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FORM 5471: REPORTING REQUIREMENTS FOR INTERESTS IN FOREIGN ENTITIES

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John Samtoy, HCVT LLP
John.Samtoy@HCVT.com

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FORM 5471 - TOPICS COVERED

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

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

- Penalties
 - \$10,000 failure to file Form 5471 or Schedule O or for a substantially incomplete filing
 - 10% reduction in foreign taxes available for credit in the case of a failure to file
 - 40% accuracy related penalty
 - Statute of limitations stays open indefinitely on the entire return if form is not filed
- 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

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

FILING REQUIREMENTS - FILING CATEGORIES

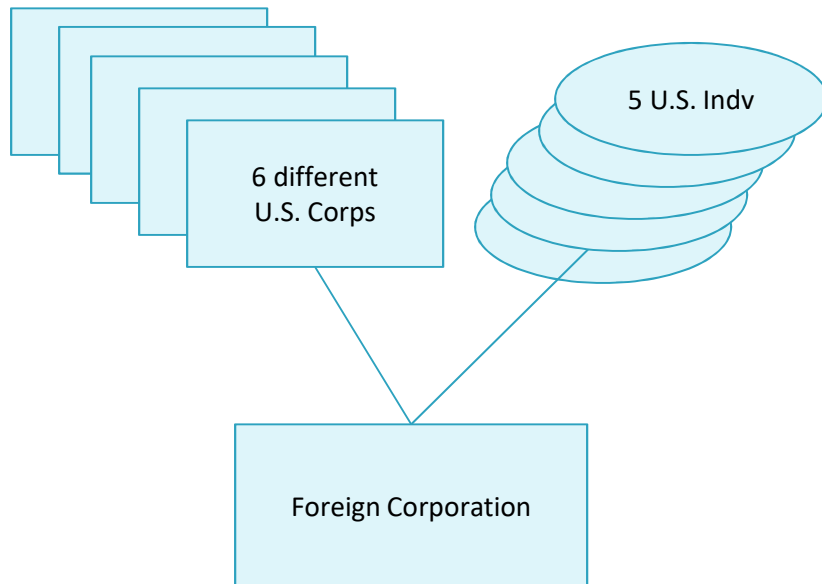
- Category 1 Filer (new) – A U.S. shareholder of a section 965 specified foreign corporation (SFC) at any during the year that also owned the stock on the last day in the year that it was an SFC.
 - SFC = a CFC or
 - FC that is not a CFC or PFIC to the extent that there is a U.S. corporate shareholder.
- 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.
- 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.

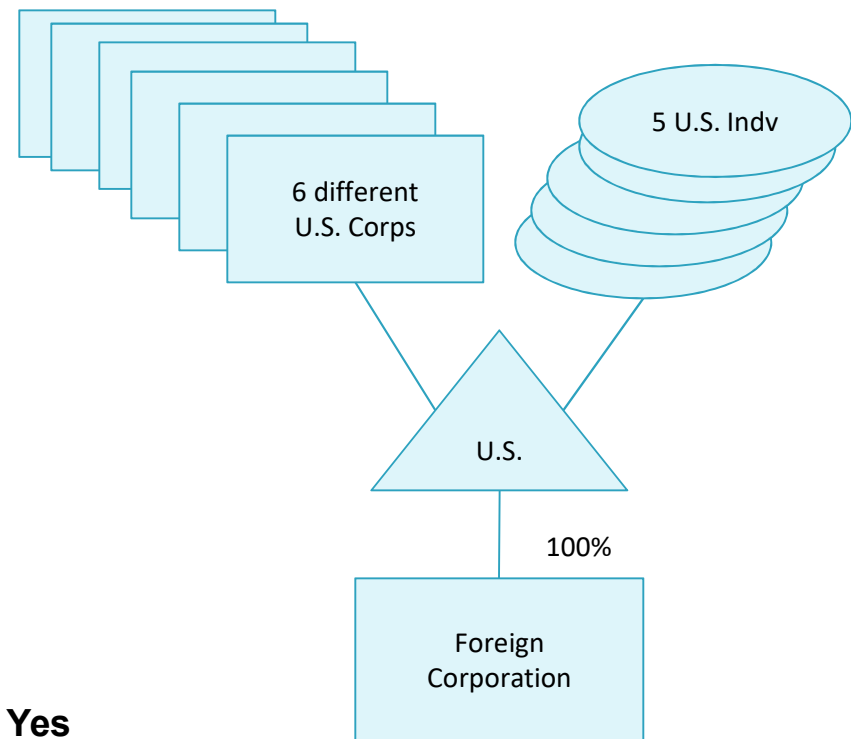
EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A CFC?

