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This thought leadership deals with the impact of TD 9796 regulations issued by IRS on foreign owned single member LLCs treated as disregarded entities for tax purposes.

The United States *(US)* Treasury Department *(Treasury)* and Internal Revenue Service *('IRS')* issued final regulations *(TD 9796)* on December 13, 2016. These regulations apply to tax years of entities beginning on or after January 1, 2017, and ending on or after December 13, 2017. The objective of these new regulations is to treat domestic disregarded entities wholly owned, directly or indirectly, by foreign persons as "domestic corporations" specifically for the purpose of subjecting them to the reporting requirements under Internal Revenue Code Section 6038A.

Background:

Under US tax regulations, a Domestic Limited Liability Company *('LLC'),* which is formed in any state in the United States or the District of Columbia owned by a single member, is either treated as a disregarded entity *(i.e. DRE)* or as a corporation for tax purposes. By default, a single member LLC would be treated as a DRE unless it makes a specific entity classification election by filing form 8832 to be treat as a corporation.

Unlike disregarded entities, domestic corporations and partnerships, as well as foreign corporations engaged in a trade or business in the US, are required to file annual income tax returns. They are also subject to filing of certain information returns in the United States. These filings are regulated by IRC section 6038A and one of the key filing requirement is Form 5472. This applies to a domestic corporation that is directly or indirectly owned by foreign owner, with a 25%-or-greater interest and having reportable transactions with related parties either domestic or foreign. The penalty provisions for non-compliance or delayed compliance of Form 5472 are extremely stringent and IRS may assess a penalty of $ 10,000 for each form 5472.

Additionally, as mentioned above, since these disregarded entities are not subject to income tax filings, they also generally do not need to obtain an employer identification number *('EIN')* unless they are filing an entity classification election.

Impact of these new regulations:

Form 5472 filing requirement:

The final regulations treat US disregarded entities wholly owned by one foreign person as a domestic corporation separate from its owner **solely** for purposes of Section 6038A, making these otherwise disregarded entities subject to the reporting and record-keeping requirements that currently apply to 25% foreign-owned US corporations. The regulations do not affect the entity's classification for other purposes. As a result, these entities must file Form 5472, and maintain related records, for reportable transactions with the entities' foreign owners or other foreign-related parties.

The Treasury and the IRS believes that this information will enhance the United States' compliance with international standards of transparency and exchange of information for tax purposes and will strengthen the enforcement of US tax laws.

Definition of reportable transactions expanded:

The final regulations add to the category of reportable transactions any transaction within the meaning of Reg. Section 1.482-1*(i)(7*), including 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. This includes any amounts paid or received in connection with the formation, dissolution, acquisition and disposition of the entity, including contributions to and distributions from the entity.

Illustrative example provided in the regulations:

(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.

Mandatory to obtain EIN:

In order to comply with Form 5472 filings mentioned above, such disregarded entities will also need to obtain EINs by filing a Form SS-4 with responsible- party information, including the responsible party's social security number *('SSN'),* individual taxpayer identification number *('ITIN')* or EIN. The definition of this "responsible party" is "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.

Conclusion:

These new regulations have created new *(burdensome)* responsibilities for foreign owned disregarded entities. Though some disregarded entities and their foreign owners may not have obligations to file a tax return or obtain an EIN currently, the final regulations impose new filing requirements as well as obligations to maintain sufficient records. Given the severe penalty implications of being non-compliant with Form 5472 filings, the foreign corporations with such disregarded LLC structure must now gear up for these compliances.