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# Controlled Foreign Corporations

As a U.S. person, being a business owner of a foreign company may affect your U.S. tax regardless of whether you receive any distribution from the foreign company or not. Depending on the percentage of your shares or the tax status of other shareholders, a such business entity can be classified as a “controlled foreign corporation” (CFC). Generally speaking, a foreign corporation is a CFC if more than 50 percent of its voting power or value is owned by U.S. shareholders. CFC tax regulations normally apply to U.S. shareholder who owns 10 percent or more of the total voting power of that foreign corporation. If the foreign corporation at issue is an insurance company, special rules apply. Normally, the ownership threshold for a foreign insurance corporation to be considered as a CFC is much lower. Besides, circumstantial factors will also be taken into account when it comes to the determination of a foreign corporation’s CFC status.

Subpart F Income

What is Subpart F income and why is it important? Subpart F income earned by a controlled foreign corporation is taxed to its U.S. shareholders regardless of whether such income has been distributed or not. There are different categories of Subpart F income. Normally, Subpart F income includes investment income such dividends, rents, annuities, and interests. Subpart F income also includes gains received by the CFC from the purchase or sale of personal property involving a related person and from the performance of services by a related person. A person will qualify as a related person with respect to a CFC if such person (or business entity) controls or is controlled by such CFC (or by the same person who controls the CFC).

Wherever the U.S. shareholder of a CFC resides, he or she should include in their gross income his or her pro rate share of the CFC’s subpart F income as constructive distribution. Although direct, indirect, and constructive ownership are used to determine whether a U.S. person is a U.S. shareholder, only direct and indirect ownership are used for purpose of assessing the subpart F income inclusion. The good news is that the included constructive distribution can be deducted in the future when the U.S. shareholder actually receives such income. However, the calculation of such constructive distribution is no simple task. If you would like to speak to a professional, contact us today and let us know how we can help.

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