Example 1



No

Example 2

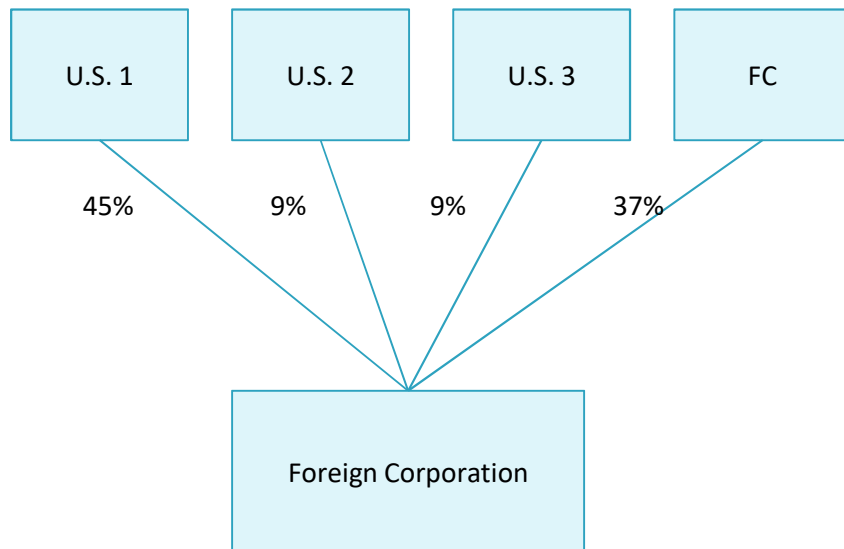


Yes

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

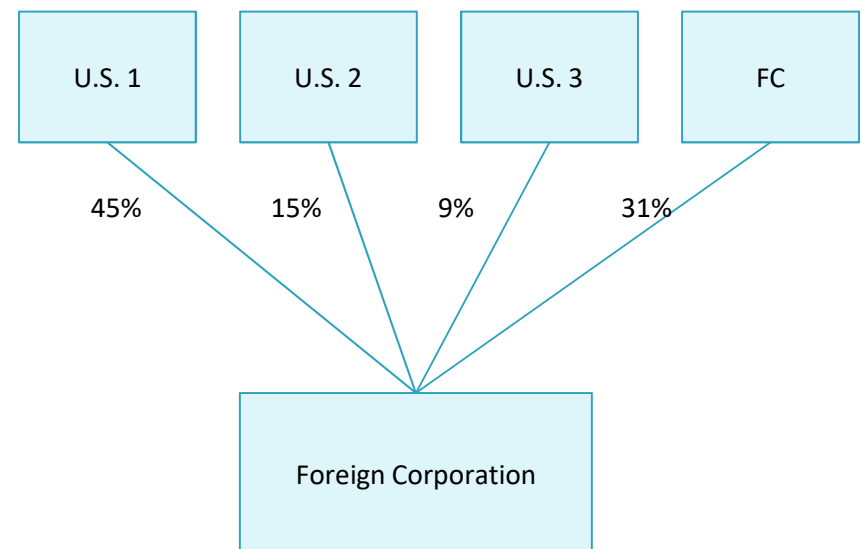
EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A CFC?

