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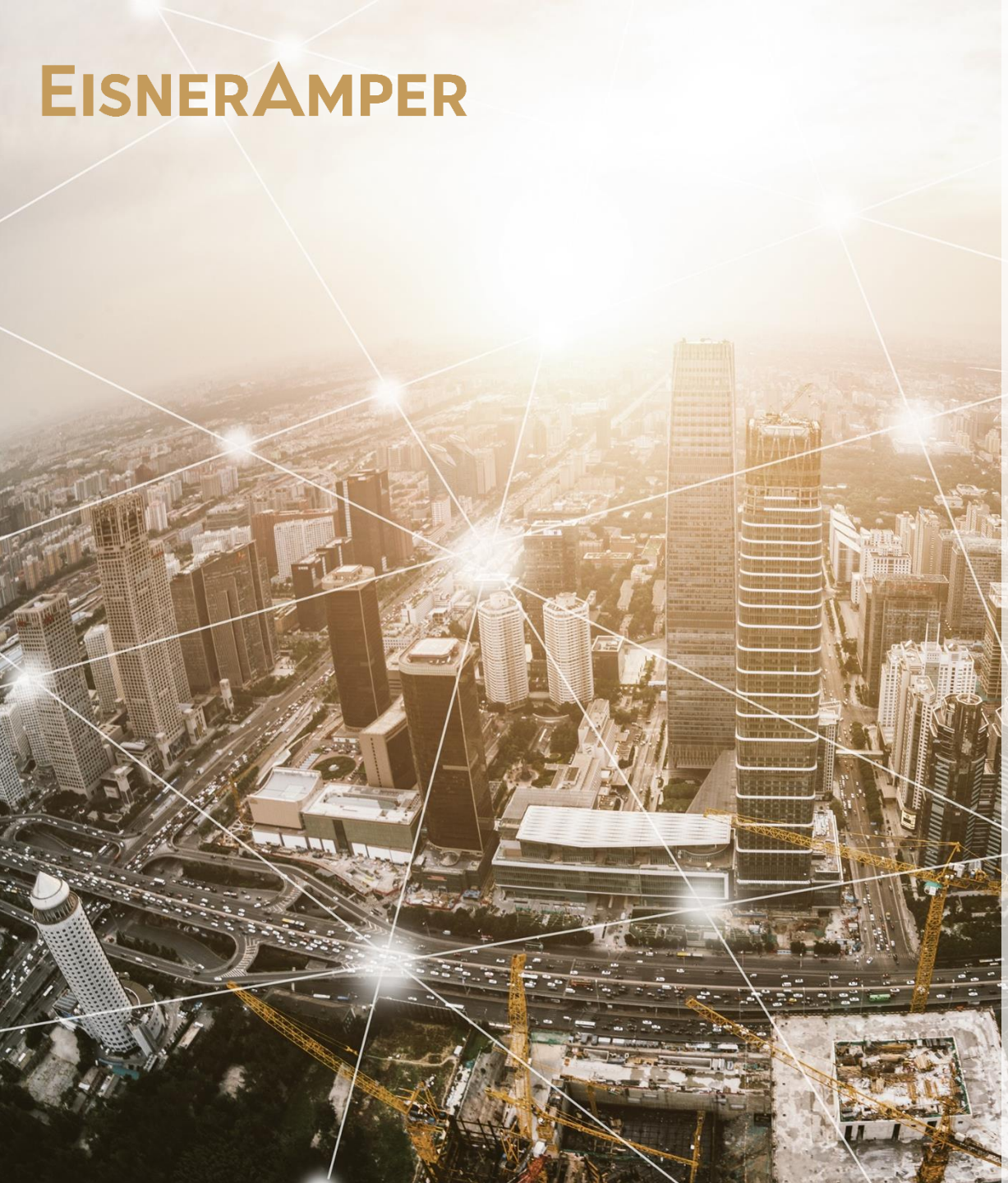

