

# SOP: Determine Category 5a, 5b, or 5c Status

## Standard Disclaimer, Warning Shot, and Preemptive Strike

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*This SOP is as-is, where is—no warranty, express or implied, etc. It might be wrong. It might be incomplete. There might be typos. I'm a damn fool for sharing this in public and you're a damn fool for relying on this without double-checking everything it says.*

*Vaya con Dios.*

*Phil.*

## Subject matter

You have decided that you have a Form 5471, Category 5 filing obligation. This SOP helps you determine whether you are a Category 5a, 5b, or 5c filer. It applies the principles of Notice 2018-13 and Rev. Proc. 2019-40 to do so.

## Filing exceptions

This SOP will alert you to the Category 5 filing exceptions provided by Notice 2018-13, §5.02 and Rev. Proc. 2019-40, §8.04. If you determine that you have a Category 5a, 5b, or 5c filing obligation, consult the Instructions for Form 5471 for other possible filing exceptions that might apply to you.

## Precursor assumptions

You already have answers to the following:

- 1 Taxpayer, entity status
  - 1.1 You are a United States person.<sup>1</sup>

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<sup>1</sup> IRC §7701(a)(30).

- 1.2 This entity is foreign<sup>2</sup> corporation.<sup>3</sup>
- 2 Category 5 filing status
  - 2.1 You are a United States shareholder<sup>4</sup> of the foreign corporation.
  - 2.2 This foreign corporation is a controlled foreign corporation.<sup>5</sup>
- 3 Attribution rule data
  - 3.1 You know your stock ownership in the foreign corporation, broken down by direct,<sup>6</sup> indirect ownership,<sup>7</sup> and constructive ownership.<sup>8</sup>
  - 3.2 You know the identities, nationalities, and residences of the other shareholders. You know how much stock they own, and whether it is direct, indirect, or constructive ownership. You have applied the constructive ownership rules of IRC §318(a) to the full extent required by IRC §958(b) to do this.

### Does the Notice 2018-13, §5.02 filing exception apply?

This quick filing exception might eliminate any further work. You know that you are a United States shareholder of a controlled foreign corporation. This creates a filing obligation via IRC §6038(a)(4). You may satisfy that filing requirement by putting the Notice 2018-13, §5.02 plug in the IRC §6038(a)(4) jug. Then you don't have to file Form 5471 as a Category 5 filer at all.

- 4 Does *any* United States shareholder of the foreign corporation (including you) own stock of any amount (even one tiny little share) of the foreign corporation as defined in IRC §958(a)?<sup>9</sup>
  - 4.1 If yes, you are not eligible for the Notice 2018-13, §5.02 filing exception. The exception only applies to foreign corporations where all the United States shareholders are constructive shareholders.<sup>10</sup>

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<sup>2</sup> IRC §7701(a)(5).

<sup>3</sup> IRC §7701(a)(3). See also Regs. §301.7701-2(b)(8)(i) for a list of foreign entities that are per se corporations, and Regs. §301.7701-3(b) for the default classification of a foreign entity that is not a per se corporation.

<sup>4</sup> IRC §951(b).

<sup>5</sup> IRC §957(a).

<sup>6</sup> IRC §958(a)(1)(A).

<sup>7</sup> IRC §958(a)(1)(B).

<sup>8</sup> IRC §958(b).

<sup>9</sup> Rev. Proc. §2019-40, §3.09.

<sup>10</sup> Notice 2018-13, §5.02; *Instructions for Form 5471 (rev. January 2023)*, page 6.

4.1.1 Continue to step 5.

4.2 If no, you are eligible for the Notice 2018-13, §5.02 filing exception. All United States shareholders are constructive United States shareholders<sup>11</sup> of foreign corporation stock.

**4.2.1 STOP. You are eligible for the Notice 2018-13, §5.02 filing exception. Do not file Form 5471 as a Category 5 filer.**

### Are you a section 958(a) United States shareholder?

This is the first of three questions to answer; the combined effect of your three answers will determine your filing category as a Category 5 filer.

5 From step 3.1, do you own any shares of stock of the foreign corporation within the definition of ownership in IRC §958(a)?

5.1 If yes, **you are a section 958(a) United States shareholder.**<sup>12</sup>

5.1.1 Proceed to step 6.

5.2 If no, then you are not a section 958(a) United States shareholder. **You are a constructive United States shareholder** because a constructive United States shareholder is any United States shareholder who is not a section 958(a) United States shareholder.<sup>13</sup>

5.2.1 Proceed to step 6.

### Is this CFC a foreign-controlled CFC?

This is the second of three questions to answer; the combined effect of your three answers will determine your filing category as a Category 5 filer.

6 Is the foreign corporation a foreign-controlled CFC?

6.1 Step 1. Determine CFC status as normal, using downward attribution as computed using IRC §318(a)(2), from U.S. persons and foreign persons. The foreign corporation has already been classified as a CFC by you.

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<sup>11</sup> Rev. Proc. 2019-40, §3.02.

<sup>12</sup> Rev. Proc. 2019-40, §3.09.

<sup>13</sup> Rev. Proc. 2019-40, §3.02.