Example 3



No

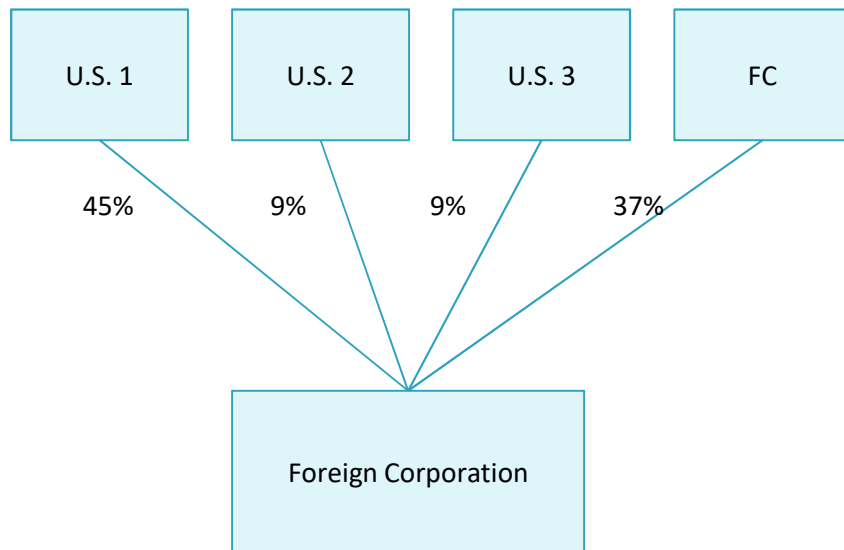
Example 4



Yes

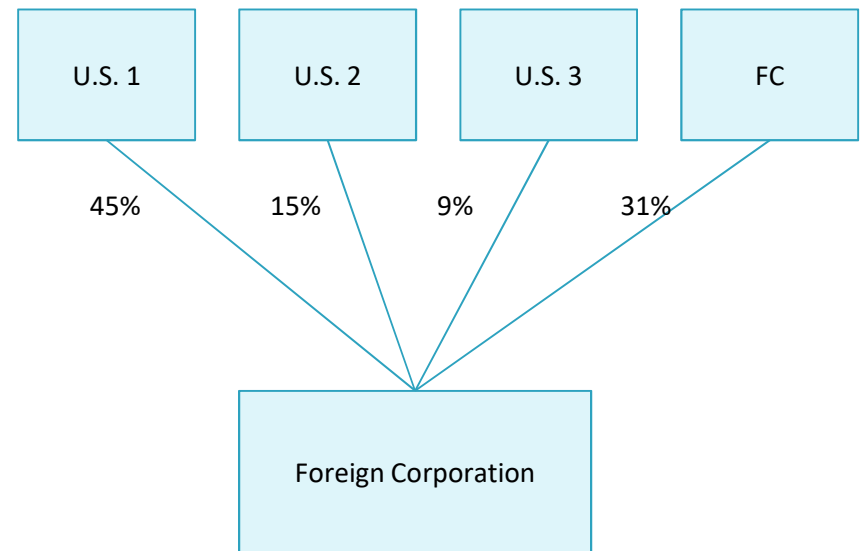
EXAMPLE – FILING REQUIREMENTS – IS FOREIGN CORPORATION A SFC?