Tax Reform: Downward Attribution

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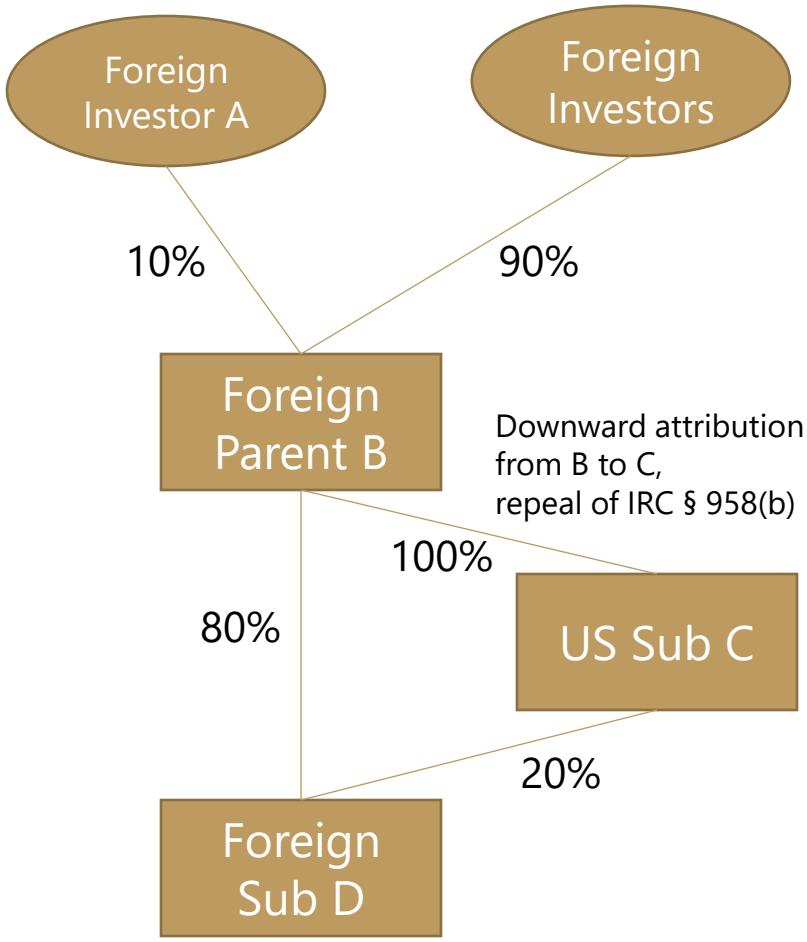
Downward Attribution

- Modification of CFC attribution rules
  - repeal of IRC §958(b)(4).
- "Downward attribution" from foreign person to U.S. person may result in a foreign corporation being classified as a CFC.
- Effective for 2017 onward
- Disjoint between letter of the law and legislative history
- How do you advise clients (e.g. in M&A transaction)

Modification of CFC Attribution Rules: Repeal of IRC §958(b)(4)

Example 1 ("The Mischief"):

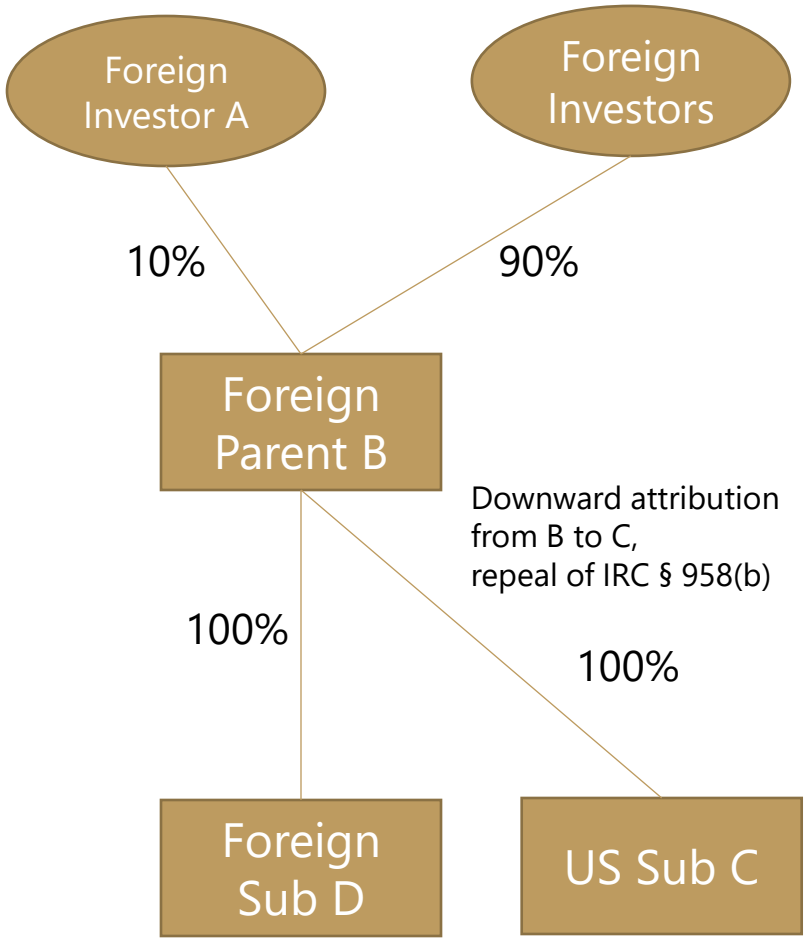
- Under pre-TCJA law, Foreign Sub (D) is not a CFC - IRC §958(b)(4) prevented U.S. Sub (C) from being treated as owning Foreign Parent's (B) 80% interest in Foreign Sub (D)
- After repeal of IRC §958(b)(4), U.S. Sub (C), for purposes of determining U.S. Shareholder and CFC status, is treated as owning all of the stock of the Foreign Sub (D) (20% directly and 80% constructively under IRC §318(a)(3)), causing it to be a U.S. Shareholder of Foreign Sub (D), which becomes a CFC
- U.S. Sub's (C) inclusion of Subpart F income is limited to its pro rata share in respect of its directly held stock (20%)
- U.S. Sub (C) is required to file Form 5471 in respect of Foreign Sub (D)
- No impact on Foreign Investors



