

The Form 5471 Series

Episode 2

The Indirect and Constructive Ownership Rules

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The Form 5471 Series: 2023 - 2024

Date	Episode	Title
Part 1. The Filer		
April 28, 2023	1	Overview: Who is a Form 5471 Filer?
May 26, 2023	2	The Attribution Rules for Form 5471
June 30, 2023	3	The Nine Categories of Form 5471 Filers
July 28, 2023	4	Filing Exceptions and Reduced Filing Requirements
Part 2. The Income Items		
August 25, 2023	5	Subpart F Income
September 29, 2023	6	Global Intangible Low-Taxed Income
October 27, 2023	7	Distributions from Controlled Foreign Corporations
Part 3. Damage Control		
November 17, 2023	8	Foreign Tax Credit
January 26, 2024	9	Restructuring, Reorganization, and Liquidation of a Controlled Foreign Corporation
February 23, 2024	10	The Section 962 Election
March 29, 2024	11	Tax Performance Comparison: CFCs vs. Other Structure Types

Form versions, cutoff date

- Form versions used in this episode:
 - Form 5471 (Rev. December 2022).
 - Instructions for Form 5471 (Rev. January 2023).
- Cutoff date:
 - The information in these slides is current as of May 26, 2023.

Objective

- Knowing stock ownership—your taxpayer’s and other shareholders’—is foundational. If you don’t know who owns the shares, you can’t prepare Form 5471.
- The hardest part of knowing stock ownership is applying the attribution rules to determine indirect and constructive stock ownership.
- Today: identify the three different attribution rulesets that are in play for Form 5471, show how the rulesets differ from each other, and show some typical scenarios and how the attribution rules work within those scenarios.


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1. Introduction

Wherein we identify the hard part of the hard part of the question “Who must file Form 5471?”

What you need to have a Form 5471 filing requirement

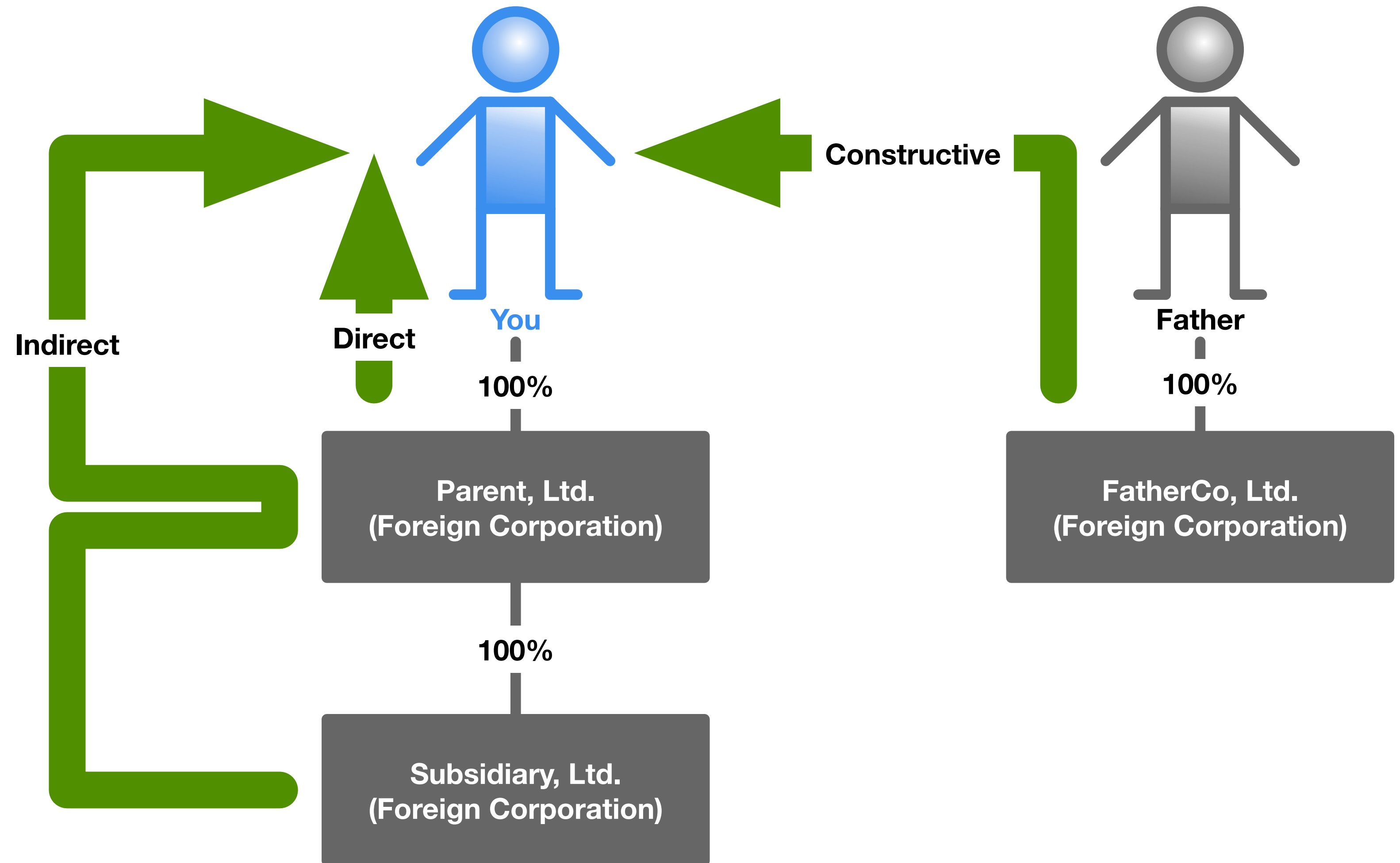
1. United States person who is a shareholder **and** owns (or owned) “enough” shares.
 - United States person
 - Owns (or owned)  The hard part
 - Enough shares (on a specific date or after a specific type of event)
2. A foreign corporation.
 - Foreign
 - Corporation

“Own” — the hard part of the hard part

- Direct ownership
- **Indirect** ownership  **The hard part of the hard part**
- **Constructive** ownership  **The hard part of the hard part**

Use the words with care: direct, indirect, and constructive

- You have **constructive** ownership of 100% of FatherCo, Ltd.'s stock.
- You have **indirect** ownership of 100% of Subsidiary, Ltd.'s stock.
- You have **direct** ownership of 100% of Parent, Ltd.'s stock.



Stock ownership requirements exist in every filing category

Type of Filer	File Form 5471 When . . .	Category
U.S. person who is an officer or director	Any U.S. person acquires “enough” foreign corporation stock: IRC §6046(a)(1)(A)	2
	You acquire “enough” stock: IRC §6046(a)(1)(B)	3
	You dispose of “enough” stock: Reg. §1.6046-1(c)(1)(ii)(c)	3
	You own “enough” stock and become a resident alien: IRC §6046(a)(1)(D)	3
U.S. person who is (or were) a shareholder of a foreign corporation	You own “enough” stock and there is a reorganization: Reg. §1.6046-1(c)(1)(ii)(b)	3
	You own stock and it’s a captive insurance company: Reg. §1.6046-1(c)(1)(iii)	3
	You own enough stock to “control” the corporation: IRC §6038(a)(1)	4
	You own 10%+ of a section 965 specified foreign corporation’s stock: IRC §6038(a)(4)	1
	You own 10%+ of a controlled foreign corporation’s stock: IRC §6038(a)(4)	5

What makes it hard: too many rulesets, modifications, and exceptions

Category	Filing Requirement Created By	Attribution Rules	Modifications to the Attribution Rules
2, 3	IRC §6046(a)	IRC §6046(c)	Reg. §1.6046-1(i)
4	IRC §6038(a)	IRC §318(a)	IRC §6038(e), Reg. §1.6038-2(c)
1, 5	IRC §6038(a)(4)	IRC §958(a), (b), IRC §318(a)	IRC §958(b), Reg. §§1.958-1, 1.958-2

2. The Category 2 and Category 3 Attribution Rules

Category 2 filers: U.S. citizens or residents who are officers/directors

- **Category 2** — U.S. persons who are officers and directors. They tell the IRS when someone else acquired foreign corporation stock within the triggering thresholds. IRC §6046(a)(1)(A).

Category 3 filers: U.S. persons who are/were shareholders

- A **U.S. person** who acquired or disposed of foreign corporation stock within the triggering thresholds. IRC §6046(a)(1)(B), Reg. §1.6046-1(c).
- A nonresident alien **who becomes a U.S. person** while holding foreign corporation stock. IRC §6046(a)(1)(D), Reg. §1.6046-1(c)(3).
- A nonresident alien **who is treated as a U.S. person** by IRC §953(c) for insurance-driven controlled foreign corporations we don't care about. IRC §6046(a)(1)(C). Reg. §1.6046-1(c)(1)(iii).
- A 10%+ U.S. shareholder when a **reorganization** occurs. Reg. §1.6046-1(c)(1)(ii)(b).
- A U.S. shareholder in a **captive insurance company**. Reg. §1.6046-1(c)(1)(iii).

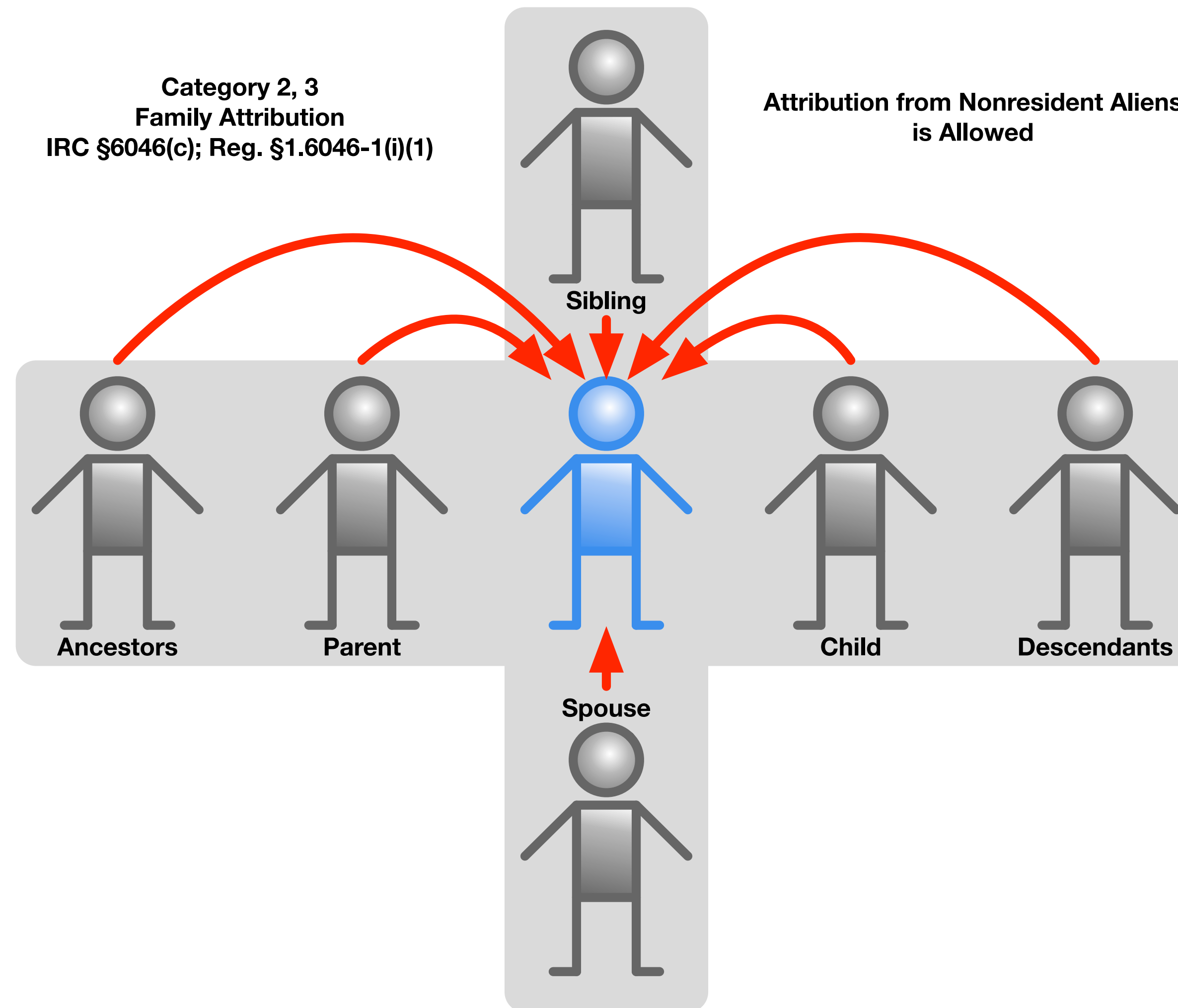
2.A. Categories 2, 3: Family Attribution

