

Episode 4. Filing Exceptions and Reduced Filing Requirements

- *Do No Work, Do Less Work, or Let Someone Else Do the Work*
-

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The Form 5471 Series (2023-2024)

July 28, 2023

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Introduction

How this episode is organized

- Categories 5, 1, and 4 (in that order). All are based on IRC §6038, so they share a lot of exceptions.
- Category 5 first (start with the hard work), then Category 1 (almost the same as Category 5), then Category 4 (because there's not much to it).
- Categories 3, 2 (in that order). Both are based on IRC §6046; again, there is a lot of overlap.
- Category 3 first (start with the hard work), then Category 2 (filing obligations depend on what happens in Category 3).

For each category, look for . . .

- **No work** - exceptions that eliminate Form 5471 filing requirements for that category.
- **Less work** - you must file Form 5471 for that category, but the exception waives some filing requirements. Fewer schedules for you to prepare!
- **Someone else does the work** - you can't find an applicable “no work” exception, but someone else is filing Form 5471. Their Form 5471 satisfies your Form 5471 filing obligation.

Category 5

Reporting obligations (and exceptions) created by IRC §6038(a)(4).

“No work”

No Direct/Indirect U.S. Shareholders of a Foreign-Controlled CFC

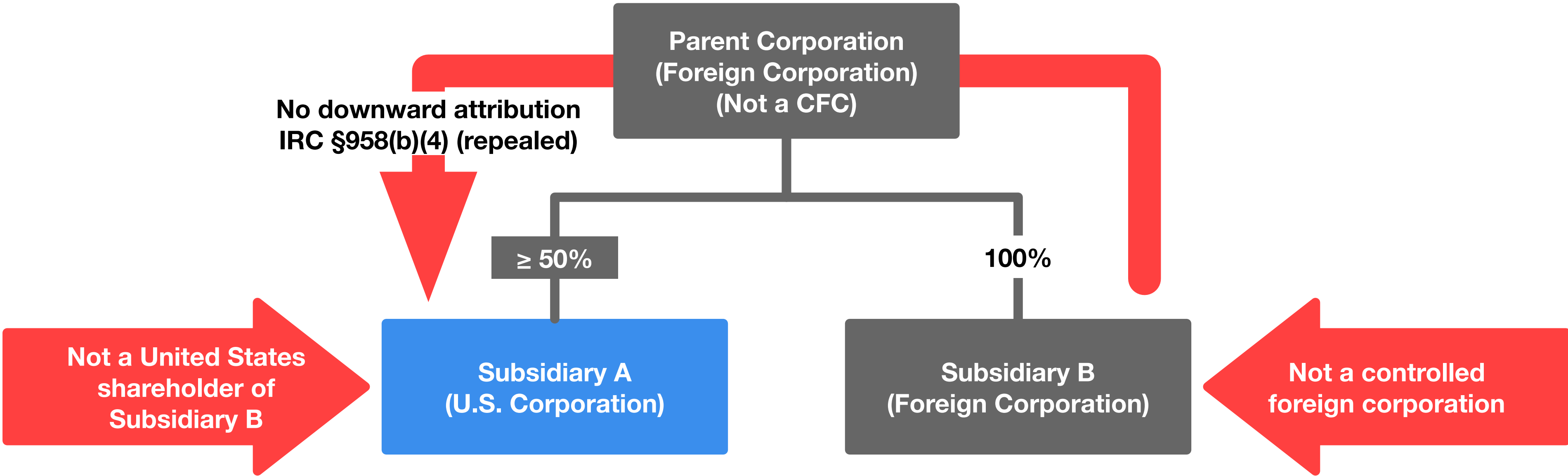
Notice 2018-13, §5.02.

Full exception: Notice 2018-13, §5.02

- No section 958(a) U.S. shareholder (including you) of the foreign corporation's stock.
- The foreign corporation is a foreign-controlled CFC (see Rev. Proc. 2019-40, §3.03 for the definition).
- The Instructions for Form 5471 (and the Notice) are silent on the question of whether you attach a statement to your income tax return.

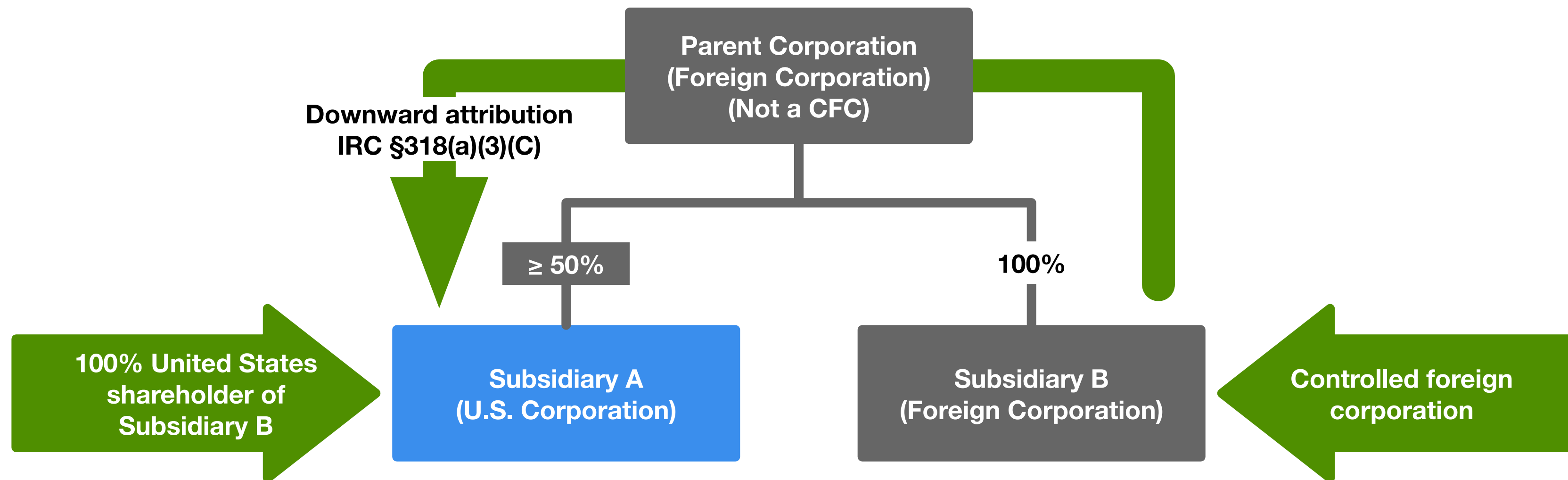
No section 958(a) U.S. shareholder. A Category 5 filer does not have to file Form 5471 if no U.S. shareholder (including the Category 5 filer) owns, within the meaning of section 958(a), stock in the CFC on the last day in the year of the foreign corporation in which it was a CFC and the CFC is a foreign-controlled CFC. See section 5.02 of [Notice 2018-13, 2018-6 IRB 341](#) for additional information.

