

Private Foundations Bulletin

Foreign Investments, Now What?

Private foundations across the country are at various points in their life cycle and have different approaches to their investment portfolio composition. While some foundations may have a traditional portfolio of U.S. stocks and bonds, others may have alternative investments or, in many cases, a mixture of both. Some foundations have long invested both domestically and internationally while others may be dipping their toe into the pool of “foreign investments” for the first time.

It's important for foundation managers, and especially those responsible for their tax compliance, to know what comes next with regard to tax compliance now that monies were transferred offshore. This bulletin will cover the basic considerations and items that one should be aware of when it comes to foreign investing.

Foreign Investments

We generally see foundations directly (or indirectly through onshore partnerships that, in turn, invest offshore) investing in foreign entities which are treated as either a foreign corporation or a foreign partnership for U.S. tax purposes.

General Filing Requirements

Generally, when \$100,000 or greater in cash is transferred to an offshore entity (directly or indirectly), the IRS requires information reporting on Form 926 with respect to certain foreign corporations and Form 8865 with respect to foreign partnerships. Different sections of the forms are completed based on the specifics of the transaction(s).

Another common, yet more complex, tax form related to investments in foreign corporations is the Form 5471. Some scenarios that may require this form are *very generally* summarized below:

- **Own 10%** or more of a foreign corporation;
- **Purchase** of stock of a foreign corporation and now own 10% or more of the foreign corporation's stock or combined voting power of all classes of stock with voting rights;
- **Dispose** of sufficient stock in the foreign corporation to reduce interest to less than the 10% stock ownership;
- **Control** a foreign corporation, with ownership of more than 50% of the voting power of all classes of stock OR own more than 50% of the total value of shares of all classes of stock of the foreign corporation.

If you own 10% or more of a controlled foreign corporation (CFC) – over 50% owned by U.S. shareholders who each own at least 10% – the 5471 is used to calculate foreign earnings that are potentially subject to tax (and includable on your tax return) even though you may not have received a distribution of income. This is called Subpart F income.

Foundations have two primary means of identifying the need for these more common foreign filings (926, 8865, and 5471):

1. K-1s received from limited partnership interests
 - This requires analysis of the footnotes to the K-1s much in the same way UBIT is looked for, as there are specific footnotes that have the foundation's pro rata share of an underlying

foreign investment that requires a particular foreign filing. The information should be reviewed carefully to determine if the quality of the information provided fulfills the needs of the foreign filing or if further inquiry into the fund is deemed necessary.

2. Tracking of direct foreign transfers into foreign investment vehicles

- This requires direct monitoring and ultimately correspondence with the funds themselves, their administrators and potentially analysis of their audited financial statements

Some other less common forms to note are Form 3520 with respect to report transactions with Foreign Trusts and Receipt of Foreign Gifts, and Form 3520-A with respect to Foreign Trusts with a U.S. Owner.

FinCEN Form 114

We can't talk about foreign filing requirements without also briefly discussing the FinCEN Form 114. Any person or entity (including individuals, corporations, partnerships, trusts, and estates) having a financial interest, signature or other authority over bank accounts, securities, or other financial accounts having an aggregate value exceeding \$10,000 outside the U.S. must report such a relationship. Filing requirements also apply to taxpayers that have direct or indirect control over a foreign or domestic entity with foreign financial accounts, even if the taxpayer does not have foreign account(s). Failure to disclose the required information to the U.S. Department of the Treasury may result in substantial civil and/or criminal penalties.

If you have a financial interest in any foreign account, you are responsible for providing your tax preparer with all the information necessary to prepare FinCEN Form 114 required by the U.S. Department of the Treasury. Generally, foundations find themselves filing FinCEN Form 114 due to having signatory authority over foreign checking accounts or certain types of mutual funds that constitute a foreign financial account. Typically, simply having an investment in a foreign partnership does not constitute a foreign financial account.

Non-Compliance Penalties

Monetary penalties begin at \$10,000, per form, per year, for each filing that is filed after the due date of the income tax return (including extensions). It's important to note that the foreign filings such as 5471, 926 and 8865 are generally required to be filed with an organization's Form 990-PF, or in the event the organization has a federal unrelated business income tax filing requirement, with their Form 990-T. In addition to the monetary penalties, failure to include those forms also renders the federal return incomplete. FinCen Form 114, however, is a separate tax filing with its own due date.

Contact Us

This is a complex area of the tax code which is constantly evolving. We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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