Example 5



Yes

Example 6



Yes

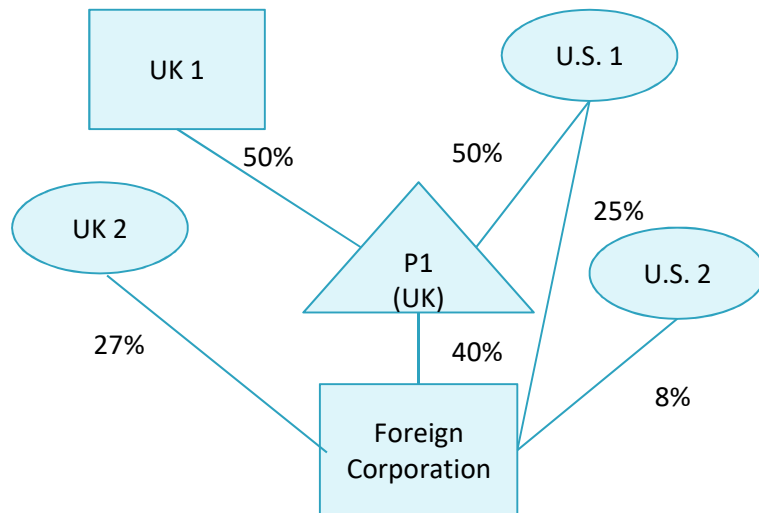
ATTRIBUTION AND CONTROL – DETERMINING TOTAL OWNERSHIP

- 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

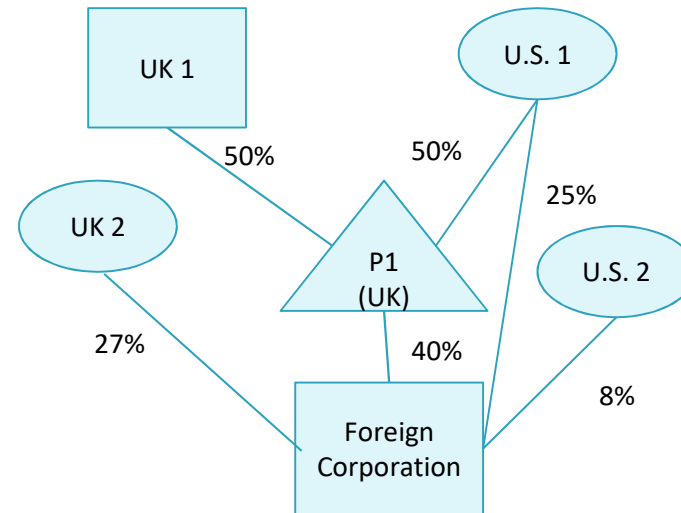
- a) Family – Individual owns stock owned directly or indirectly by spouse, children, grandchildren, and parents.
- b) From partnerships – stock is owned proportionately by partners.
- c) From corporations – If 10% or more of the value is owned, then considered to own the stock owned by the corporation 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?

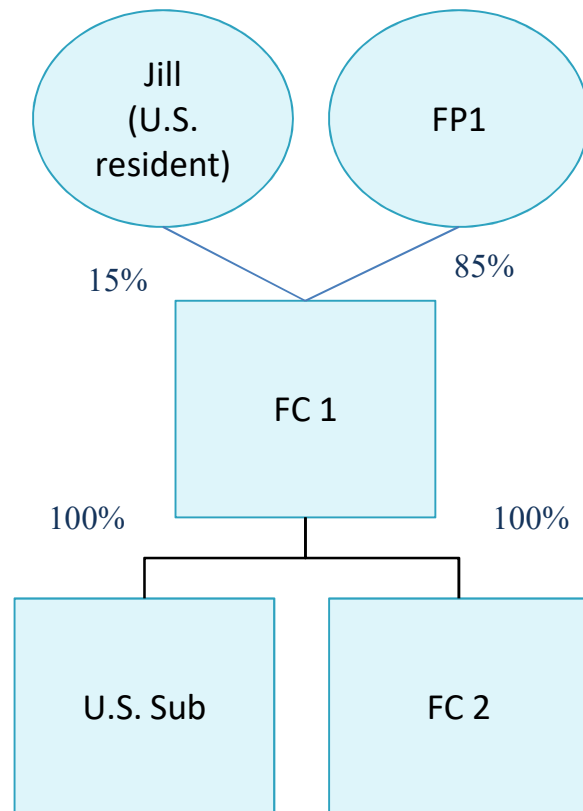
U.S. 1 is the only U.S. Shareholder. Foreign corporation is not a CFC so reporting not required on an annual basis (only when transaction occurs to trigger).



