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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG-127199-15]

RIN 1545-BM94

Treatment of Certain Domestic Entities Disregarded as Separate From Their Owners as Corporations for Purposes of Section 6038A

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would treat a domestic disregarded entity wholly owned by a 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 under section 6038A of the Internal Revenue Code. These changes 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 U.S. tax laws.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-127199-15), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to

CC:PA:LPD:PR (REG-127199-15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC., or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-127199-15).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Ronald M. Gootzeit, (202) 317-6937; concerning submissions of comments and/or requests for a hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1191. The estimated average annual recordkeeping burden per recordkeeper is 10 hours. The estimated reporting burden is being reported under Form 5472 (OMB # 1545-0123).

The collection of information in this proposed regulation is in sections 1.6038A-1 through 1.6038A-3 and 1.6038A-5. This information is required in order 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 U.S. tax laws. The likely respondents are foreign-owned domestic entities that are disregarded as separate from their owners.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the

Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Sections 301.7701-1 through 301.7701-3 (“the entity classification regulations”) classify a business entity with two or more members as either a corporation or a partnership, and a business entity with a single owner as either a corporation or an entity disregarded as separate from its owner (“disregarded entity”). Certain domestic business entities, such as limited liability companies (“LLCs”), are classified by default as partnerships (if they have more than one member) or as disregarded entities (if they have only one owner) but are eligible to elect for federal tax purposes to be classified as corporations. Under special rules, an entity that is otherwise disregarded is not disregarded for certain excise and employment tax purposes. Section 301.7701-2(c)(2)(iv) and (v).

Some disregarded entities are not obligated to file a return or obtain an employer identification number (“EIN”). In the absence of a return filing obligation (and associated record maintenance requirements) or the identification of a responsible party as required in applying for an EIN, it is difficult for the United States to carry out the obligations it has undertaken in its tax treaties, tax information exchange agreements and similar international agreements to provide other jurisdictions with relevant information on U.S. entities with owners that are tax resident in the partner jurisdiction

or otherwise have a tax nexus with respect to the partner jurisdiction.

Section 6001 of the Internal Revenue Code (“Code”) provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep such records, render such statements, make such returns and comply with such rules and regulations as the Secretary may from time to time prescribe, and that whenever in the judgment of the Secretary it is necessary, he may require any person, by notice served upon such person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not such person is liable for tax. Thus, the Treasury Department and the IRS have broad authority under section 6001 of the Code to promulgate regulations to require the keeping of records and the reporting of information by persons who may be liable for any tax. The Code also requires many categories of persons to file returns, even if no tax is owed in a particular year. For example, all corporations organized in the United States must file annual income tax returns, which may include schedules requiring the identification of owners exceeding specified ownership thresholds. Moreover, foreign corporations engaged in a trade or business in the United States (“U.S. trade or business”) must file annual income tax returns. Section 6012(a)(2); section 1.6012-2. Domestic partnerships must file information returns with schedules identifying each partner. Section 6031; section 1.6031(a)-1. In addition, domestic corporations that are at least 25% foreign-owned are subject to specific information reporting and record maintenance requirements. Section 6038A.

All entities, including disregarded entities, must have an EIN to file a required return. Section 6109(a)(1); see section 301.6109-1(a)(1)(ii)(C) and (b). An entity must

also have an EIN in order to elect to change its classification. An entity that accepts its default classification and is not required to file a return need not obtain an EIN.

Because a domestic single-member LLC is classified as a disregarded entity by default rather than by election and has no separate federal tax return filing requirements, there is typically no federal tax requirement for it to obtain an EIN. Other applicable federal or state laws may require an entity to obtain an EIN. For example, pursuant to federal law, financial institutions in the United States generally require an entity to have an EIN to open an account. See 31 CFR 1020.220(a)(1)(i)(A)(4).

An entity obtains an EIN by filing Form SS-4, Application for Employer Identification Number, in which the entity must identify a responsible party. The instructions to Form SS-4 define “responsible party” for an entity (including a disregarded entity) that is not traded on a public exchange or registered with the Securities and Exchange Commission as “the individual who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets.” The entity must also report any subsequent change in the responsible party. See section 301.6109-1(d)(2)(ii).

