section 954 (c)(3) for dividends, interest, rents, and royalties received from a related company operating in the same country.[55] This proposed modification of the 1986 Act would exclude

[53]This article does not reflect those additional TCA changes proposed for the first time in the TCA introduced on March 31, 1988. However, while the additional time for certain elections under section 1295(b)(2) is commendable, these limited additional proposed changes do not address the criticisms presented herein.

[54]I.R.C. section 552(c).

[55]H.R. 3545, 100th Cong., 1st Sess. section 10212(p)(5) (1987).

from the definition of passive income certain types of foreign personal holding company income such as income from estates and trusts, from personal service contracts, and from the use of corporate property by shareholders. It would also eliminate certain ambiguities.

The proposed elimination of the exception of section 954(c)(3) is not a proposed expansion of the definition of passive income, but rather a part of a legislative revision that would narrow the definition of passive income to the extent such income is from related sources. The section 954(c)(3) exception applies only where the related payor company is organized in the same country as the payee. The TCA would provide a broader exception than section 954(c)(3) for interest, rents, and royalties received from a related person by a proposed addition of a third exception in section 1296(b)(2).[56] This would exempt interest, rents, and royalties received from a related person (as defined in section 954(d)(3)) wherever such person is located to the extent such amount is properly allocated to income of such related person which is not passive income, subject to regulations to be prescribed by the Secretary. While this proposed provision does not apply to dividends, to the extent that a PFIC owns 25 percent or more stock interest in the related payor, these dividends would be eliminated from passive income by the operation of the previously discussed look-through rules of section 1296(c).

[TCA] would narrow the definition of passive income to the extent such income is from related sources.

In addition, the TCA would make two amendments to the look-through rules. One would treat stock of certain United States corporations as an active asset when such stock is owned by another United States corporation which is itself 25 percent or more owned by a foreign corporation, provided the second-tier United States corporations are C corporations and the foreign corporation is subject to section 531 liability.[57] Thus, if foreign corporation X owns 25 percent of the share value of United States corporation Y which holds a portfolio of shares in United States C corporations,[58] under the look-through rule the foreign corporation will be regarded as having a 25 percent interest in nonpassive assets and nonpassive income from its share ownership of the first-tier United States corporation, provided the foreign corporation is not exempt by treaty or otherwise from section 531 liability. This is intended to provide comparable treatment to ownership in a United States investment corporation. It is difficult to evaluate the practical significance of this proposal, but it may offer some planning possibilities and certainly avoids an inequity.

The other modification is to include indirect as well as direct ownership in applying the 25 percent stock ownership requirement.[59]

In addition to changes in the definition of passive income and the operation of the look-through rules, the TCA would make two major changes in the PFIC definitional rules. Under the 1986 Act the 50 percent asset test of section 1296(a)(2) is based on value. The TCA would offer an election to use adjusted basis rather than value.[60] This would avoid most of the problems discussed above with regard to the value standard. It could also open up some opportunities for foreign corporations with investment assets that have current fair market values well in excess of the adjusted basis of such assets to avoid PFIC status by purchasing active assets or a 25 percent or greater stock interest in a corporation engaged in an active business. In essence, this permits avoiding the 50 percent asset test by juxtaposing historical cost basis with current purchases.

In support of language in the 1986 Act legislative history, the TCA would provide that if a United States person is deemed to be a PFIC shareholder under the attribution rules of section 1297(a), upon any disposition by the person actually owning the PFIC shares that results in such United States person being treated as no longer owning such shares, or upon any distribution of property from the actual PFIC owner to such United States person, such disposition or distribution, as the case may be, shall be treated either as a disposition of the PFIC shares by such United States person or as a distribution from the actual PFIC shareholder to such United States person with respect to the PFIC shares.[61] The Secretary is authorized through regulations to provide rules similar to those under section 959(b) (and also to section 1293(a)) to avoid double taxation. Regulations under this proposed delegation are likely to be extensive and complicated.

Finally, the TCA would expand the attribution rules to treat an option to acquire shares as actual ownership under the section 1297(a) attribution rules.[62]

B. Shareholders of a Nonqualified Fund

The TCA would further penalize the United States person who is a shareholder of a nonqualified PFIC, while providing some ameliorating changes. Most importantly, the TCA would repeal section 1291(f) of the 1986 Act which provides that, to the extent provided by regulations, gain shall be recognized on disposition and replace it with a broader and more forceful rule. The new section 1291(f) would authorize regulations providing that gain shall be recognized on any transfer of PFIC shares which would not otherwise be fully recognized, notwithstanding any statutory provision to the contrary, to the extent that the fair market value of the stock exceeds its adjusted basis at the time of such transfer.[63] This addition is clearly intended to tax the gain on transfers of PFIC shares at death, but it would be equally applicable to transfers by gift and nontaxable reorganizations. Thus, if a PFIC that

[56] *Id.* section 10212(p)(26).
[57] *Id.* section 10212(p)(24).
[58] The C corporation may not be a RIC or a REIT. On a separate point, it is not clear why the statutory language needs to require a C corporation since a corporation cannot be a shareholder in an S corporation in any event.

