

After the Client Has Passed

Post-Mortem Tax Planning



Tax Law Update



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Recent Amendment to Treasury Regulations Creates New Reporting and Record-Keeping for Foreign-Owned Single-Member Limited Liability Companies

On December 13, 2016, certain Treasury Regulations (the “Amended Regulations”) were amended to require a domestic LLC that is wholly owned by a foreign person (a “New Reporting Entity”) to abide by the reporting and record-keeping obligations of Section 6038A of the Internal Revenue Code and its related Treasury Regulations. See Reg. § 1.6038A-1.

Prior to the amendments, these obligations applied to domestic business entities taxed as corporations and at least 25% foreign-owned (collectively, the “Prior Reporters”). Now, these obligations will also be applicable to domestic LLCs that are wholly owned directly or indirectly by a foreign person. Importantly, such domestic LLCs will be subject to these obligations even if owned through one or more foreign or domestic grantor trusts or other disregarded entities. See Reg. § 301.7701-2(c)(2)(vi).

A New Reporting Entity must file a separate Form 5472 for each “related party” with which the entity has had a “reportable transaction” during the applicable year. Among other things, a “related party” is any direct or indirect 25% foreign interest-holder in the New Reporting Entity or any person related to the New Reporting Entity or the owner of such New Reporting Entity. See Reg. §§ 1.6038A-1(d). “Reportable transactions” include, among others, (i) sales and purchases of inventory; (ii) sales and purchases of other tangible property; (iii) payments of rent and royalties to or by the New Reporting Entity; (iv) sales and purchases or amounts paid to or by New Reporting Entity for use of intangible property (i.e., patents, trademarks, and copyrights); (v) payment to or by the New Reporting Entity for management and other services; (vi) commission payments to or by the New Reporting Entity; (vii) loans provided and interest payments in each case to or by the New Reporting Entity; (viii) premium payments to or by the New Reporting Entity for insurance, (ix) other

amounts taken into account in determining the taxable income of the New Reporting Entity, and (x) other payments made to or by the New Reporting Entity in connection with the formation, dissolution, acquisition, and disposition of the New Reporting Entity, including capital contributions to and distributions from the New Reporting Entity. See Reg. § 1.6038A-2(b)(3).

As a complement to the Form 5472 reporting requirements, the Amended Regulations also require New Reporting Entities to abide by the record-maintenance requirements of Treasury Regulation § 1.6038A-3, which provides, among other things, a specific list of records regarding reportable transactions that can be maintained to come within a “safe-harbor” under the regulation. The New Reporting Entity must have access to such relevant documents if the documents are in the possession of the foreign related party.

Failure to abide by the Amended Regulations can result in significant monetary and other penalties, and the New Reporting Entities do not get the benefits of the exceptions available to the Prior Reporters. To avoid such penalties, it may be advisable to discuss these obligations with foreign trust clients utilizing domestic LLCs. The Amended Regulations apply to a New Reporting Entity’s taxable year beginning on or after January 1, 2017. If a New Reporting Entity has a foreign owner with a U.S. filing obligation, such entity has the same taxable year as its foreign owner. However, since many foreign owners will not have such a filing requirement, a New Reporting Entity, to the extent that it does not have one, must obtain an employer identification number and file its relevant Form 5472s on the calendar taxable year.