



BDO Seidman, LLP
Accountants and Consultants

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Issue:

New Filing Requirement for Foreign Disregarded Entities

International Tax Alert

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Date/Timing:

In Announcement 2004-4, 2004-4 IRB 357, released in December 2003, the IRS and the Department of Treasury proposed new annual reporting requirements by U.S. direct and indirect owners of a foreign disregarded entity (FDE). In October 2004, the IRS posted to its website a draft version of Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities, effective for annual accounting periods of tax owners of FDEs beginning on or after January 1, 2004.

Affecting:

U.S. companies that directly own FDEs will be required to file a Form 8858 with respect to each FDE. Additionally, certain U.S. persons that indirectly own at least 10 percent of an FDE through a controlled foreign corporation (CFC) or a controlled foreign partnership (CFP) also will be required to file the Form 8858 with respect to each FDE in which there is an indirect interest. Direct owners of an FDE would attach the Form 8858 to their federal income tax returns. Indirect owners of an FDE would attach the form to any form that must be filed that pertains to the foreign entity that owns the FDE (e.g., Form 5471 if the FDE is owned by a CFC).

Details:

- Form 8858 is three pages and consists of one section and five schedules, plus a separate Schedule M. See: <http://www.irs.gov/pub/irs-dft/d8858.pdf> and <http://www.irs.gov/pub/irs-dft/d8858sm.pdf> for draft versions of Form 8858 and Schedule M respectively.

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- The introductory section of the form requests standard identifying information as well as an organizational chart.
- The schedules include:
 1. Schedule C - abbreviated income statement in functional currency and U.S. dollars.
 2. Schedule C-1 - Section 987 gain or loss information, including information on remittances from the FDE.
 3. Schedule F - abbreviated balance sheet in functional currency and U.S. dollars.
 4. Schedule G - five questions regarding activities of the FDE during the year. The first two questions ask whether the FDE owned an interest in a trust and whether the FDE owned a 10 percent or greater direct or indirect interest in a partnership. The last three questions target transactions that may trigger strict compliance/reporting requirements or contain business purpose requirements, such as a loss with respect to stock taken in the first year of the election to be treated as disregarded, a net operating loss incurred by the FDE, and inter-company transactions between a CFC and its FDE in which the FDE acted as a manufacturing, selling or purchasing agent.
 5. Schedule H - computation of the FDE's earnings and profits in its functional currency and translated into U.S. dollars.
- Schedule M must be completed if either a CFC or a CFP owns the FDE. It requires reporting of related party transactions such as property sales, services, rents, licenses and borrowings. No reporting is required with respect to transactions between the FDE and its owner.
- The IRS is accepting comments on the draft version of Form 8858 through November 12. The current target date for release of the final form and its instructions is January 6, 2005.

Recommended Action:

- Review any FDEs for the targeted transactions listed above and determine appropriate compliance.
- Review remittances from any FDEs and ensure proper compliance with the rules under section 987.
- Be aware of when the IRS releases the final version of Form 8858.

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Material Discussed in this newsletter is meant to provide general information and should not be acted on without obtaining professional advice tailored to your firm's individual needs.

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