Once upon a time, the Code didn't create phantom Category 5 filers



Prior to repeal of IRC §958(b)(4), it was not permitted to attribute stock ownership from a foreign person to a U.S. entity under IRC §318(a)(3).

The Tax Cuts and Jobs Act (2017) created phantom Category 5 filers

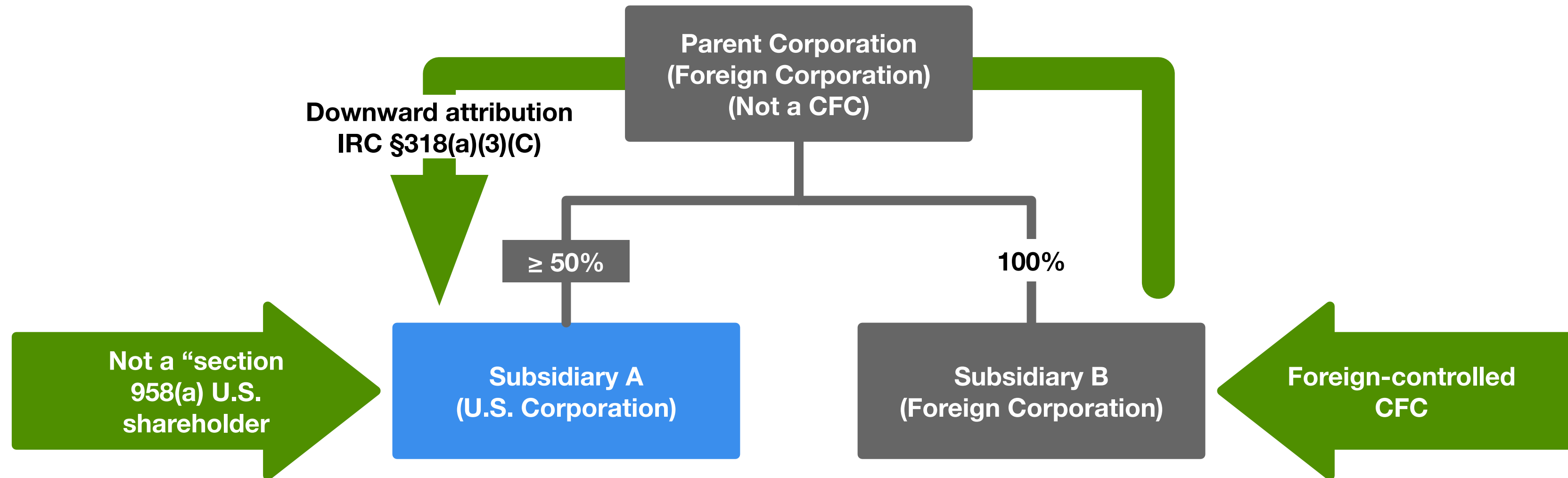


After the repeal of IRC §958(b)(4), attribution of constructive ownership from a foreign person to a U.S. entity under IRC §318(a)(3) became possible.

Parent Corporation's 100% stock ownership of Subsidiary B is constructively owned by Subsidiary A. IRC §318(a)(3)(C).

Therefore, Subsidiary A is a U.S. shareholder of Subsidiary B. IRC §951(b). This makes Subsidiary B a controlled foreign corporation because U.S. shareholders control more than 50% of Subsidiary B's stock. IRC §957(a).

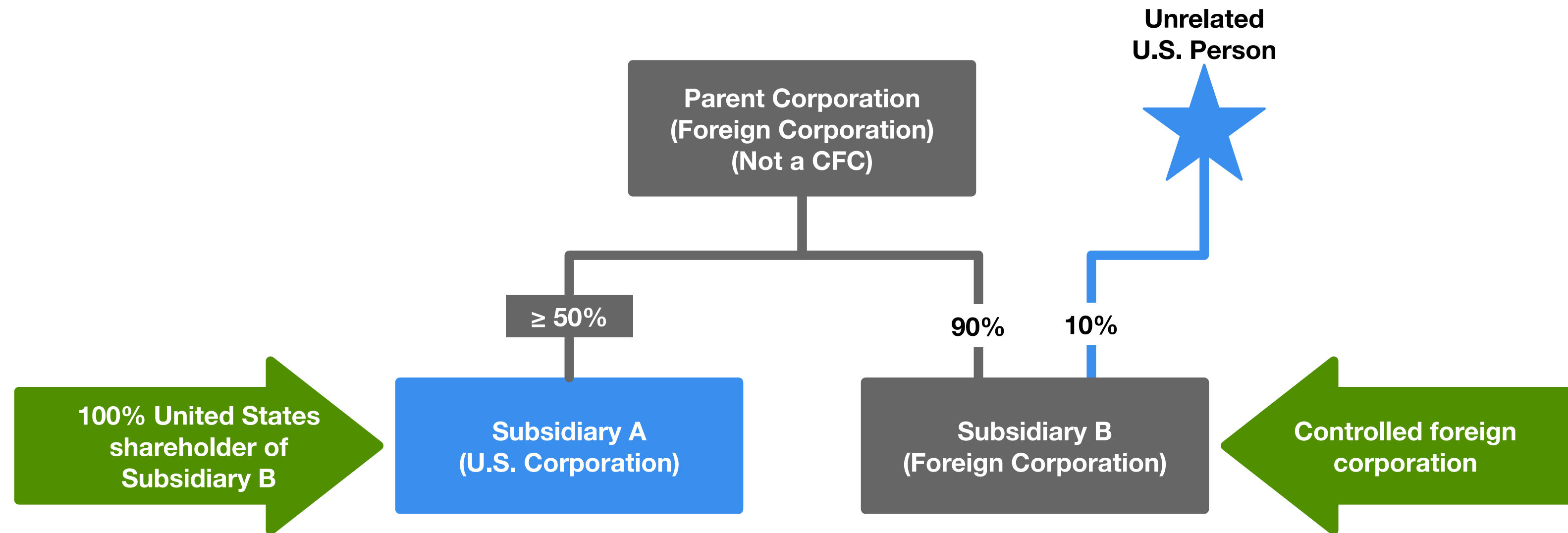
Notice 2018-13, §5.02: no Category 5 filing for Subsidiary A



