



FORM 5471: REPORTING REQUIREMENTS AFTER TAX REFORM

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FORM 5471 - TOPICS COVERED

- I. Overview and Background
- II. Filing Requirements
- III. Attribution and Control
- IV. Exceptions to Filing
- V. Penalties and Remediation

OVERVIEW AND BACKGROUND

- Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations
 - The requirements to file are established in IRC §§ 6038 and 6046.
- Form 5471 is an important IRS tool for assessing the scope of a taxpayer's foreign holdings and operations.
- The Form is also useful for keeping track of the earnings and profits of foreign corporations, determining whether an entity has undergone a taxable restructuring event or change in ownership, and determining whether a foreign entity is generating any income that may be subject to current U.S. tax under an anti-deferral regime.
 - Subpart F income, GILTI, 956, 965 deemed repatriation.

OVERVIEW AND BACKGROUND

- International Tax Enforcement
 - Global efforts to combat base erosion, hybrid instruments - BEPS, CBCR, ATAD.
 - Cooperation between tax authorities (J5)
 - Push towards global transparency – FATCA, CRS
- IRS LB&I Campaigns
 - Loose Filed Forms 5471, OVDP Declines-Withdrawals Campaign, Related Party Transactions Campaign, Repatriation via Foreign Triangular Reorganizations, Section 965 Transition Tax, Section 956 Avoidance

FILING REQUIREMENTS - FILING CATEGORIES

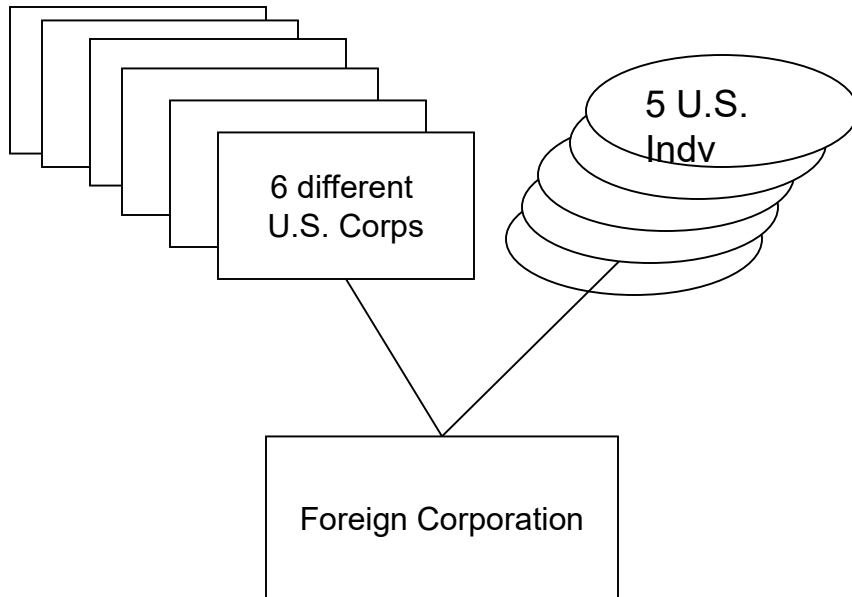
- Category 1 Filer (new) – A U.S. shareholder of a section 965 specified foreign corporation (SFC) at any during the year that also owned the stock on the last day in the year that it was an SFC.
 - SFC = a CFC or
 - FC that is not a CFC or PFIC to the extent that there is a U.S. corporate shareholder.
- Category 2 Filer is a U.S. citizen or resident who is an officer or director of a foreign corporation in which a U.S. person has acquired the requisite shares (10% vote or value) in one or more transactions.
- Category 3 Filer is a U.S. person who acquires or disposes of shares in a foreign corporation and exceeds or falls below a 10% ownership threshold, a U.S. person who acquires stock that would on its own meet the 10% threshold, or a person who becomes a U.S. person while meeting the requisite ownership requirements.

FILING REQUIREMENTS - FILING CATEGORIES

- A Category 4 Filer is a U.S. person who had “control” of a foreign corporation during the accounting period of the foreign corporation.
 - 30 day requirement is gone.
- A Category 5 Filer is a “U.S. shareholder” that owns stock in a foreign corporation that is a CFC at any time during the year (30 day requirement gone) and that owned that stock on the last day of the year in which it was a CFC.
 - A “U.S. Shareholder” is defined as a U.S. Person that owns 10% of a foreign corporation (vote or value) directly or indirectly or constructively.
 - A CFC is a foreign corporation with U.S. Shareholders that own more than 50% of the vote or value of the corporation.

EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A CFC?