When an entity, such as an LLC, is classified as a corporation or a partnership for tax purposes, general ownership and accounting information is available to the IRS through the return filing and EIN application requirements. However, a disregarded entity is not subject to a separate income or information return filing requirement. Its owner is treated as owning directly the entity’s assets and liabilities, and the information available with respect to the disregarded entity depends on the owner’s own return

filings, if any are required. For a disregarded entity that is formed in the United States and wholly owned by a foreign corporation, foreign partnership, or nonresident alien individual, generally no U.S. income or information return must be filed if neither the disregarded entity nor its owner received any U.S. source income or was engaged in a U.S. trade or business during the taxable year. Moreover, if a disregarded entity only receives certain types of U.S. source income, such as portfolio interest or U.S. source income that is fully withheld upon at source, its owner may not have a U.S. return filing requirement. Even in cases when the disregarded entity has an EIN, as well as in cases when income earned through a disregarded entity must be reported on its owner's return (for example, income from a U.S. trade or business), it may be difficult to associate the income with the disregarded entity based solely on the owner's return.

Although ownership and accounting information is generally available under the reporting requirements established by the U.S. federal tax system with respect to many types of domestic entities, the absence of specific return filing and associated recordkeeping requirements for foreign-owned, single-member domestic entities hinders law enforcement efforts and compliance with international standards of transparency and cooperation in the area of tax information exchange. These difficulties have been noted in reviews of the U.S. legal system by international organizations, including the Financial Action Task Force and the Global Forum on Transparency and Exchange of Information for Tax Purposes, which is affiliated with the Organisation for Economic Co-operation and Development. The lack of ready access to information on ownership of, and transactions involving, these entities also makes it difficult for the IRS to ascertain whether the entity or its owner is liable for any federal tax.

In general, section 6038A imposes reporting and recordkeeping requirements (together with certain procedural compliance requirements) on domestic corporations that are 25-percent foreign-owned. They are required to file an annual return on Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code), with respect to each related party with which the reporting corporation has had any “reportable transactions.” See section 1.6038A-2. These corporations must keep the permanent books of account or records as required by section 6001 that are sufficient to establish the accuracy of the federal income tax return of the corporation, including information, documents, or records to the extent they may be relevant to determine the correct U.S. tax treatment of transactions with related parties. See section 1.6038A-3.

Explanation of Provisions

These proposed regulations would amend section 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 with respect to employment and excise taxes, these proposed regulations would not alter the framework of the existing entity classification regulations, including the treatment of certain entities as disregarded. These 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 U.S. tax laws.

Because the proposed regulations would treat the affected domestic entities as foreign-owned domestic corporations for the specific purposes of section 6038A under the proposed regulations, and because such entities are foreign-owned, they would be reporting corporations within the meaning of section 6038A. Consequently, they would be 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) 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 to obtain an EIN by filing a Form SS-4 that includes responsible party information.

To ensure that such entities are required to report all transactions with foreign related parties, these regulations would specify as an additional reportable category of transaction for these purposes any transaction within the meaning of section 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 section 6038A) to the extent not already covered by another reportable category. The term “transaction” is defined in section 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 these 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 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. The penalty provisions associated with failure to file the Form 5472 and failure to maintain records would apply to these entities as well.

The proposed regulations would also provide that the exceptions to the record maintenance requirements in section 1.6038A-1(h) and (i) for small corporations and de minimis transactions will not apply to these entities.

Consistent with the changes contemplated by these proposed regulations, the IRS 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.

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. The Treasury Department and the IRS request comments on possible alternative methods for reporting the disregarded entity's transactions in such cases.

Proposed Effective/Applicability Date

The regulations are proposed to be applicable for 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.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that these regulations will primarily affect a small number of foreign-owned domestic entities that do not themselves otherwise have a U.S. return filing requirement, and that the requirement to file a return for these entities will not impose a significant burden on them. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department and the IRS request comments on aspects of the proposed rules for which additional

guidance is desired. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, then notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is Ronald M. Gootzeit, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and part 301 are proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entries for §§1.6038A-1 and 1.6038A-2 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.6038A-1 also issued under 26 U.S.C. 6001.

