



Final Regulations Issued for Foreign-Owned Disregarded Entities

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The U.S. Treasury issued final regulations under Code Section 6038A implementing reporting rules for certain foreign-owned disregarded entities ("DREs"). Effective December 13, 2016, the final regulations treat a domestic DRE, wholly owned by one foreign person, as a domestic corporation separate from its owner for the limited purposes of the reporting, record maintenance and associated compliance requirements that apply to 25 percent foreign-owned domestic corporations. The final regulations implement proposed regulations issued in May 2016.

A DRE is generally not subject to separate income or information return filing requirements. Its owner is treated as owning directly the entity's assets and liabilities, and the information available with respect to the DRE depends on the owner's own return filings, if any are required. Prior to the effective date of the new regulations, a DRE that is formed in the United States and wholly owned by a foreign corporation, foreign partnership, or nonresident alien individual, was generally not required to file U.S. income or information returns if neither the DRE nor its owner received any U.S. source income or was engaged in a U.S. trade or business during the taxable year.

The new regulations now treat a domestic DRE that is wholly owned by one foreign person as a domestic corporation separate from its owner for the limited purposes of the reporting and record maintenance requirements (including the associated procedural compliance requirements) under Code section 6038A. The regulations do not alter the framework of the existing entity classification regulations, including the treatment of certain entities as disregarded for other purposes of the Code.



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Because the regulations treat the affected domestic entities as foreign-owned domestic corporations for the specific purposes of section 6038A, and because such entities are foreign-owned, they are "reporting corporations" within the meaning of Code section 6038A. Consequently, they are required to file the Form 5472 information return with respect to reportable transactions between the entity and its foreign owner or other foreign related parties (transactions that would have been regarded under general U.S. tax principles if the entity had been, in fact, a corporation for U.S. tax purposes). These entities are also required to maintain records sufficient to establish the accuracy of the information return and the correct U.S. tax treatment of such transactions. In addition, because these entities have a filing obligation, they are required to obtain an EIN by filing Form SS-4.

The final regulations specifically require all foreign-owned single-member DREs to report all transactions with related parties (with such entities being treated as separate taxpayers for the purpose of identifying transactions and being subject to requirements under section 6038A) to the extent not already covered by another reportable category. The term "transaction" is defined in Treas. Reg. 1.482-1(i)(7) to include any sale, assignment, lease, license, loan, advance, contribution, or other transfer of any interest in or a right to use any property or money, as well as the performance of any services for the benefit of, or on behalf of, another taxpayer. Accordingly, a transaction between such an entity and its foreign owner (or another disregarded entity of the same owner) would be considered a reportable transaction for purposes of the section 6038A reporting and record maintenance requirements, even though, because it involves a disregarded entity, it generally would not be considered a transaction for other purposes, such as making an adjustment under section 482.

Consistent with the proposed regulations, the final regulations provide that the exceptions to the record maintenance requirements in Treas. Reg. 1.6038A-1(h) and (i) for small corporations and *de minimis* transactions do not apply to these entities as they do for actual corporations. In addition, the Form 5472 reporting exceptions provided Treas. Reg. 1.6038A-2(e)(3) and (4) do not apply to DREs that are subject to the new rules. As a result, these rules arguably have broader applicability than has been the case previously. Failure to file Form 5472 results in a \$10,000 penalty.

The final regulations apply to taxable years of entities beginning on or after January 1, 2017, and ending on or after December 31, 2017.