Subsidiary A can use the Notice 2018-13, §5.02 filing exception to eliminate Category 5 filing requirements. The two requirements for the exception are satisfied:

- There are “**no IRC §958(a) U.S. shareholders**” because no U.S. person owns 10% or more of Subsidiary B stock in a method defined by IRC §958(a)(1)(A) (direct ownership) or IRC §958(a)(1)(B) (indirect ownership). Subsidiary A owns Subsidiary B stock in a method defined in IRC §958(b).
- Subsidiary B is a **foreign-controlled CFC** because if you don’t apply downward attribution of stock from Parent Corporation to Subsidiary A, Subsidiary B is not a CFC. IRC §957(a). But *with* downward attribution, it is a CFC. See Rev. Proc. 2019-40, §3.03 for the definition of “foreign-controlled CFC.”

Notice 2018-13, §5.02 fails - “section 958(a) U.S. shareholder” exists



Subsidiary A cannot use the Notice 2018-13, §5.02 filing exception to eliminate Category 5 filing requirements. Only one of the two requirements for the exception are satisfied:

- There is a “IRC §958(a) U.S. shareholder” because Unrelated U.S. Person directly owns 10% of Subsidiary B stock directly as defined by IRC §958(a)(1)(A). This is enough to make Unrelated U.S. Person a U.S. shareholder. IRC §951(b) by virtue of ownership as defined by IRC §958(a). The Notice 2018-13, §5.02 exception’s requirement of “no section 958(a) U.S. shareholders” fails.
- Subsidiary B is a foreign-controlled CFC because if you eliminate downward attribution of stock from Parent Corporation to Subsidiary A, Subsidiary B is not a CFC. IRC §957(a). With downward attribution, it is a CFC. See Rev. Proc. 2019-40, §3.03 for the definition of “foreign-controlled CFC.”

“No work”

Unrelated Constructive U.S. Shareholder

Rev. Proc. §2019-40, §8.04.

Rev. Proc. 2019-40, §8.04 - if a “section 958(a) U.S. shareholder” exists

- Notice 2018-13, §5.02 gives a filing exception if there is **no section 958(a) U.S. shareholder** of a foreign-controlled CFC.
- Rev. Proc. 2019-40, §8.04 might work for you even if there **is a section 958(a) U.S. shareholder**—as long as *you* are not a section 958(a) U.S. shareholder.

Unrelated constructive U.S. shareholder. A Category 5 filer does not have to file Form 5471 if all of the following conditions are met:

1. The foreign corporation is a foreign-controlled CFC;
2. The filer is a U.S. shareholder that does not own stock, within the meaning of section 958(a), in the foreign-controlled CFC; and
3. The filer is not related, using principles of section 954(d)(3), to the foreign-controlled CFC.

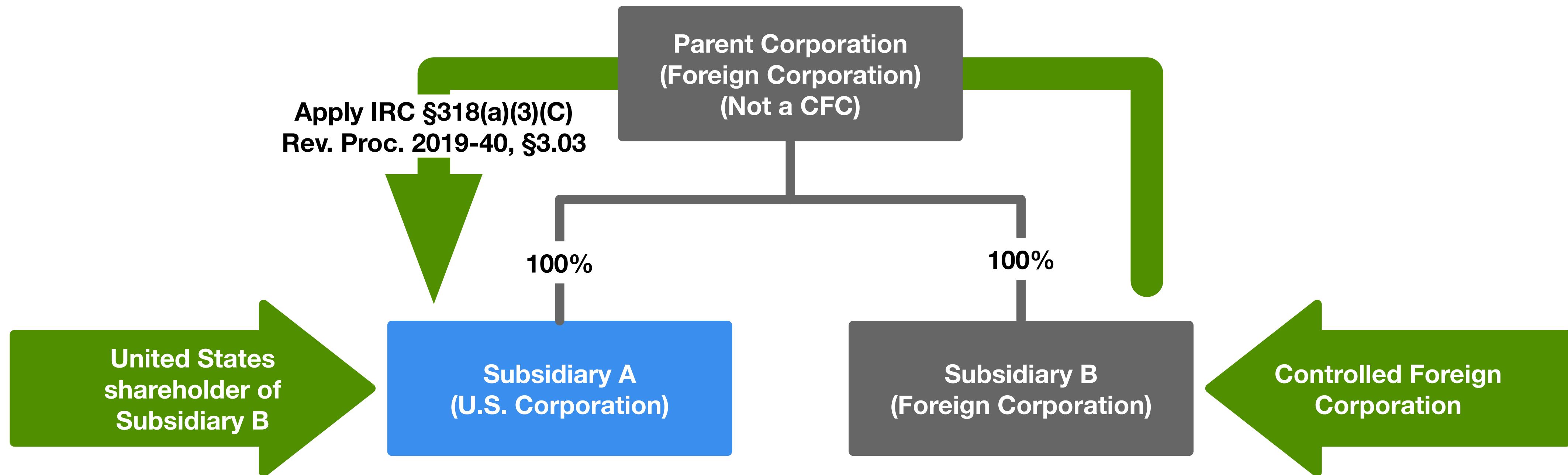
See section 8.04 of [Rev. Proc. 2019-40, 2019-43 IRB 982](#) for additional information.

The meaning of “foreign-controlled CFC” - Rev. Proc. 2019-40, §3.03

- Determine the foreign corporation’s status as a CFC under **current law**, which **allows** downward attribution of stock ownership under IRC §318(a)(3) from foreign persons.
- Determine the foreign corporation’s status as a CFC under **prior law**, which **prohibited** downward attribution of stock ownership under IRC §318(a)(3) from foreign persons.
- If the answer to (1) is “it’s a CFC” and the answer to (2) is “it’s not a CFC,” then it’s a CFC (because that’s the current law) but it’s a “foreign-controlled CFC”.