2.A.1. Attribution to Family Members

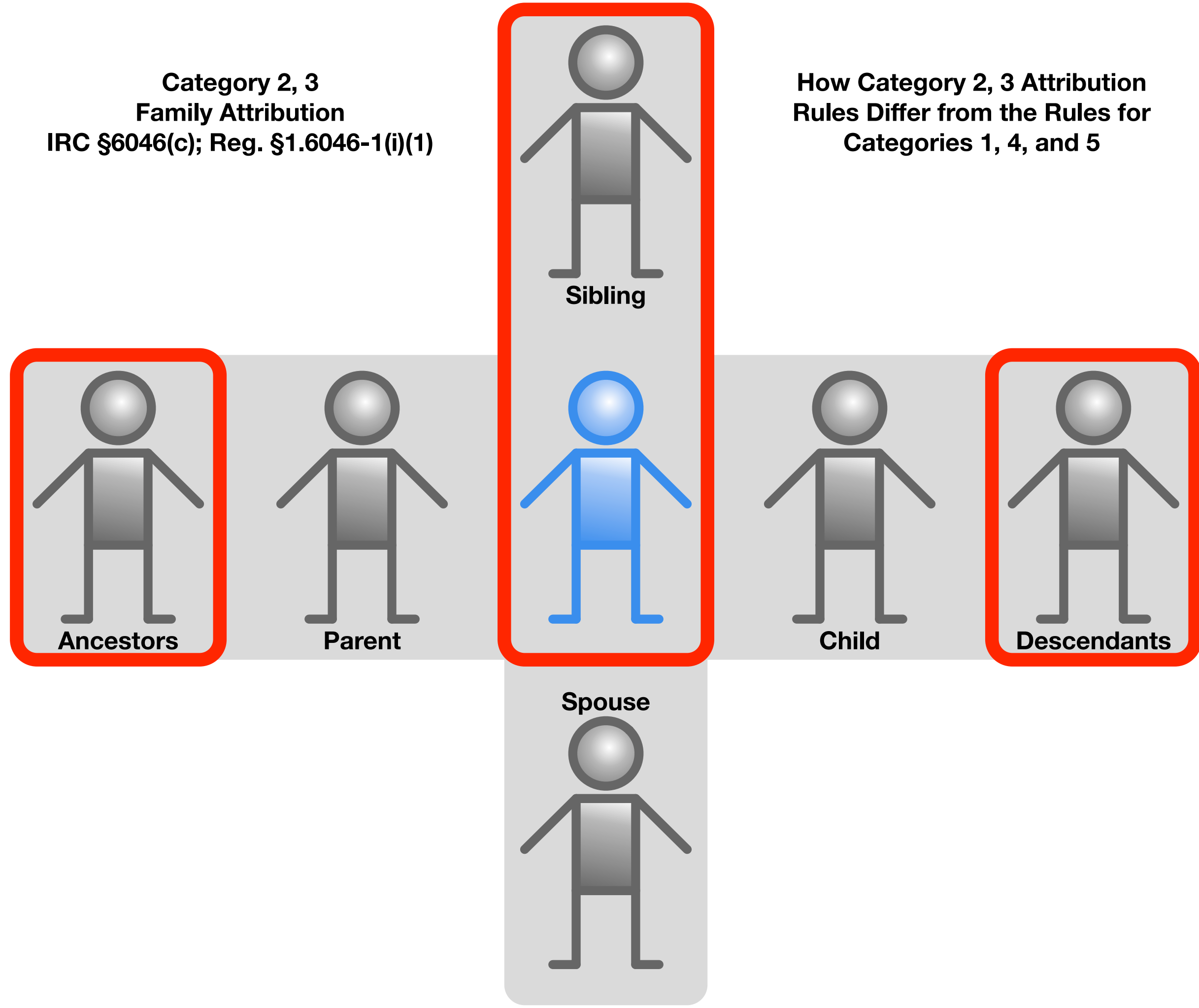
Family attribution rule for Categories 2, 3

- “An individual shall be considered as owning the stock owned directly or indirectly by or for his brothers and sisters (whether by the whole or half blood), his spouse, his ancestors, and his lineal descendants. * * *
- Reg. §1.6046-1(i)(2).
- **Note: attribution from nonresidents is not prohibited, therefore is allowed.** Compare this to Categories 1, 5, where attribution from nonresident individuals is prohibited.

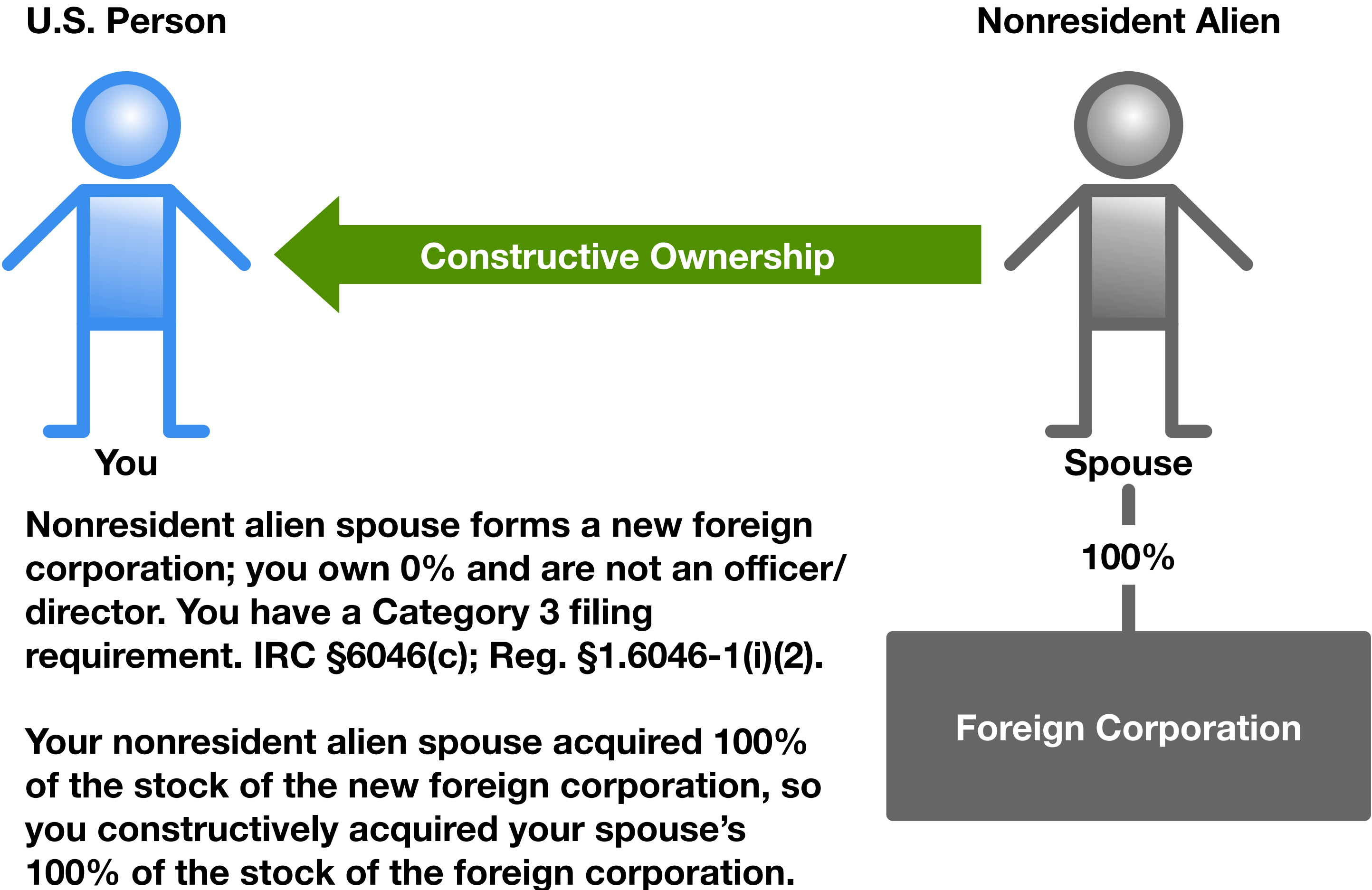
Family attribution for Categories 2, 3



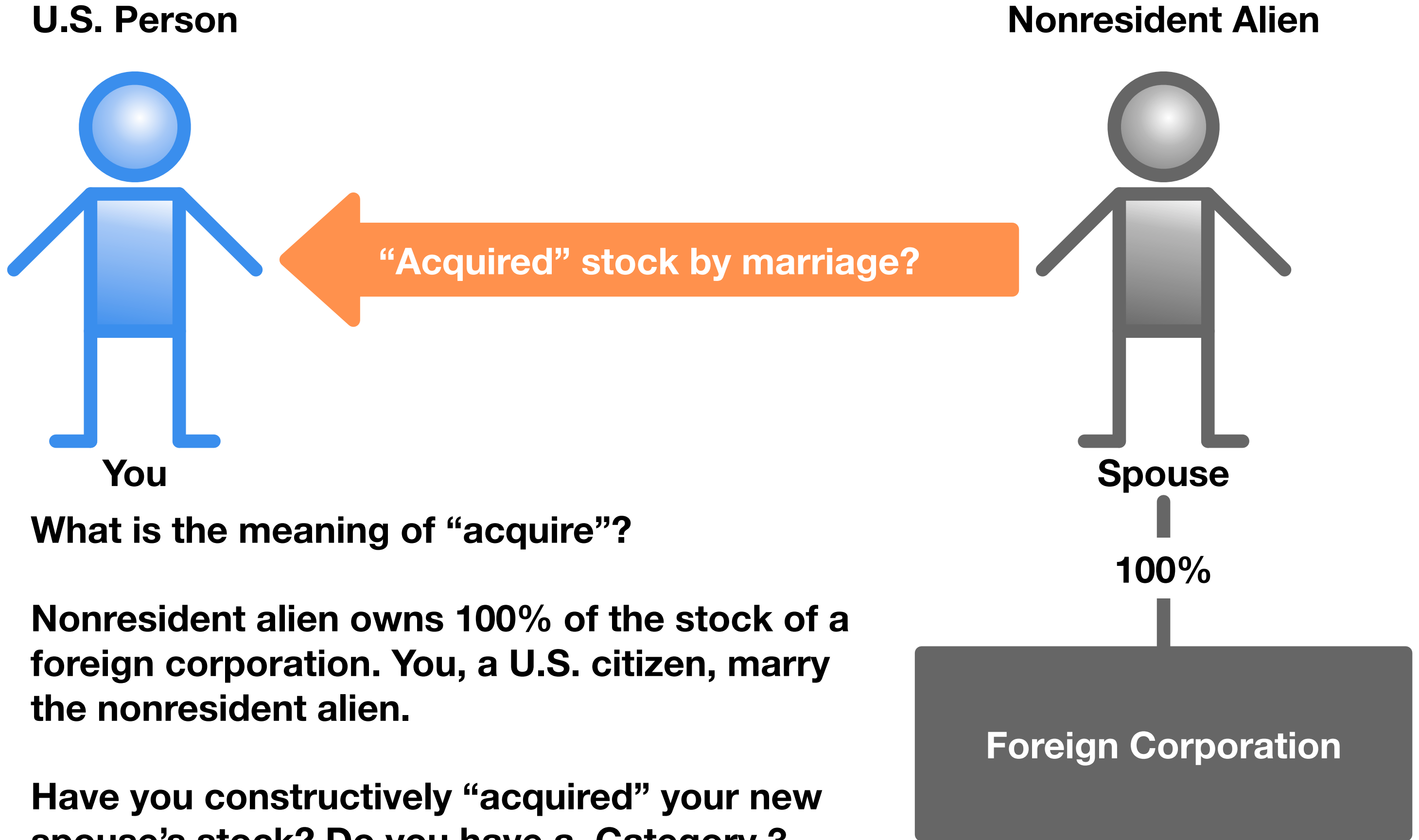
Category 2, 3 family attribution: the key differences



Acquisition by attribution – an example



Acquisition by marriage? A puzzler



What is the meaning of “acquire”?