[59] H.R. 3545, *supra* note 54, section 10212(p)(2). *See* Rev. Notice 88-22, which so provides under the 1986 Act.
[60] *Id.* section 10212(p)(27).
[61] *Id.* section 10212(p)(17).
[62] *Id.* section 10212(p)(10).
[63] *Id.* section 10212(p)(6)(A).

is incorporated in Country X adopts a new situs in Country Y with no change in assets or shareholders, that transaction would cause a taxable disposition for a shareholder of a nonqualified PFIC under the regime of section 1291 unless the regulations provided some relief.

Section 1291(d)(1) would be amended to apply the same restrictive rules to distributions as applies to dispositions under the 1986 Act in coordinating section 1291 and section 1293.[64] Thus, a shareholder of a QEF who receives a distribution from a PFIC would still be taxed as a shareholder in a nonqualified PFIC unless (1) the PFIC was a QEF for each year beginning after December 31, 1986 and for each year that includes any portion of the taxpayer's holding period, or (2) the shareholder has elected to recognize under section 1291(d)(2). The net result is to apply the same rules to distributions and dispositions.

The definition of excess distribution would be modified to exclude from the three preceding years any excess distributions received in such years which were deferred tax amounts and thus subject to interest charges.[65] This is considered necessary to block the avoidance of interest charges by distributing accumulated earnings of a PFIC over more than three years to avoid the interest charge in the fourth and later years.

While it is certainly reasonable to limit taxation of a PFIC shareholder to his share of applicable earnings and profits, it is difficult to understand why this relief should be limited to United States shareholders in controlled foreign corporations.

One ameliorating provision relates to a corporate shareholder of a nonqualifying PFIC who owns 10 percent or more of the shares. The denial of the section 902 credit to such shareholders would be repealed.[66] Under another, if a PFIC is a controlled foreign corporation under section 957(a) and the taxpayer is a United States shareholder under section 951(b), such a shareholder may make an election, when the PFIC becomes a qualified electing fund, to include in gross income as a dividend its portion of post-1986 accumulated earnings and profits during the period the foreign corporation was a PFIC.[67]

Under this latter proposed modification, instead of recognizing the entire gain in the value of stock, a United States shareholder in a controlled foreign corporation that is a PFIC and becomes a QEF can include in gross income as a dividend its share of the PFIC post-1986 earnings and profits since the corporation was a PFIC. While it is certainly reasonable to limit taxation of a PFIC shareholder to his share of applicable earnings and profits, it is difficult to understand why this relief should be limited to United States shareholders in controlled foreign corporations.

[64] *Id.* section 10212(p)(1).
[65] *Id.* section 10212(p)(13).
[66] *Id.* section 10212(p)(7).
[67] *Id.* section 10212(p)(28).

C. Shareholders of a Qualified Electing Fund

The substantive changes in this area are limited, but again would provide certain benefits only to United States shareholders of controlled foreign corporations. In such case, only for section 904(d) purposes, the income of a PFIC would not automatically be treated as passive for foreign tax credit limitation purposes as it is under the 1986 Act.[68] Other benefits are provided for United States shareholders of controlled foreign corporations by appropriately excluding from section 1248 amounts already taxed under section 1293.[69]

The definition of earnings and profits of a QEF would be determined without regard to sections 312(h)(4) (LIFO), (h)(5) (installment sales), and (h)(6) (completed contract method). This only affects earnings and profits for income inclusion purposes under the PFIC rules and not for other purposes such as whether a distribution is a dividend.[70]

Various clarifications are made to emphasize that any transfer, including transfers by gifts, are transfers terminating the election to defer under section 1294. In addition, a provision would be added treating any loan to a shareholder from a qualified PFIC as a distribution to the shareholder.

D. Coordination With Related Provisions

The TCA would make two further helpful modifications. Proper adjustment would be made by regulation to avoid double taxation under section 1291 for amounts previously taxed under section 551, subpart F, or section 1293.[71] Also, as noted above, amounts included in income under section 1293 are excluded under section 1248.[72]

IV. Evaluation of the PFIC Provisions

In evaluating the PFIC provisions, it is assumed that the proposed TCA changes will be adopted. Certainly, the starting point for this evaluation is a consideration of the basic policy goals stated in the legislative history. While these are mentioned at the beginning of this article, it is useful to restate these policies:

(1) Congress did not believe that tax rules should effectively operate to provide United States investors tax incentives to make investments outside the United States rather than inside the United States;

(2) Congress believed that the nationality of the owners of the controlling interests should not determine the United States tax treatment of its United States owners; and

(3) Congress believed current taxation was more appropriate than continuation of deferral of tax on income derived from passive assets.