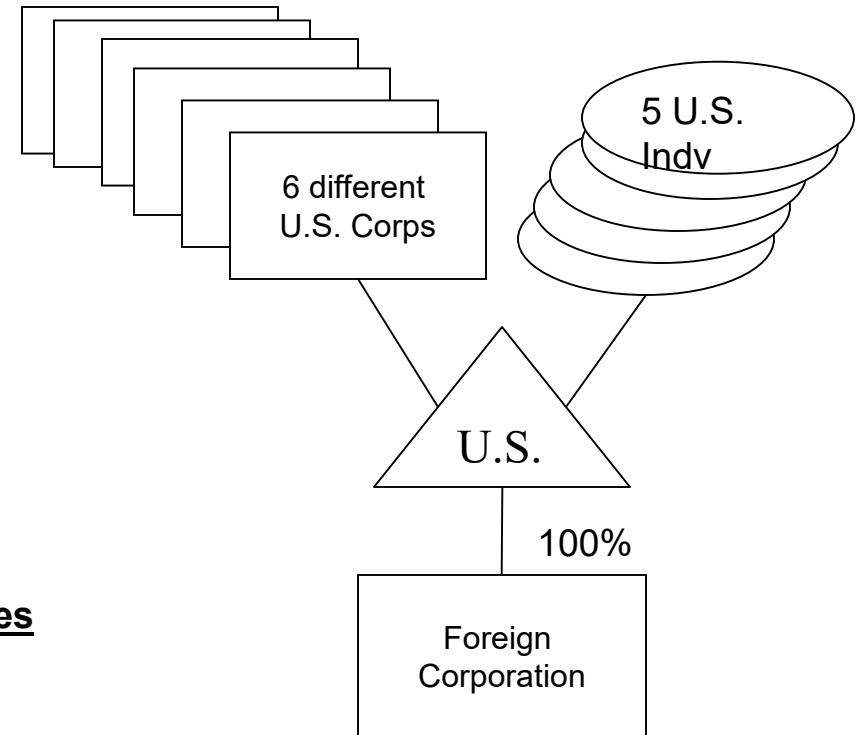
Example 1



No

There are 11 U.S. owners, each own 9.09% interest, no foreign owners. All owners are unrelated.

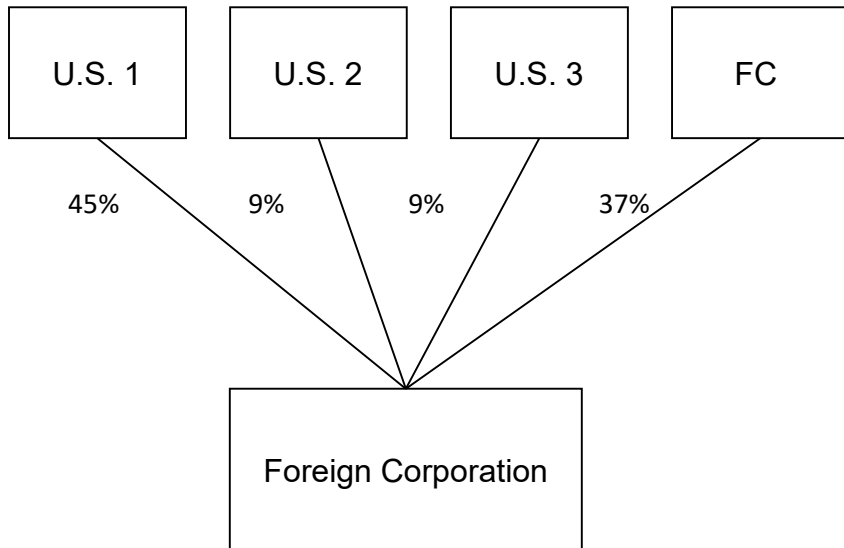
Example 2



Yes

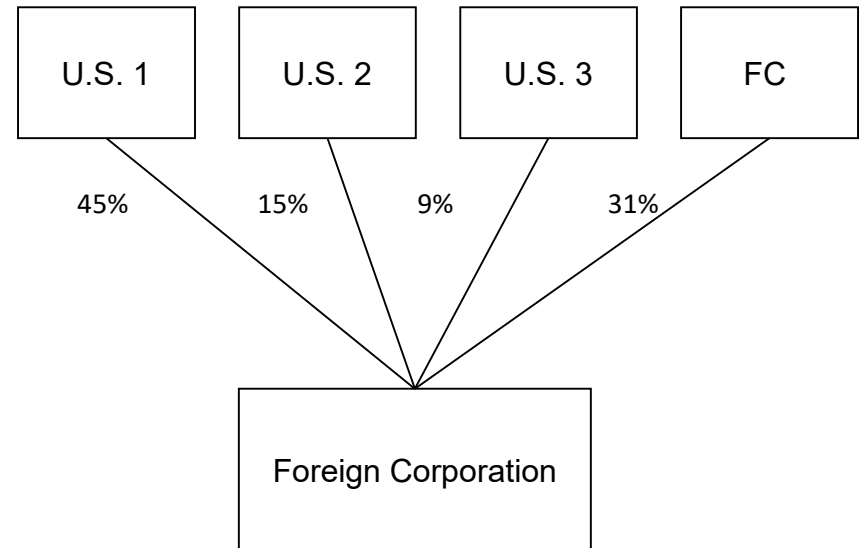
EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A CFC?