Modification of CFC Attribution Rules: Repeal of IRC §958(b)(4)

Example 2: (No direct ownership):

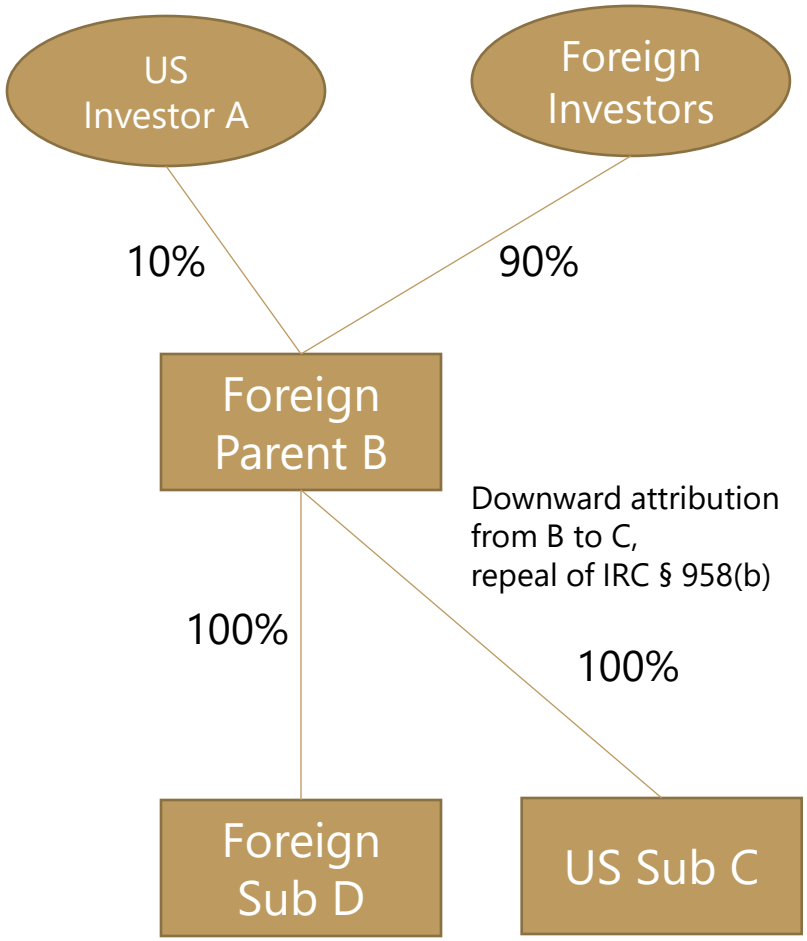
- U.S. Sub (C) constructively owns all of Foreign Sub's (D) stock; D is a CFC
- However, since C has no direct or indirect ownership in Foreign Sub D, C is not required to pick up any Subpart F income
- Since there is no direct or indirect 10% U.S. Shareholder of Foreign Sub (D), Section 5.02 of Notice 2018-13 relieves the obligation of U.S. Sub (C) to file Form 5471 (Category 5)
- No impact on Foreign Investors



Modification of CFC Attribution Rules: Repeal of IRC §958(b)(4)

Example 3: (10% US Shareholder)

- U.S. Sub (C) constructively owns all of Foreign Sub's (D) stock
- C has no direct or indirect ownership in D; C has no Subpart F income
- There is an indirect 10% U.S. Shareholder of Foreign Sub (D), i.e. US Investor A
- As D is a CFC (this has nothing to do with A's 10% ownership, but with C's deemed ownership), from the strict reading of the statute that US Investor A must include pro rata share of Subpart F income (including deemed repatriation under IRC §965 for 2017, and GILTI from 2018 on).
- In addition there is a Form 5471 filing requirement for A and C for 2017 on.