A threshold question with regard to the first stated policy is whether there is an incentive under United States tax rules (absent the PFIC provisions) to invest outside the United States rather than inside the United States. The answer to this question is not clear at all. The United States now has one of the most favorable individual and corporate tax rate structures among developed countries. Most investment in a developed country is

[68] *Id.* section 10212(p)(11).
[69] *Id.* section 10212(p)(19).
[70] S. Rep. No. 100-76, 100th Cong., 1st Sess. 523-24 (1987).
[71] H.R. 3545, *supra* note 54, section 10212(p)(3).
[72] *Id.* section 10212(p)(19).

likely to be taxed at a higher marginal rate than a comparable investment in the United States. While one might invest in a low tax rate undeveloped country, or even under certain structures in developed countries where there is no or little income tax on such structures, investment opportunities in such circumstances usually are limited and subject to far greater economic risk. To bring into play this first policy point, the United States investor's investment in a PFIC must provide little or no dividends and be held as a long-term investment. This is in sharp contrast with most United States mutual funds which may be viewed as a typical alternative to investment in a PFIC.

The stated policy reasons for the PFIC provisions do not provide logical or coherent support for such far-reaching and precedent-setting legislation.

The PFIC legislation specifically targets foreign investment companies that hold portfolio investments in stocks or interest-bearing securities. It is true that if a United States person directly purchased a pro rata portion of such securities, he would be taxed currently on any interest and dividend distributions and on gain from dispositions of such securities. However, much of the same benefits could be attained by investment in high-growth shares of corporations that pay little or no dividends.

With respect to the second stated policy, the PFIC provisions are the first time Congress has adopted a policy that the nationality of the owners of the controlling interests should not determine the United States tax treatment of its United States owners.[73] It is this policy that is most subject to challenge. If this is sound policy, why should it not apply equally to subpart F, section 1248, and the foreign personal holding company provisions? Subpart F and FPHC provisions are also concerned with passive income, but only apply where United States persons collectively hold a controlling interest. In the absence of control, United States investors lack the ability to determine investment policy, elect officers and directors, decide dividend policy, make tax elections, and exercise all other aspects of control. The minority investor in a PFIC has a number of nontax disadvantages that will normally offset the perceived tax advantages of deferral under the pre-1986 Act regime. These disadvantages include loss of control over investment policy, lack of liquidity, risks of currency fluctuations, adverse changes in foreign taxes, and potential political instability of the host country.

The problem in seeking to reach noncontrolled foreign corporations is being brought to light by certain provisions of the TCA that provide relief from the PFIC rules to United States shareholders of controlled foreign corporations. Such changes, or even total exemption of such persons from the PFIC rules, seem reasonable since United States shareholders of controlled foreign corporations are subject to current taxation on most passive income under the subpart F provisions. Yet it is absurd to impose a harsher tax regime on United States persons who own less than 10 percent of the stock of a noncontrolled foreign corporation than on those who own 100 percent of a foreign corporation. Thus, the second policy foundation for the PFIC rules, and it is this point that is the most crucial, does not seem to be well supported or consistently applied.

With regard to the third policy, while the distinction between active and passive income with respect to deferral is a traditional principle in United States taxation of foreign investments, it may be time to reexamine the basic deferral principles. Also, if there is not going to be deferral of taxation of foreign passive income, should there not be a current flow-through of losses as there would be in the case of a shareholder in a domestic S company?

In summary, the stated policy reasons for the PFIC provisions do not provide logical or coherent support for such far-reaching and precedent-setting legislation. The total revenue gains projected are $10 million in 1987, $17 million in 1988, $16 million in 1989, $18 million in 1990, and $20 million in 1991. In the context of United States fiscal policy, this is a trifling sum. It indicates that prior law did not present any significant tax benefits for this form of foreign investment. In fact, the revenue projections may indicate prior law was neutral and that the revenue raised is simply from persons who elected to invest in foreign passive investment companies for nontax reasons. Presumably a large amount of revenue would be raised if the United States taxed United States minority shareholders on their pro rata share of the undistributed income of foreign operating corporations, yet no one is suggesting that these are tax avoidance investments.

The PFIC rules seem...to assume that a distinction between capital gain and ordinary income has not been eliminated....