Nonresident alien owns 100% of the stock of a foreign corporation. You, a U.S. citizen, marry the nonresident alien.

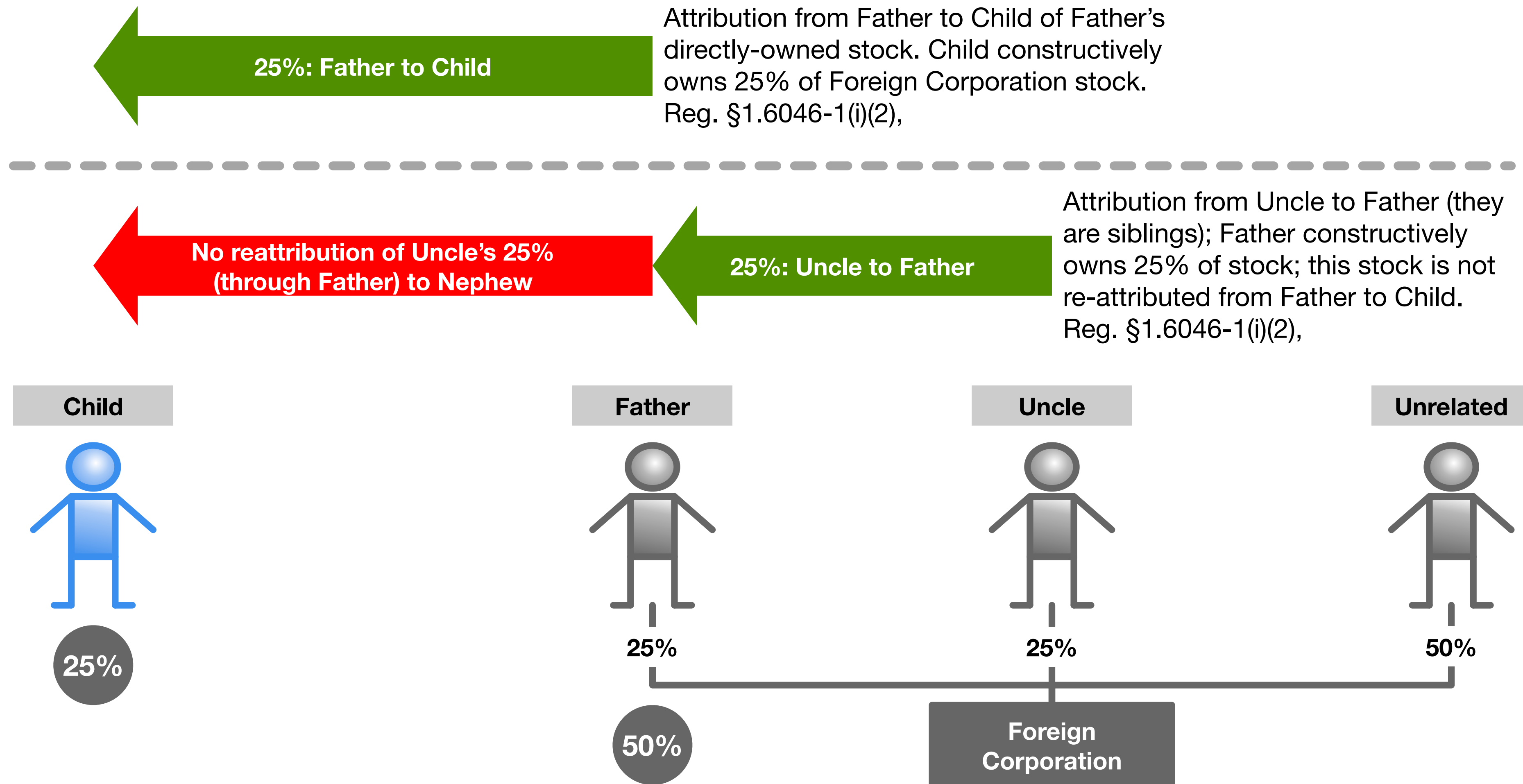
Have you constructively “acquired” your new spouse’s stock? Do you have a Category 3 filing requirement? IRC §6046(c); Reg. §1.6046-1(i)(2).

2.A.2. Reattribution of Constructively-Owned Stock

No reattribution from one family member to another

- “* * * However, when stock is treated as owned by an individual under the rule provided in this subparagraph, it shall not be treated as owned by him for the purpose of again applying such rule in order to make another the constructive owner of such stock.”
- Reg. §1.6046-1(i)(2).

Father, child; attribution and reattribution from uncle (father's brother)



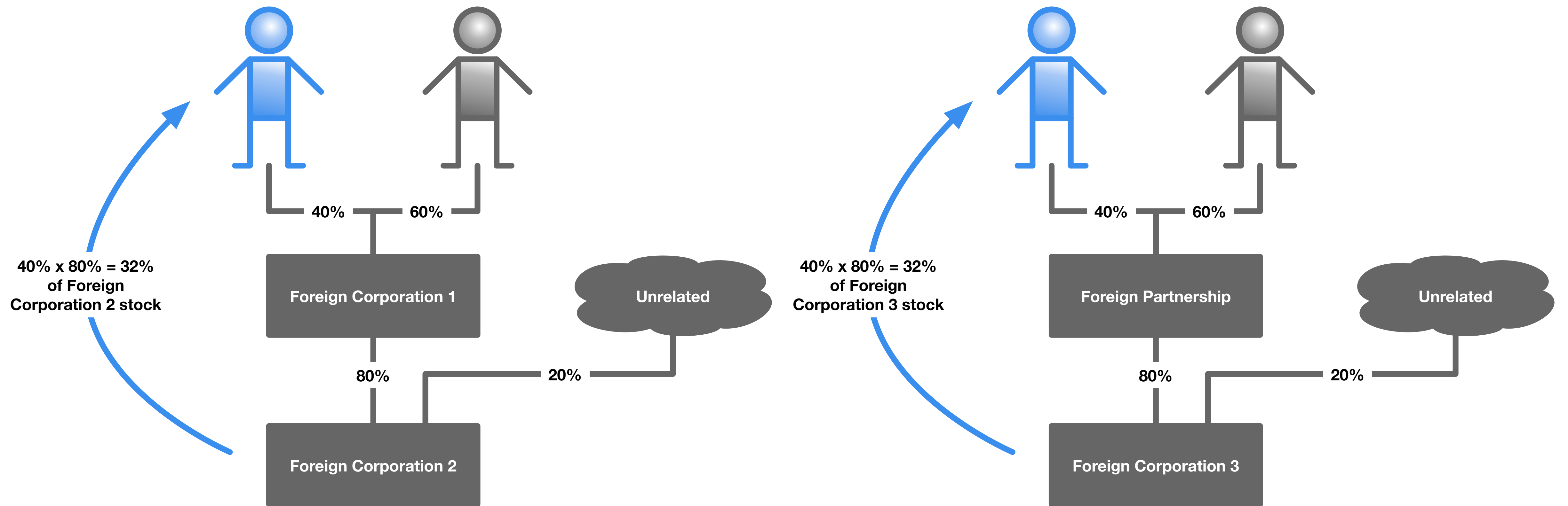
2.B. Indirect Ownership Through Entities

Upward attribution.

Entity-to-owner situations with indirect ownership: law

- **Foreign corporation:** shareholders own their proportional share of foreign corporation stock owned by the foreign corporation.
- **Foreign partnership:** partners own their proportional share of foreign corporation stock owned by the foreign partnership.
- Reg. §1.6046-1(i)(1).

Entity-to-owner situations creating indirect ownership: diagram



Entity-to-owner attribution for Categories 2, 3: silence means???

- **U.S. corporations, partnerships:** Reg. §1.6046-1(i)(1) is silent.
 - *Strong inference:* since the Regulation specifies attribution through *foreign* corporations and partnerships, there is no indirect ownership of foreign corporation stock through *domestic* corporations or partnerships. These entities would have their own Category 3 filing obligations.
- **Foreign nongrantor trusts; foreign estates:** Reg. §1.6046-1(i)(1) is silent.
 - *Moderate inference:* no attribution of ownership of foreign corporation stock owned by foreign nongrantor trusts or foreign estates to their U.S. beneficiaries or heirs. (What is not regulated is unregulated).

Entity-to-owner attribution for Categories 2, 3: silence means???

- **Grantor trusts:** Reg. §1.6046-1(i)(1) is silent.
- *Weak inference:* Rev. Rul. 85-13 says the grantor is deemed to be the direct owner of the trust's assets, so treat the grantor as the direct shareholder of (foreign or domestic) grantor trust-owned foreign corporation stock.
- **Disregarded entities:** Reg. §1.6046-1(i)(1) is silent.
- *Weak inference:* Murky (in my opinion) in light of *Suzanne Pierre v. Commissioner*, 133 T.C. 24 (2009), but for income tax purposes I think the appropriate treatment is to treat the single owner of a disregarded entity as the direct owner of foreign corporation stock owned by the disregarded entity.

3. The Category 4 Attribution Rules

3.A. Category 4: Introduction

Who is a Category 4 filer?

- A U.S. person who had control of a foreign corporation at any time in the tax year of the corporation. IRC §6038(a).
- This is not the same thing as a “controlled foreign corporation”
 - A controlled foreign corporation has potentially **multiple** “U.S. shareholders” who **collectively** own more than 50% of a foreign corporation. IRC §957(a).
 - Category 4 looks for **one person** who **alone** owns more than 50% of the stock ownership of a foreign corporation. IRC §6038(a)(1), (e)(2). There might be many of them.

“Control” = owns more than 50% of stock, by vote or value

- “A person shall be deemed to be in control of a foreign corporation if at any time during that person's taxable year it **owns** stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation.”
- Reg. §1.6038-2(b), emphasis added.
- “Owns” is the magic word that invokes the need for an attribution analysis.

