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NEW PROPOSED REGULATIONS REQUIRE DISCLOSURE OF FOREIGN OWNERSHIP

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By: Mitchell W. Goldberg

While legislation such as the Bank Secrecy Act and the Foreign Account Tax Compliance Act has hindered the ability of U.S. persons to hide assets abroad, there remains a perceived legislative gap whereby bad actors outside the U.S. can avail themselves of the U.S. financial industry to hide assets. Such legislative gap is created by the absence of meaningful legislation requiring the ownership of U.S. entities be disclosed. In an effort to address this, the Treasury Department unveiled new proposed regulations which require a single member limited liability company ("SMLLC") wholly owned by a foreign person and taxed as a disregarded entity for U.S. tax purposes to file a Form 5472, Information Return of a 25% Foreign-Owned Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. The Treasury Department stated that such proposed regulations are intended to provide improved access to information needed support law enforcement and to facilitate the exchange of information and transparency. It is another step in the ever-evolving landscape of global tax and financial compliance.

In general, a U.S. corporation is a separate taxable entity required to file tax returns and information returns with the IRS. One such information return is a Form 5472. A U.S. corporation owned at least 25% by foreign persons is required to file a Form 5472 to report certain transactions between such corporation and its foreign shareholder(s), including but not limited to rental payments, sale of inventory, loan transactions, etc. and the identity of its foreign shareholder(s). A SMLLC, unlike a corporation, is taxed as a disregarded entity unless an affirmative election is made for the SMLLC to be taxed as a corporation. Where it is a disregarded entity, the SMLLC does not exist for U.S. tax purposes, subject to certain exceptions not applicable here. The owner of the SMLLC is deemed to own the assets of the SMLCC and is deemed to conduct the activities of the SMLLC. As a result, the SMLCC is not required to file any returns or pay any taxes to the IRS. Where such SMLLC is owned by a foreign person, the SMLLC is not required to file any information with the IRS regarding the identity of such foreign owner. Please note, however, that such foreign owner may have U.S. filing obligations as a result of the activities of the SMLLC within the U.S.

Under the proposed regulations, a SMLLC will be treated as a U.S. corporation solely for purposes of the Form 5472 filing requirement. As such, a SMLLC will be required to obtain an Employer Identification Number ("EIN") from the IRS which requires information be provided regarding the "responsible party", which, generally, is the person with control over the SMLLC. The proposed regulations generally provide that, for every year the SMLLC has a reportable transaction with its foreign owner, a Form 5472 is required to be filed to report such transaction and the identity of its foreign owner, even if such foreign owner is already required to file in the U.S. as a result of such transaction. Civil penalties will apply where a SMLLC fails to timely file Form 5472 or fails to maintain proper records. Currently the penalty is $10,000, which may be increased if the failure continues after notification from the IRS. The IRS is also considering further amendments that would require tax filers to identify all SMLLCs (foreign or domestic) that it owns which are taxed as disregarded entities.

The proposed regulations go into effect for taxable years ending on or after the date that is 12 months after the date the proposed regulations are published as final.

If you have any questions on this topic, please contact the author, Mitchell W. Goldberg, on the firm's Business, Finance & Tax Team.

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