



United States Tax Alert

Final regulations address new reporting obligations for foreign-owned domestic disregarded entities

On December 13, 2016, the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) issued final regulations (the "Final Regulations")¹ that require domestic disregarded entities (DREs) that are wholly owned by a foreign person ("foreign-owned domestic DREs") to comply with reporting and recordkeeping obligations under section 6038A. The Final Regulations follow proposed regulations issued on May 10, 2016 (the "Proposed Regulations").² Consistent with the Proposed Regulations, the Final Regulations extend the following obligations to foreign-owned domestic DREs:

- The requirement to file Form 5472, *Information Return of a 25% Foreign-Owned Corporation or a Foreign Corporation* with respect to reportable transactions with related parties;
- The requirement to maintain books and records sufficient to establish the accuracy of Forms 5472 and the correct US tax treatment of reportable transactions; and
- The requirement to obtain an employer identification number (EIN) in order to file Form 5472.

While the Final Regulations generally adopt the Proposed Regulations, the Final Regulations include the following revisions:

- The Final Regulations exclude foreign-owned domestic DREs from the scope of two additional exceptions under the 6038A regulations. Under the Final Regulations foreign-owned domestic DREs are not eligible for the following exceptions to the Form 5472 reporting requirement:

- The exception with respect to certain reportable transactions already reported on a Form 5471, *Information Return of US Persons With Respect to Certain Foreign Corporations* (the “Form 5471 exception”), and
 - The exception with respect to foreign related parties that qualify as foreign sales corporations (FSCs) (the “FSC exception”);
- The Final Regulations provide a rule for determining the taxable year of a foreign-owned domestic DRE for section 6038A purposes; and
- The Final Regulations modify the effective date stated in the Proposed Regulations so that the Final Regulations apply to taxable years that begin on or after January 1, 2017, and that end on or after December 13, 2017.

Background

Under the entity classification regulations, certain domestic business entities that have one owner, such as single-member LLCs, are classified by default as DREs.³ As a result, and in the absence of regulations to the contrary, domestic DREs may not have an obligation to file US tax or information returns, maintain associated records, or obtain an EIN. In the case of foreign-owned domestic DREs, the foreign owners also have no such obligations in certain circumstances. In the preamble to the Proposed Regulations, Treasury and the IRS noted that the absence of reporting and recordkeeping obligations for foreign-owned domestic DREs “hinders law enforcement efforts and compliance with international standards for transparency and cooperation in the area of tax information exchange,” and “makes it difficult for the IRS to ascertain whether the [foreign-owned domestic DRE] or its owner is liable for any federal tax.”⁴

Section 6038A imposes reporting and recordkeeping requirements on domestic corporations that are at least 25% owned by a foreign person (a “domestic reporting corporation”).⁵ Subject to certain exceptions, a domestic reporting corporation is required to file a Form 5472 with respect to each related party that it had a “reportable transaction” with during a taxable year.⁶ In addition, unless a domestic reporting corporation is classified as a “small corporation” or only has “de minimis reportable transactions,” it must keep permanent books of accounts or records that are sufficient to establish the correctness of its federal income tax returns.⁷

The Proposed Regulations extended the section 6038A reporting and recordkeeping requirements to foreign-owned domestic DREs by treating these entities as domestic corporations for purposes of section 6038A. The Form 5472 reporting requirement, in turn, obligated foreign-owned domestic DREs to obtain an EIN.⁸ The Proposed Regulations excluded foreign-owned domestic DREs from eligibility for the “small corporation” and “de minimis reportable transactions” exceptions from the section 6038A recordkeeping requirements. In addition, the Proposed Regulations added another category of reportable transactions applicable only to foreign-owned domestic DREs, comprised of “any other transaction as defined by [Treas. Reg.] §1.482-1(i)(7).” Thus, for example, contributions and distributions were included as reportable transactions with respect to foreign-owned domestic DREs. Moreover, a transaction between the domestic DRE and its foreign owner (or another DRE of the foreign owner) was considered a reportable transaction, despite being generally disregarded for US tax purposes. The Proposed Regulations

included an effective date that was for taxable years of foreign-owned domestic DREs ending on or after the date that is 12 months after the date of the final regulations.

The Final Regulations

The Final Regulations adopt the Proposed Regulations as drafted, with limited changes.

The Final Regulations provide that foreign-owned domestic DREs are not eligible for the Form 5471 Exception and the FSC Exception from filing a Form 5472.⁹ Acknowledging that the Proposed Regulations did not address these exceptions, the preamble to the Final Regulations states:

[I]t was and remains the intent of the Treasury Department and the IRS that the generally applicable exceptions to the requirements of section 6038A should not apply to a domestic disregarded entity that is wholly owned by a foreign person. the Treasury Department and the IRS have concluded that, consistent with the scope and intent of the proposed regulations, the reporting requirements of the proposed regulations should apply without regard to the exceptions under [Treas. Reg.] §1.6038A-2(e)(3) and (4).¹⁰

The Final Regulations provide a rule for determining the taxable year of a foreign-owned domestic DRE for purposes of section 6038A. If the foreign owner of the domestic DRE files a US income tax or information return, then the taxable year of the domestic DRE is the taxable year of its foreign owner. In all other cases, the taxable year of the domestic DRE is the calendar year (unless otherwise provided in forms, instructions, or other published guidance).¹¹

Finally, the Final Regulations modify the effective date provision in the Proposed Regulations. The Final Regulations are effective for taxable years beginning on or after January 1, 2017, and ending on or after December 31, 2017.¹² As proposed, the Final Regulations would have been effective for all taxable years ending on or after December 31, 2017.

¹ T.D. 9796 (Dec. 13, 2016).

² REG-127119-15, 81 Fed. Reg. 28784 (May 10, 2016). For prior coverage of the Proposed Regulations, see "[New reporting obligations for foreign-owned disregarded entities](#)."

³ See Treas. Reg. §301.7701-2(c)(2)(i).

⁴ 81 Fed. Reg. 28785 (May 10, 2016).

⁵ Treas. Reg. §1.6038A-1(c)(1). A foreign corporation may also be considered a "reporting corporation" and subject to similar reporting and recordkeeping requirements if it is engaged in a US trade or business. See Section 6038C, Treas. Reg. §1.6038A-1(c)(1), and the exceptions in Treas. Reg. §1.6038A-1(c)(5).

⁶ See Treas. Reg. §1.6038A-2(a) and the exceptions in Treas. Reg. §1.6038A-2(e).

⁷ See Treas. Reg. §1.6038A-3 and the exceptions in Treas. Reg. §1.6038A-1(h) and (i)(1).

⁸ See section 6109(a)(1) and Treas. Reg. §301.6109-1(b)(1).

⁹ Treas. Reg. §1.6038A-2(e)(3) and (e)(4).

¹⁰ 81 Fed. Reg. 89849-50 (Dec. 13, 2016).

¹¹ Treas. Reg. §301.7701-2(c)(2)(vi)(C).

¹² Treas. Reg. §§1.6038A-1(n)(1) and (2) and 301.7701-2(e)(9).

If you have any questions or would like additional information on the topics covered in this alert, please email one of the following Deloitte professionals:

Irwin Halpern
ihalpern@deloitte.com

Jason Gritton
jgritton@deloitte.com

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