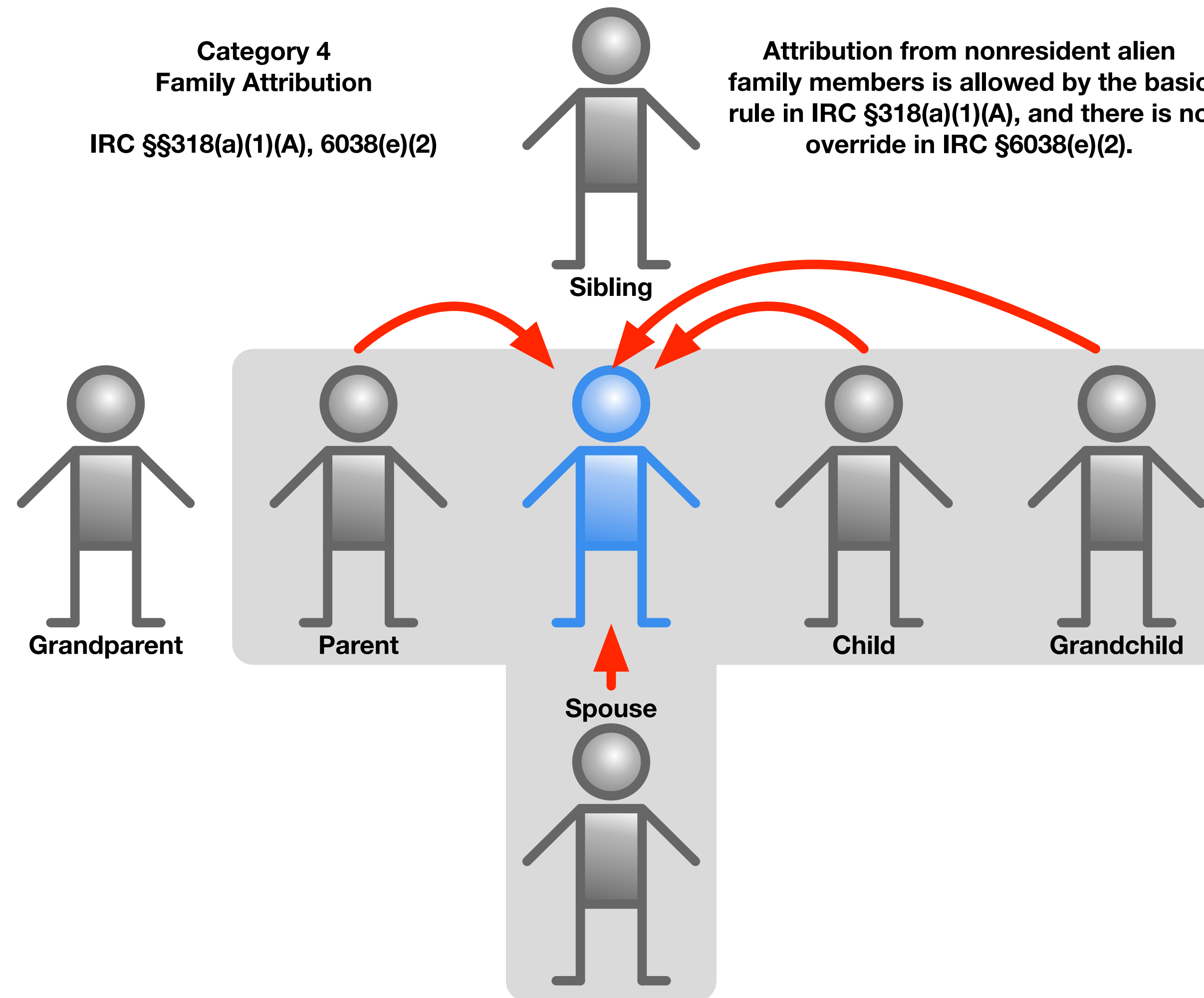
Category 4: where to find the law

- IRC §6038(e)(2) states the **governing rule** defining “control” and tells you to **use IRC §318(a)** to determine stock ownership so you can figure out if a U.S. person owns enough stock (directly, indirectly, or constructively) to have “control” of the foreign corporation.
- IRC §6038(e)(2)(A) **modifies** IRC §318(a)(3)(A), (B), (C): prohibits downward attribution from foreign persons to a domestic partnership, estate, trust, or corporations.
- IRC §6038(e)(2)(B) **modifies** IRC §318(a)(2)(C): for upward attribution from a corporation, change the default 50% ownership threshold to 10%.

3.B. Category 4: Family Attribution

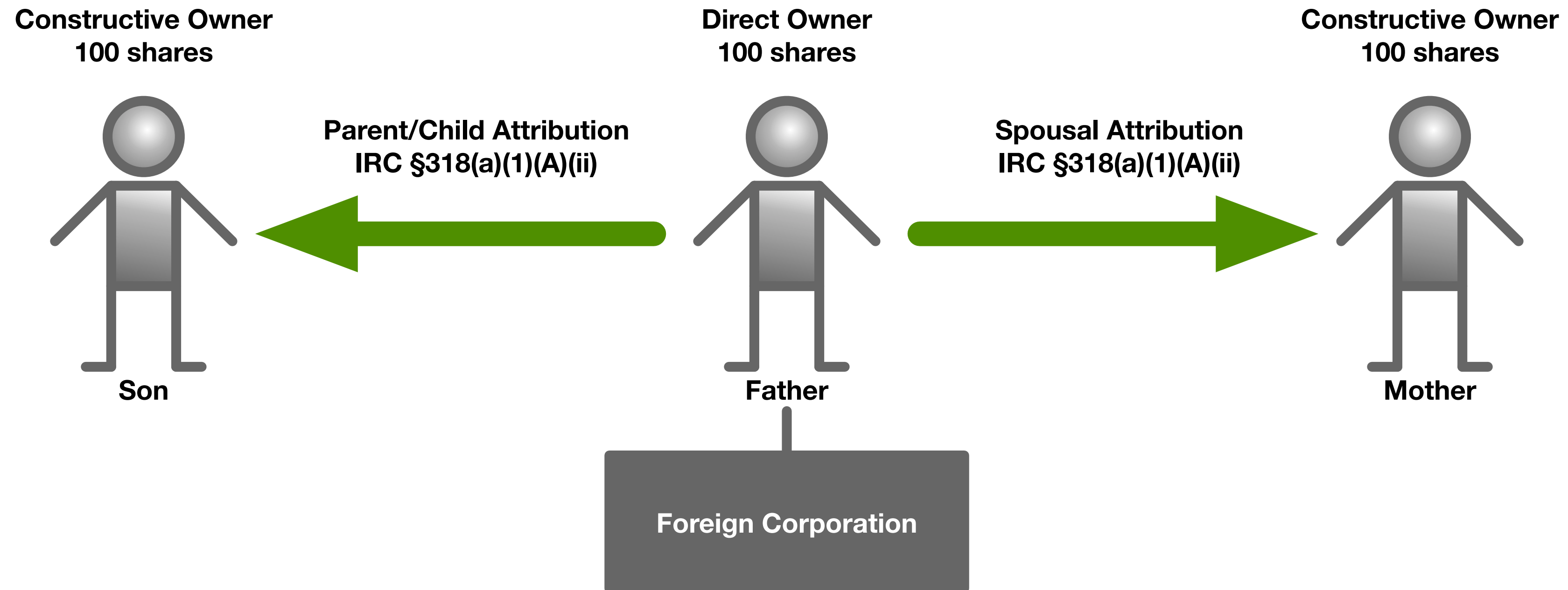
3.B.1. Attribution to Family Members

Category 4: family attribution rules



3.B.2. Attribution to Multiple Family Members

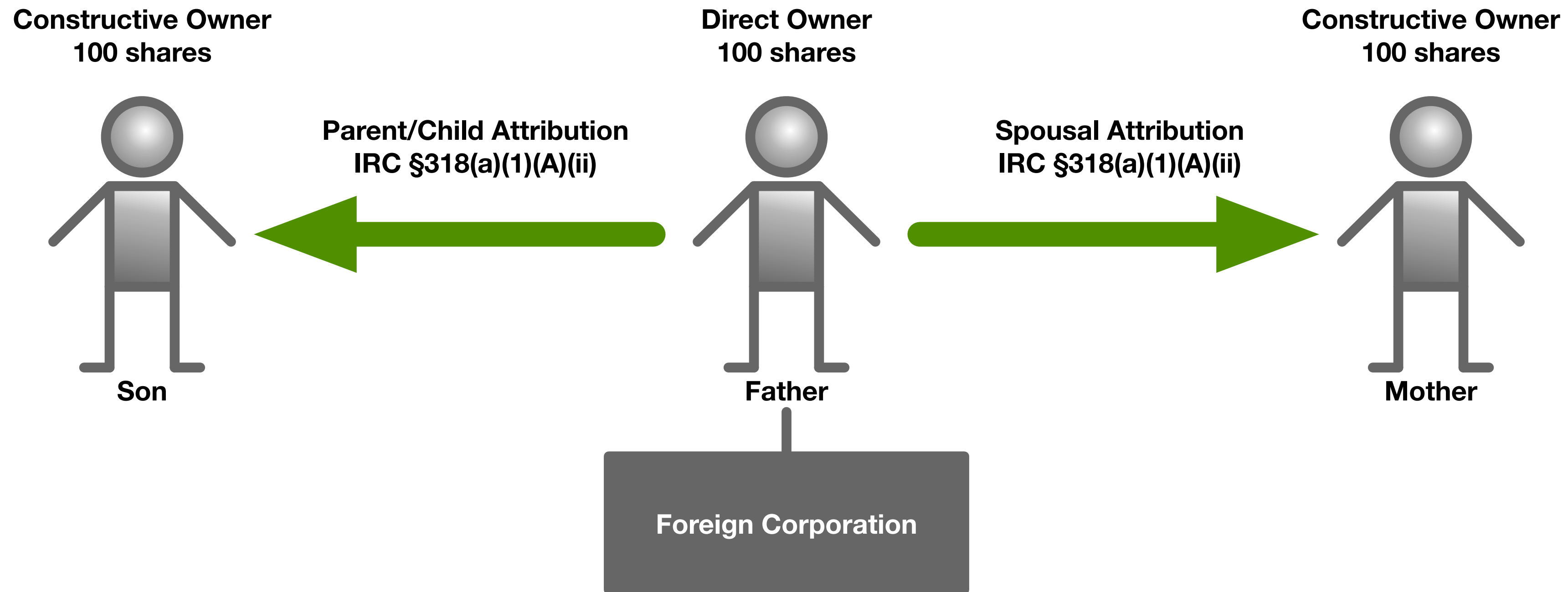
How many Category 4 filers do you see? I see three, potentially.



Attribute the stock to only one person "for any one purpose"

- “In applying section 318(a) to determine the stock ownership of any person **for any one purpose**[,] . . . [i]n any case in which an amount of stock owned by any person may be included **in the computation** more than one time, such stock shall be included only once, in the manner in which it will impute to the person concerned the largest total stock ownership[.]” *Reg. §1.318-1(b)(2)*.
- Your quest:
 - “My purpose is to identify constructive ownership of Father’s stock to identify all people who have ‘control.’ I found two people: a spouse and a child. I will now pick one of them to whom I will attribute Father’s directly-owned stock, and treat that person as the only constructive owner of that stock.”

Make *either* Mother or Son a constructive owner of Father's stock



1. Father is a Category 4 filer because he is the direct owner of 100 shares of stock. IRC §6038(e)(2).
2. Mother (spouse) is a Category 4 filer because she is a constructive owner of Father's stock. IRC §§318(a)(1)(A)(ii), 6038(e)(2).
3. Son is a Category 4 filer because he is a constructive owner of Father's stock. IRC §§318(a)(1)(A)(ii), 6038(e)(2).
4. Son is not the constructive owner of Mother's stock because there is no re-attribution of constructively owned stock. IRC §318(a)(5)(B).
5. Don't attribute Father's stock to BOTH Mother and Son. Attribute it once, to the person who would have the largest stock ownership. Reg. §1.318-1(b)(2).
6. Both Mother and Son end up at the same stock ownership position (100 shares). Pick one to declare as the constructive owner of Father's shares. Let's pick Mother.
7. If Father files Form 5471 as a Category 4 filer, Mother, as a constructive owner, doesn't need to file. See Form 5471 Instructions, pp. 5-6.
8. What about Son, who you didn't pick as the constructive owner at step 6? I personally would flag this in a statement attached to Form 5471.

3.B.3. No Reattribution of Constructively-Owned Stock

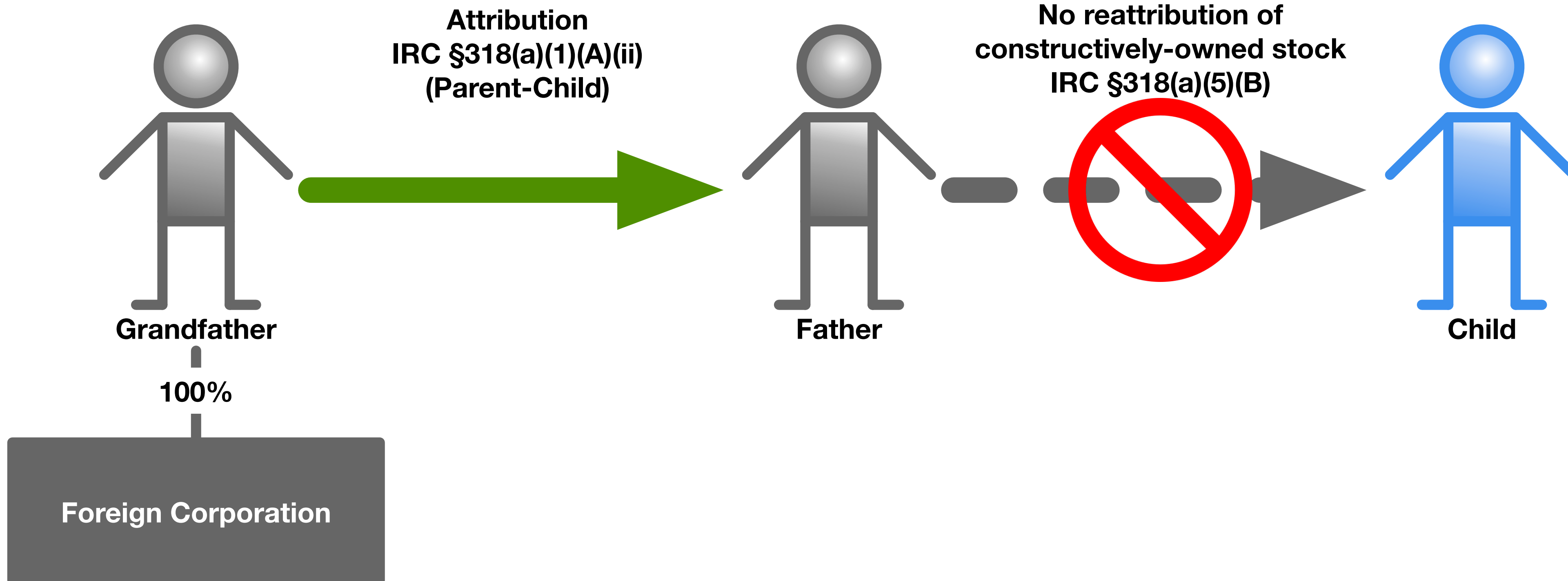
Attribute ownership from the direct owner to Individual A, then treat individual A as the owner and attribute the stock again to Individual B.

