

Not Entirely ‘Disregarded’: Obligations to File Form 5472 for Foreign-Owned Disregarded Entities

If you are a foreign person who owns a U.S. limited liability corporation (LLC), or a foreign person who owns a U.S. LLC through a foreign entity, you may have an obligation to file IRS Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business). These reporting requirements can apply even to entities that are 100% owned by a foreign person, even though these entities may be considered “disregarded” for U.S. tax purposes.

While a U.S. single-member LLC is a disregarded entity (DE) by default for U.S. income tax purposes, it is not entirely disregarded for all U.S. tax filing obligations when the LLC is wholly owned by a foreign person. Since 2017, a foreign-owned U.S. DE must file Form 5472 for each year during which the foreign-owned U.S. DE has reportable transactions with any related party. Significant penalties apply for failure to file Form 5472 or for filing a substantially incomplete Form 5472.

Form 5472 has been used for some time by domestic corporations with at least 25% foreign shareholders to provide information required under IRS Code Sections 6038A and 6038C. As of Jan. 1, 2017, pursuant to Treasury Regulations Section 1.6038A-1, the IRS treats a foreign-owned U.S. DE as a separate entity from its owner and classifies the entity as a domestic corporation for purposes of Code Section 6038A. Therefore, when applicable, a foreign-owned U.S. DE is a “reporting corporation” for purposes of Form 5472 and must fulfill its Form 5472 reporting and record maintenance obligations.

A U.S. DE is wholly owned by a foreign person when its sole owner is an individual who is neither a U.S.



citizen nor a tax resident; an individual who is a citizen or resident of a U.S. possession who is not otherwise a U.S. citizen or resident; a foreign partnership, foreign association or foreign company; a foreign estate or foreign trust (as defined in Code Section 7701(a)(31)); or a foreign government (or agency or instrumentality), to the extent that the foreign government is engaged in the conduct of a commercial activity as defined in Code Section 892.

A foreign-owned U.S. DE only has Form 5472 reporting obligations when it has reportable transactions with any related party. A “reportable transaction” includes a broad range of transactions, such as sales, rents, royalties, loans, transactions concerning intangible property rights and other transactions as listed in Part IV of Form 5472, for which monetary consideration is the sole consideration paid or received during the LLC’s tax year. Reportable transactions also include amounts paid or received in connection with the formation, dissolution, acquisition and disposition of the entity, including contributions to and distributions from the entity. Nonmonetary and less-than-full consideration transactions between the LLC and its foreign related party are also reportable on Form 5472.

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A "related party" is defined quite broadly and includes direct or indirect 25% foreign owners of the LLC, a related person within the meaning of Code Sections 267(b) or 707(b)(1) to the LLC or its owner, and a related person within the meaning of Code Section 482 and related regulations to the LLC. In determining whether a person is a related party, the constructive ownership rules in Code Section 318 apply, with certain modifications. For a foreign-owned U.S. DE, a common related party may be the LLC's foreign owner (which may be an individual, a company or a trust), certain family members of the LLC's foreign owner (if the owner is an individual), other companies owned directly or indirectly by the LLC's foreign owner, or in certain situations the beneficiaries of the LLC's foreign trust owner.

Foreign-owned U.S. DEs should review their transactions and ownership structures carefully to determine whether they have any Form 5472 reporting obligations.

In order to file Form 5472, a foreign-owned U.S. DE must first obtain a U.S. tax identification number. Since it has no U.S. income tax return filing requirement, a foreign-owned U.S. DE must file a pro forma Form 1120 (U.S. Corporation Income Tax Return) with Form 5472 attached by the due date of the Form 1120. Foreign-owned U.S. DEs must use a special mailing address and filing instructions for submitting Forms 1120 and 5472.

Penalties for not complying with Form 5472 filing obligations can be significant. A \$25,000 penalty will be assessed on a foreign-owned U.S. DE that fails to timely file Form 5472 or files a substantially incomplete Form 5472.

Non-U.S. persons who own entities in the U.S. must ensure compliance with all applicable U.S. tax, reporting and record-keeping obligations. Form 5472 is a key document for a foreign-owned U.S. DE and should not be overlooked.

Loeb & Loeb's International Trust and Estate Planning practice has assisted many clients in handling their Form 5472 obligations. For more information, please contact any of the attorneys below.

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