Example 3



No

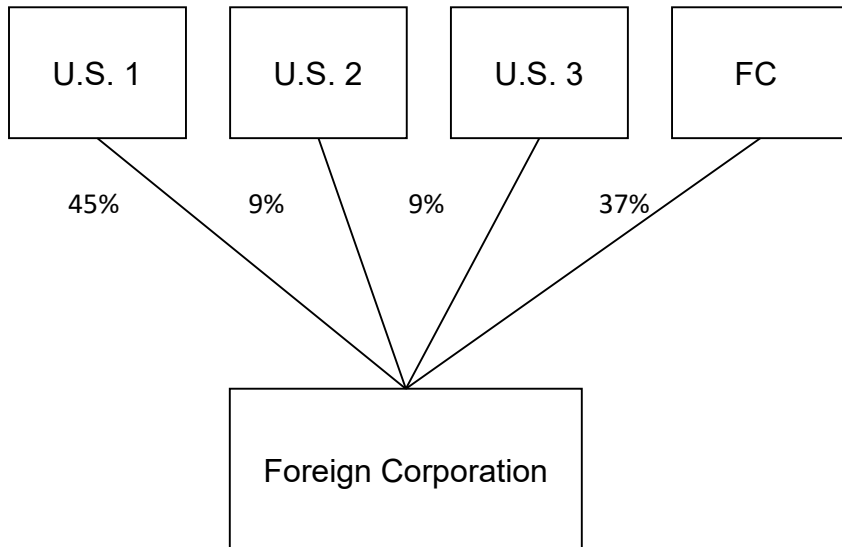
Example 4



Yes

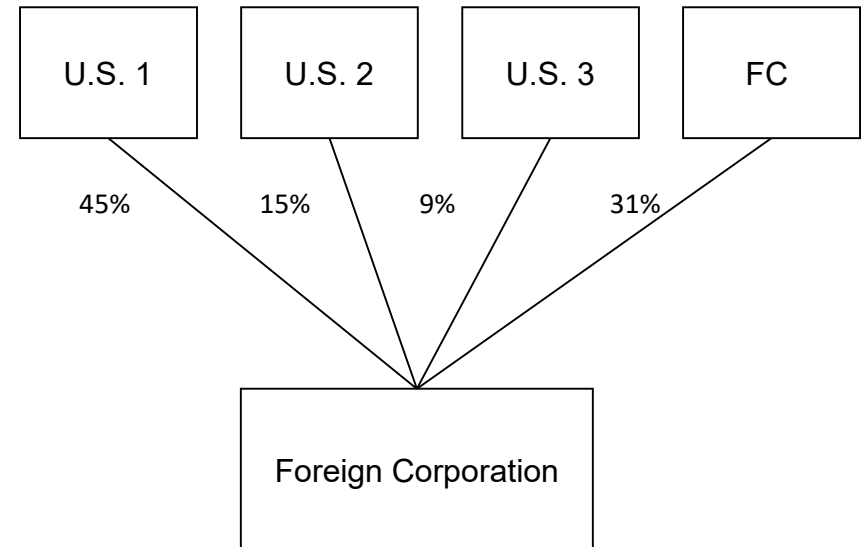
EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A SFC?

Example 5



Yes

Example 6



Yes

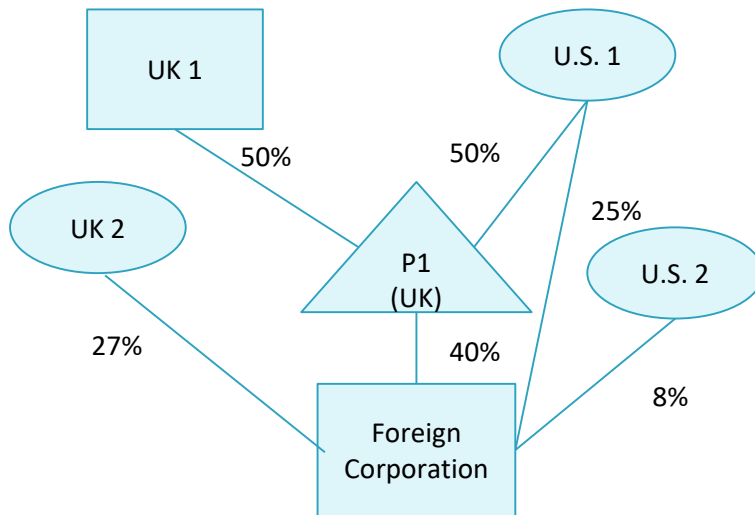
ATTRIBUTION AND CONTROL – DETERMINING TOTAL OWNERSHIP

- Determining ownership of a foreign company is not as straightforward as looking at a U.S. person's direct ownership percentage. Attribution rules can combine direct, indirect, and constructive ownership to determine total ownership of a foreign corporation.
- There are attribution rules for a variety of purposes and the rules are not always the same. Attribution is used to determine:
 - Acquisitions and dispositions reporting total ownership determination - § 1.6046-1(i) – includes siblings – Category 3
 - Determination of control for information reporting requirements - § 1.6038-2(c) based on §318 with modifications – Category 4
 - Determining U.S. Shareholder and CFC status - IRC § 958(b) – based on §318 with modifications – Category 5
- Indirect – IRC § 958(a) stock owned through foreign entities is treated as being actually proportionately owned.
- Constructive Ownership – IRC § 318(a) as modified by IRC § 958(b)