Category 4: no reattribution of constructively-owned stock

Grandfather is the direct owner of foreign corporation stock

Father is the constructive owner of Grandfather's foreign corporation stock

Child is not the constructive owner of Father's constructively-owned foreign corporation stock



3.C. Category 4: Attribution From Entities to Owners

Upward Attribution

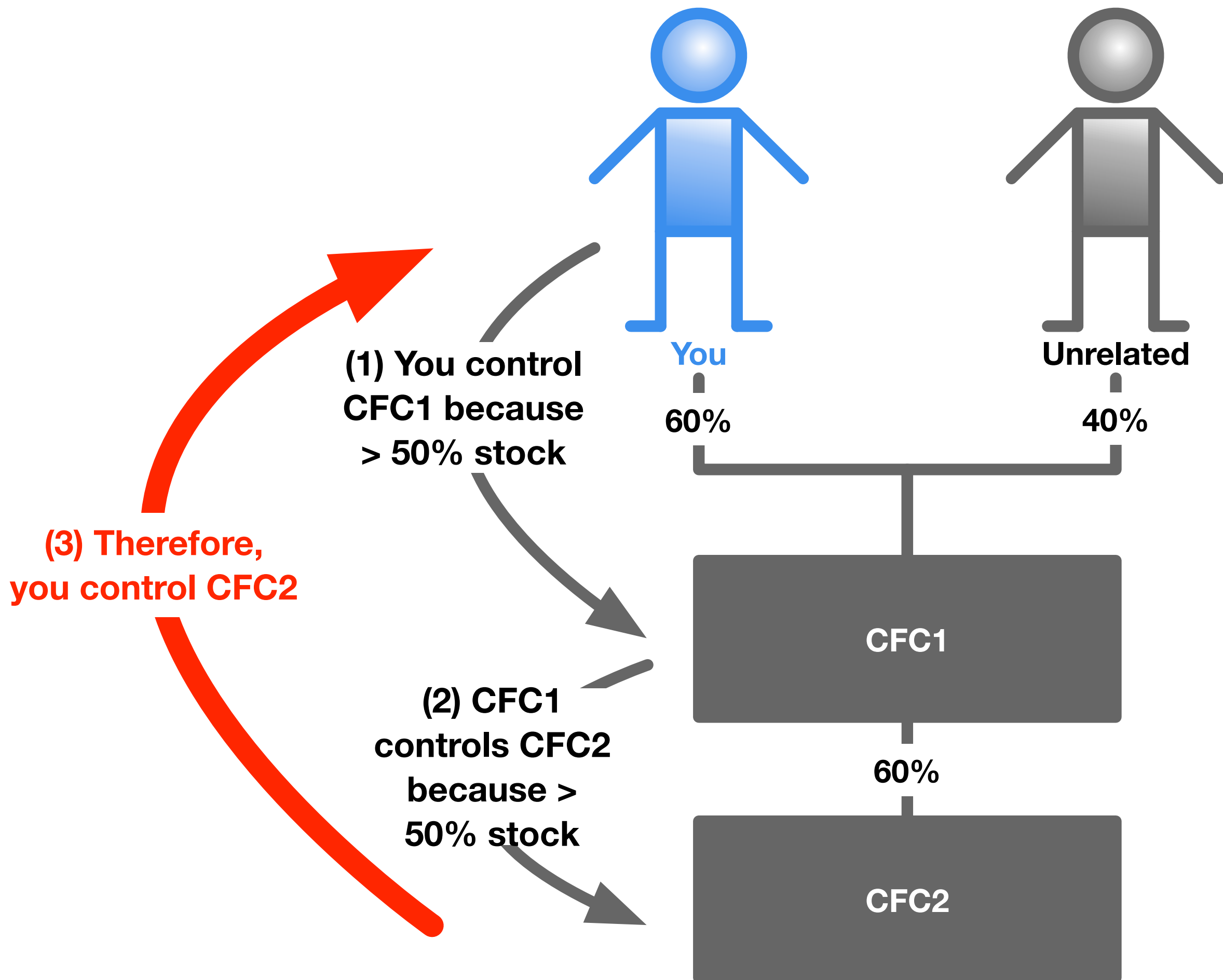
Category 4: upward attribution from entities other than corporations

Entity Type	Rule	Authority
Partnership	Partners own a proportional share of partnership-owned stock	IRC §318(a)(2)(A)
Estate	Beneficiaries own a proportional share of estate-owned stock	IRC §318(a)(2)(A)
Nongrantor trust	Beneficiaries own their actuarially-computed share of nongrantor trust-owned stock	IRC §318(a)(2)(B)(i)
Grantor trust	Owner under the grantor trust rules owns 100% of grantor trust-owned stock	IRC §318(a)(2)(B)(ii)

Category 4: upward attribution from corporations

Your Parent stock ownership percentage	If Parent owns up to 50% of Subsidiary stock	If Parent owns more than 50% of Subsidiary stock
Less than 10%	No attribution of Subsidiary stock to you for determining your “control” of Subsidiary. IRC §§318(a)(2)(C), 6038(e)(2)(B).	
10% or more	You own a pro-rata share of Subsidiary stock for determining your “control” of Subsidiary. IRC §§318(a)(2)(C), 6038(e)(2)(B).	
More than 50%	You own a pro-rata share of Subsidiary stock for determining your “control” of Subsidiary. IRC §§318(a)(2)(C), 6038(e)(2)(B).	You automatically have “control” and are a Category 4 filer for Subsidiary. IRC §6038(e)(2).

Automatic control rule for majority ownership



“A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as being in control of such other corporation.” Regs. §1.6038-2(b).

Math: you own 60% of 60% of CFC2’s stock = 36%. That’s not enough to “control” CFC2.

But the special rule of Regs. §1.6038-2(b) says you do, in fact, control CFC2. Which is, in fact, true in the real world.

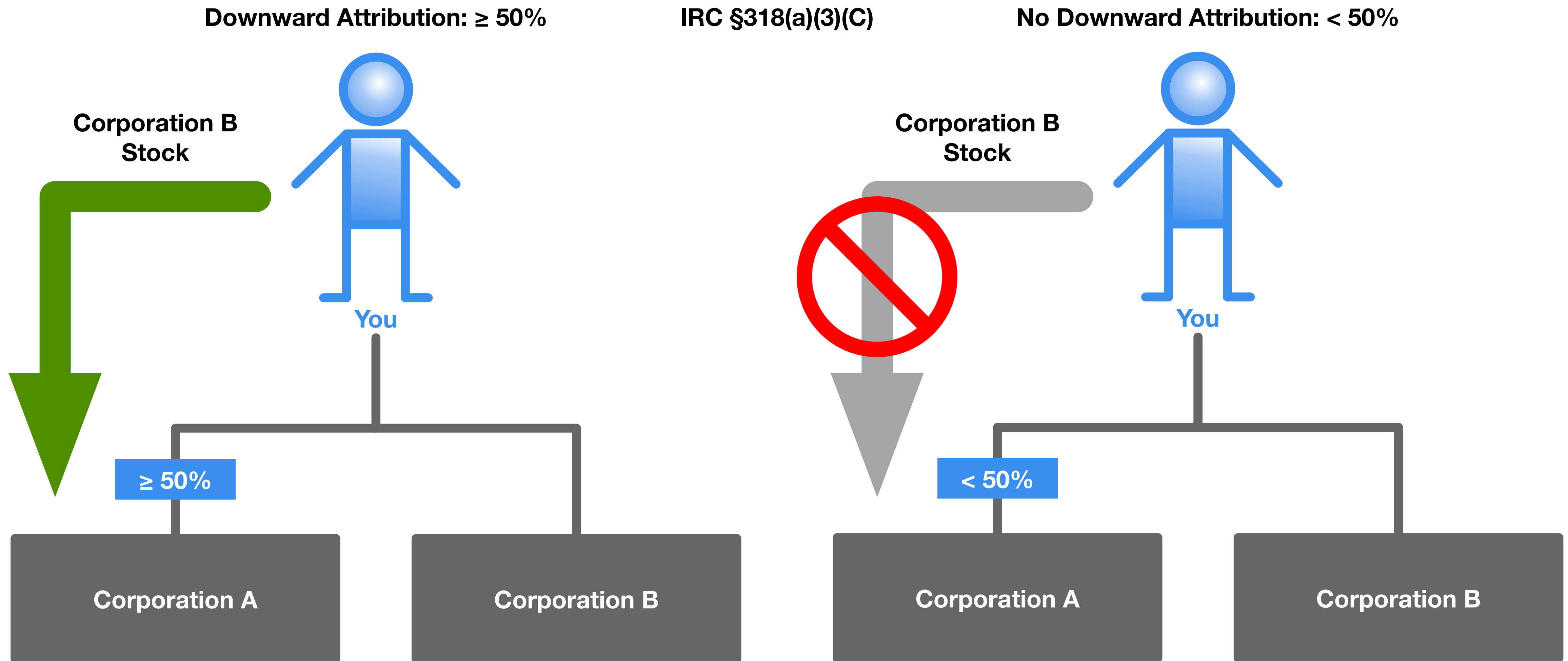
3.D. Category 4: Attribution from Owners to Entities

Downward Attribution

Attribution to partnerships, estates, and trusts: no threshold

Entity Type	Rule	Authority
Partnership	Partnerships are constructive owners of the partners' stock in foreign corporations	IRC §318(a)(3)(A)
Estate	Estates are constructive owners of the beneficiaries' stock in foreign corporations	IRC §318(a)(3)(A)
Nongrantor trust	Nongrantor trusts are constructive owners of beneficiaries' stock in foreign corporations (except $\leq 5\%$ actuarial interest beneficiaries)	IRC §318(a)(3)(C)(i)
Grantor trust	Grantor trusts are constructive owners of stock held by the owners under grantor trust rules.	IRC §318(a)(3)(C)(ii)

