

LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Individual Outbound	–	–
Volume	11	Foreign Corporations	Level 1 UIL	9433
Part	11.1	Individuals with Investments in a CFC	Level 2 UIL	9433.01
Chapter	11.1.1	Taxability of Income from the CFC	Level 3 UIL	9433.01-01
Sub-Chapter	11.1.1.1	Determination of CFC Status	–	–

Unit Name	Determination of U.S. Shareholder and CFC Status
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Issue and Transaction Overview

Determination of U.S. Shareholder and CFC Status

You are auditing a taxpayer who has been linked to a foreign entity. Perhaps during an interview, the taxpayer is asked whether they own any stocks in a foreign entity and they say “yes,” or you notice deposits wired from a foreign company during your review of the taxpayer’s bank statements. What audit steps should you take to determine whether the taxpayer is a U.S. Shareholder in a Controlled Foreign Corporation (CFC), and why is this determination important?

A major tax advantage of using a foreign corporation is income tax deferral; generally, United States (U.S.) tax on the income of a foreign corporation is deferred until the income is distributed as a dividend or otherwise repatriated by the foreign corporation to its U.S. owners. In order to discourage the use of foreign corporations to defer tax, U.S. taxpayers with certain ownership in a CFC are subject to special reporting requirements called Subpart F.

The Subpart F provisions eliminate deferral of U.S. tax for some categories of income earned by certain foreign corporations. The Subpart F rules operate by treating a U.S. Shareholder of a CFC as if it actually received its proportionate share of certain categories of the CFC’s current earnings. The U.S. shareholder is required to report this income (“Subpart F inclusion”) currently in the United States whether or not the CFC actually makes a distribution to the U.S. Shareholder.

Issue and Transaction Overview (cont'd)

Determination of U.S. Shareholder and CFC Status

In general, a foreign corporation is a CFC if more than 50 percent of its voting power or value is owned by U.S. Shareholders. A U.S. Shareholder of a foreign corporation is a U.S. person who owns 10 percent or more of the total voting power of that foreign corporation. In order to determine CFC status, an examiner must consider all of the facts and circumstances of how a U.S. person may effectively have control or ownership of the foreign corporation. Special rules apply for certain foreign insurance companies for the purposes of determining CFC status; primarily there is a lower U.S. ownership threshold for certain foreign insurance companies to be considered a CFC.

This unit will help you determine whether a taxpayer is a U.S. Shareholder in a CFC for U.S. tax purposes and therefore, subject to the reporting requirements of Subpart F. If the taxpayer is determined to be a U.S. Shareholder of a CFC, certain information returns, such as Form 5471, are required to be filed. The filing requirements and penalties for non-filing are discussed in other IPS units that are referenced where applicable.

A U.S. person who owns shares in a foreign corporation that is not determined to be a CFC may still have other tax issues (e.g., PFIC) and tax filing requirements. This unit will provide awareness of other issues an examiner may need to consider and related IPS Units that cover those issues.

Summary of Potential Issues

Determination of U.S. Shareholder and CFC Status	
Issue 1	Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?
Issue 2	Is the taxpayer a U.S. Shareholder?
Issue 3	Is the foreign entity a CFC?
Issue 4	How is CFC status determined if the foreign entity is an insurance company?

All Issues, Step 1: Initial Factual Development

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Background information must be gathered on both the taxpayer and the foreign entity to make a determination of CFC status.▪ The foreign entity must be owned predominately by U.S. Shareholders to be a CFC. The taxpayer's and other shareholder's citizenship and/or residency and percentage of ownership are important facts that must be determined. See other IPS Practice Units that cover U.S. residency rules.▪ How a U.S. person may be attributed ownership must be considered. This will require gathering information on related individuals and entities. A U.S. Person's ownership (whether directly, indirectly, or constructively) is taken into account in determining the status of a CFC.	<ul style="list-style-type: none">▪ IRC 957, IRC 958, IRC 953	