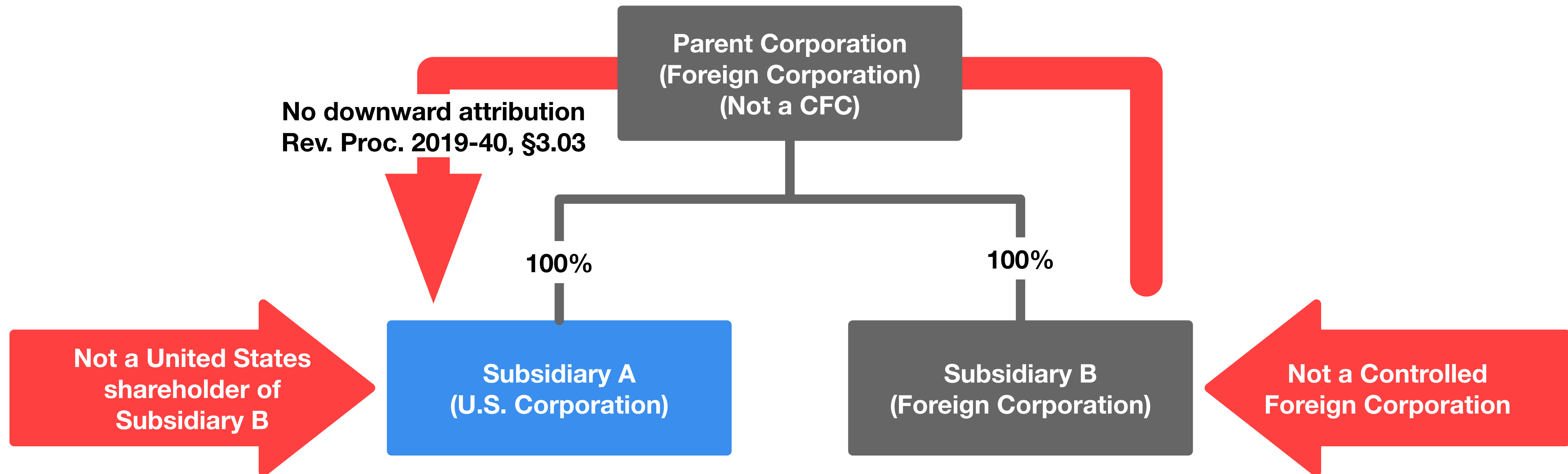
Rev. Proc. 2019-40, §3.03, step 1 - it's a CFC

**Is Subsidiary B a “foreign-controlled CFC?” Rev. Proc. 2019-40, §3.03.
Step 1. With downward attribution, Subsidiary B is a CFC.**



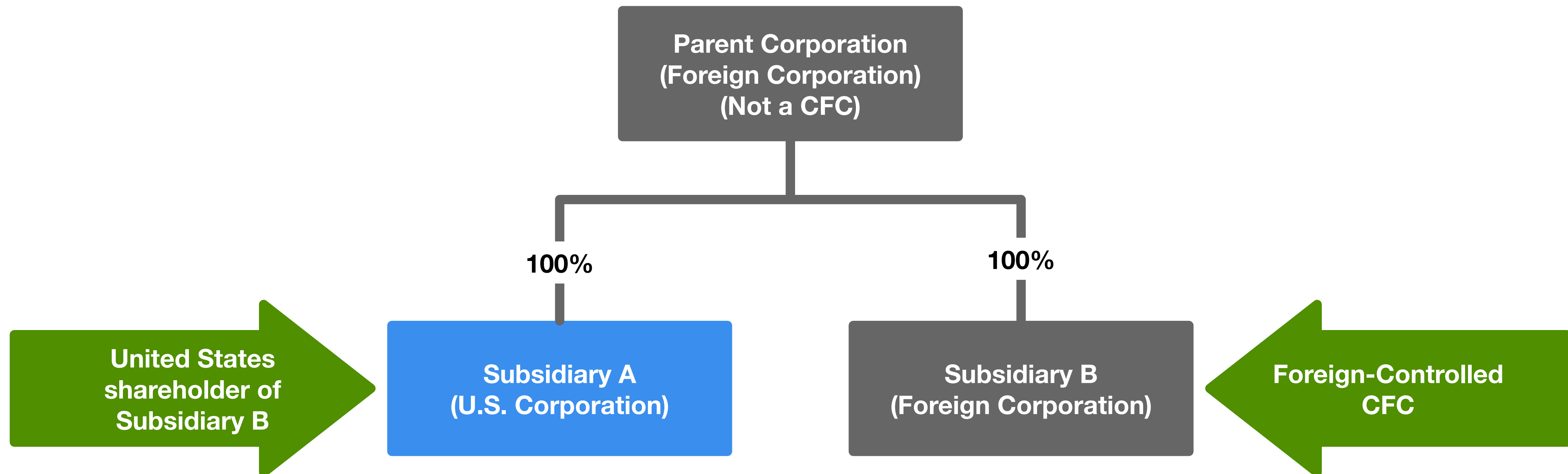
Rev. Proc. 2019-40, §3.03, step 2 - it's not a CFC

**Is Subsidiary B a “foreign-controlled CFC?” Rev. Proc. 2019-40, §3.03.
Step 2. Without downward attribution from a foreign person, Subsidiary B is not a CFC.**



Rev. Proc. 2019-40, §3.03, conclusion - it's a *foreign-controlled* CFC

**Is Subsidiary B a “foreign-controlled CFC?” Rev. Proc. 2019-40, §3.03.
Step 3. Conclusion: Subsidiary B is a foreign-controlled CFC.**