ATTRIBUTION AND CONTROL – ATTRIBUTION RULES

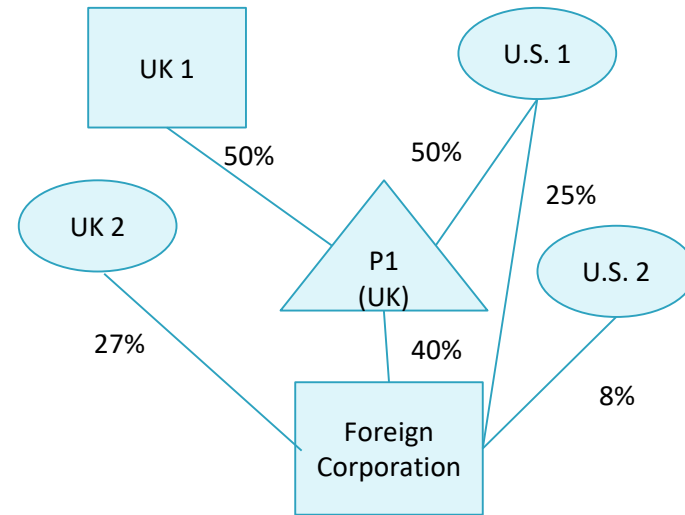
- a) Family – Individual owns stock owned directly or indirectly by spouse, children, grandchildren, and parents.
- b) From partnerships – stock is owned proportionately by partners.
- c) From corporations – If 10% or more of the value is owned, then considered to own the stock owned by the corporation proportionately .
- d) To Partnership – partnership is considered to own stock owned by the partner.
- e) To Corporations – If 50% or more of a corporation is owned, then corporation will own stock owned by shareholder.
- f) Do not attribute from NRA or ~~nonresident entity~~ for purposes of (a), (d), or (e)
 - a) “Downward” attribution after tax reform; Limitation on family attribution from an NRA still applies
- g) For (b) and (c) if a partnership or corporation owns more than 50% of the voting stock it shall be considered to own all of the voting stock.
- h) Do not re-attribute stock owned by reason of:
 - a) (a) for re-applying (a) to another person.
 - b) (d) or (e) for applying (b) or (c) to another person

EXAMPLE - ATTRIBUTION



U.S. 1 and U.S. 2 are siblings. Who is a U.S. Shareholder? Is an annual Form 5471 required?

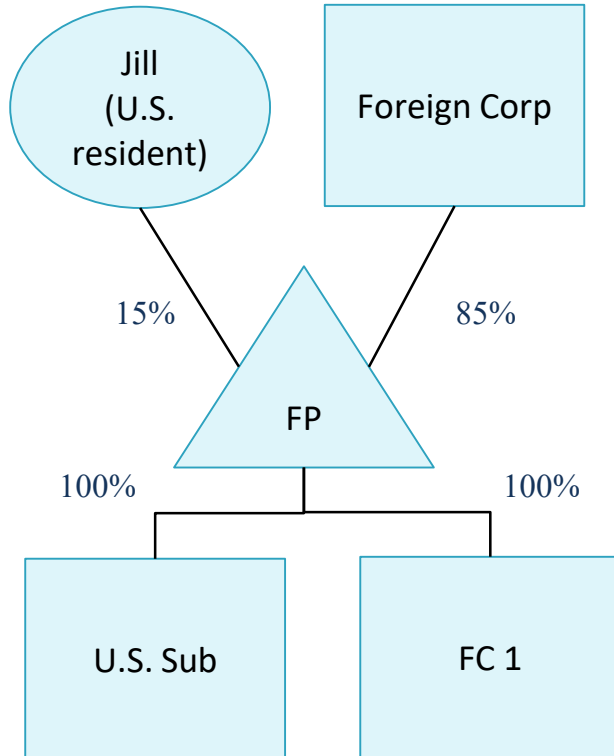
U.S. 1 is the only U.S. Shareholder. Foreign corporation is not a CFC so reporting not required on an annual basis (only when transaction occurs to trigger).



U.S. 1 is U.S. 2's parent. Who is a U.S. Shareholder? Is an annual Form 5471 required?

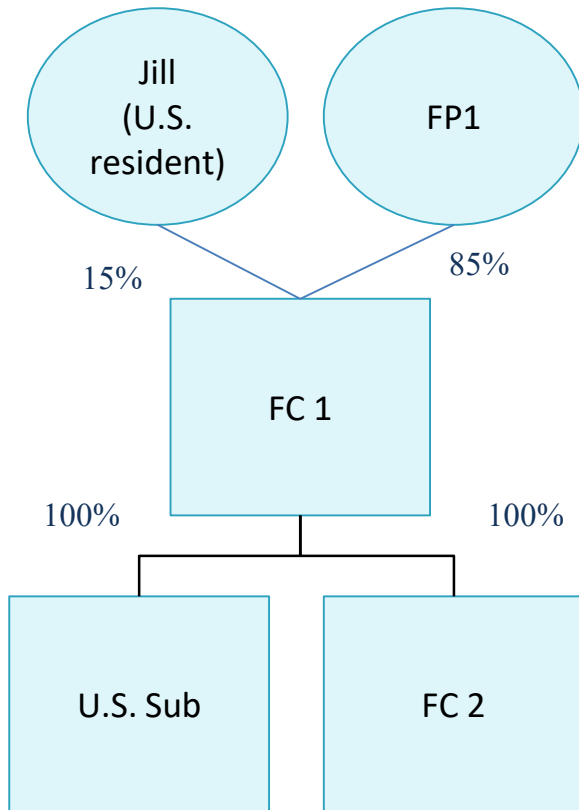
U.S. 1 and U.S. 2 are U.S. Shareholders. Foreign corporation is a CFC. U.S. 1 and U.S. 2 are deemed to own more than 50%. Reporting required annually. Cat 1, 4 and 5