All Issues, Step 1: Initial Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In order to be a CFC, the foreign business entity must be treated as a corporation for U.S. tax purposes. Under the check-the-box regulations, certain foreign entities are always (“per se”) corporations. The regulations allow foreign eligible entities to elect their classification (i.e., corporation or partnership if two owners, disregarded entity if only one owner) on Form 8832, <i>Entity Classification Election</i>. ▪ The following information return forms may shed light on the ownership structure of a CFC: <ul style="list-style-type: none"> ▪ Form 5471 <i>Information Return of U.S. Persons With Respect to Certain Foreign Corporations</i> and Form 5471 Instructions ▪ Form 926 <i>Return by a U.S. Transferor of Property to a Foreign Corporation</i> ▪ Form 8832 <i>Entity Classification Election</i> 	<ul style="list-style-type: none"> ▪ Treas. Reg. 301.7701-1 through -3 ▪ IPS Practice Unit, “Check-the-Box Rules for Foreign Entities,” future unit. 	

All Issues, Step 1: Initial Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Form 8865 <i>Return of U.S. Persons With Respect to Certain Foreign Partnerships</i> and Form 8865 Instructions ▪ Form 3520 <i>Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts</i> and Form 3520 Instructions ▪ Form 3520A <i>Annual Return of Foreign Trust With a U.S. Owner</i> and Form 3520A Instructions ▪ Form 8938 <i>Statement of Foreign Financial Assets</i> 		

All Issues, Step 1: Initial Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Documents to request and review in order to determine the ownership of the foreign corporation include: <ul style="list-style-type: none"> ▪ Foreign Entity Stock Certificates – who has ownership or control in the entity and what percent do they have. ▪ Foreign Entity Articles of Organization – what type of entity and the types of shares issued. ▪ Organization chart – provides entity ownership needed to determine direct and indirect ownership of foreign corporation plus the potential for any stock attribution rules. ▪ If questions remain, consider issuing the following: 		

All Issues, Step 1: Initial Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Form 4564 <i>Information Document Request</i> (IDR) ▪ Formal Document Requests ▪ Summons ▪ The examiner should also consider using the following tools and/or contacting: <ul style="list-style-type: none"> ▪ Internet Research ▪ Integrated Data Retrieval System (IDRS) ▪ Accurint ▪ FinCen Query ▪ YK1 Link Analysis ▪ FEDWIRE ▪ # [REDACTED] # 		

All Issues, Step 1: Initial Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

This unit will focus on the identification of a foreign entity as a CFC. The unit will outline the information needed to determine if the taxpayer is a U.S. Shareholder and if it directly, indirectly, or constructively has ownership in, or control of, a foreign entity that qualifies as a CFC for U.S. tax purposes.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Exchange of Information (EOI) or Joint International Tax Shelter Information and Collaboration (JITSIC) Network request for information▪ Information Gathering IPN		