Section 1.6038A-2 also issued under 26 U.S.C. 6001.

* * * * *

Par. 2. Section 1.6038A-1 is amended as follows:

1. Paragraph (c)(1) is amended by adding a sentence at the end of the paragraph.

2. The first sentence of paragraph (h) is revised.

3. The first sentence of paragraph (i)(1) is revised.

4. Paragraph (n)(1) is amended by adding a sentence at the end of the paragraph.

5. Paragraph (n)(2) is amended by adding a sentence at the end of the paragraph.

The additions and revisions read as follows:

§1.6038A-1 General requirements and definitions.

* * * * *

(c) * * *

(1) * * * A domestic business entity that is wholly owned by one foreign person and that is otherwise classified under §301.7701-3(b)(1)(ii) of this chapter as disregarded as an entity separate from its owner is treated as an entity separate from its owner and classified as a domestic corporation for purposes of section 6038A. See §301.7701-2(c)(2)(vi) of this chapter.

* * * * *

(h) Small corporation exception. A reporting corporation (other than an entity that is treated as a reporting corporation by reason of §301.7701-2(c)(2)(vi) of this chapter)

that has less than \$10,000,000 in U.S. gross receipts for a taxable year is not subject to §§1.6038A-3 and 1.6038A-5 for that taxable year.* * *

(i) Safe harbor for reporting corporations with related party transactions of de minimis value--(1) In general. A reporting corporation (other than an entity that is treated as a reporting corporation by reason of §301.7701-2(c)(2)(vi) of this chapter) is not subject to §§1.6038A-3 and 1.6038A-5 for any taxable year in which the aggregate value of all gross payments it makes to and receives from foreign related parties with respect to related party transactions (including monetary, nonmonetary consideration, and the value of transactions involving less than full consideration) is not more than \$5,000,000 and is less than 10 percent of its U.S. gross income.* * *

* * * * *

(n)* * *

(1) * * * The last sentence of paragraph (c)(1) of this section (relating to certain domestic business entities), the parenthetical language in paragraph (h) of this section (relating to entities that are treated as reporting corporations by reason of §301.7701-2(c)(2)(vi) of this chapter), and the parenthetical language in paragraph (i)(1) of this section (relating to entities that are treated as reporting corporations by reason §301.7701-2(c)(2)(vi) of this chapter) apply to taxable years of such entities ending on or after the date that is 12 months after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

(2) * * * Paragraphs (b)(3)(xi) and (b)(9) of this section and the last sentence of paragraph (d) of §1.6038A-2 apply to taxable years of the entities described in §301.7701-2(c)(2)(vi) of this chapter ending on or after the date that is 12 months after

the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

* * * * *

Par. 3. Section 1.6038A-2 is amended as follows:

1. In paragraph (b)(3)(ix), remove the word “and”.
2. In paragraph (b)(3)(x), remove the period at the end of the paragraph and add “; and” in its place.
3. Add paragraph (b)(3)(xi).
4. Add paragraph (b)(9).
5. Add a sentence at the end of paragraph (d).

The additions and revisions read as follows:

§1.6038A-2 Requirements of return.

* * * * *

(b) * * *

(3) * * *

(xi) With respect to an entity that is treated as a reporting corporation by reason of §301.7701-2(c)(2)(vi) of this chapter, any other transaction as defined by §1.482-1(i)(7), such as amounts paid or received in connection with the formation, dissolution, acquisition and disposition of the entity, including contributions to and distributions from the entity.

* * * * *

(9) Examples. The application of paragraph (b)(3) of this section may be illustrated by the following examples:

Example 1. (i) In year 1, W, a foreign corporation, forms and contributes assets to X, a domestic limited liability company that does not elect to be treated as a corporation under §301.7701-3(c) of this chapter. In year 2, W contributes funds to X. In year 3, X makes a payment to W. In year 4, X, in liquidation, distributes its assets to W.