EXAMPLE – CONSTRUCTIVE OWNERSHIP AFTER TCJA



- Under prior law, U.S. Sub would not be a U.S. shareholder of FC 1 because section 958(b)(4) prevented constructive ownership under section 318 from a foreign person to a U.S. entity.
- After the repeal of §958(b)(4), U.S. Sub is considered to have constructive ownership of Foreign Sub and thus Foreign Sub is considered a CFC.
- Jill is allocated subpart F income because she is a >10% indirect shareholder of FC 1 which is now a CFC.

EXAMPLE – CONSTRUCTIVE OWNERSHIP AFTER TCJA

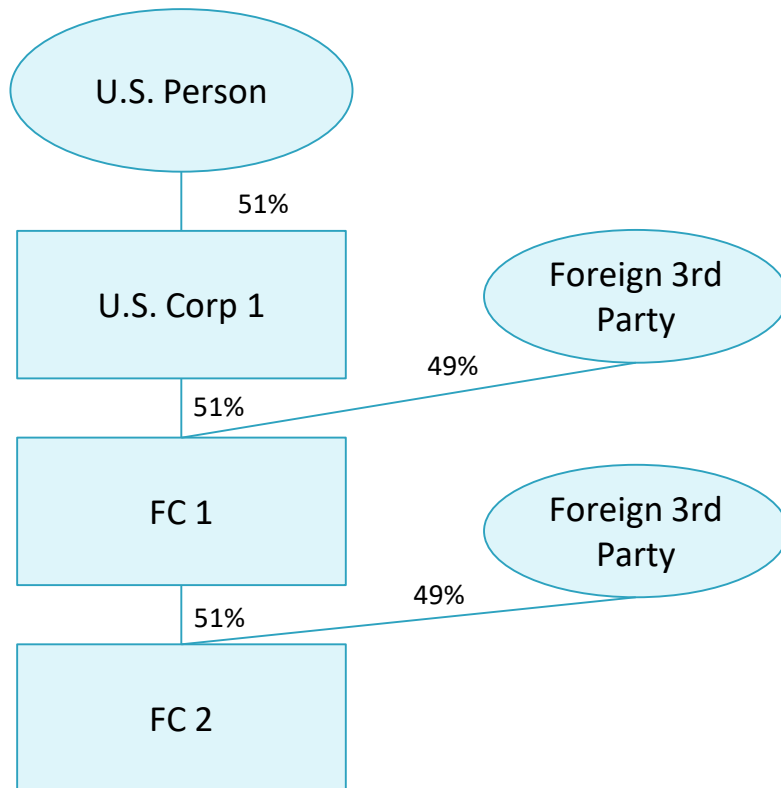


- Potential for future guidance –
 - May 1st 2019 – IRS technical reviewer announces that the IRS intend to address “... non-Subpart F issues caused by the repeal of Section 958(b)(4) to the extent we have authority to do so”
 - May 20th 2019 – Proposed regulations limit downward attribution for determining related party and control but only for determining related parties for Subpart F (954).

ATTRIBUTION AND CONTROL – CONTROL (CATEGORY 4)

- A person in control of a corporation which, in turn, owns more than 50 % of the vote or of the value of all classes of stock of another corporation is also treated as being in control of that other corporation.
 - A U.S. C corporation ABC Co is a 51 % owner of a U.S. corporate joint venture and the joint venture entity controls a foreign corporation. As a result, ABC Co controls the foreign corporation
 - Steve, a U.S. person, owns 51% of foreign company X. Foreign company X owns 51% of foreign company Y. Steve controls both foreign company X and foreign company Y.

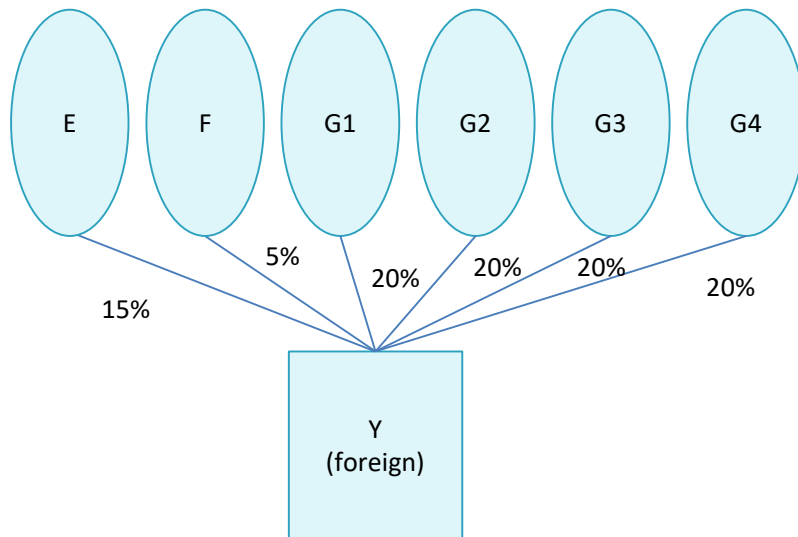
EXAMPLE - CONTROL (CATEGORY 4)