Downward attribution for corporations: $\geq 50\%$ threshold

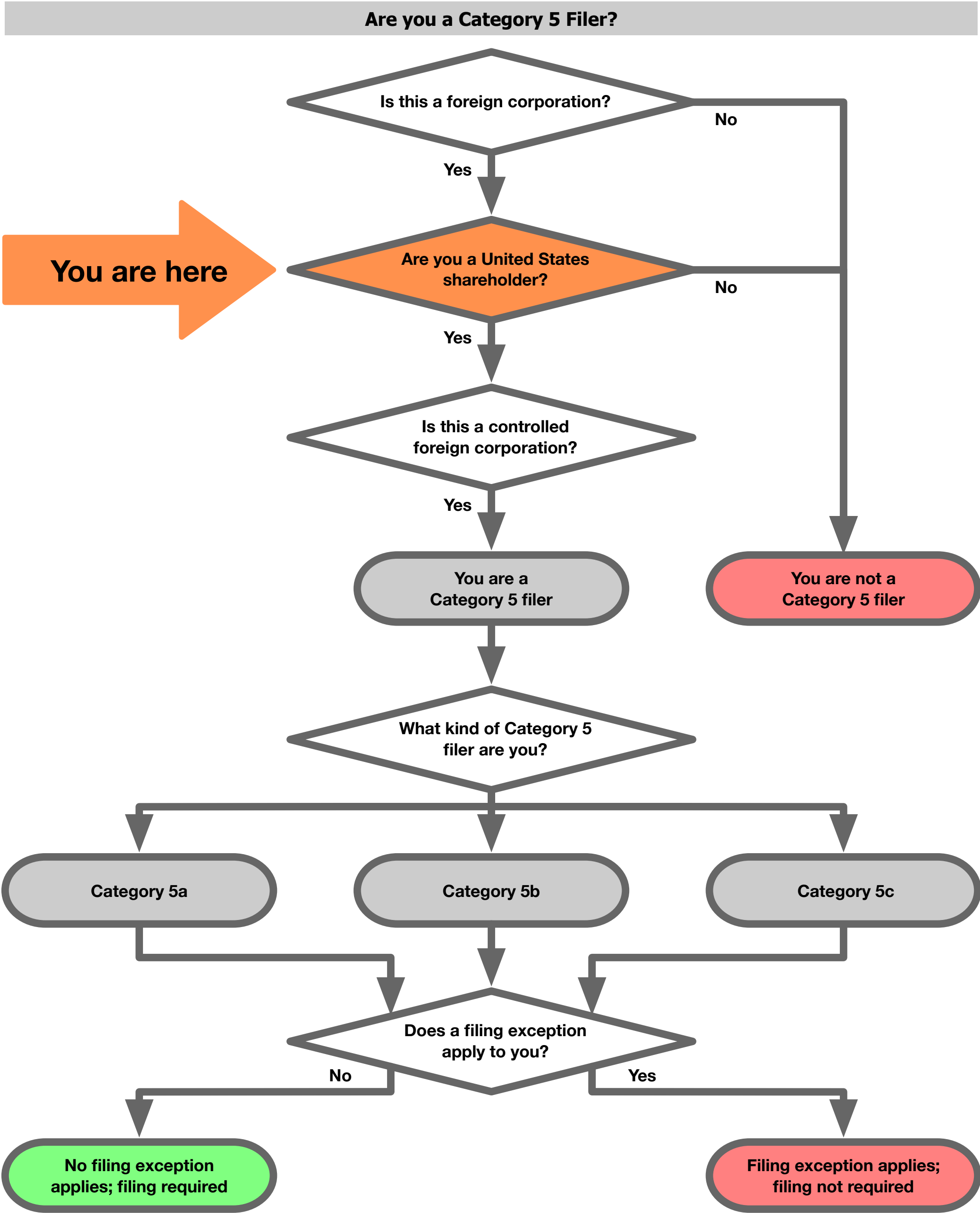


Category 4: no downward attribution from a foreign person

- IRC §6038(e)(2)(A):
 - “[S]ubparagraphs (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person[.]”

4. The Category 1 and Category 5 Attribution Rules

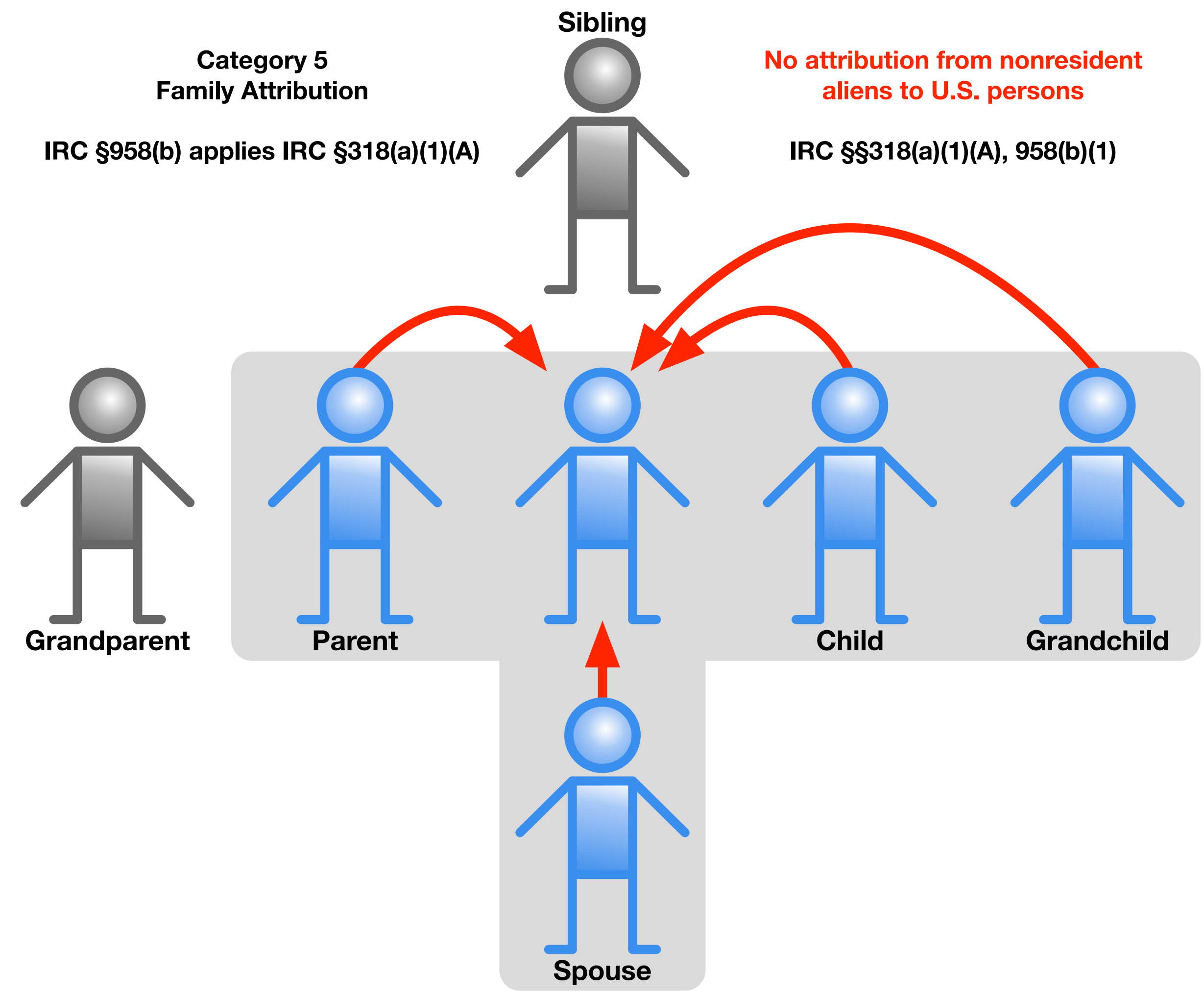
4.A. Categories 1, 5: Introduction



4.B. Category 5: Family Attribution

4.B.1. Attribution to Family Members

Category 5: family attribution



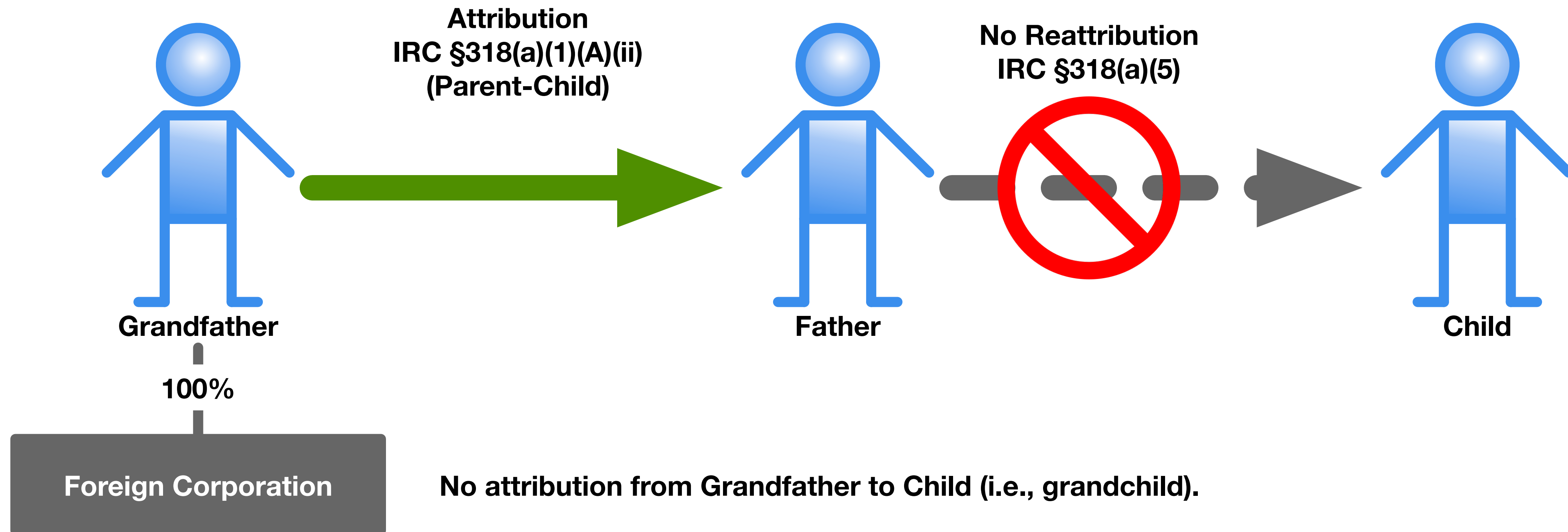
4.B.2. No Reattribution of Constructively-Owned Stock

Category 5: reattribution of stock not allowed

Grandfather is the direct owner of foreign corporation stock

Father is the constructive owner of Grandfather's foreign corporation stock

Child is not the constructive owner of Father's constructively-owned foreign corporation stock



4.B.3. No Attribution from Nonresident Aliens

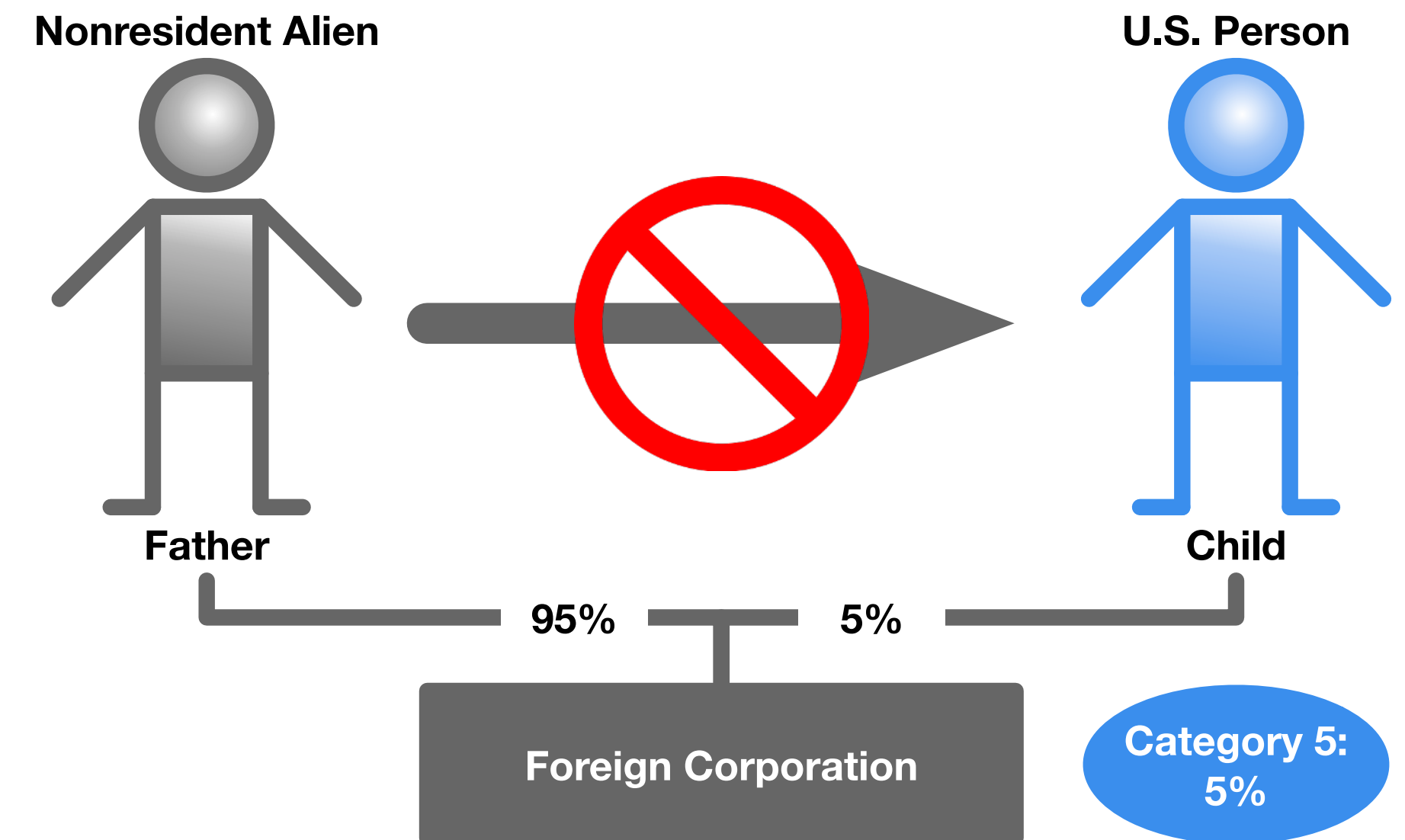
Example: no Category 5 constructive ownership from a nonresident

Category 5

Parent-child attribution
IRC §318(a)(1)(A)(ii)

Override to IRC §318(a) rules: no attribution from a
nonresident alien to a U.S. person. IRC §958(b)(1).