(ii) In accordance with §301.7701-3(b)(1)(ii) of this chapter, X is disregarded as an entity separate from W. In accordance with §301.7701-2(c)(2)(vi) of this chapter, X is treated as an entity separate from W and classified as a domestic corporation for purposes of section 6038A. In accordance with paragraphs (a)(2) and (b)(3) of this section, each of the transactions in years 1 through 4 is a reportable transaction with respect to X. Therefore, X has a section 6038A reporting and record maintenance requirement for each of those years.

Example 2. (i) The facts are the same as in Example 1 of this paragraph (b)(9) except that in year 1 W also forms and contributes assets to Y, another domestic limited liability company that does not elect to be treated as a corporation under §301.7701-3(c) of this chapter. In year 1, X and Y form and contribute assets to Z, another domestic limited liability company that does not elect to be treated as a corporation under §301.7701-3(c) of this chapter. In year 2, X transfers funds to Z. In year 3, Z makes a payment to Y. In year 4, Z distributes its assets to X and Y in liquidation.

(ii) In accordance with §301.7701-3(b)(1)(ii) of this chapter, Y and Z are disregarded as entities separate from each other, W, and X. In accordance with §301.7701-2(c)(2)(vi) of this chapter, Y, Z and X are treated as entities separate from each other and W, and are classified as domestic corporations for purposes of section

6038A. In accordance with paragraph (b)(3) of this section, each of the transactions in years 1 through 4 involving Z is a reportable transaction with respect to Z. Similarly, the contribution to Y in year 1, the payment to Y in year 3, and the distribution to Y in year 4 are reportable transactions with respect to Y. Moreover, X's funds transfer to Z in year 2 is a reportable transaction. Therefore, Z has a section 6038A reporting and record maintenance requirement for years 1 through 4, Y has a section 6038A reporting and record maintenance requirement for years 1, 3 and 4, and X has a section 6038A reporting and record maintenance requirement in year 2 in addition to its section 6038A reporting and record maintenance described in Example 1 of this paragraph (b)(9).

(d) * * * In the case of an entity that is treated as a reporting corporation by reason of §301.7701-2(c)(2)(vi) of this chapter, Form 5472 must be filed at such time and in such manner as the Commissioner may prescribe in forms or instructions.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues in part to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 5. Section 301.7701-2 is amended by revising the last sentence of paragraph (a) and adding paragraphs (c)(2)(vi) and (e)(9) to read as follows:

§301.7701-2 Business entities; definitions.

(a) * * * But see paragraphs (c)(2)(iii) through (vi) of this section for special rules that apply to an eligible entity that is otherwise disregarded as an entity separate from its owner.

* * * * *

(c) * * *

(2) * * *

(vi) Special rule for reporting under section 6038A--(A) In general. An entity that is disregarded as separate from its owner for any purpose under this section is treated as an entity separate from its owner and classified as a corporation for purposes of section 6038A if--

(1) The entity is a domestic entity; and

(2) One foreign person has direct or indirect sole ownership of the entity.

(B) Definitions--(1) Indirect sole ownership. For purposes of paragraph (c)(2)(vi)(A)(2) of this section, indirect sole ownership means ownership by one person entirely through one or more entities disregarded as separate from their owners or through grantor trusts, regardless of whether any such disregarded entity or grantor trust is domestic or foreign.

(2) Entity disregarded as separate from its owner. For purposes of this paragraph (c)(2)(vi)(B), an entity disregarded as separate from its owner is an entity described in paragraph (c)(2)(i) of this section, without regard to the exceptions provided in paragraphs (c)(2)(ii) through (vi) of this section.

(3) Grantor trust. For purposes of this paragraph (c)(2)(vi)(B), a grantor trust is any portion of a trust that is treated as owned by the grantor or another person under subpart E of subchapter J of chapter 1 of the Code.

* * * * *

(e) * * *

(9) Reporting required under section 6038A. Paragraph (c)(2)(vi) of this section

applies to taxable years ending on or after the date that is 12 months after the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

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