Form 5471—The Next FBAR

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Since the commencement of the IRS's offshore voluntary disclosure programs in 2009, the most significant form in the IRS's reporting arsenal seems to have been the Form TD F 90-22.1 (*Report of Foreign Bank and Financial Accounts*), better known as "FBAR." Around for decades, FBAR emerged as preeminent only recently. Of course, FBAR isn't even a form required by the Internal Revenue Code. It is instead a form to report interests required by the Bank Secrecy Act, which is administered by the Financial Crimes Enforcement Network ("FinCEN").

However, the Form 5471 (*Information Return of U.S. Persons with Respect to Certain Foreign Corporations*) is an equally important form. This form is specifically designed to report interests in foreign entities and contains markedly more complex rules and nuances than those that dictate FBAR. There is a distinct possibility that the Form 5471 will soon become as great a worry to U.S. taxpayers as the now ubiquitous FBAR.

Finicky FBAR Filings

As most taxpayers are now aware, FBAR must be filed by U.S. taxpayers if they have a financial interest in, or signature authority over, at least one financial account located outside of the U.S. *and* if the aggregate value of all their foreign financial accounts exceeded $10,000 at any time during the calendar year. Signature authority even without benefit interest can be enough to necessitate the filing of an FBAR. For corporate officers and directors, however, FBAR can present particular problems.

The final FBAR regulations (76 FR 10245) promulgated by FinCEN make clear that U.S. taxpayers who are officers or directors of corporations with foreign financial accounts may have an obligation to file FBARs, even if their interest in such accounts is exceedingly attenuated. Often corporate officers or directors have the authority (alone or in conjunction with others) to control the disposition of money, funds or other assets held in a corporation's foreign financial accounts. Such authority is enough to constitute signature authority and can give rise to time-consuming and costly reporting obligations for the individual taxpayer. [*See* 31 CFR §1010.350.]

In fact, FBAR can be a veritable minefield for corporate officers and directors. FBAR rules impute reporting requirements to an individual officer or director's personal return for *any corporate foreign account* over which the officer or director may have minimal cover. This blanket imputation can create a personal reporting obligation for an individual U.S. taxpayer where he may have no idea about the existence of the foreign accounts.

However, there are certain exceptions to the general signature authority rules for corporate officers and directors. An officer or director of a company who is registered with the SEC or CFTC need not report that he has signature or other authority over a foreign financial account if he has no direct financial interest in the account. [31 CFR §103.24(f)(2)(ii).] Similarly, an officer or director of entities who have securities listed upon a U.S. national securities exchange need not report his signature authority over the entities' foreign accounts. [31 CFR §103.24(f)(2)(v).]

Nevertheless, the strikingly wide breadth of FBAR reporting obligations leaves little doubt that corporate officers and directors will be double-checking the extent of their authority over foreign corporate bank accounts each June.

The Next Reporting Crisis

FBAR seems to be on everyone's mind now and may actually lull some taxpayers into inaction or complacency. There are other significant reporting forms that have not yet had their time in the reporting limelight. Our focus here is the Form 5471 that reports the interests in foreign entities as required by Internal Revenue Code Sections ("Code Secs.") 6038 (Information reporting with respect to certain foreign corporations and partnerships) and 6046 (Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock).

This form must be filed by U.S. taxpayers who are officers, directors or shareholders in certain foreign corporations. Importantly, the Form 5471 is an actual part of a taxpayer tax return. This is in contrast to other reporting forms like FBAR and the Form 3520 (used to report transactions with foreign trusts and the receipt of certain foreign gifts) that are stand-alone forms, filed separately from the Form 1040.

The Form 5471 presents particular problems for U.S. taxpayers who have ownership interests in foreign entities. In part, this is because the Form 5471 has become a sort of dumping ground for reporting foreign corporate interests. The various interests to be reported on the Form 5471 have resulted in a tax form of Byzantine complexity. Additionally, Congress has recently tinkered with the statute of limitations controlling Forms 5471 in ways that can lead to rather inequitable results.

Categorical Imperative

Unlike the relatively simple test used to determine whether a U.S. taxpayer must file an FBAR, Form 5471 requires U.S. taxpayers with interests in foreign entities to undergo a gauntlet of examinations to determine whether they must file the form. Their ownership interest must be scrutinized under four distinct categories.

Officers or directors of a foreign corporation must file the Form 5471 as a "Category 2 Filer" if a U.S. person acquires a 10-percent stock ownership in that corporation. [*See* Code Sec. 6046(a)(1)(A).] U.S. persons who acquire or dispose of a 10-percent stock ownership interest in a foreign corporation must also file the Form 5471. However, they generally must file as a "Category 3 Filer" simply by virtue of acquiring or disposing of a 10-percent interest. [*See* Code Sec. 6046(a)(1)(B).]

While Category 2 and 3 filers must generally test to see if a shareholder has acquired or disposed of a 10-percent interest in a foreign corporation, Category 4 and 5 filers must report their interests in controlled foreign corporations (CFCs). A CFC is any foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock, or 50 percent of the total value of the stock of the corporation, is owned by U.S. shareholders on any day during the tax year of such foreign corporation. [*See* Code Sec. 957.] Ownership interest in a CFC can give rise to the Subpart F income rules requiring a U.S. taxpayer to include amounts in income even if the CFC has not distributed its earnings to its shareholders.