Result: child does not have constructive ownership of father's
stock of Foreign Corporation for Category 5



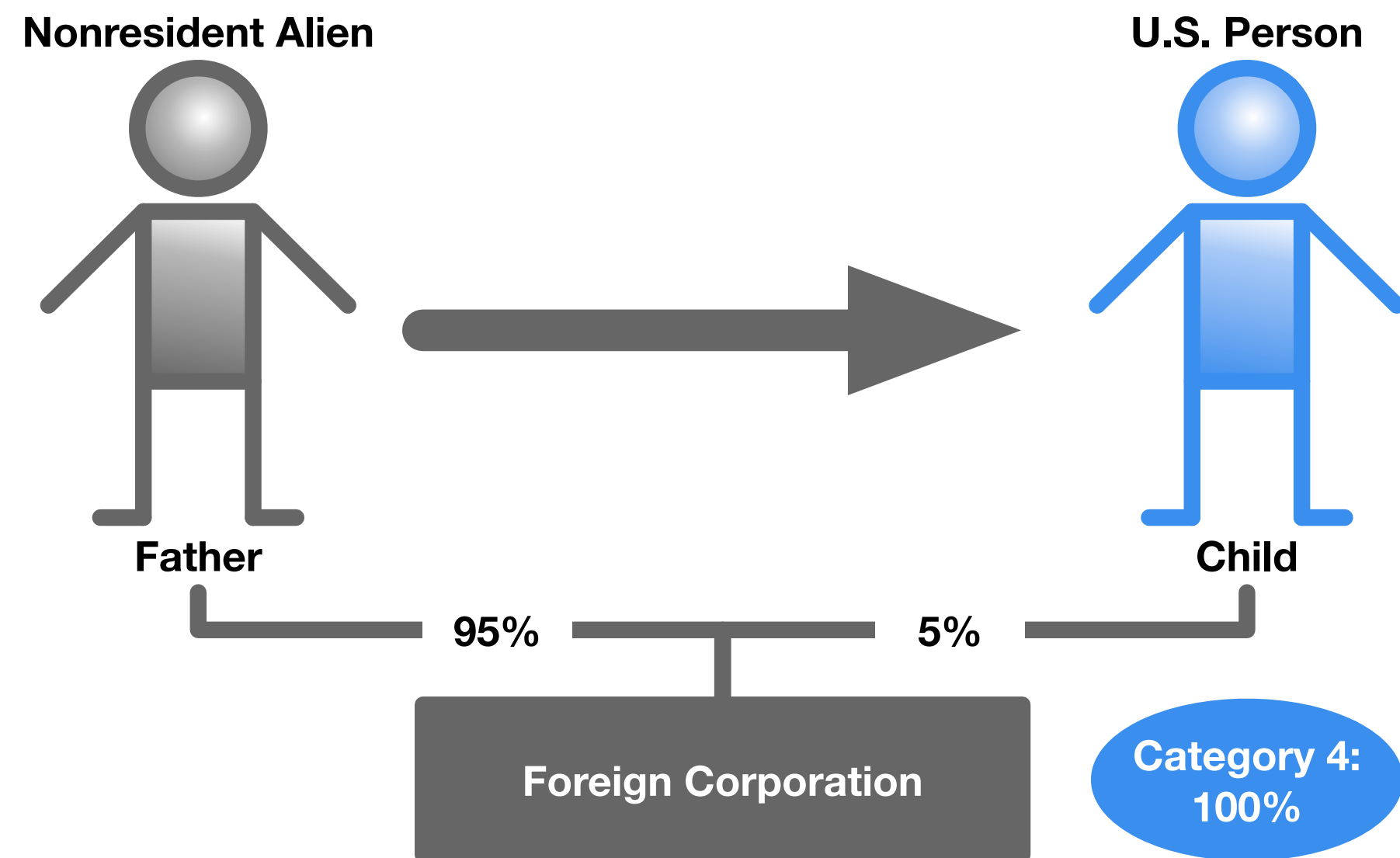
Category 4 vs. Category 5: constructive ownership from nonresident

Category 4

Parent-child attribution
IRC §318(a)(1)(A)(ii)

No override to IRC §318(a) rules for attribution from a nonresident alien to a U.S. person. IRC §6038(e)(2).

Child has constructive ownership of father's stock of Foreign Corporation for Category 4

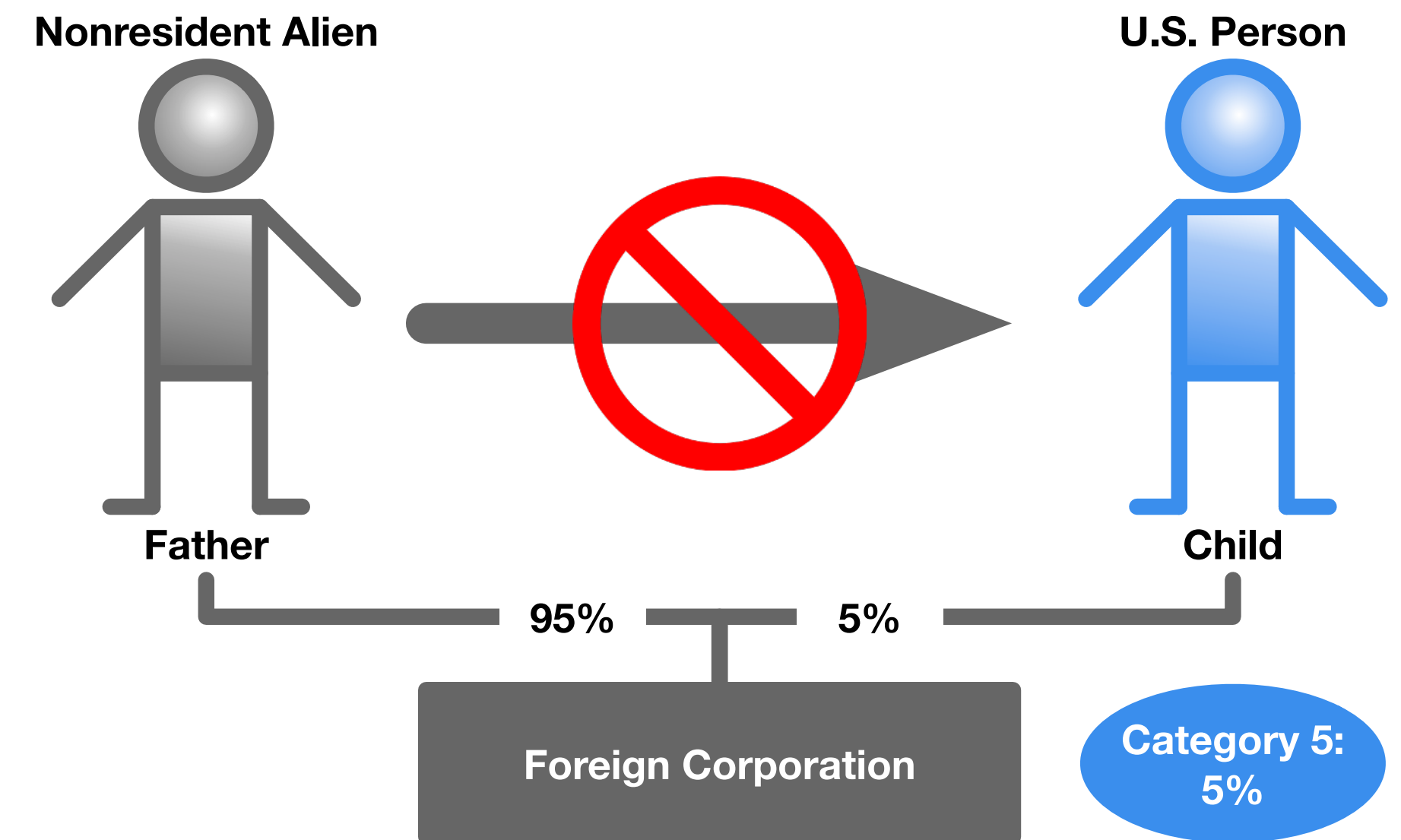


Category 5

Parent-child attribution
IRC §318(a)(1)(A)(ii)

Override to IRC §318(a) rules: no attribution from a nonresident alien to a U.S. person. IRC §958(b)(1).

Result: child does not have constructive ownership of father's stock of Foreign Corporation for Category 5



4.C. Categories 1, 5: Attribution from Entities to their Owners

Upward attribution

Upward attribution from domestic partnership, estate

Partnership or estate's ownership % of foreign corporation stock	Partner or beneficiary's constructive stock ownership %
Voting power: 0% to 50% by vote	By voting power: Taxpayer's % interest in the partnership/estate x partnership/estate's % interest by vote in foreign corporation stock <i>IRC §§318(a)(2)(A), 958(b)</i>
Voting power: More than 50% by vote	By voting power: Taxpayer's percentage interest in the partnership/estate x 100% <i>IRC §§318(a)(2)(A), 958(b)(2)</i>
Value: Any percentage	By value : Taxpayer's percentage interest in the partnership/estate x partnership/estate's % interest by value in foreign corporation stock <i>IRC §§318(a)(2)(A), 958(b)</i>

Upward attribution from a domestic trust to beneficiaries

Type of Trust, Ownership Percentage	Beneficiary's stock ownership %
Nongrantor trust - ownership by voting power is 50% or less	By vote : Beneficiary's actuarial interest in the trust x the trust's stock ownership % by vote <i>IRC §§318(a)(2)(B)(i), 958(b)</i>
Nongrantor trust - ownership by voting power is more than 50%	By vote : Beneficiary's actuarial interest in the trust x 100% <i>IRC §§318(a)(2)(B)(I), 958(b)(2)</i>
Nongrantor trust - ownership by value is any percentage	By value : Beneficiary's actuarial interest in the trust x trust's stock ownership % by value <i>IRC §§318(a)(2)(B)(i), 958(b)</i>
Grantor trust - ownership by vote or value	Grantor owns the grantor trust's stock <i>IRC §§318(a)(2)(B)(ii), 958(b)</i>

