

Understanding the Section 956 Deemed Income Inclusion

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When it comes to foreign investing, tax laws are often confusing and convoluted; Section 956 inclusions are no exception. US Code Section 956 calls for the inclusion in the income of US taxpayers for certain investments that a controlled foreign corporation (CFC) has made into US property. If left unchecked, the existence of Section 956 can sneak up on unsuspecting taxpayers and leave them with less than ideal tax implications. But, through diligent and targeted tax planning strategies, the burden of the Section 956 income inclusions can often be mitigated.

Section 956 was first included with the introduction of Section 951 and Subpart F income as part of the Revenue Act of 1962. These foreign income tax reporting rules encapsulate US taxpayers that hold at least 10% of a Controlled Foreign Corporation, or CFC. A CFC is defined as a legal corporation that operates outside of the United States but has at least 50% of its shares and/or voting rights held by US shareholders. Within Code Section 951, there are two types of income that these US shareholders must report. The first consideration of Section 951 directs that these shareholders must report their pro rata share of Subpart F income, which is made up of income made by the CFC outside of the United States. Historically, this foreign income created an opportunity for shareholders to defer tax because it was only required to be reported as Subpart F income when it was “constructively repatriated” through dividends or distributions. This all changed when the Tax Cuts and Jobs Act of 2017 mandated that US shareholders of CFC’s recognize all deferred income, i.e. foreign income earned but not yet distributed, as Subpart F income. The specifics of this “deemed distribution” are detailed in IRC Code Section 965.

The second component to Section 951 states that, in addition to the Subpart F income, the US shareholders of a CFC must also report any amounts calculated under Section 956. The main principal of Section 956 is that the shareholders must also account for the CFC’s investments in US property to the extent that they may exceed any Subpart F income already reported. In other words, if the CFC makes an investment in US property that exceeds the amount of current Subpart F income and previously taxed earnings and profits, the shareholder will have a “deemed income inclusion” and must report that excess. It is important to note that the calculation takes into account prior Section 956 inclusions, and therefore prevents any amounts invested from double taxation.

The “investment in US property” is calculated as the average amount of property held at the end of each quarter during the tax year. The property’s value is calculated using the adjusted basis, rather than fair market value.

“US Property” as defined by the IRS for the purposes of this calculation includes:

- Tangible property located in the United States,
- Stock of a domestic corporation
- An obligation of a US person (including certain pledges or guarantees of such obligations)
- Any right to use, in the United States, a patent or copyright; an invention, model, or design; a secret formula or process; or any other similar property right that the CFC acquires or develops for use in the United States.

US property does not include, among other things, US government obligations or deposits, property purchased within the US with the intention for export or use in other countries, and obligations of state agencies and municipalities. For a comprehensive list of exclusions to what is considered US property for the purposes of Section 956 calculations, please visit www.IRS.gov.

While it may be a daunting task, it is very important that US taxpayers with investments in controlled foreign corporations understand and accurately report their foreign activity. Not only will this help avoid unsuspected tax bills and prevent potentially hefty penalties for misreporting, but it may present opportunities in the forms of tax planning in order to maximize financial wellbeing.

For more information, please contact:



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Garrett provides tax preparation and compliance services for individuals and businesses with a focus primarily in multi-state corporations and fiduciary trusts. He routinely assists clients with international accounting, tax planning, and depreciation related matters.