6.1.1 This is your answer from step 2.2, above.

6.2 Step 2. Determine CFC status as normal, using downward attribution as computed using IRC §318(a)(2), from U.S. persons only. Is the foreign corporation a controlled foreign corporation?

6.2.1 If yes, then this means that the foreign corporation was a CFC with downward attribution (Step 1) and also was a CFC without downward attribution (Step 2) of stock from foreign persons to United States persons. The downward attribution of stock from foreign persons made no difference: it is a CFC purely because of the United States shareholders' direct and indirect stock ownership. **The foreign corporation is a U.S.-controlled CFC.**

**6.2.1.1 STOP. Your filing category is 5a. All U.S. shareholders of a U.S.-controlled CFC are Category 5a filers.**

6.2.2 If no, then this means that the only thing that pushed stock ownership by United States shareholders above 50% was constructive ownership from foreign persons using the downward attribution rules of IRC §318(a)(2). **The foreign corporation is a foreign-controlled CFC.**

6.2.2.1 Proceed to step 7.

## Are you related to the foreign-controlled CFC?

This is the third of three questions to answer; the combined effect of your three answers will determine your filing category as a Category 5 filer.

7 Are you related to the foreign-controlled CFC?<sup>14</sup>

7.1 If you are an individual:

7.1.1 Do you own<sup>15</sup> more than 50% of the voting power ("control")<sup>16</sup> of issued stock of the foreign-controlled CFC?<sup>17</sup> You computed this in step 2.1.

7.1.1.1 If yes, **you are related** to the foreign-controlled CFC.

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<sup>14</sup> IRC §954(d)(3);

<sup>15</sup> Reg. §1.954-1(f)(2)(iv). Stock you own directly or indirectly under principles of IRC §958(a) and Reg. §1.958-1 plus stock you own constructively under the principles of IRC §958(b) and Regs. §1.958-2.

<sup>16</sup> Reg. §1.954-1(f)(2)(i). "Control" means own more than 50% of the voting power of the CFC's stock.

<sup>17</sup> Reg. §1.954-1(f)(1)(i).

7.1.1.2 If no, **you are not related** to the foreign-controlled CFC.

7.2 If you are a corporation, partnership, trust, or estate:

7.2.1 Do you own<sup>18</sup> more than 50% of the voting power ("control")<sup>19</sup> of issued stock of the foreign-controlled CFC?<sup>20</sup>

7.2.1.1 If yes, **you are a related person** to the foreign-controlled CFC.

7.2.1.2 If no, **you are not a related person** to the foreign-controlled CFC.

7.2.2 Does the foreign-controlled CFC own more than 50% of your voting power; in other words are you "controlled by" the foreign-controlled CFC?<sup>21</sup>

7.2.2.1 If yes, **you are a related person** to the foreign-controlled CFC.

7.2.2.2 If no, **you are not a related person** to the foreign-controlled CFC.

7.2.3 Does a common owner or group of owners control<sup>22</sup> both you and the foreign-controlled CFC?

7.2.3.1 If yes, **you are a related person** to the foreign-controlled CFC.

7.2.3.2 If no, **you are not a related person** to the foreign-controlled CFC.

## Classification of U.S.-controlled CFCs

8 If your answer to step 6.2.1 is yes, then the foreign corporation is a **U.S.-controlled CFC**, and you are a **Category 5a filer**.

8.1 You can be a section 958(a) U.S. shareholder of a U.S.-controlled CFC. You have a Category 5a filing obligation.

8.2 You can be a constructive U.S. shareholder of a U.S. controlled CFC. You have a Category 5a filing obligation.

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<sup>18</sup> Reg. §1.954-1(f)(2)(i). Stock you own directly or indirectly under principles of IRC §958(a) and Reg. §1.958-1 plus stock you own constructively under the principles of IRC §958(b) and Regs. §1.958-2. IMPORTANT: do not apply the IRC §318(a)(3) downward attribution rules to attribute ownership to a corporation, partnership, estate, or trust.

<sup>19</sup> Reg. §1.954-1(f)(2)(i). "Control" means own more than 50% of the voting power of the CFC's stock.

<sup>20</sup> Reg. §1.954-1(f)(1)(ii).

<sup>21</sup> Reg. §1.954-1(f)(1)(ii).

<sup>22</sup> Reg. §1.954-1(f)(1)(ii).

- 8.3 Related status has no relevance if the foreign corporation is a U.S.-controlled CFC.

### Classification of foreign-controlled CFCs

- 9 Take your answers to step 5, step 6, and step 7 and find your Category 5 classification in this table:

	You are a section 958(a) United States shareholder	You are a constructive United States shareholder
You are related to the foreign-controlled CFC	<b>Category 5a</b>	<b>Category 5c</b>
	Related section 958(a) United States shareholder Instructions for Form 5471, p. 5.	Related constructive United States shareholder Rev. Proc. 2019-40, §8.03; Instructions for Form 5471, p. 5.
You are unrelated to the foreign-controlled CFC	<b>Category 5b</b>	<b>Category 5 Exemption</b>
	Unrelated section 958(a) United States shareholder Rev. Proc. 2019-40, §8.02; Instructions for Form 5471, p. 5.	Unrelated constructive United States shareholder Rev. Proc. 2019-40, §8.04; Instructions for Form 5471, p. 6.