

# Controlled Foreign Corporations & Statutes of Limitation

By Robert W. Wood • Wood LLP • San Francisco

Controlled foreign corporations (“CFCs”) seem almost plain vanilla in the context of a transaction or even in an ongoing business enterprise. Yet the rules surrounding CFCs are not only important, they can be downright devastating if you fail to comply. The meat-

and-potatoes problem arises for individual investors and closely held companies.

When a U.S. shareholder holds more than 50 percent of the total voting power or value of a foreign corporation, the company is classified as a CFC. A U.S. shareholder is a

U.S. person that owns 10 percent or more of the foreign corporation's total voting power. That triggers reporting obligations, including the annual filing of an IRS Form 5471.

It is an understatement to say that this is an important form. A separate \$10,000 penalty can apply to each Form 5471 filed after the due date and each Form 5471 that is incomplete or inaccurate. This penalty can apply even if no tax is due on the return. Finally, if you fail to file a required Form 5471, the taxpayer's return remains open for audit *indefinitely*.

Normally, of course, the statute of limitations expires after three or six years, depending on the issue and its magnitude. But in the case of the Form 5471, this statutory override of the normal statute of limitations doesn't cover only the income flowing from the CFC. In fact, the IRS can make any adjustments to *any and all* items in the *entire* tax return with no expiration until the required Form 5471 is filed.

And do not assume that you have no issue if there is no CFC. In fact, Forms 5471 are not only required of U.S. shareholders in CFCs, they are also required from U.S.

shareholders in any foreign corporation when the U.S. shareholder acquires stock that results in a 10-percent ownership of the foreign corporation's total voting power or value. In the year that the U.S. shareholder's acquisition results in a 10-percent ownership, the U.S. shareholder must also file a Form 5471.

This harsh statute-of-limitation consequence was the result of the HIRE Act, passed on March 18, 2010. Not coincidentally, this was the same law that brought us FATCA, the Foreign Account Tax Compliance Act. This particular CFC provision applies to all tax returns filed after March 18, 2010, and to any other return for which the assessment period has not yet expired as of the date of enactment.

This certainly does not cover the waterfront about CFCs. On top of everything else, they are taxed in a somewhat punitive way too. At least the U.S. shareholders of CFCs can claim a foreign tax credit for any foreign taxes paid by the CFC. Still, the possibility that a statute will remain open can ruin more than your day. Bottom line: be careful with CFCs and with Form 5471.

#### Article Submission Policy

THE M&A TAX REPORT welcomes the submission of unsolicited articles. Submissions should be 2,000 words or less and use textual citations, rather than footnotes. All submissions should be made via email attachment in either Microsoft Word or WordPerfect format to Robert W. Wood, Editor-in-Chief, at [wood@woodLLP.com](mailto:wood@woodLLP.com). THE M&A TAX REPORT reserves the right to accept, reject, or edit any submitted materials.

TO SUBSCRIBE TO THE M&A TAX REPORT CALL 1-800-638-8437.

4025 W. Peterson Ave.  
Chicago, IL 60646

PRESORTED  
FIRST-CLASS MAIL  
U.S. POSTAGE  
PAID  
CCH