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Federal Tax ADVISORY ■

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Downward Stock Attribution for CFC Purposes

The Senate released a draft of a bill addressing various coronavirus issues, but also including a handful of corrections to the Tax Cuts and Jobs Act (TCJA) of 2017. One addresses the repeal of Section 958(b)(4) and apparently attempts to write the rule that Congress intended to write in 2017. The proposal does not appear in the CARES Act that was passed. However, it is likely to come up again. So understanding its unusual regime may be useful yet.

Restoration of Section 958(b)(4)

Section 2209 of the Senate bill would have added Section 958(b)(4), which is identical to the subsection stricken by the TCJA. It restores the section to its pre-2017 wording, exactly. The change's effective date is identical to the effective date of the 2017 amendment (foreign corporation's last taxable year beginning before January 1, 2018). Therefore, the change should have the effect of repealing the 2017 change ab initio, meaning it never had effect. For a foreign corporation with a calendar year, the prior amendment was in effect for all of 2017, 2018, 2019, and part of 2020. If the repeal passes, it should never have been in effect.

Section 2209 is titled "Restoration" of the limitation on downward attribution. That does not by itself indicate a meaning of void ab initio. Therefore, the repeal as written depends on a technical understanding of the consequence of making a new statute effective on the same date as a prior inconsistent statute, rather than flatly stating that the prior statute will be null and void ab initio.

Does use of this method of repeal have significance? Why would not Congress repeal the 2017 amendment and state that the law would apply as if it had never been enacted? Evidently it will not matter how the repeal is worded, unless intervening events occurred depending on the TCJA.

Congress has used the same method in repealing before they began other important tax changes. TEFRA (1982) adopted withholding on interest and dividends. Congress repealed it "as of the close of June 30, 1983." However, that repeal also stated that the Code would be applied as if the 1982 provision had not been enacted, with stated exceptions that were needed because taxpayers had taken some actions in reliance on the statute before its repeal. The 1982 statute was effective for interest and dividends paid after June 30, 1983. So the enactment date and the repeal date were the same.

When Congress repealed the 1976 carryover basis at death rule in 1980, it repealed that rule and stated that the Code would be applied as if it had never been enacted. Other repeals of tax amendments have been made "as if [the prior law] had not been enacted." In 1984, P.L. 98-369, Sec. 16(a) repealed as if not enacted Sec. 302(c)(2) of P.L. 97-34.

By not providing rules for any intervening actions or events based on the 2017 change, the 2020 change implies or assumes there were no such actions that need be dealt with. There were required reportings of controlled foreign corporation (CFC) status. It was possible that a foreign parent with U.S. and foreign subsidiaries and a direct United States shareholder (10 percent) could have caused that shareholder to recognize income of the newly minted CFCs. There are other foreign tax rules that depend on CFC status that existed during those years but has been wiped away, apparently retroactively. The draft includes regulatory authority, but not related to that issue.

New Section 951B

Section 2209 also adds to the Code a new Section 951B titled Amounts Included in Gross Income of Foreign Controlled United States Shareholders. That title is similar to the titles of Section 951 and 951A (added in 2017), which tax to certain United States shareholders Subpart F income and global intangible low-taxed income (GILTI) of CFCs. The title of the new section signals that Congress did not originally intend to create a lot of new CFCs but rather intended to tax U.S. subs of foreign corporations on their proportionate part of the income of partly directly owned foreign subs of the foreign parent, under Sections 951 and 951A.

Example. Foreign parent wholly owns U.S. sub, which owns 20 percent of foreign sub; foreign parent owns the other 80 percent. Congress intended to tax U.S. sub on 20 percent of foreign sub's Subpart F and GILTI.

Section 951(b) defines "United States shareholder" as a United States person that owns 10 percent of the vote or value of the foreign corporation, applying the attribution rules of Section 958(b). That means the U.S. subsidiary of a foreign parent corporation was a United States shareholder of the parent's foreign subsidiaries, which were therefore caused to be CFCs, from the beginning of the CFC's year beginning in 2017 until now. That is the aspect of the repeal of Section 958(b)(4) that had the most impact and caused the most concern. The repeal will remove those foreign subsidiaries from the definition of CFC in Section 957.

However, that U.S. subsidiary did not have to include Subpart F income and GILTI of the newly minted CFCs because of the special rule limiting inclusion to United States shareholders with direct Section 958(a) ownership, not applying Section 958(b). But if the foreign parent had a shareholder that was a United States person that owned as much as 10 percent of the vote or value of the CFC by direct attribution, that United States person would have to include the Subpart F and GILTI income. And if the U.S. subsidiary of the foreign parent did directly own stock of the CFC, it would have to include its pro rata share of Subpart F and GILTI. It is that scenario that new Section 951B aims at (the example above).

By restoring Section 958(b)(4), the change would prevent such foreign subsidiaries from being CFCs and would prevent inclusions by such direct United States shareholders, even including a U.S. sub that directly owned some stock of the foreign subsidiary, absent a further change.

That further change is in Section 951B. It continues the newly minted CFC regime in a very limited way. It continues the downward inbound attribution of the stock of a foreign corporation from a foreign parent to its U.S. subsidiary if the foreign parent owns at least 50 percent of a U.S. corporation Then the U.S. sub will be attributed all the foreign parent's stock under Section 318(a)(3)(C). Consequently, the U.S. sub will own more than 50 percent of the foreign sub's stock either if the foreign parent owns more than half of that stock or the U.S. sub owns some stock directly that can be added to the 50 percent of stock attributed from the foreign parent.

So new Section 951B creates a new type of CFC, in effect, that would not otherwise exist, but not for any purpose other than to cause an inclusion to the U.S. subs that directly own stock of the newly minted CFCs based on Section 958(a) attribution and direct ownership that is required for Sections 951 and 951A inclusion of CFC income (and Section 965).

The mechanism for creating the new special regime is in the definitions of "foreign controlled United States shareholders" and "foreign controlled foreign corporations." The latter term is central because it adds to the term CFC a new category of foreign corporations that are not CFCs. They are foreign corporations with these characteristics: (1) their United States shareholders are determined without regard to Section 958(b)(4) as restored in 2020; and (2) their United States shareholders deemed to own more than 50 percent of their stock can only be foreign controlled United States shareholders.

A foreign controlled United States shareholder is a United States person that would not otherwise be a United States shareholder but would be made one by downward attribution from a foreign shareholder, which could occur only if the foreign shareholder owned at least 50 percent of its stock and the combination of foreign corporation stock directly owned by the United States shareholder plus 100 percent attribution of all the foreign corporation's stock owned by the foreign parent to the United States shareholder under Section 318(a)(3)(C) totaled more than 50 percent of the stock of the foreign corporation.

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