Issue 1, Step 2: Review Potential Issues

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Direct, indirect, and constructive ownership are used to determine whether a U.S. person is a U.S. Shareholder with respect to a foreign corporation, but only direct and indirect ownership are used to determine the percentage of stock owned by a U.S. Shareholder for purposes of computing its Subpart F inclusion. ▪ Stock in a foreign corporation that is owned directly by a foreign entity (such as a foreign corporation, foreign partnership or foreign estate) is considered to be owned indirectly by the shareholders, partners or beneficiaries of that foreign entity in proportion to their ownership in the foreign entity. ▪ For indirect ownership, only stock held by a foreign entity is considered, not stock owned by a domestic entity. ▪ Constructive ownership means the effective ownership of stock actually owned by related persons (including entities). ▪ Stock owned directly or indirectly by the taxpayer's spouse, children, grandchildren or parents is considered in constructive ownership. 	<ul style="list-style-type: none"> ▪ IRC 951(a)(1) ▪ IRC 958(a) and (b) ▪ Treas. Reg. 1.958-1 ▪ Treas. Reg. 1.958-2 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<p>Indirect Ownership:</p> <p><i>Example:</i></p> <p>U.S. persons A and B each own directly 50% of foreign Corporation U. Corporation U owns directly 60% of foreign Corporation V.</p> <p>A and B are each a 30% indirect shareholder of V (50% x 60% = 30%).</p> <p>If Corporation U were a domestic corporation, under the indirect ownership rules, neither A nor B would have any indirect ownership in Corporation V, because attribution stops with the first U.S. person in the chain of ownership from the foreign corporation.</p>	<ul style="list-style-type: none"> ▪ IRC 958(a)(2) 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<p>Constructive Ownership:</p> <ul style="list-style-type: none"> ▪ Constructive ownership rules apply for determining whether the U.S. person is a U.S. Shareholder and whether a foreign corporation is a CFC, but are not considered in determining the amount of a U.S. Shareholder's Subpart F inclusion. ▪ A corporation, partnership, trust or estate that owns more than 50% of the voting stock of a corporation is considered to own 100% of the voting stock of that corporation. ▪ Stock owned by a non-resident alien individual is not treated as owned by a U.S. person. ▪ More than one family member can be attributed the same stock. For example, stock owned by a child can be attributed to both a parent and a grandparent. ▪ There is no attribution between siblings and stock owned by grandparents is not considered owned by the grandchildren. 	<ul style="list-style-type: none"> ▪ IRC 958(b) ▪ Treas. Reg. 1.958-2 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<p>Constructive Ownership: <i>Example:</i></p> <p>A, B, C, and D are U.S. persons. A and B are married and each own 25% of foreign Corporation X. Additionally, C, their daughter, and D, C's daughter, each own 25% of Corporation X. A and B are each considered to own 100% of Corporation X because they are attributed each other's stock, as well as the stock owned by C (their daughter) and D (their granddaughter).</p> <p>C also constructively owns 100% of Corporation X, because she is attributed her parents' and daughter's stock. D constructively owns 50% (only her own and her mother's stock).</p> <p>If D was a non resident alien, A, B, and C would only constructively own 75% of Corporation X because stock of a non-resident alien is not considered to be owned by a U.S. person.</p>	<ul style="list-style-type: none"> ▪ IRC 958(b) 	

Issue 1, Step 3: Additional Factual Development

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<p>Direct Ownership:</p> <ul style="list-style-type: none"> ▪ Determine stock owned directly by the U.S. person by reviewing the foreign entity stock certificates. 		
<p>Indirect Ownership:</p> <p>Determine Stock owned indirectly:</p> <ul style="list-style-type: none"> ▪ Determine if the U.S. person has ownership in a foreign entity (such as a foreign corporation, foreign partnership or foreign estate) that owns stock in the foreign corporation. Stock owned by a foreign entity is attributed to its owners proportionately to each person's ownership in the foreign entity 	<ul style="list-style-type: none"> ▪ IRC 958(a) ▪ Treas. Reg. 1.958-1 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Consider other ways the U.S. person may have ownership directly, indirectly, or constructively in a foreign entity. For example, the taxpayer may have: <ul style="list-style-type: none"> – Nominee ownership – stock held for the benefit of a U.S. person through a third party (such as an agent, attorney, or a trustee) such that the U.S. person obtains an actual or constructive benefit. <ul style="list-style-type: none"> ▪ Bank statements of the foreign corporation can provide evidence which may support the substantive control the taxpayer has over an entity. – Signature authority – a U.S. person effectively controls the foreign entity. – Voting agreement – a U.S. person may have authority to select a majority of the board of directors. 	<ul style="list-style-type: none"> ▪ Garlock v. Commissioner, 489 F .2d 197 (2d Cir. 1973) ▪ Treas. Reg. 1.951-1(g)(2) 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Some tools the examiner can use to make this determination include:<ul style="list-style-type: none">▪ Taxpayer interview▪ Internet research▪ Organization charts▪ Accurint▪ FinCen Query▪ Contacting EOI and/or JITSIC		

Issue 1, Step 4: Develop Arguments

Determination of U.S. Shareholder and CFC Status

Issue 1

Does the taxpayer directly, indirectly, or constructively own shares in a foreign corporation?