- What is U.S. Person's ownership of FC 1 and FC 2?
 - Using Category 4 constructive ownership rules we get to:
 - FC 1 – 26%
 - FC 2 - 13%
- U.S. Person controls both FC 1 and FC 2 for Category 4 filing purposes.
- Is FC 2 a CFC ?
 - YES – if more than 50% of voting stock is owned then 958 attribution rules state that all voting stock shall be considered owned. See examples in 1.958-2(g)

EXAMPLE – ATTRIBUTION

Example From Reg 1.958-2(g)



- Facts: United States citizen E owns 15 percent of the one class of stock in foreign corporation Y, and United States citizen F, E's spouse, owns 5 percent of such stock. E and F's four nonresident alien grandchildren each own 20 percent of the stock in Y Corporation.

Abbreviated analysis:

- E owns what F owns and F owns what E owns so they each constructively own 20 % of the stock of Y.
- E and F are not attributed any of the stock that G1-G4 own because of the restriction on family attribution from an NRA.
- What if G1 and G2 moved to the U.S. to attend college and became U.S. persons?
 - Interests of G1 and G2 would be attributed to E and F and interests of E and F would be attributed to G1 and G2.
 - Y would be a CFC. E, F, G1, and G2 would be U.S. shareholders of Y.

FILING EXCEPTIONS – MULTIPLE FILERS

- One person may file Form 5471 and the applicable schedules for other persons who have the same filing requirements
 - For example, a category 4 filer may file on behalf of a category 5 filer
 - Category 3 filers - form may only be filed by another person having an equal or greater interest (measured in terms of vote or value)
- The person filing Form 5471 must complete item F on page 1 of the form.
- All persons identified in F must attach a statement to their income tax return. Category 1, 4, and 5 filers – must attach Schedule P

FILING EXCEPTIONS – MULTIPLE FILERS

SAMPLE CLIENT
FORM 1040, SUPPORTING STATEMENT
2016

XXX-XX-XXXX

CONTROLLED FOREIGN CORPORATION REPORTING

THE TAXPAYER QUALIFIES AS A CATEGORY 4 & 5 FILER DUE TO DIRECT AND CONSTRUCTIVE OWNERSHIP IN A CONTROLLED FOREIGN CORPORATION BUT IS NOT SUBMITTING FORM 5471 UNDER THE MULTIPLE FILER EXCEPTION.

THE NAME AND ADDRESS OF THE FOREIGN CORPORATION:

SAMPLE FOREIGN CORP
EIN: N/A
ADDRESS

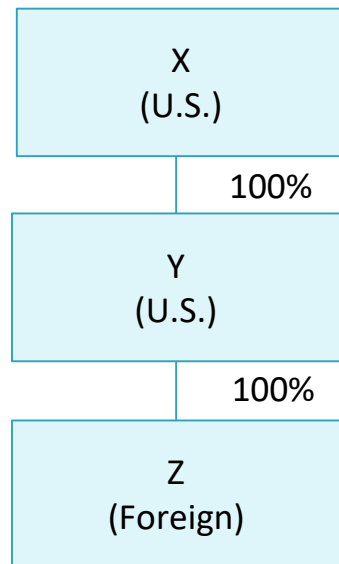
THE FORM 5471 FILING REQUIREMENT HAS BEEN SATISFIED BY THE FOLLOWING US PERSON:

US PERSON FILING FORM
EIN: XX-XXXXXXX
ADDRESS
IRS SERVICE CENTER WHERE RETURN FILED: SERVICE CENTER

FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

- A U.S. person described in Category 1, 3, 4 or 5 does not have to file Form 5471 if all of the below apply:
 - The U.S. person does not own a direct interest in the foreign corporation,
 - The U.S. person is required to furnish the information requested solely because of constructive ownership from another U.S. person, and
 - The U.S. person through which the U.S. person constructively owns an interest in the foreign corporation files Form 5471 to report all of the required information.
- The instructions clarify that there is no statement that needs to be attached for persons claiming the constructive owners exception. The regulations have been updated to reflect this as well (previously some ambiguity)

EXAMPLE - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS



- Caution – X is not just a constructive owner. X has control over Z.