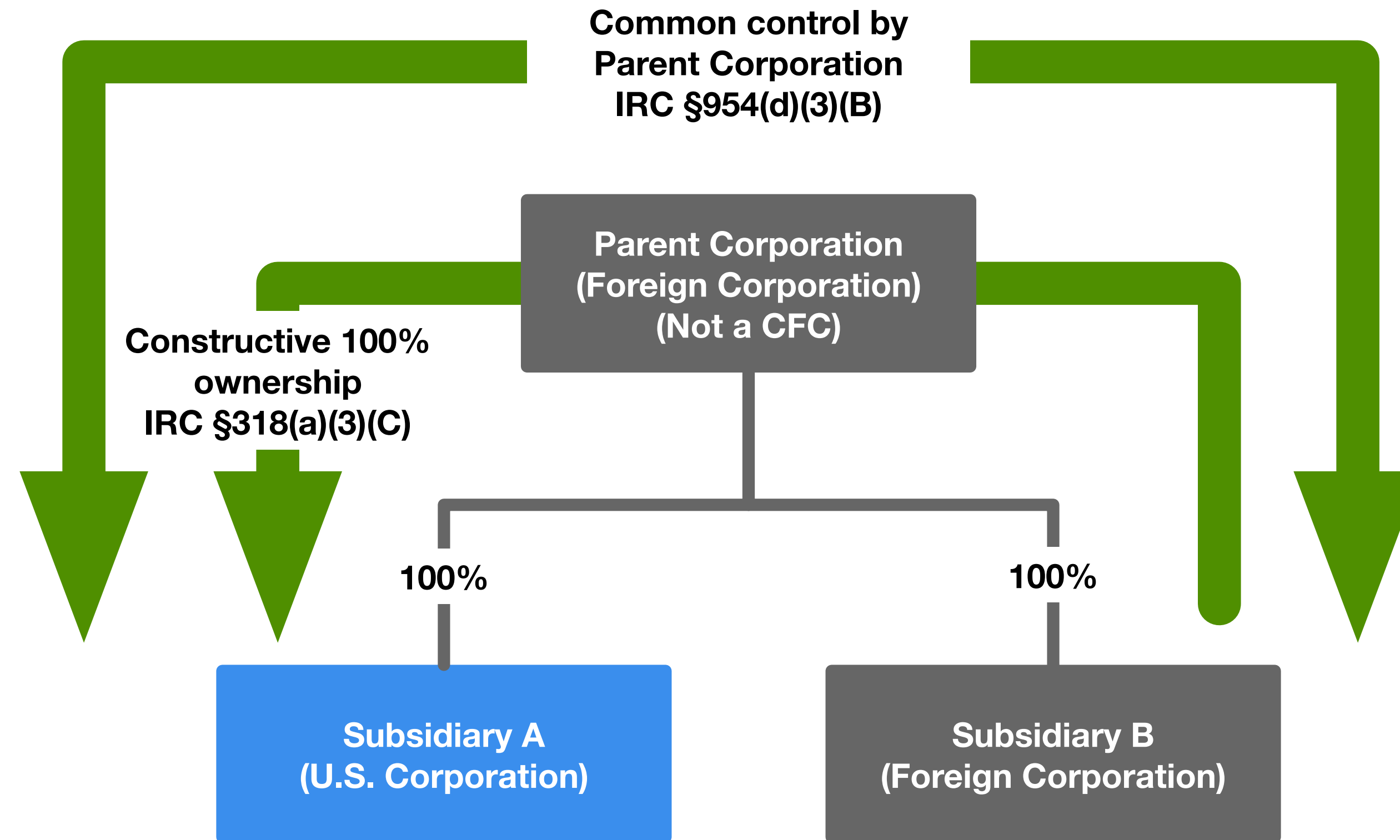
The meaning of “section 958(a) U.S. shareholder”

- You are a U.S. shareholder because you own 10% or more of the stock of the foreign corporation. IRC §951(b).
- You are a “section 958(a)” U.S. shareholder if you own even one share of stock directly (IRC §958(a)(1)(A)) or indirectly through foreign entities (IRC §958(a)(1)(B)), even if all of the rest of the stock you own is constructive ownership under IRC §958(b).
- Rev. Proc. 2019-40, §3.09.

The meaning of “related”: a shareholder is related if it is

- An individual who **controls** the foreign-controlled CFC. IRC §954(d)(3)(A).
- A partnership, estate, trust, or corporation **controls** the foreign-controlled CFC. IRC §954(d)(3)(A).
- A partnership, estate, trust, or corporation is **controlled by** the foreign-controlled CFC. IRC §954(d)(3)(A).
- A partnership, estate, trust, or corporation is **controlled by the same person(s)** who control the foreign-controlled CFC. A partnership, estate, trust, or corporation controls the foreign-controlled CFC. IRC §954(d)(3)(B).
- “Control” means more than 50% ownership. IRC §954(d)(3), flush language.