Fact Element	Resources	6103 Protected Resources
 DECISION POINT: Based on evidence, determine whether the U.S. person has direct, indirect, or constructive ownership of a foreign corporation. If the taxpayer does have direct, indirect or constructive ownership in a foreign corporation then go to next step to determine if the taxpayer is considered a U.S. Shareholder as explained in Issue #2.	IRC 958	

Issue 2, Step 2: Review Potential Issues

Determination of U.S. Shareholder and CFC Status

Issue 2

Is the taxpayer a U.S. Shareholder?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ For purposes of determining CFC status, a U.S. Shareholder is a U.S. person who owns 10% or more of the voting power of all classes of stock of the foreign entity. ▪ A U.S. person is: <ul style="list-style-type: none"> – a citizen of the United States – a non-U.S. citizen who is a U.S. resident (including a lawful permanent resident or an individual who meets the substantial presence test) – a domestic partnership – a domestic corporation – any estate or trust (other than a foreign estate or trust) ▪ A U.S. person will be deemed to own 10% or more of the total combined voting power if that person owns 10% or more of the total number of shares of a class of stock that has certain powers, such as the power to elect, appoint, or replace a majority of the board of directors (or equivalent). ▪ Special rules apply to shareholders of certain foreign insurance companies. 	<ul style="list-style-type: none"> ▪ IRC 957(c) ▪ IRC 7701(a)(30) ▪ IRC 7701(b)(3) ▪ IRC 7701(b)(7) ▪ IRC 951(b) ▪ Treas. Reg. 1.951-1(g) ▪ IRC 953 	

Issue 2, Step 3: Additional Factual Development

Determination of U.S. Shareholder and CFC Status

Issue 2

Is the taxpayer a U.S. Shareholder?

Fact Element	Resources	6103 Protected Resources
<p>How much of the foreign corporation does the U.S. person/taxpayer own?</p> <ul style="list-style-type: none"> ▪ Request documents of how and when the taxpayer acquired ownership, for example Form 926 <i>Return by U.S. Transferor of Property to a Foreign Corporation</i>, Articles of Organization, and organization chart. ▪ Foreign records may be obtained by Exchange of Information or Treaty requests. Other points of contact that could provide assistance in this regard are: Tax Attaché, JITSIC, and Information Gathering IPN. ▪ Consider how ownership of stock may be attributed to the taxpayer. Gather information on related parties who own shares. ▪ Use internet research to look for articles or documents associating the taxpayer to foreign entities. 		

Issue 2, Step 4: Develop Arguments

Determination of U.S. Shareholder and CFC Status

Issue 2

Is the taxpayer a U.S. Shareholder?

Fact Element	Resources	6103 Protected Resources
<p> DECISION POINT Based on the evidence, determine whether the taxpayer is a U.S. Shareholder.</p> <ul style="list-style-type: none"> ▪ First determine whether the taxpayer is a U.S. person. Recall that the term U.S. person includes individuals, corporations, partnerships, estates and trusts. It may include a taxpayer that is a resident of a U.S. commonwealth, territory or possession, there are exceptions. ▪ If the taxpayer is not a U.S. person, it is not a U.S. Shareholder. ▪ Once you have determined that the taxpayer is in fact a U.S. person, determine whether its voting power in the foreign corporation is at least 10%. ▪ If the U.S. person does not have sufficient direct ownership in the foreign corporation to meet the definition of a U.S. Shareholder, consider stock deemed to be owned by the U.S. person through indirect or constructive ownership. See Issue 1. ▪ If the foreign entity is an insurance company, the required ownership to be considered a U.S. Shareholder is less. See Issue 4. 	<ul style="list-style-type: none"> ▪ IRC 957(c) 	

Issue 2, Step 4: Develop Arguments (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 2

Is the taxpayer a U.S. Shareholder?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ If the taxpayer does not own at least 10% of the voting power, it still may have certain filing requirements and other tax issues. Refer to the following IPS Practice Units: <ul style="list-style-type: none"> – “Failure to File the Form 5471 – Information Returns of U.S. Persons With Respect to Certain Foreign Corporations – Category 2 and 3 Filers – Monetary Penalty,” in process as of 5/15. – “Failure to File the Form 926 – Return by a U.S. Transferor of Property to a Foreign Corporation – Monetary Penalty,” in process as of 5/15. – “Determination of PFIC Status,” DCN: FEN/9433.02_04 (2013), in process as of 5/15. – “Check-The-Box Rules for Foreign Entities,” future unit. – “Private Banking – FATCA Compliance (Form 8938),” future unit. 		

