



BDO Seidman, LLP
Accountants and Consultants

July 2007

Subject:

Finalization of temporary regulations clarifying information reporting by foreign and foreign-owned domestic corporations

International Tax Alert

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On July 12, 2007 the Internal Revenue Service (IRS) issued final rules (T.D. 9338) putting in place new reporting requirements and penalties for information returns, Forms 5471 and 5472, filed for certain controlled foreign corporations and foreign-owned domestic corporations. In June 2006 the IRS issued final, temporary, and proposed regulations under Code Sec. 6038 and Code Sec. 6038A, dealing with the reporting requirements for certain foreign and foreign-owned domestic corporations. The IRS has now adopted the temporary and proposed regulations as final regulations without any change.

Date/Timing

Effective July 13, 2007

Affecting

Taxpayers with an interest in certain controlled foreign corporations and foreign-owned domestic corporations.

Background

A U.S. person must provide the IRS certain information with respect to any foreign business entity that it controls. This includes information relating to transactions between the foreign business entity and the U.S. person, any corporation or partnership controlled by the U.S. person, and any U.S. person owning—at the time the transaction takes place—a 10% or greater interest in the foreign business entity. Similarly, certain foreign-owned domestic corporations must provide certain information to IRS. In particular, a 25% foreign-owned domestic corporation must provide information with respect to certain transactions between the corporation and certain related parties.

Final Regulations

The temporary regulations clarified the required information reporting for certain related party transactions and reflected increased

penalties plus other statutory changes; they also expand the information taxpayers must report for related-party transactions by foreign and foreign-owned companies, including both sales and purchases of tangible property. The IRS has now adopted the temporary and proposed regulations as final regulations without any change.

The preamble to the final regulations notes, without any elaboration, that the Treasury Department and the IRS are considering additional information reporting pursuant to Section 6038A regarding Section 163(j) to further the administration of the earning stripping rules.

The final regulations for foreign corporations include the reporting of summary sales and purchases (previously just purchases), of tangible property. They also include the reporting of premiums paid, (previously only premiums received), for insurance or reinsurance (Treasury Regulations § 1.6038-2(f)(11)).

The final regulations also provide clarification that foreign corporations that use an accrual method of accounting must report the summary of the total amount of the transactions described in Treasury Regulations 1.6038-2(f)(11) on an accrual basis. To maintain conformity, the rule for foreign-owned domestic corporations is similarly clarified.

The final regulations also reflect the penalty increases provided by the Taxpayer Relief Act of 1997 resulting in a \$10,000 penalty under Code Sec. 6038(b)(1) for a failure to timely furnish required information and the additional \$10,000 penalty (not to exceed a total of \$50,000) under Code Sec. 6038(b)(2) for a continuing failure to furnish the required information. In addition, they add two examples to illustrate the determination, after reasonable cause has been established, of the time for filing Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations, and the beginning of the 90-day period (dealing with an increase in the penalty for continued failure after notification).

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