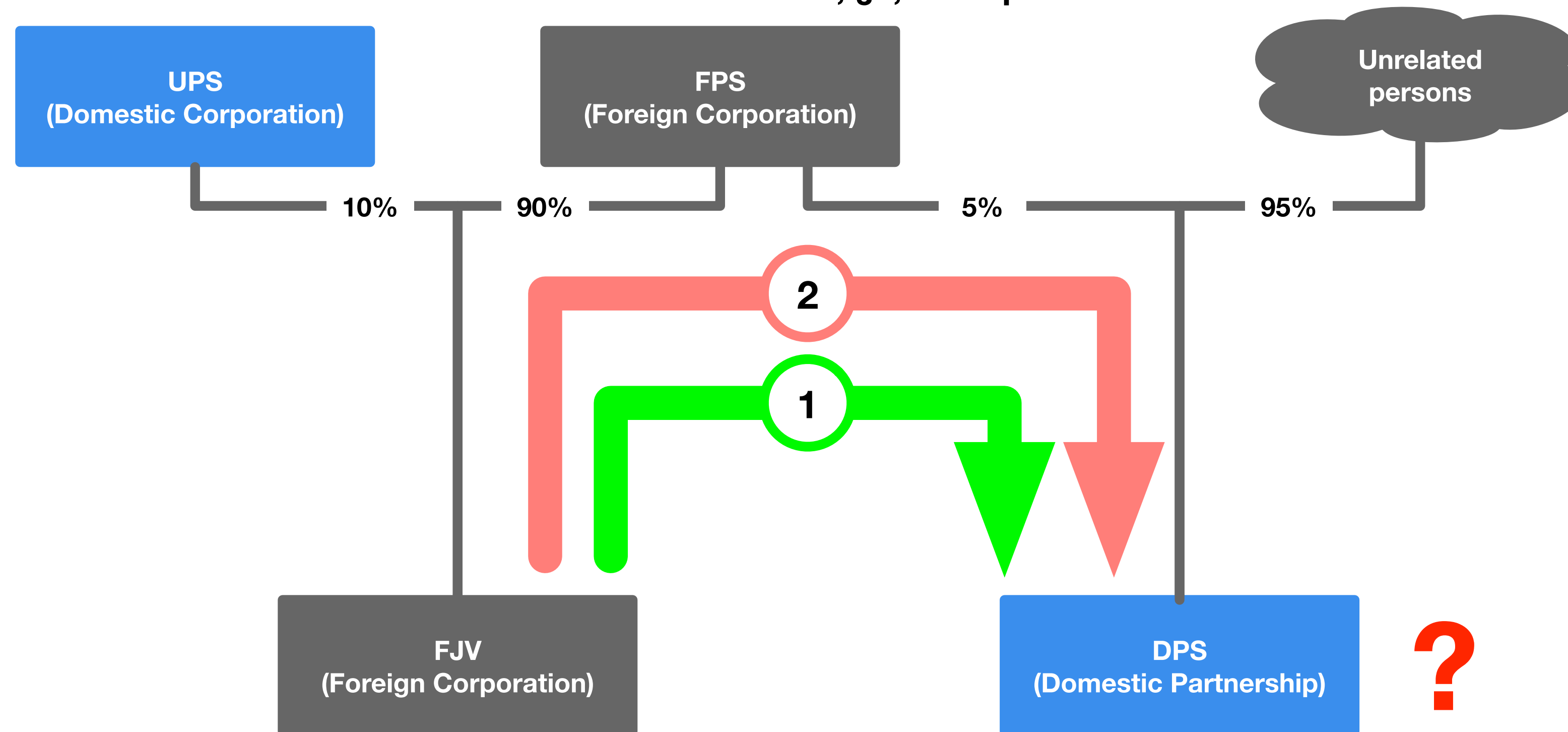
Example: related U.S. shareholder



Subsidiary A is related to Subsidiary B because a common owner, Parent Corporation, controls both Subsidiary A and Subsidiary B. IRC §954(d)(3)(B). *Subsidiary A is a “related person” to Subsidiary B. Rev. Proc. 2019-40, §3.06.*

Rev. Proc. 2019-40, §8.04: unrelated constructive U.S. shareholder

Downward Attribution Applies for Stock Ownership, Not for Related Party Status Rev. Proc. 2019-40, §9, Example 3



1. DPS is a constructive shareholder of FJV by downward attribution from FPS. IRC §318(a)(3)(A).
2. DPS is not “related” to FJV. Do not apply IRC §318(a)(3)(C) to determine related party status. Reg. §1.943-1(f)(2)(iv)(B)(1).

DPS is an “unrelated constructive United States shareholder” of FJV.

“No work”

Constructive Ownership of Stock from a Nonresident Alien

Reg. §1.6038-2(l).

Constructive ownership through a nonresident alien

- You do not own stock directly (IRC §958(a)(1)(A)) or indirectly (IRC §951(a)(1)(B)) in the foreign corporation.
 - You own stock constructively (IRC §958(b)) from a nonresident individual (IRC §318(a)(1)).
 - No Category 5 filing required. Reg. §1.6038-2(l). No need to attach a statement to your tax return.
Instructions for Form 5471, pp. 5-6.
- A Category 5 filer does not have to file Form 5471 if it:
 1. Does not own a direct or indirect interest in the foreign corporation; and
 2. Is required to file Form 5471 solely because of constructive ownership from a nonresident alien.

“No work”

Constructive Ownership of Stock from a U.S. Person

Reg. §1.6038-2(j)(2)(i).

Constructive ownership through a U.S. person

- No statement is required with your tax return to claim the exception. Instructions for Form 5471, pp. 5-6.
 - Use Reg. §1.958-2 for Category 5 purposes to determine constructive ownership.
 - Note that you are relying on someone else's diligence to protect yourself from penalties for screwing things up.
- A Category 5 filer does not have to file Form 5471 if **all** of the following conditions are met:
 1. The Category 5 filer does not own a direct interest in the foreign corporation;
 2. The Category 5 filer is required to furnish the information requested solely because of constructive ownership (as determined under Regulations section 1.958-2, 1.6038-2(c), or 1.6046-1(i)) from another U.S. person; and
 3. The U.S. person through which the Category 5 filer constructively owns an interest in the foreign corporation files Form 5471 to report all of the information required of the Category 5 filer.

“No work”

Jointly-filed Form 5471

Reg. §1.6038-2(j)(1).

File jointly with another person (Item H)

- They complete Item H on Form 5471 to name you.
- You attach a statement to your income tax return to tell the IRS that someone else filed on your behalf.
- If they screw up or file late, *you* failed your Form 5471 filing obligations and *you* bear the penalty risk.
- See Instructions for Form 5471, page 6.

“No work”

Foreign Corporations Electing Domestic Status

As a bookmark only; no discussion

- Foreign sales corporations — these are foreign corporations that file Form 1120-FSC as domestic corporations.
- Captive insurance corporations — foreign captive insurance corporations can elect to be taxed as domestic corporations.
- These exceptions make sense — the entity is reporting its activities and paying U.S. tax on current income. Form 5471 is unnecessary.

“Less work”

Categories 5b, 5c Make You File Form 5471, but with Fewer Schedules

Rev. Proc. 2019-40, §§8.02, 8.03.