The difference between a Category 4 and a Category 5 Filer is as follows: A U.S. person who had control (*i.e.*, more than 50 percent of vote or value) of a foreign corporation for 30 days during the year must file the Form 5471 as a "Category 4 Filer." [*See* Code Sec. 6038(a)(1).] A U.S. person who owns *any amount of* stock in a CFC for an uninterrupted period of 30 days or more during the year, and who owned that stock on the last day of that year, must file the Form 5471 as a "Category 5 Filer." [*See* Code Sec. 6038(a)(4).]

Importantly, domestic partnerships and corporations are included within the definition of U.S. persons for purposes of Category 2 through 5 Filers. This means that U.S. corporate and other business entities must pay particular attention to the application of these rules on their ownership interest of foreign subsidiaries and other foreign entities. [*See* Code Sec. 7701(a)(30).]

For those readers counting, you will notice that there are only four groups listed—Categories 2 through 5—but five categories. What about Category 1? The Form 5471 has retained the "Category 1 Filer" classification that once was used to report ownership interests in foreign personal holding companies as required by Code Sec. 6035. Although this Code section was repealed by the American Jobs Creation Act of 2004 [Act Sec. 413 of P.L. 108-357], we still have the Category 1 Filer classification with us.

Attribution Arrabiata

Nowhere is the hodgepodge of the Form 5471 better illustrated than in the attribution rules for determining which interests should be reported on the form. One would think that Congress and the IRS would apply consistent family attribution rules on a form reporting various foreign entity interests. Quite the opposite.

Category 2 and 3 filers (related to the 10-percent ownership changes) are controlled by Code Sec. 6046. Under Code Sec. 6046(c), an individual will be deemed to indirectly own shares owned by members of his or her family. "Family" for this purpose means "brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants." This sibling attribution rule found in Code Sec. 6046 may be unique. Nowhere else in the Code does it appear ownership can be attributed through a sibling.

In contrast, for Category 4 and 5 filers (related to CFC ownership), Code Sec. 6038(e) adopts the general family attribution rules provided at Code Sec. 318. Under these general rules, only the ownership interests of spouses, children, grandchildren and parents are attributed to a taxpayer. Brothers and sisters are not counted for purposes of determining family attribution. [*See* Code Sec. 318(a)(1).]

If missing categories and inconsistent family attribution rules were not enough, the statute of limitations governing the filing of Forms 5471 seems just as complex and convoluted as the rest of the form.

Statute of Limitations Snafus

In general, the IRS must assess taxes within three years after a taxpayer has filed his return, whether or not it was timely filed. [*See* Code Sec. 6501(a)(1).] However, for Forms 5471, there are special rules governing the statute of limitations. The current iteration of Code Sec. 6501(c)(8) indicates that the IRS may assess tax on any tax return, event or period to which a Form 5471 relates for three years after the date on which the Form 5471 was filed.

Thus, as a general proposition, Code Sec. 6501(c)(8) provides that if a taxpayer files his tax return but fails to include a Form 5471 reporting his interest in a foreign entity, the statute of limitations *for the entire return* does not begin to run until the Form 5471 has been filed. At that time, the three-year statute commences for the IRS to assess tax on any portion of the return.

There is a reasonable cause exception contained in Code Sec. 6501(c)(8). If the failure to provide the Form 5471 is due to reasonable cause and not to willful neglect, the extended limitations period will only apply to the item or items on the Form 5471, not to the entire tax return. However, these special statute of limitations rules are a relatively recent change to the Code.

Prior to March 18, 2010, Code Sec. 6501(c)(8) provided that if a taxpayer failed to include a Form 5471 with his return, the statute of limitations remained open only "with respect to any event or period to which" the Form 5471 related. The entire tax return was not swept into the tolled statute. Perhaps inspired by the success of the voluntary disclosure programs, Congress amended Code Sec. 6501(c)(8) in 2010 with the Hiring Incentives to Restore Employment Act ("the HIRE Act") (Act Sec. 513 of P.L.111-147). It was the HIRE Act amendment that tolled the statute of limitations for any part of a taxpayer return—irrespective of whether it relates to a foreign entity—if the taxpayer fails to timely file the Form 5471. The inclusion of "tax return" in Code Sec. 6501(c)(8) meant that the extended period would apply to *all* the information reported on the tax return and not just adjustments to income related to the information that should have been reported on the Form 5471.

The results of this HIRE Act amendment appear to be already affecting taxpayers. In CCA 201206014 (Oct. 17, 2011), the IRS ruled that the tax returns of an S corporation and its two majority shareholders, which were filed after the enactment of the HIRE Act and without the required Forms 5471, were subject to the tolled statute. According to the IRS, the statute of limitations for the assessment of taxes was extended to include the assessment of the S corporation and majority shareholders' *entire tax returns*, not just adjustments related to the failure to report CFC ownership on the Form 5471.

Conclusion

The foreign tax reporting forms are here to stay. Indeed, FBAR appears to have already become part of our tax return Zeitgeist. However, it may behoove taxpayers—especially domestic partnerships and corporations—to look closely at their reporting obligations for purposes of the Form 5471. Not only are these reporting requirements markedly more complicated than FBAR, but a failure to comply with the required reporting can toll the statute of limitations for the entire tax return.