Even if one assumes that the stated policy reasons for the PFIC provisions have reasonable merit, this has to be weighed against the problems caused by the antidote. In my judgment the more serious problems created by the PFIC solution include:

1. The definition of a PFIC is overly broad.
2. The taxation of shareholders of a nonqualifying PFIC is not only Draconian, it is outrageous.
3. The permanent stigmatization of shareholders of a foreign corporation if the corporation is ever a PFIC (subject only to certain elections to accelerate taxes) produces unfair results that are inconsistent with the stated policy.
4. The system virtually mandates a section 1295 election (QEF), but makes it difficult to file a timely election.[74]

[73]The 1986 Act also introduces another provision where the nationality of the controlling interest is not determinative, but this is a limited situation relating to captive insurance companies. *See* section 953(c).

[74]Also, many United States investors will be unable to influence their PFIC to make a section 1295 election. Perhaps many more will simply ignore the PFIC rules by tax evasion and/or the hope that the rules will change before they dispose of their shares.

5. The reversal of long-established rules on non-recognition of gain at death and under many other situations is a serious issue that was not fully considered in this legislation.

6. The PFIC rules establish a system that is complicated and confusing for both the Service and taxpayers in response to a rather narrow problem.

The timing of the introduction of this regime is particularly odd. The major characteristics of the 1986 Act were to broaden the tax base, lower rates, and eliminate the distinction between capital gain and ordinary income. The principal tax incentive for investing outside the United States has been to defer current high rate tax and to convert ordinary income into capital gain. The 1986 Act reduced the former advantage and eliminated the latter. Many persons believe the ordinary rate of 28 percent (34 percent for corporations) offers an opportunity to accelerate current income to take advantage of these historically low rates. The PFIC rules seem to be out of phase with the basic policies of the 1986 Act. They seem to assume that a distinction between capital gain and ordinary income has not been eliminated and that United States tax rates are going up rather than down.

If there is any need to address this relatively minor problem, there must be better and simpler solutions. One would be to treat United States persons as controlling a foreign investment company for purposes of section 1246 if such persons, directly or indirectly, control the investment policy or if artificial means are used (e.g., two classes of stock) to avoid the 50 percent requirement. Another would be to tax United States persons who are shareholders in a PFIC as though they were shareholders of an S corporation or a mutual fund, with a deferral election comparable to section 1294.

There remains a prospect that Congress (in reality the applicable congressional staffs and the Treasury) will make significant additional changes in the PFIC rules, or even adopt an alternative. Revenue restraints and political considerations impose problems, but another approach seems to be essentially to correct the fundamental problems of the present PFIC provisions.

GAO REPORTS

GAO SAYS IRS COULD IMPROVE SPECIAL ENFORCEMENT PROGRAM. While convictions resulting from investigations by the Service's Special Enforcement Program (SEP) have increased, management improvements in the program could yield increased revenues, according to the General Accounting Office. The SEP, which is charged with investigations of major criminals who violate Federal tax laws, resulted in the collection of about $11 million in fiscal 1982—the last year for which complete data were available, GAO found. However, the report, prepared at the request of the Joint Committee on Taxation, found that the Service "could take steps to more actively pursue tax revenues from closed criminal cases."

The report recommended that more grand jury cases be forwarded to the Service's Examination Division for possible civil action. In addition, those cases that are referred to Examination should be assessed expeditiously. The GAO found that "Examination took an average of 14 months to assess taxes in sample cases closed in 1982, thus giving taxpayers an opportunity to dissipate assets and conceal income." In addition, the report found that the Collection Division failed to review Criminal Investigation information as required in at least three cases "before declaring about $1.3 million in tax assessments as currently uncollectible." The report further recommended that the Service improve the quality of the SEP's management information and that it provide better guidance on working with grand jury information.

The full text of the GAO report has been placed in the May 2, 1988 *Tax Notes Microfiche Database* as *Doc 88-4192.*

GAO EVALUATES ABILITY OF IRS COMPUTERS TO HANDLE 1988 WORKLOAD. IRS computers should be able to handle returns processing for the 1988 filing season, according to a recent General Accounting Office study. The study of the Service's software and mainframe computers, requested by Senate Finance Committee Chairman Lloyd Bentsen, D-Tex., was based on "computer utilization data" for the Austin, Fresno, and Ogden Service Centers and on the projection that the Service's workload would grow by 10 percent. (In 1986, it grew by six percent.) GAO assessed the mainframe computers' capacity for both weekend update processing and daily online processing.

GAO also predicted that IRS' "old communications processors should prove reliable during 1988." The Service uses these computers to support the recently installed Communications Replacement System and to process information where the new system has not been completely installed. GAO points out that although the old processors "experienced short periods of downtime in 1987, these instances did not significantly affect IRS operations."

The full text of the GAO report has been placed in the May 2, 1988 *Tax Notes Microfiche Database* as *Doc 88-4090.*