Issue 3, Step 2: Review Potential Issues

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The foreign entity must be a corporation for U.S. tax purposes. Certain foreign entities are always ("per se") corporations. Other foreign entities are eligible ("foreign eligible entities") to be treated as corporations or not as corporations, either by default or by making a check-the-box election. See Form 8832, <i>Entity Classification Election</i>. ▪ A foreign corporation is a CFC for a particular year if, on any day during such year, U.S. Shareholders own more than 50% of the: <ul style="list-style-type: none"> – total combined voting power of all classes of stock, or – total value of the stock ▪ Corporations organized in U.S. commonwealths, territories and possessions are generally considered to be foreign corporations and may be treated as a CFC. ▪ Voting and value tests must be applied to determine whether a foreign entity that is classified as a corporation for U.S. tax purposes, is a CFC. ▪ A U.S. Shareholder is subject to the current inclusion rules of Subpart F only if the foreign corporation was a CFC for an uninterrupted period of 30 days or more during the taxable year and the U.S. Shareholder owned stock in the foreign corporation on the last day of such taxable year. 	<ul style="list-style-type: none"> ▪ IPS Practice Unit , "Check-the-Box Rules for Foreign Entities," future unit. ▪ IRC 957 ▪ Treas. Reg. 1.957-1(b) ▪ IRC 951(a)(1) ▪ IRC 7701(a)(3) 	

Issue 3, Step 2: Review Potential Issues (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<p>Is it Controlled?</p> <p><i>Substantive Voting Control:</i></p> <ul style="list-style-type: none"> ▪ Determine the voting power held by U.S. Shareholders. The examiner should consider the substantive voting power and not only the mere number of votes that a U.S. Shareholder is entitled to cast. Items to consider when determining the substantive voting control of U.S. Shareholders are the powers to: <ul style="list-style-type: none"> – elect, appoint or replace a majority of the board of directors (or corresponding governing group under local law); – elect exactly half of the members of the board of directors and break a deadlock or exercise managerial powers during a deadlock; – elect the person who exercises the powers ordinarily exercised by the board of directors. ▪ Determine if there are any arrangement to shift formal voting power away from U.S. Shareholders. These arrangements will not be given effect if in reality voting power is retained. For example, if there is an agreement that a shareholder owning 50% or less of the voting power will exercise power normally possessed by a majority of shareholders, the agreement should be disregarded. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.957-1(b)(2) 	

Issue 3, Step 2: Review Potential Issues (cont'd)

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ To help the examiner determine whether there is substantive voting control, he or she should perform internet research and conduct taxpayer interviews. The examiner should also request and review the following:<ul style="list-style-type: none">– Organization chart– Corporate minutes– Foreign country Articles of Organization– Shareholder Agreements		

Issue 3, Step 3: Additional Factual Development

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<p>Determine if U.S. Shareholders own more than 50% of Total Value of Stock in Corporation:</p> <ul style="list-style-type: none"> ▪ This rule prevents a U.S. Shareholder from avoiding CFC status by shifting the voting power to foreign shareholders while retaining more than 50% of the value of the stock. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.957-1(a)(2) 	
<p>Confirm that the Entity is Foreign.</p> <ul style="list-style-type: none"> ▪ An entity is considered foreign if it is not domestic. If it is organized under the laws of the United States, it is not a CFC. ▪ Request from the taxpayer Articles of Organization. ▪ If necessary, contact JITSIC and/or EOI. 		
<p>Verify that the entity is a Corporation for U.S. Tax Law</p> <ul style="list-style-type: none"> ▪ To be a CFC, the foreign entity must be a corporation. Verify that the foreign entity has not elected to be treated as a disregarded entity or a 	<ul style="list-style-type: none"> ▪ IPS Practice Unit – Check- the-Box Rules for Foreign Entities, future unit. 	

