TCJA: DOES FAMILY TRUST SUDDENLY OWN A CFC?

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Due to the us Tax Cuts and Jobs Act (TCJA) effective after 2017, old family trusts must be reviewed for whether shares they own are CFC shares. Assume that when the estate freeze transaction was entered into, the Canadian adviser took note that one child had moved permanently to the United States, and extra care was taken to review the us tax implications of a Canadian trust with US beneficiaries that owns shares of a Canadian corporation. The plan was vetted by both the Canadian and US tax advisers, and it was determined that the company was not a controlled foreign corporation (CFC) and not a passive foreign investment company, and that the US subpart F anti-deferral regime was not implicated. The TCJA has broadened the definition of companies that are treated as CFCS; as a result, many more Canadian companies will suddenly be CFCS.

If Canco is a CFC, a "US Shareholder" (as defined below) may be taxed on some of its subpart F income on the last day of the CFC's tax year, even if no income is actually distributed to the US Shareholder. Subpart F income generally includes most passive income. In addition, a US person who owns an interest in a CFC must file form 5471 ("Information Return of us Persons with Respect to Certain Foreign Corporations") with the IRS, and may also have to file form 8938 ("Statement of Specified Foreign Financial Assets") depending on the specific facts.

A non-US corporation is a CFC if US Shareholders own more than 50 percent of the total combined voting power or more than 50 percent of the total value of the stock in the corporation on any day during the corporation's taxable year. For CFC purposes, a "US Shareholder" is specifically defined as a US person that owns directly or indirectly 10 percent or more of the total combined voting power, or of the value, of the non-US corporation. Before the TCJA, a US person was deemed to be a US Shareholder only if he or she owned, directly or indirectly, 10 percent or more of the voting power; value was not taken into consideration.

Indirect ownership includes stock that is deemed to be owned by the beneficiary under trust attribution rules. Pretcja, if the US beneficiary owned no voting stock directly or indirectly in Canco, and if the trust of which the US person was a beneficiary owned no voting stock, then the required analysis was complete: the US

beneficiary was not a US Shareholder. For example, a parent owns the sole voting share of stock in Canco. A child, a US person and a Canadian family trust beneficiary, owns directly non-voting stock equal to 8 percent of Canco's value. The family trust owns non-voting stock equal to 45 percent of Canco's value. Under prior law, Canco was not a CFC because a US person did not own 10 percent or more of the voting shares. But post-TCJA, the child may be a US Shareholder if enough of the trust's stock is attributed to him or her, increasing his or her corporate ownership to the 10 percent value threshold. This test applies even if the child and the trust own no voting stock. If the child is a US Shareholder (because of the trust attribution rules), then the 50 percent test for all us Shareholders must be applied to determine whether Canco is a CFC.

Stock owned directly or indirectly by a trust is generally treated as owned proportionately by the trust beneficiaries. This rule is more straightforward if on the facts a trust has mandatory distribution provisions: for instance, if a trust is solely for the benefit of x, and all income must be distributed to x each year, then it seems fair to attribute 100 percent of the trust's stock to x.

But many trusts are created as discretionary "pot trusts" for multiple beneficiaries: the trustee is given broad power to distribute, or not distribute, income and capital among the beneficiaries. If the trust is purely discretionary, the IRS will likely apply a facts-and-circumstances test to determine how the stock should be attributed to the beneficiaries, taking into account any pattern of distributions previously made from the trust. But what if the trust has never made any distributions or if distributions were sporadic and few and far between? In those situations, a taxpayer is left with no guidance as to how to attribute the trust's stock to the us beneficiaries, and the taxpayer and his or her adviser must work to arrive at a defensible position for deciding how that attribution should be made.

As if enough acronyms were not already in the mix, the TCJA added another complexity to the CFC rules: the tax on global intangible low-taxed income (GILTI), which is imposed on a CFC's 10 percent US Shareholders. Now the US Shareholder must currently include in income the shareholder's allocable portion of the CFC's net income that exceeds the income deemed earned on the CFC's tangible assets. This tax will be an unwelcome surprise to many individuals, especially one who carefully planned to avoid being a us Shareholder under the old rules, but who is now caught by the new definition of a US Shareholder under the TCJA.