

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

# BDO KNOWS:

## INTERNATIONAL TAXATION



### SUBJECT

## IRS PROPOSES REGULATIONS REQUIRING NEW REPORTING REQUIREMENTS UNDER INTERNAL REVENUE CODE (“IRC”) SECTION 6038A FOR FOREIGN-OWNED DOMESTIC DISREGARDED ENTITIES

### SUMMARY

On May 6, 2016, the Internal Revenue Service (“IRS”) and Treasury issued proposed regulations (“Proposed Regulations”) that would amend Treas. Reg. §301.7701-2(c) to treat a domestic disregarded entity 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 section 6038A. As with the existing special rules for employment and excise taxes, the Proposed Regulations would not alter the framework of the existing entity classification regulations, including the treatment of certain entities as disregarded. Such regulations are intended to provide the IRS with improved access to information that it needs to satisfy its obligations under U.S. tax treaties, tax information exchange agreements and similar international agreements, as well as to strengthen the enforcement of United States tax laws.

### TIMING

The Proposed Regulations would apply to taxable years ending on or after the date that is 12 months after the date these regulations are published as final regulations in the Federal Register.

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## DETAILS

### *Reporting and maintenance requirements*

The Proposed Regulations would treat the affected domestic entities as foreign-owned domestic corporations for the specific purposes of IRC section 6038A, and because such entities are foreign owned, they would be reporting corporations within the meaning of IRC 6038A. Consequently, they would be required to file Form 5472, an 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), and would also be 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 would have a filing obligation, they would be required under the Proposed Regulations to obtain an EIN by filing a Form SS-4 that includes responsible party information.

The Proposed Regulations would specify that as an additional reportable category of transaction for these purposes any transaction within the meaning of Treas. Reg. §1.482-1(i)(7) (with such entities being treated as separate taxpayers for the purpose of identifying transactions and being subject to requirements under IRC 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. For example, under the Proposed Regulations, contributions and distributions would be considered reportable transactions with respect to such entities. 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 IRC 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 IRC section 482. The penalty provisions associated with failure to file the Form 5472 and failure to maintain records would apply to these entities as well.

Moreover, the Proposed Regulations would also provide that the exceptions to the record maintenance requirements that are currently contained in Treas. Reg. §1.6038A-1(h) and (i) for small corporations and *de minimis* transactions will not apply to these entities.

The Proposed Regulations would impose a filing obligation on a foreign-owned disregarded entity for reportable transactions it engages in, even if its foreign owner already has an obligation to report the income resulting from those transactions—for example, transactions resulting in income effectively connected with the conduct of a U.S. trade or business.

In the preamble, the IRS also indicated that it is also considering modifications to corporate, partnership, and other tax or information returns (or their instructions) to require the filer of these returns to identify all the foreign and domestic disregarded entities it owns.

## BDO INSIGHTS

These Proposed Regulations would expand the reporting that is required under IRC section 6038A. Such enhanced reporting required by these Proposed Regulations should not come as a surprise, especially given the expanded reporting in other areas and the general theme of greater transparency and documentation that has been seen in recent years (e.g., BEPS and FATCA). Please contact a BDO international tax specialist to assist you in reviewing how these Proposed Regulations may impact your Company's reporting requirements.

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