Issue 3, Step 3: Additional Factual Development

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
partnership. The examiner may use IDRS and request Form 8832 <i>Entity Classification Election</i> from the taxpayer.		

Issue 3, Step 4: Develop Arguments

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<p> DECISION POINT – Based on the evidence, determine whether the foreign entity is a CFC.</p> <ul style="list-style-type: none"> ▪ If you determine that the taxpayer is a U.S. person who owns 10% or more of the voting power of a foreign corporation and that corporation is owned more than 50% by U.S. Shareholders, the entity is a CFC. ▪ If you determine that the taxpayer does own a CFC, consider whether the taxpayer has properly included Subpart F income. ▪ Refer to the following IPS Practice Units should be considered when the taxpayer is a U.S. Shareholder of a CFC: <ul style="list-style-type: none"> – “Overview of Subpart F Income for U.S. Individual Shareholders,” DCN: FEN/9433.01_09(2013). – “IRC 956 – Investment in U.S. Property,” future unit. – “Failure to File the Form 5471 – Information Return of U.S. Persons With Respect to Certain Foreign Corporations - Category 4 and 5 Filers – Monetary Penalty,” DCN: FEN/9433.01_06(2013)(b). – “Failure to File the Form 5471 – Information Return of U.S. Persons With Respect to Certain Foreign Corporations - Category 2 and 3 Filers – Monetary Penalty,” in process as of 5/15. 		

Issue 3, Step 4: Develop Arguments

Determination of U.S. Shareholder and CFC Status

Issue 3

Is the foreign entity a Controlled Foreign Corporation?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> – “Failure to File the Form 926 – Return by a U.S. Transferor of Property to a Foreign Corporation – Monetary Penalty,” future unit. – “Determination of PFIC Status,” in revision as of 5/15. (Even if the foreign entity is not a CFC, there may be PFIC issues). – “Check-The-Box Rules for Foreign Entities,” future unit. – “Disposition of a CFC – IRC §1248,” future unit. – “Distributions from a CFC,” future unit. – “IRC §962 Election – Election by Individuals to be Subject to Tax at Corporate Rates,” future unit. 		

Issue 4, Step 2: Review Potential Issues

Determination of U.S. Shareholder and CFC Status

Issue 4

How is CFC status determined if the foreign entity is an insurance company?

Fact Element	Resources	6103 Protected Resources
<p>Insurance companies are often formed in foreign countries including tax haven countries, such as Bermuda and Cayman islands, by U.S. shareholders. Special rules apply in determining whether insurance companies are CFCs. There are two types of insurance CFCs:</p> <ul style="list-style-type: none"> ▪ First, insurance companies that sell insurance to unrelated persons. ▪ Second, insurance companies that sell insurance (all or in part) to related parties and are sometimes referred to as “captive insurance companies.” <p>A foreign insurance company that sells insurance to unrelated persons is generally subject to the normal CFC rules and must have 10 percent U.S. Shareholders that own more than 50 percent of the company.</p> <p>However, a foreign insurance company that earns over 75 percent of its premiums from selling insurance on U.S. risks is a CFC if 25 percent or more of the company is owned by 10 percent U.S. Shareholders.</p>	<ul style="list-style-type: none"> ▪ IRC 953(c) ▪ IRC 957(b) 	

Issue 4, Step 3: Additional Factual Development

Determination of U.S. Shareholder and CFC Status

Issue 4

How is CFC status determined if the foreign entity is an insurance company?