Categories 5b and 5c require fewer schedules than Category 5a

- Category 5a - 13 schedules
- Category 5b - 7 schedules
- Category 5c - 6 schedules

Table of Required Information

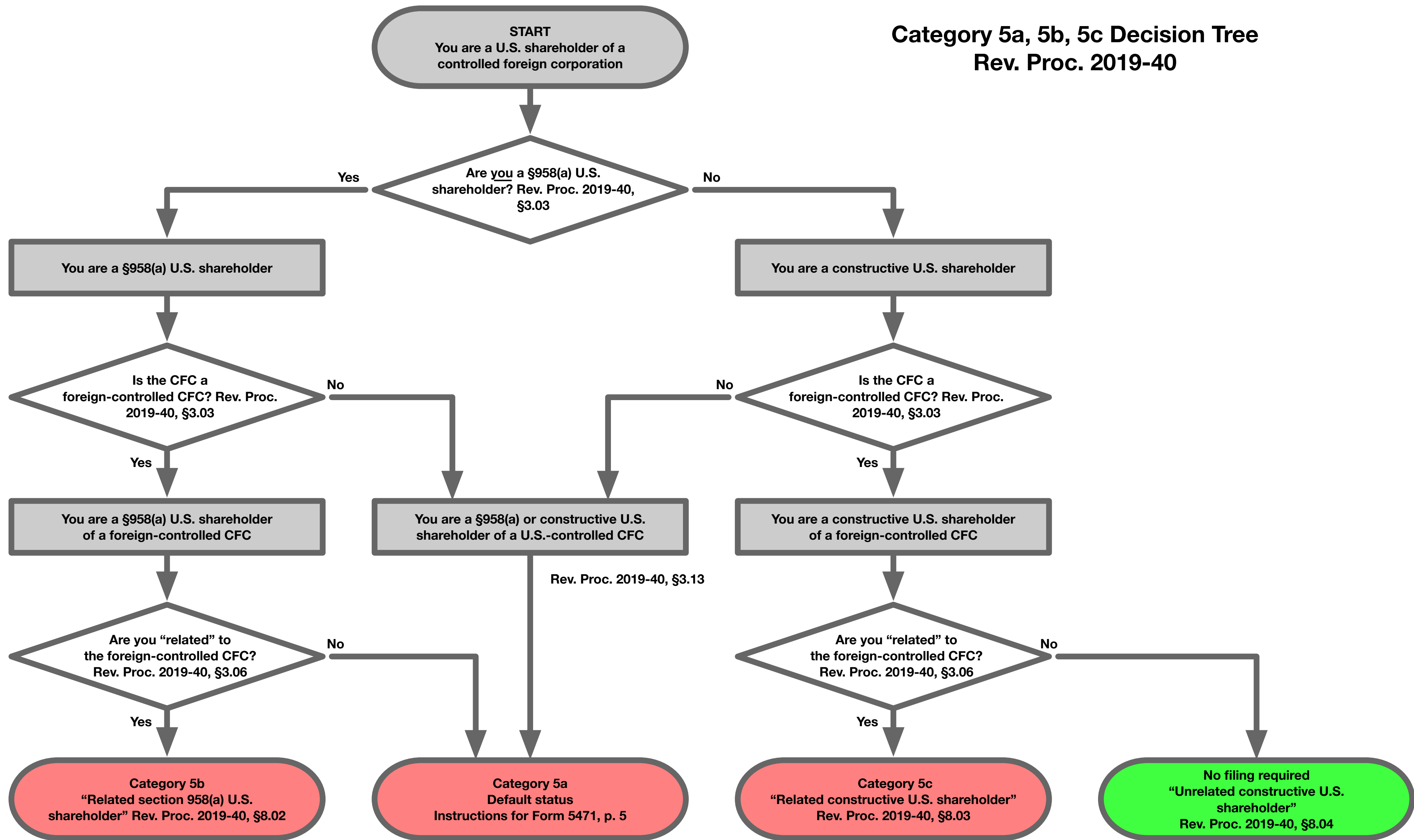
Required Information*	Category of Filer								
	1a	1b	1c	2	3	4	5a	5b	5c
The identifying information on page 1 of Form 5471 above Schedule A; see Specific Instructions	✓	✓	✓	✓	✓	✓	✓	✓	✓
Schedule A					✓	✓			
Schedule B, Part I					✓	✓			
Schedule B, Part II	✓		✓		✓	✓	✓		✓
Schedules C and F					✓	✓			
Separate Schedule E	✓	✓ ₁	✓ ₂			✓	✓	✓ ₁	✓ ₂
Schedule E-1 (included with separate Schedule E)	✓	✓ ₁				✓	✓	✓ ₁	
Schedule G			✓		✓	✓	✓		✓
Separate Schedule G-1			✓		✓	✓	✓		✓
Separate Schedule H						✓	✓		
Schedule I						✓	✓	✓	
Separate Schedule I-1						✓	✓	✓	✓
Separate Schedule J	✓					✓	✓		
Separate Schedule M						✓			
Separate Schedule O, Part I				✓					
Separate Schedule O, Part II					✓				
Separate Schedule P	✓	✓				✓	✓	✓	
Separate Schedule Q						✓	✓	✓	
Separate Schedule R						✓	✓		

*See also [Additional Filing Requirements](#).

1. Schedules E and E-1 are required for an [unrelated section 958\(a\) U.S. shareholder](#) only if the filer claims deemed paid foreign income taxes of the foreign-controlled section 965 SFC or foreign-controlled CFC under section 960 for the filer's tax year. See Rev. Proc. 2019-40 for more details.

2. [Related constructive U.S. shareholders](#) only need to complete Schedule E (they can leave Schedule E-1 blank). See Rev. Proc. 2019-40 for more details.

Category 5a, 5b, 5c Decision Tree
Rev. Proc. 2019-40



(Related or unrelated) section 958(a) U.S. shareholder of a foreign-controlled CFC
 Constructive (related or unrelated) U.S. shareholder of a U.S.-controlled CFC

“Less work”

Dormant Foreign Corporations

Rev. Proc. 92-70.

Dormant foreign corporations file a summary Form 5471

- The big question: is it “dormant”? Rev. Proc. 92-70, Section 3:
 - \$5,000 maximum gross receipts, \$5,000 maximum expenses
 - Assets of \$100,000 or less (not reduced by liabilities)
 - No distributions, share transfers, reorganizations.
 - Did not conduct business
 - Earnings and profits only change because of the de minimis income, expense

What to file for a dormant foreign corporation

- Instructions for Form 5471, page 8.

If you elect the summary procedure, complete only page 1 of Form 5471 for each dormant foreign corporation as follows.