Conflict between Statute and Congressional Intent

- Legislative history indicates Congress did not intend the repeal of IRC §958(b)(4) to cause a foreign corporation to be treated as a CFC, as a result of downward attribution, with respect to a U.S. person (i.e. US 10% investor A) not related via 50% common ownership, to the U.S. person to whom the stock is attributed (i.e. US Sub C).
- However, it is difficult to read the actual statutory language as consistent with such intent. While the IRS may issue guidance that interprets the statute in the narrower sense that it was intended, it may conclude that it lacks the authority to do so absent a technical correction.
- In IRS Notice 2018-13 the IRS addressed 2 issues resulting from the repeal of IRC §958(b)(4) (noting that more foreign corporations will now have become CFCs), but remained silent with respect to inconsistency between the legislative history and the statute. At the same time, the notice does request comments as to whether it would be appropriate to reconsider the provisions of any form, publication, regulation, or other guidance that reference CFCs, and if so, what.

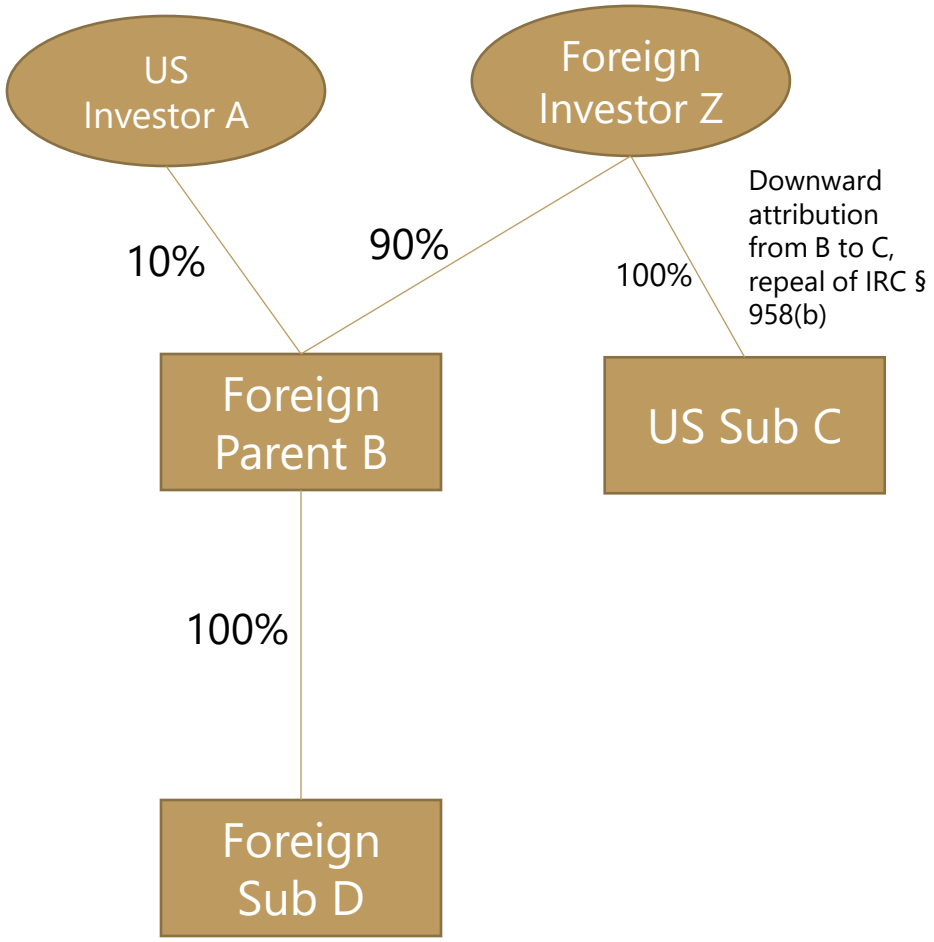
Possible Planning Options

- Taking a position based on the legislative history (assuming there'll be a technical correction or/and IRS guidance that is consistent with the legislative history???
- Liquidate US Sub C, i.e. operate US business as SMLLC/DRE owned by foreign company.
  - Consider US tax consequences of the liquidation
- File an election (CTB) with respect to the foreign subsidiary(ies) to be treated as transparent for U.S. tax purposes.
  - The foreign parent is not a CFC(?)

Modification of CFC Attribution Rules: Repeal of IRC §958(b)(4)

Example 4: (No US Sub in group)

- Neither US Investor A nor Foreign Parent B owns any direct or indirect interest in US Sub C
- Nevertheless, C constructively owns 90% of Foreign Parent's B stock and 100% of Foreign Sub's D stock. B and D are CFCs.
- A is a US shareholder of CFC's B and D, from the strict reading of the statute US Investor A must include pro rata share of Subpart F income (including deemed repatriation under IRC §965 for 2017, and GILTI from 2018 on) of B and D.



Other CFC Changes

- Definition of a US shareholder for CFC purposes expanded to 10% of vote or value of foreign corporation.
- Under old law careful structuring of ownership of the voting stock could successfully avoid CFC or “US shareholder”.
- May cause foreign corporation to be classified as a CFC (or a U.S. person to be classified as a “U.S. shareholder” of a CFC),
- Effective for 2018 onward

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