Navigating U.S. Reporting for Foreign-Owned U.S. Entities

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New Developments

- Form 5472 for foreign-owned disregarded entities.
  - Effective date – tax years of entities beginning on or after January 1, 2017, and ending on or after December 13, 2017.
- Form 8938 for entities.

Form 5472

- Generally has been to report reportable transactions by a "reporting corporation" with a foreign or domestic related party.

- A "reporting corporation" is either:
  - A 25% foreign-owned U.S. corporation, or
  - A foreign corporation engaged in a U.S. trade or business.

- A corporation is 25% foreign –owned if at least one direct or indirect shareholder owns at least 25%.

- Constructive ownership rules of IRC Section 318 applies, with modifications.

Form 5472

- A reportable transaction is:
  - Any type of monetary transaction between the reporting corporation and a foreign related party.
  - Any transaction listed in Part IV of Form 5472 where consideration paid or received was not monetary, or less than full consideration was paid or received.

Form 5472

Exceptions to filing Form 5472

- No reportable transactions.
- If a U.S. person that controls the foreign related corporation files Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.
- The related corporation is a foreign sales corporation.
- Foreign corporation with no permanent establishment in the U.S. under an applicable income tax treaty and timely files Form 8833 (Treaty-Based Return Position Disclosure).
- Foreign corporation whose gross income is exempt from taxation under IRC Section 883 and timely & fully complies with reporting requirements of IRC Sections 883 and 887.
- Both reporting corporation and related party are not U.S. persons and transactions will not generate gross income that is ECI or any expense apportionable to such income.

Form 5472

- Due with corporate tax return on the due date (or extended due date) of the corporate tax return.
- Penalty of $10,000 for failure to file.
- Additional $10,000 penalty if failure continues more than 90 days after notification by the IRS.
- Criminal penalties may also apply for failure to submit information or for filing false or fraudulent information.

Form 5472

Foreign-owned Disregarded Entity

- Same rules and requirements as for corporations.
- Purpose is to improve information collection to satisfy U.S. tax treaties and tax information exchange agreements.
- A disregarded entity
  - Is an entity with one owner.
  - Unless incorporated, by default, is considered disregarded.
  - Is a look-through for income tax filings, including disclosure forms. The owner of a disregarded entity is the taxpayer/filer for U.S. purposes (the entity is "disregarded" for tax purposes).
  - With no transactions between itself and its 100% owner, or related parties, Form 5472 is not required.

Form 8938 – Specified Domestic Entity Reporting

- A U.S. entity with foreign owners may have foreign accounts and foreign financial assets.
- For tax years beginning after 12/31/2015, specified domestic entity reporting began.
- Specified domestic entity
  - Certain corporations.
  - Certain partnerships.
  - Trust.
- Entity is a specified domestic entity if
  - It is a closely held U.S. corporation or partnership that has at least 50% of its gross income from passive income.
  - It is a closely held U.S. corporation or partnership that at least 50% of its assets produce, or are held for, the production of passive income.
  - A U.S. trust that has one or more specified persons as a current beneficiary.

Form 8938 – Specified Domestic Entity Reporting

- Passive income
  - Dividends
  - Interest
  - Interest or dividend equivalents
  - Annuities
  - Gains or losses from the sale or exchange of property that gives rise to passive income, or gain or loss from sale of some commodities.
  - Foreign currency gains or losses
  - Net income from notional principal contracts.
- Form 8938 required if the total value of specified foreign financial assets of the specified domestic entity exceeds $50,000 on the last day of the tax year, or exceeds $75,000 at any time during the year.

Form 1120-F

U.S. Disregarded Entity or U.S. Partnership Owned by Foreign Corporation (non-U.S.)

- Form 1120-F must be filed by the foreign corporation.
  - Requires a balance sheet – may choose either U.S. basis or worldwide basis.
  - Branch Profits Tax calculation.
- State and local income tax return.

Foreign Partnership

U.S. Entity Owned by Foreign Partnership

- Pass-through treatment
- Form 1065
  - Must file if the partnership has gross income effectively connected ("ECI") with a trade or business (including rental) within the U.S.
  - Must report its U.S. source <u>and</u> foreign source income
  - Foreign source income is separately stated on K-1
  - Foreign partners must file U.S. tax return to report U.S. source income and deductions

Foreign Partnership

U.S. Entity Owned by Foreign Partnership (continued)

- Exceptions to filing
  - Has U.S. partners
    - No ECI during the year
    - Had U.S. source income of $20,000 or less during the year
    - Less than 1% of total partnership items is allocable to direct U.S. partners <u>and</u>
    - The partnership is not a withholding partnership as it relates to distributions and guaranteed payments

Foreign Partnership

U.S. Entity Owned by Foreign Partnership (continued)

- Exceptions to filing
  - Has no U.S. partners
    - No ECI during the year
    - Had no U.S. partners <u>at any time</u> during the year
    - All required withholding forms were filed
    - The tax liability of each partner has been fully satisfied by the withholding of tax at source <u>and</u>
    - The partnership is not a withholding foreign partnership

Foreign Trust

U.S. Entity Owned by Foreign Trust

- Types of trusts
  - Grantor
    - No income tax advantage – files as if foreign individual
  - Non-grantor
    - No separate tax form for a foreign trust
    - Files like a nonresident alien on Form 1040-NR
    - Alternative – create U.S. trust (i.e. Delaware)
- Trust may have foreign assets if beneficiaries or grantor is foreign.

U.S. Tax Withholdings

- Foreign-owned U.S. corporation
  - No withholdings since annual taxable income is taxed to the corporation.
  - U.S. withholding on the payment of dividends to foreign owner.
  - 30% withholding, or lower treaty withholding rate.
  - HIRE Act of 2010 – payments to payees that are Foreign Financial Institutions (“FFI”), withholding agent must withhold 30% unless the FFI is a participating FFI, deemed-compliant FFI, or an exempt beneficial owner.

U.S. Tax Withholdings

- Foreign-owned U.S. partnership
  - Federal withholding on effectively connected taxable income (“ECTI”) allocable to foreign partners.
  - ECTI – excess of gross income that is effectively connected under IRC Section 864(c), or treated as effectively connected with the conduct of a U.S. trade or business, over the allowable deductions that are connected to such income.
  - Quarterly withholding payments.
  - Form 8804 filed after year-end. Withholding tax rates range from 20%-35%, depending on the type of income.
  - Sale of partnership’s real property – FIRPTA withholding may be credited against withholding tax on Form 8804.
  - State-level nonresident withholdings.