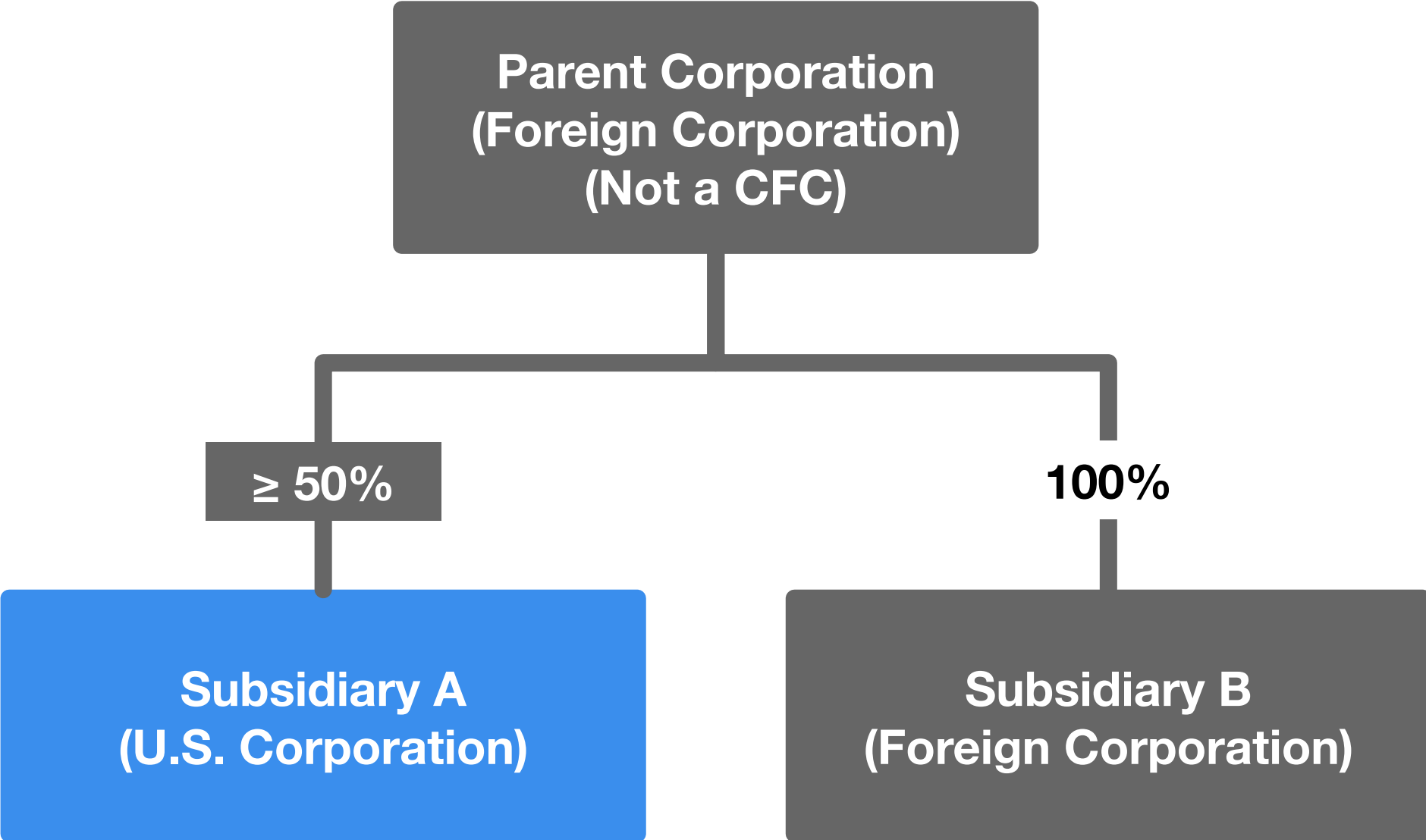
Upward attribution from corporation to shareholder

You own x% of parent stock (by value)	Parent ownership of subsidiary stock	Your ownership of subsidiary stock
Less than 10%	Any	None IRC §§318(a)(2)(C), 958(b)(3)
10% or more	Up to and including 50% by vote	Voting: your % of parent corporation x parent corporation's stock of subsidiary by vote IRC §§318(a)(2)(C), 958(b)(2)
	More than 50% by vote	Voting: your % of parent x 100% of the voting stock owned by parent IRC §§318(a)(2)(C), 958(b)(2)
	Any	Value: your % of parent x parent's stock by value of subsidiary IRC §318(a)(2)(C), 958(b)

4.D. Category 5: Attribution from Owners to Entities

Downward attribution: pretend that the entity owner's stock in a random corporation is owned by the entity.

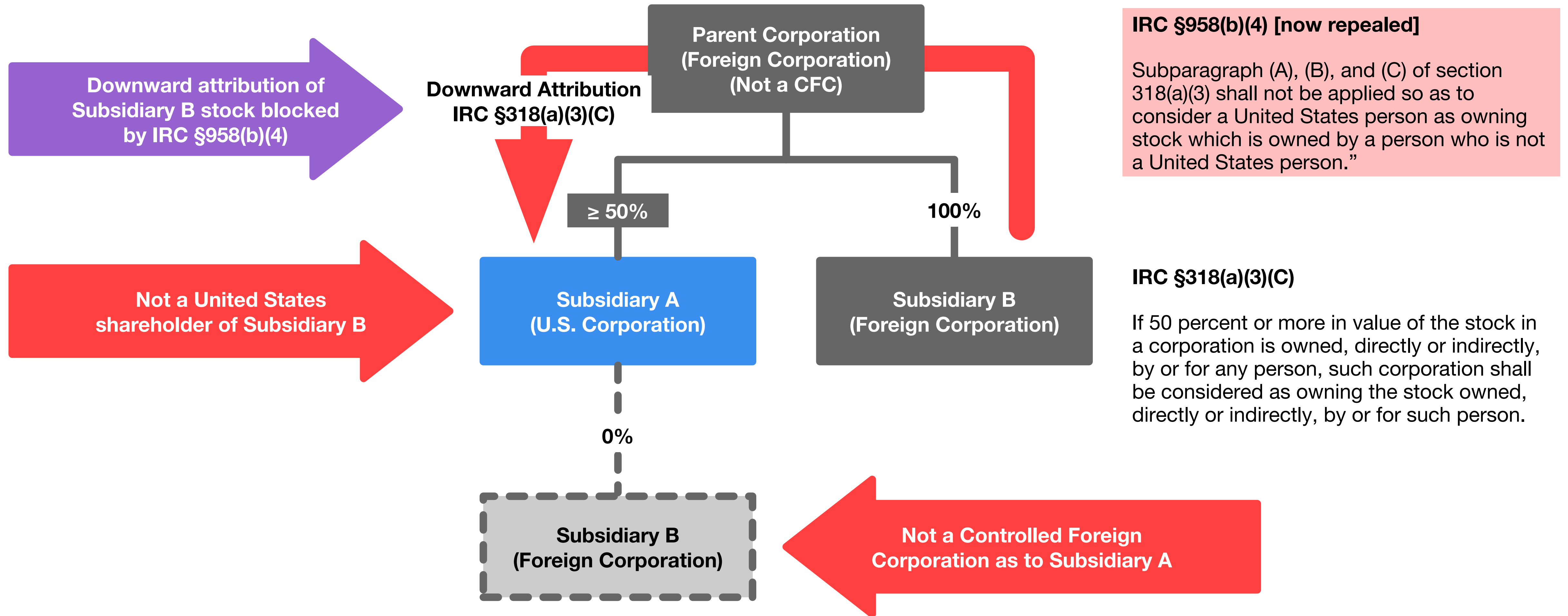
Why does Subsidiary A file Form 5471 as a Category 5 filer?



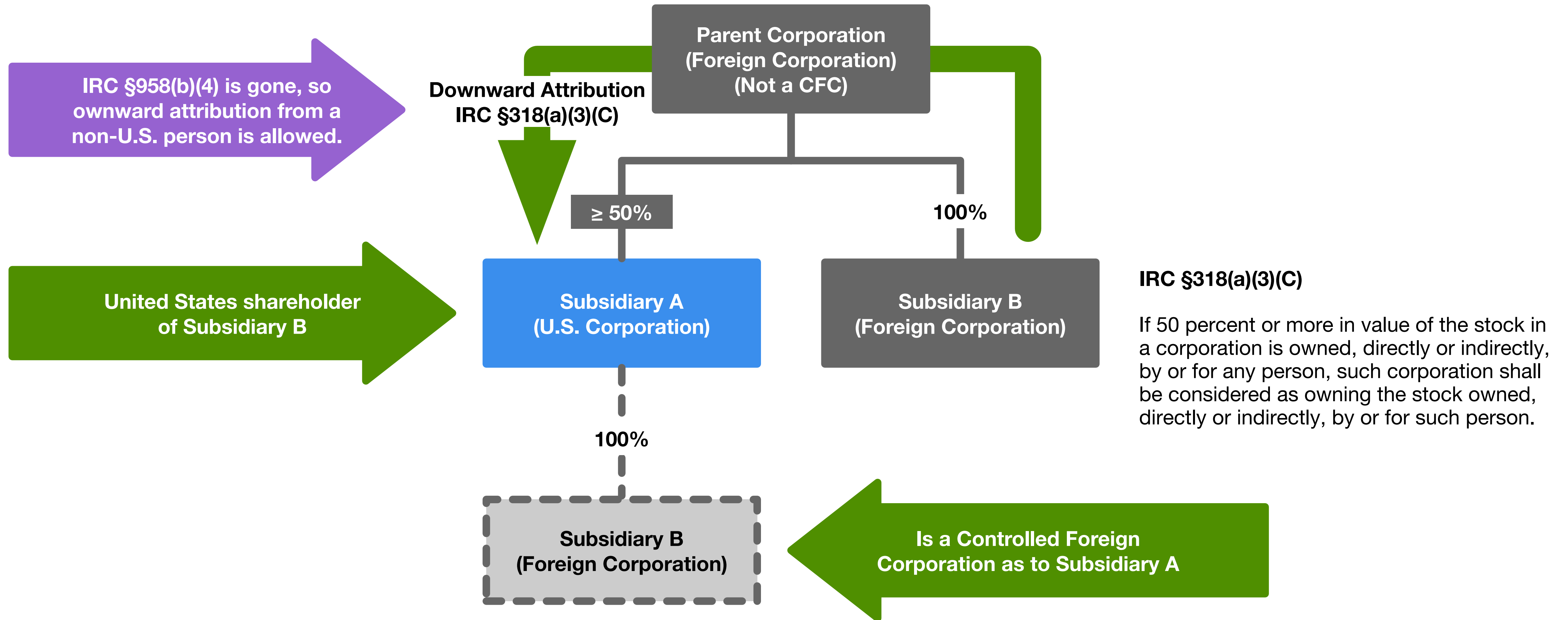
The Repeal of IRC §958(b)(4) in 2017

- In late 2017, Congress repealed IRC §958(b)(4). Before its repeal, IRC §958(b)(4) said:
 - “Subparagraph (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.”
- Now IRC §958(b)(4) is gone, so the attribution rule is IRC §318(a)(3)(C).
 - “If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.”

No downward attribution from non-U.S. persons before 2017 TCJA



Downward attribution from non-U.S. persons is now allowed



Conclusion: Subsidiary A is a Category 5 filer for Subsidiary B

- Subsidiary A is treated as owning all of the shares of Subsidiary B that Parent Corporation owns. IRC §318(a)(3)(C). That means Subsidiary A is treated as owning 100% of the shares of Subsidiary B.
- Subsidiary A is a United States shareholder of Subsidiary B because it owns 10% or more of Subsidiary B's shares. IRC §951(b).
- Subsidiary B is a controlled foreign corporation because United States shareholders own more than 50% of its stock. IRC §957(c).
- Therefore, Subsidiary A is a United States shareholder of a controlled foreign corporation and is a Category 5 filer. IRC §6038(a)(4).

Next steps . . . Category 5a, 5b, or 5c? Is there a filing exception?

- Now that you have determined that Subsidiary A has a Category 5 filing requirement, your next step is to determine which subcategory applies: Category 5a, 5b, or 5c?
- After that, you look for filing exceptions to see if you can get out of the job of filing Form 5471 on behalf of Subsidiary A.
- These discussions will be held for another time.

4.E. Category 5: Downward Attribution With Other Entities

Category 5 — attribution from an owner to an entity

Entity Type	Rule	Authority
Partnership	A partnership owns its partners' stock	IRC §§318(a)(3)(A), 958(b)
Estate	An estate owns its beneficiaries' stock	IRC §§318(a)(3)(A), 958(b)
Nongrantor trust	A nongrantor trust owns its beneficiaries' stock, except for $\leq 5\%$ actuarially-valued beneficiaries	IRC §§318(a)(2)(B)(i), 958(b)
Grantor trust	A grantor trust owns the stock of its owner under the grantor trust rules	IRC §§318(a)(2)(B)(ii), 958(b)

5. Conclusion

Conclusion

- There are many, many rules and exceptions and I skipped most of them.
- The Code and Regulations are not exactly models of clarity. Yet, you must spend time carefully reading them every time you analyze a structure for direct, indirect, and constructive ownership of stock of a foreign corporation.
- Look carefully for the phrases “by value,” “by vote,” or “by vote or value,” because usage is not consistent. Look for “50% or more” vs. “more than 50%.”
- Know the entity ownership structure extremely well. Make an org chart and think through every link in the chain. Write down why you think attribution exists or not.

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Disclaimer

This is not legal advice and I am not your lawyer. Do not rely on this presentation—do your own research to verify that the information is correct and that it applies to you. Or hire someone (maybe an intelligent someone?) to help you.