Example from the regulations:

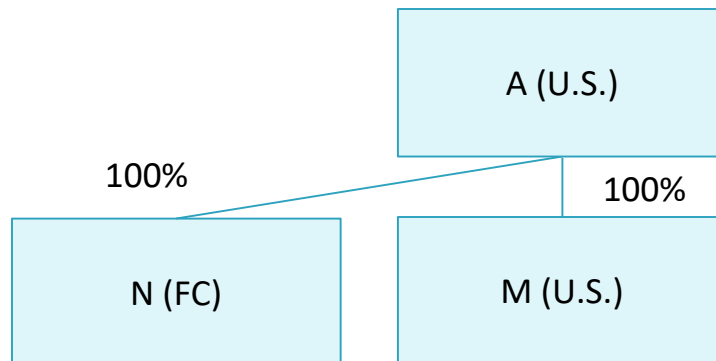
X, a domestic corporation owns 100 percent of the stock of Y, a domestic corporation, Y Corporation owns 100 percent of the stock of Z, a foreign corporation. X Corporation is not excused by this paragraph (j)(2) from filing information with respect to Z Corporation because X Corporation is deemed to control Z Corporation under the provisions of paragraph (b) of this section without recourse to the attribution rules in paragraph (c) of this section

- X – could still qualify for the multiple filers exception

FORM 5471 - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

Example from the regulations:

A, a U.S. person owns 100 percent of the stock of M, a domestic corporation. A also owns 100 percent of the stock of N, a of foreign corporation. A files a Form 5471 furnishing all of the information required of M Corporation with respect to N Corporation. M Corporation does not need to file a Form 5471.



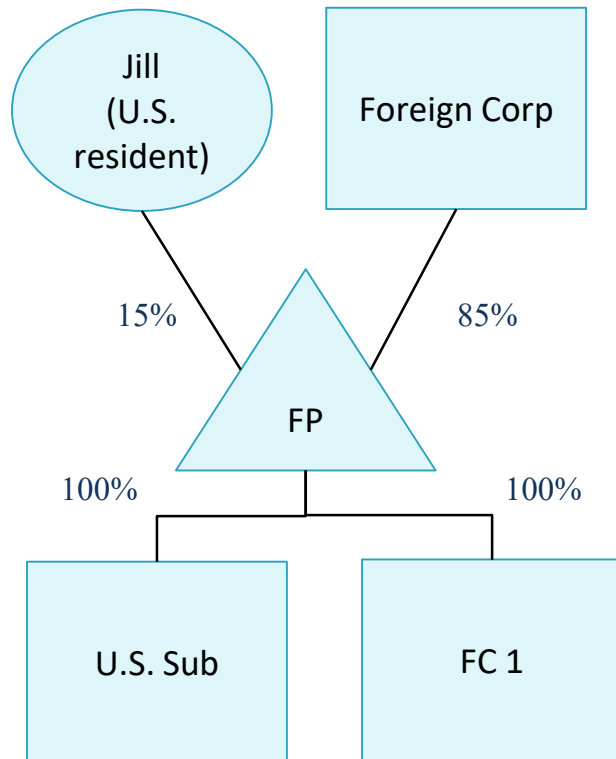
FORM 5471 - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

- Category 2 filer is not required to file if either of the below apply:
 - Immediately after the acquisition, 3 or fewer U.S. persons own 95% or more of the CFC and the U.S. acquirer is filing a category 3 Form 5471; or
 - U.S. person for which the Category 2 filer is required to file does not directly own an interest in FC but is required to file under constructive ownership rules and the U.S. person from whom the stock ownership is attributed properly files Form 5471.
- Category 4 or 5 filers – constructive from nonresident alien
 - U.S. person does not own a direct or indirect interest and is required to file solely due to constructive ownership from a non-resident alien.

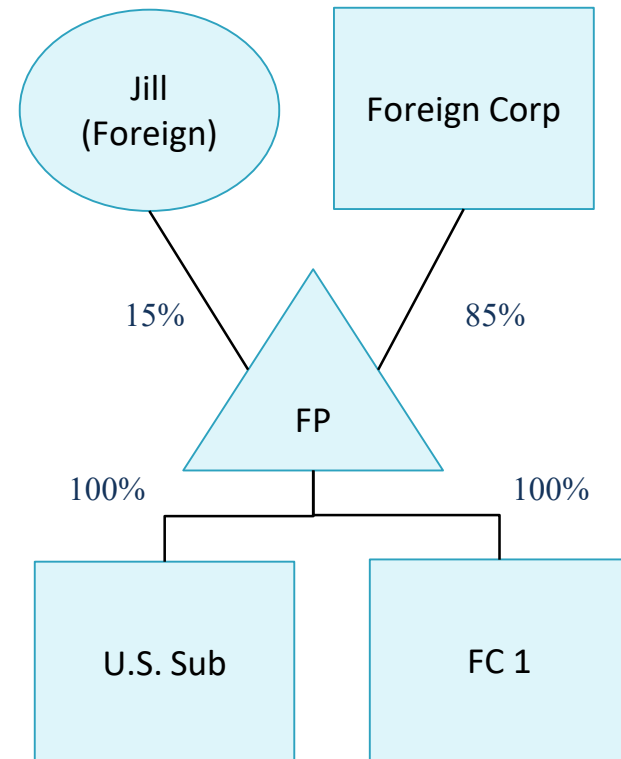
FORM 5471 - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

- Category 1 or 5 filers – exception for downward attribution
 - No U.S. shareholder (including potential filer) owns the foreign corporation directly or indirectly through foreign entities and the foreign corporation is an SFC or CFC solely because of downward attribution from a foreign person to a U.S. entity.
 - Limited to scenarios where there is no U.S. shareholder other than a U.S. shareholder from downward attribution.