- The top margin of the summary return must be labeled “Filed Pursuant to Rev. Proc. 92-70 for Dormant Foreign Corporation.”
- Include filer information such as name and address, Items A through C, and tax year.
- Include corporate information such as the dormant corporation's annual accounting period (below the title of the form) and Items 1a, 1b, 1c, and 1d. For more information, see Rev. Proc. 92-70.

“Less work”

Form 5471 for a Treaty Tiebreaker Nonresident

Reg. §1.6038-2(j)(2)(ii).

Who is this for?

- **Taxpayer.** Individual who is a resident alien for income tax purposes (i.e., not U.S. citizens). Green card holders, usually. Substantial presence people, sometimes.
- **Treaty benefits.** Is eligible to claim — and actually claims — that an income tax treaty will classify the individual as a resident of another country and a nonresident of the United States for income tax purposes.
- **Other shareholders.** The foreign corporation does not have any other U.S. persons required to provide information under Categories 1, 4, or 5.
- Reg. §1.6038-2(j)(2)(ii).

Provide audited financial statements instead of selected schedules

- “. . . the individual may satisfy the requirements of paragraphs (f)(10), (f)(11), (g), and (h) of this section by filing the audited foreign financial statements of the foreign corporation with the individual's return required under section 6038.”
Reg. §1.6038-2(j)(2)(ii).

Category 1

Reporting obligations (and exceptions) created by IRC §6038(a)(4).

Almost the same as Category 5, but with two extra features

- IRC §965 created one-time taxable income (treated as Subpart F income).
- Category 1 captures the IRC §965 tax reporting and collection. The Category 1 reporting requirements are authorized by IRC §6038(a)(4)—just like Category 5.
- Category 1 differs from Category 5 as follows:
 - The type of foreign corporation: Category 1 filers are U.S. shareholders of CFCs **or foreign corporations that have a domestic corporation U.S. shareholder.**
 - Extra filing exception—as soon as you’ve wiped out **IRC §965 earnings and profits**, you don’t need to file as a Category 1 filer anymore.

Additional Category 1 filing exception: no IRC §965 E & P

- IRC §965 caused CFC earnings and profits to be included in the U.S. shareholder's gross income.
- Stop filing as a Category 1 filer when:
 - No accumulated earnings and profits related to IRC §965 on Schedule J and
 - No previously taxed earnings and profits related on IRC §965 on Schedule P.
- See Instructions for Form 5471, pp. 2-3.

Category 4

Reporting obligations created by IRC §6038(a)(1).

Category 4 - fewer exceptions, and they all overlap with Category 5

- Constructive ownership from a U.S. person — Reg. §1.6038-2(j)(2)(i).
- Constructive ownership from a nonresident alien — Reg. §1.6038-2(l).
- Foreign sales corporations, captive insurance companies electing domestic status.
- Treaty tiebreaker nonresident — Reg. §1.6038-2(j)(2)(ii).
- Joint filing (Item H) - Reg. §1.6038-2(j)(1).

Category 3

For shareholders — event-triggered filing obligations. IRC §6046.

Constructive ownership from a U.S. person - Reg. §1.6046-1(e)(4)(iii)

- No direct ownership interest in the foreign corporation;
- Category 3 filing required solely because of attribution of stock ownership (applying the attribution rules of Reg. §1.6046-1(i)).
- Attribution is from a U.S. person who files correctly as a Category 3 person.
- No statement is required on your tax return to claim this filing exception.
- Cross-reference: this excuses a U.S. officer/director from a Category 2 filing requirement if you claim this Category 3 filing exception.

Joint filing - Reg. §1.6046-1(e)(5)

- Joint filing is acceptable but the person you're filing with must be a U.S. person who has at least as much stock ownership as you. Report on Item H.
- See Instructions for Form 5471, page 6.

Category 2

Reg. §1.6046-1(e)(4)(ii) - the 95% exception

- The U.S. person acquiring stock files as a Category 3 filer;
- Immediately after the acquisition, three or fewer U.S. persons own 95% or more (measured by value, not vote) of the outstanding stock.

Reg. §1.6046-1(e)(4)(iv) - constructive Category 3 filer

- If the Category 3 filer uses the exception at Reg. §1.6046-1(e)(4)(iii), then the Category 2 filer's obligation to report the transaction is eliminated, too.
- The Category 3 exception is for constructive filers who rely on the actual U.S. person who acquired the stock to file as the Category 3 filer.
- If the reporting requirement is waived for the person who has a constructive (only) stock acquisition, then it makes sense that a U.S. officer/director should have the Category 2 reporting waived for that same constructive stock acquisition.

Reg. §1.6046-1(e)(1) - joint filing

- An officer/director may jointly file Form 5471 with someone else who is filing Form 5471. The Regulation is poorly worded. What do you think it means: Category 2 people can only file jointly with other Category 2 people? Or Category 2 people can file jointly with Category 3 people?
 - “Any two or more persons required under paragraph (a) of this section to make a return with respect to one or more shareholders of the same corporation, or under paragraph (b) or (c) of this section to make a return with respect to the same corporation, may in lieu of making several returns, jointly make one return.” Reg. §1.6046-1(e)(1).
- Use Item H.

Reg. §1.6046-1(e)(3)(i) - power of attorney given to another officer/director

- A U.S. person who is an officer/director and has a Category 2 filing requirement can give the authority to another U.S. person officer/director to handle the Category 2 filing.
 - “Any two or more persons required under paragraph (a) of this section to make a return with respect to one or more shareholders of the same corporation may, by means of one or more duly executed powers of attorney, constitute one of their number as attorney in fact for the purpose of making such returns or for the purpose of making a joint return under subparagraph (1) of this paragraph.”
- “Subparagraph (1) of this paragraph” means the joint filing rule.

Conclusion

My decision tree

- Is there a Form 5471 filing requirement? (Category by category). Yes/no.
- If yes, can I use the dormant foreign corporation exception? Yes/no.
- If you can't use the dormant foreign corporation exception, is there an exception that applies to one or more of the categories for which the taxpayer is required to file Form 5471? Yes/no.
- If there are filing categories for which no exceptions apply, can you file Form 5471 jointly with someone else? Do you trust that person? Yes/no.
- If no joint filing is possible, get to work. You have a Form 5471 project.

Next episode

- Next up in the series: we launch into the income items for U.S. shareholders.
- August 25, 2023: Subpart F income.
- See you then.

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