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

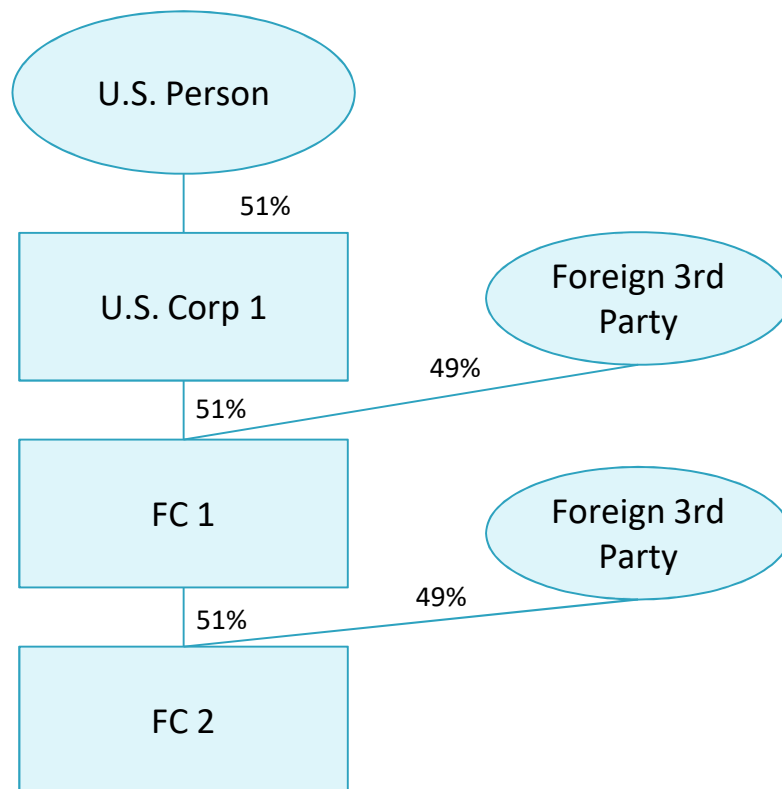


- Potential for future guidance – Guidance has been coming out limiting the scope / application of downward attribution since 958(b)(4) was repealed -
 - May 1st 2019 – IRS technical reviewer announces that the IRS intend to address “... non-Subpart F issues caused by the repeal of Section 958(b)(4) 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).
 - 2018 Form 5471 instruction provide limited filing exception.
- Rev Proc 2019-40 (October 2019) introduced additional definitions and reporting limitations in cases of downward attribution.

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.
- Limitations on downward attribution for Category 4 –
 - Rules are in 1.6038-2 as opposed to 958 and are slightly different.
 - No downward attribution to partnerships, estates, trusts, or corporations from non-US persons

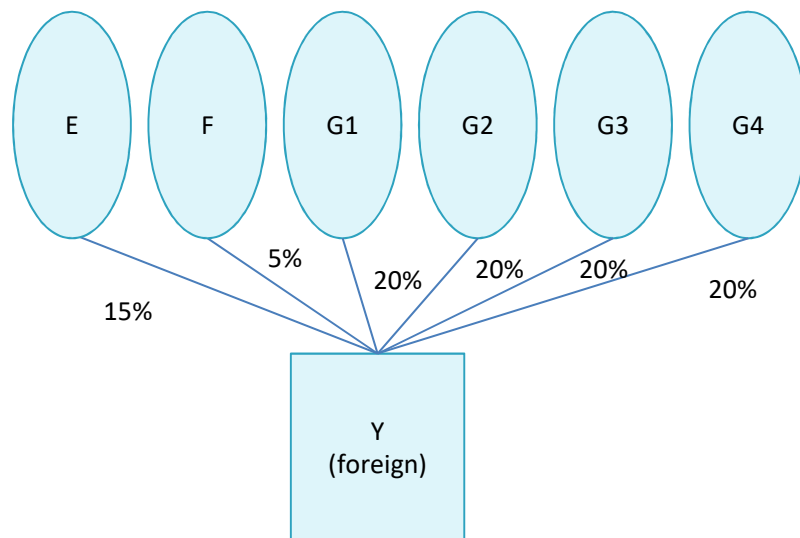
EXAMPLE - CONTROL (CATEGORY 4)



- 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

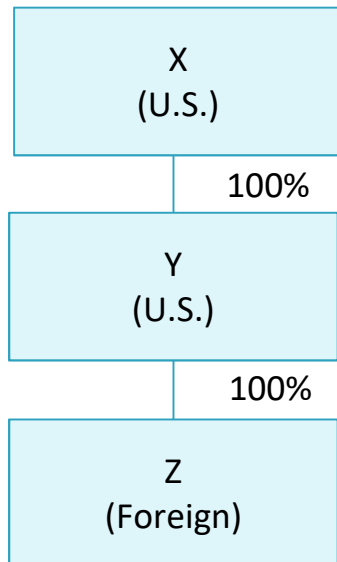
THE FORM 5471 FILING REQUIREMENT HAS BEEN SATISFIED BY THE FOLLOWING US PERSON:

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:

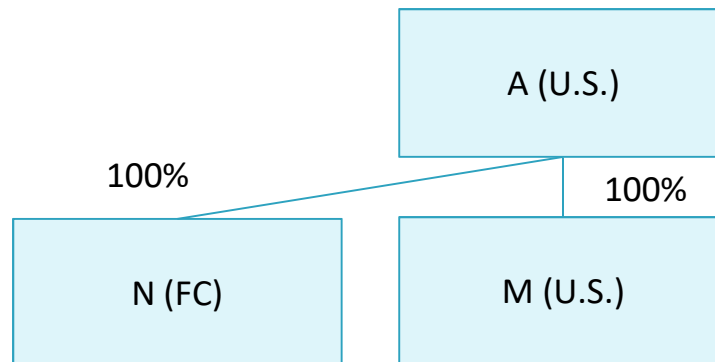
X, a domestic corporation owns 100 percent of the stock of Y, a domestic corporation, Y Corporation owns 100 percent of the stock of Z, a foreign corporation. X Corporation is **not excused** by this paragraph (j)(2) from filing information with respect to Z Corporation because X Corporation is deemed 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.



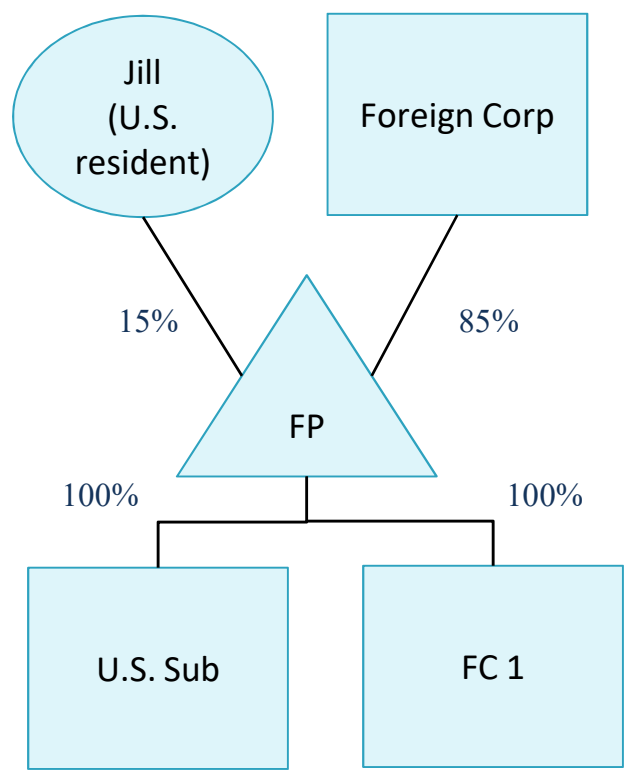
FORM 5471 - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

- 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.

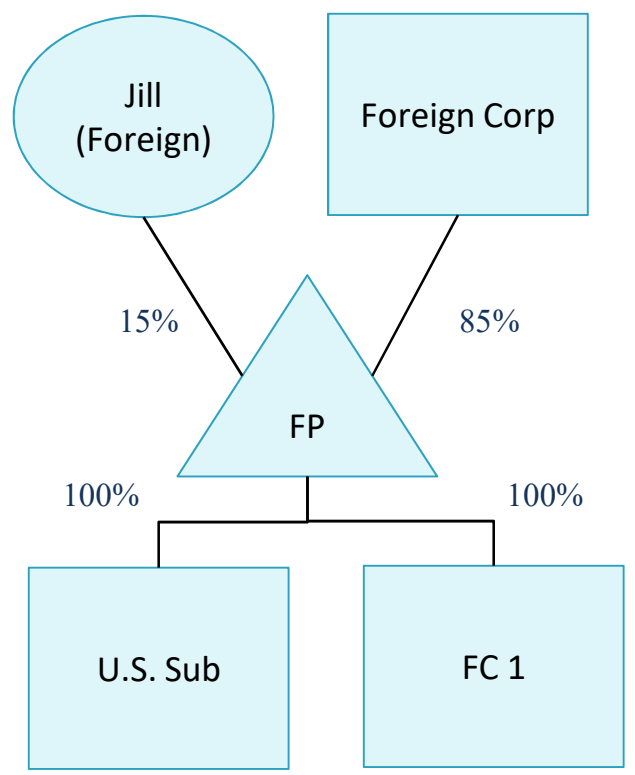
FORM 5471 - FILING EXCEPTIONS – CONSTRUCTIVE OWNERS

- 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.