EXAMPLE – DOWNWARD ATTRIBUTION FILING EXCEPTION



Exception **does not** apply



Exception **does** apply

FORM 5471 - FILING EXCEPTIONS – ENTITIES TREATED AS DOMESTIC CORPORATIONS

- Forms 5471 are not required for certain entities that are treated as domestic corporations.
 - Form 5471 not required for insurance companies that have elected under section 953(d) to be treated as domestic and have filed their U.S. income tax returns.
 - Category 4 filers are not required to file a Form 5471 for a corporation defined in section 1504(d) that files a consolidated return for the tax year.

FORM 5471 - APPLICABLE FOREIGN CORPORATIONS

- What is an association taxable as a corporation (“corporation”)? Consider the check-the-box regulations.
- By default a foreign entity with limited liability for all members will be treated as a foreign corporation. An entity with unlimited liability for at least one member will be treated as a pass-through.
 - A member of a foreign eligible entity has limited liability if the member has no personal liability for the debts of or claims against the entity by reason of being a member
- We are permitted to elect whether or not a foreign entity is treated as a corporation or pass-through by filing Form 8832 “check-the-box” election.
- If we are dealing with a per se corporation, it is a corporation for U.S. tax purposes.
- The foreign legal form of the entity can be useful in classifying it e.g., SA or Srl
- Remember that a separate 5471 is required for each foreign entity even if it is included in a foreign consolidated group, e.g., a German “*Organschaft*.”

FORM 5471 - PENALTIES

- IRC §§ 6038(a) and 6046 - Penalties for failure to file Form 5471, Schedule M, and Schedule O
 - \$10,000 failure to file penalty is automatically imposed for each late or incomplete Form 5471
 - If not filed within 90 days after IRS notice of failure to the U.S. person, an additional \$10,000 penalty (per foreign corporation) is charged for each 30-day period, or fraction thereof up to \$50,000 per Form per year.
- IRC §6038(c) – 10% reduction of foreign taxes available for credit under 901 and 960.
 - If the failure continues 90 days or more after the IRS mails a notice of failure, an additional 5% reduction for each 3-month period (or fraction thereof) during which the failure continues after the 90-day period has expired.
 - Limitation on the 6038(c) penalties - the greater of \$10,000 or the income of the foreign business entity for its annual accounting period with respect to which the failure occurs.

FORM 5471 - PENALTIES

- IRC §6662(j) – 40% accuracy related penalty for underpayments of tax as a result of transactions involving an undisclosed specified foreign financial asset.
- IRC §6501(c)(8) – Will keep the statute of limitations open indefinitely when information is required to be reported under Sections 6038, 6038A, 6038B, 6046, 6046A or 6048 and is not reported.

FORM 5471 – PENALTY REMEDIATION

- Abatement, reduction, or modification of penalties is possible.
- Taxpayers now have several options for submitting late returns due to IRS efforts to encourage taxpayers to come forward.
 - Quiet Disclosure
 - Delinquent International Information Return Submission Procedures
 - OVDP - Program has ended
 - New disclosure program with CI
 - Streamlined Filing Compliance Procedures
- Reasonable cause – Where taxpayer can demonstrate that failures to file are due to reasonable cause and not due to willful neglect.
 - The regulations indicate what the IRS deems reasonable cause as exercising “ordinary business care and prudence”.
 - The Internal Revenue Manual says that “ordinary business care and prudence standard requires that taxpayers make reasonable efforts to determine their tax obligations.... Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances”

FORM 5471 – PENALTY REMEDIATION

- Reliance on a professional advisor constitutes reasonable cause where special training is required – *U.S. v. Boyle*
- *Neonatology Assocs., P.A.* – confirms that taxpayers may rely on a professional advisor and establishes three factors for reliance:
 - The advisor was a competent professional with sufficient expertise to justify reliance.
 - The taxpayer provided necessary and accurate information to the adviser.
 - The taxpayer actually relied in good faith on the adviser’s judgement.
- Reliance on a professional advisor continues to be upheld – See *James v. U.S.*
- Complexity is a factor that should be considered – IRM, Court cases – *Congdon v. U.S.* , *Dillin v. Commissioner*

FORM 5471 – PENALTY REMEDIATION – STREAMLINED FILING

- Eligibility for individuals including estates. Two separate programs:
 - Streamlined Foreign Offshore Procedures - resident outside the U.S.
 - Streamlined Domestic Offshore Procedures – U.S. residents
 - Both - filers must certify failure to file was not due to willful conduct
- Payment Requirements:
 - Full amount of tax and interest
 - 5% of highest aggregate balance for any year (Domestic only)
- Foreign Offshore Procedures requirements for eligibility:
 - U.S. citizens or green card holders - 1 of last 3 years did not have a U.S. abode and outside the U.S. for at least 330 days during the year
 - Non-U.S. citizens and non-green card holders - 1 of the last 3 years the individual did not meet the substantial presence test
- Filing Requirements: three most recent years' U.S. tax returns (including information returns) and six most recent years' FBARs



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