Fact Element	Resources	6103 Protected Resources
<p>Determine if the foreign insurance company that sells insurance to related parties is subject to the lower threshold for determining whether it is a CFC.</p> <ul style="list-style-type: none"> ▪ Confirm the insurance income meets the definition of related party insurance income. The insurance income should be attributable to a policy of insurance or reinsurance with respect to which the person insured is a U.S. Shareholder in the foreign corporation or a related person to such shareholder. ▪ If so, then determine if the foreign corporation meets the lower threshold for determining CFC status. First, consider all shareholders who are U.S. persons who own any stock (rather than the normal 10% requirement). Then determine if those U.S. shareholders own 25% or more of the stock (by vote or value) on any day in the year (rather than more than 50%). Some tools/information the examiner can use to make this determination include: <ul style="list-style-type: none"> ▪ Internet research ▪ Organizational documents ▪ Corporate minutes ▪ Customer lists 	<ul style="list-style-type: none"> ▪ IRC 953(c)(2) ▪ IRC 953(c) 	

Issue 4, Step 4: Develop Arguments

Determination of U.S. Shareholder and CFC Status

Issue 4

How is CFC status determined if the foreign entity is an insurance company?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The attribution rules must be considered to determine if 25% or more of the combined voting power or value of stock is owned by U.S. Shareholders. See Issue 1. ▪ Taxation of foreign insurance companies is complex. The types of income a captive insurance company receives must be considered in order to determine whether the Subpart F rules are applicable. 	<ul style="list-style-type: none"> ▪ Non-Life Insurance IPG 	
 <p>CONSULTATION: The determination of foreign insurance companies is beyond the scope of this IPS Unit. If you identify that your taxpayer has ownership in a foreign insurance entity, consultation with counsel is recommended.</p>		

Training and Additional Resources

Chapter 11.1.1 Taxability of Income from the CFC		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Issue Toolkits	The Large Business and International Issue Practice Groups contain specialized knowledge of insurance companies	Non-Life Insurance IPG
Guidance	IRM	IRM 4.61.7 Controlled Foreign Corporations
Podcasts / Videos	CPE 2011 – Day 1 – Foreign Corporations and Pass-Throughs	
Other Training Materials	Checkpoint Learning (formerly Micromash) BNA Tax Management Portfolios - Foreign Income Series - Taxation of U.S. Persons' Foreign Income	Fundamentals of International Tax: I : Subpart F and CFC's (Course # FITAX1) 926-3 rd : CFC's General Overview : IV. Definition of U.S. Shareholder V. Definition of Controlled Foreign Corporation VI. Stock Attribution Rules

Glossary of Terms and Acronyms

Acronym	Definition
CFC	Controlled foreign corporation
EOI	Exchange of Information
IDR	Information document request
IDRS	Integrated Data Retrieval System
IPG	Issue Practice Groups
IPN	International Practice Networks
IRM	Internal Revenue Manual
JITSIC	Joint International Tax Shelter Information and Collaboration

Index of Related Issues

Issue	Associated UIL(s)	References
Overview of Subpart F Income	9433.01-01	FEN/9433.01_09(2013)
General Subpart F Computational Issues	9433.01-01	To be developed
Failure to File the Form 5471 – Category 4 & 5 Filers – Monetary Penalty	9433.01-02	FEN/9433.01_06(2013)(b)
Failure to File the Form 5471 – Category 2 & 3 Filers – Monetary Penalty	9433.01-02	In process as of 5/15
Failure to File the Form 926 – Monetary Penalty	9433.01	In process as of 5/15
Determination of PFIC Status	9433.02	In revision as of 5/15
Check-The-Box Rules for Foreign Entities	TBD	To be developed
Section 956 – Investments in U.S. Property	9433.01-01	To be developed
Dispositions of a CFC - IRC1248	9433.01-01	To be developed
Distributions from a CFC	9433.01-01	To be developed
IRC 962 Election - Election by individuals to be subject to tax at corporate rates	9433.01-01	To be developed
Issues associated with offshore bank accounts	9435.04	To be developed
Foreign Personal Holding Company Income	9433.01-01	In process as of 5/15
Foreign Base Company Sales Income	9433.01-01	To be developed
Foreign Base Company Services Income	9433.01-01	To be developed