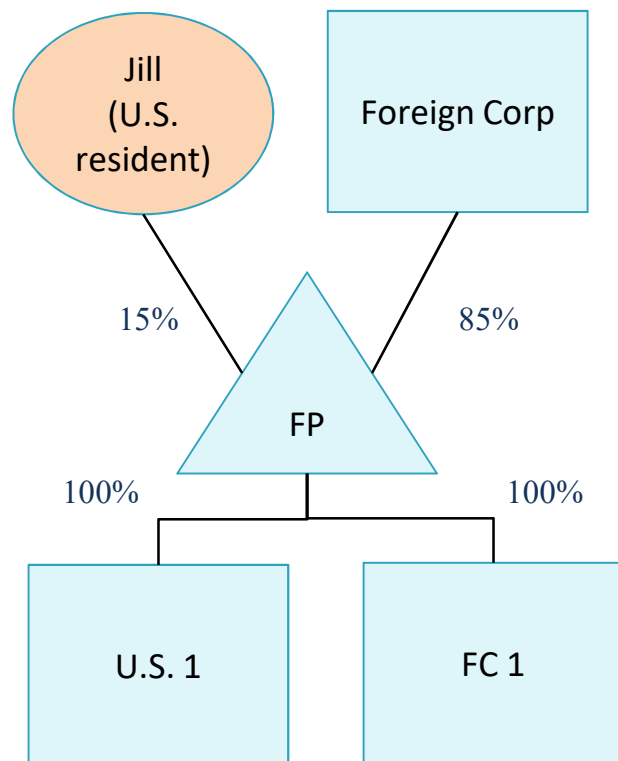
REV PROC 2019-40 DEFINITIONS

- Related person – if they control or are controlled by the CFC or if they are controlled by the same person or persons that control the CFC.
- Related section 958(a) U.S. shareholder – a 958(a) (direct or indirect through foreign entities) U.S. Shareholder that is related to the CFC.
- Unrelated section 958(a) U.S. shareholder – a 958(a) U.S. shareholder that is not related.
- Related constructive U.S. shareholder – a constructive U.S. shareholder that is related person to the CFC.
- Unrelated constructive U.S. shareholder – a constructive U.S. shareholder that is not a related person to the CFC.
- Foreign controlled CFC – CFC that would not be a CFC except for downward attribution from foreign persons to entities under 318(a)(3).

REV PROC 2019-40 – SAFE HARBOR FOR CFC STATUS DETERMINATION

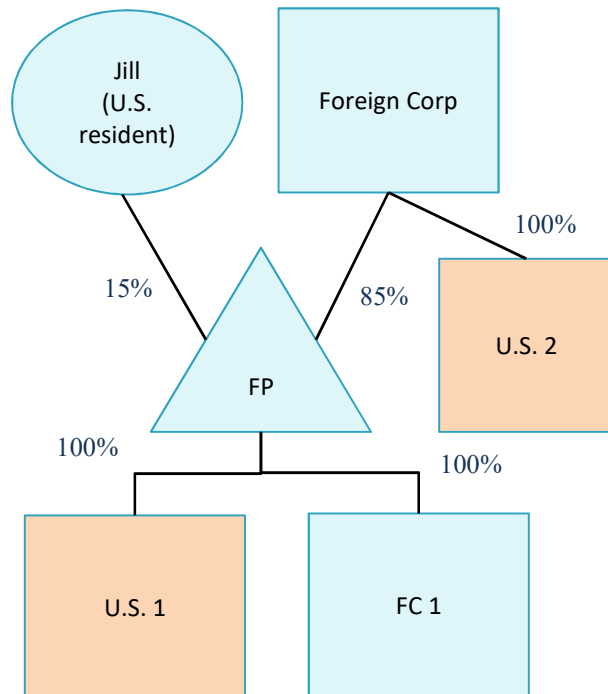
- The IRS will accept a U.S. person’s determination that a foreign corporation is not a CFC and will not issue penalties if:
 - The FC is a foreign controlled CFC
 - The U.S. person does not have actual knowledge, statements received, and/or publicly available information that would allow the U.S. person to determine that the FC is a CFC.
 - If the U.S. person directly owns an interest in a foreign entity (“top tier entity”) the U.S. person confirms with the top tier entity whether the top tier entity is itself a CFC, whether and to what extent the top tier directly or indirectly owns stock in one or more foreign corporations, and whether and to what extent the top tier entity owns stock of or an interest in a domestic corporation.

REV PROC 2019-40 EXCEPTIONS AND REPORTING LIMITATIONS



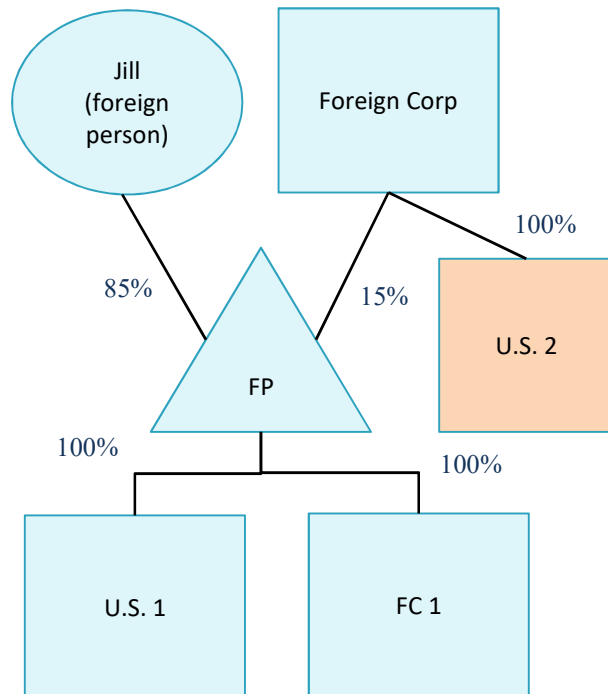
- Unrelated 958(a) U.S. shareholders of foreign controlled CFCs (that are Category 5 filers) –
 - Complete only identifying information on Page 1 above Schedule A, Schedule I, Schedule I-1, and Schedule P.
 - If claiming indirect credits under 960 – also complete schedule E and E-1.
 - No longer required to complete Schedule B Part II, Schedule G, Schedule H, or Schedule J.
- Definitions review:
 - Jill is a 958(a) U.S. shareholder because she owns FC1 indirectly through a foreign entity.
 - Jill is an unrelated 958(a) U.S. shareholder because she does not control FC 1, is not controlled by FC 1, and is not controlled by the same person or persons that control the FC 1.
- Jill would not be able to meet the safe harbor for CFC status determination here because she must verify with FP to what extent FP owns any foreign or domestic entities.

REV PROC 2019-40 EXCEPTIONS AND REPORTING LIMITATIONS



- Related constructive U.S. shareholder - of foreign controlled CFCs (that are Category 5 filers) –
 - Complete only identifying information on Page 1 above Schedule A, Schedule B Part II, Schedule E, Schedule G, and Schedule I-1.
 - No longer required to complete Schedule E-1, Schedule H, Schedule I, Schedule J, or Schedule P.
- Definitions review:
 - U.S. 1 and U.S. 2 are constructive U.S. shareholders because they are U.S. shareholders that are not 958(a) U.S. shareholders.
 - U.S. 1 and U.S. 2 are related shareholders because they are controlled by persons that control FC 1.
 - FC 1 is a foreign controlled CFC because it would not be a CFC without downward attribution to U.S. persons under 318(a)(3).

REV PROC 2019-40 EXCEPTIONS AND REPORTING LIMITATIONS



- Unrelated constructive U.S. shareholder - of foreign controlled CFCs (that are Category 5 filers) – are not required to file the Form 5471
- Definitions review:
 - U.S. 2 is a constructive U.S. shareholder because they are a U.S. shareholder that is not a 958(a) U.S. shareholder.
 - U.S. 2 is an unrelated shareholder because it does not control FC 1, is not controlled by FC 1, and is not controlled by the same person or persons that control FC 1.
 - FC 1 is a foreign controlled CFC because it would not be a CFC without downward attribution to U.S. persons under 318(a)(3).

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.
 - Streamlined Filing Compliance Procedures
 - Quiet Disclosure
 - Delinquent International Information Return Submission Procedures
 - OVDP - Program has ended
 - New disclosure program with CI
- 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”



**JOHN SAMTOY – INTERNATIONAL TAX PARTNER
HCVT LLP**

john.samtoy@hcv.com

