

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

MONDAY, OCTOBER 24, 2022, 1:00-2:50 pm Eastern

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October 24, 2022

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Sean Dokko, J.D., LL.M.  
International Tax Partner  
Citrin Cooperman  
[sdokko@citrincooperman.com](mailto:sdokko@citrincooperman.com)

Alison N. Dougherty, CPA  
Managing Member  
Googolplex Tax Services  
[adougherty@googolplextax.com](mailto:adougherty@googolplextax.com)

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## FOCUS ON WHAT COUNTS

Preparing Form 1120-F for Foreign Corporations:  
2021 Revisions, ECI, Protective Claims, and  
Branch Profits Tax  
October 24, 2022

Sean Dokko  
[sdokko@citrincooperman.com](mailto:sdokko@citrincooperman.com)

# I. Who Should File Form 1120-F

# General Rules for Filing Form 1120-F

## Who must file a Form 1120-F?

Subject to certain exceptions, a foreign corporation (“FC”) files if the FC:

- Was engaged in a U.S. trade or business (“ETOB”)
- Had income, gains, or losses treated as if they were effectively connected with the conduct of a U.S. trade or business
- Received U.S. source fixed, determinable, annual or periodical (“FDAP”) income where §1442 withholding not fully satisfied
- Wants to claim a refund, benefits of any deductions/credits or treaty benefits
- Wants to file a ***protective return***

Other limited situations where filing may be required. See instructions to Form 1120-F

# Protective Returns

## **Section 882(c)(2)**

- Essentially provides that a FC can take deductions for purposes of determining its taxable income effectively connected with a U.S. trade or business (“ECI”) only by filing a tax return
- Statute does NOT provide specific rules as to when the FC must file a tax return to get the benefit of deductions and credits

## **Reg. §1.882-4(a)(2) and (3)**

- Requires a “timely” return be filed for FC to get the benefit of deductions and credits
- If return filed for the immediately preceding tax year or is the first tax year where a return is required, the return generally needs to be filed within 18 months of the due date set forth in §6072 for filing the return for the current tax year
  - Additional rule if a return for the preceding tax year was required to be filed but was not. See Reg. §1.882-4(a)(3)(i)

# Protective Returns

## **Reg. §1.882-4(a)(3)(v)**

- Provides that FCs with U.S. permanent establishments (PEs) under an applicable tax treaty are subject to the same filing deadlines

## **Reg. §1.882-4(a)(4)**

- Provides consequences for failing to timely file a return
- Essentially disallows deductions and credits when calculating the taxes due

# Protective Returns

## **Reg. §1.882-4(a)(3)(vi)**

- Provides a mechanism for FCs to preserve their deductions and credits
- If a FC conducts limited U.S. activities that it determines do not give rise to gross ECI, the FC may nonetheless file a protective return to protect the right to receive the benefit of deductions and credits if it is later determined, the original determination was incorrect
  - Not required to report any gross ECI or any deductions or credits
  - Should attach a statement indicating that the return is being filed for the reason set forth in Reg. §1.882-4(a)(3)
- A FC that conducts limited activities in the U.S. and determines that only some of these activities give rise to ECI must file a return on a timely basis to report the ECI, and should attach a statement with regard to the other activities
- Also provides that a FC may follow the same procedure if it determines initially that it has no U.S. tax liability under a tax treaty

# Protective Returns

## ***Swallows Holding Ltd. v. Comm’r*, 515 F.3d 162 (3d Cir. 2008), rev’g 126 T.C. 96 (2006)**

- FC filed U.S. tax returns after deadline in Reg. §1.882-4(a)(3)(i)
- IRS disallowed deductions and credits
- FC challenged at Tax Court arguing Reg. §1.882-4(a)(3)(i) was invalid
- Tax Court held reg was invalid
  - The Tax Court concluded that Congress did not intend §882(c)(2) to embody a filing deadline
  - Held that the IRS's interpretation of the statute to include a timely filing requirement in the language of Regs. §1.882-4(a)(3)(i) was unreasonable and the FC was entitled to deductions

# Protective Returns

## ***Swallows Holding Ltd. v. Comm’r*, 515 F.3d 162 (3d Cir. 2008), rev’g 126 T.C. 96 (2006)**

- IRS appealed and Third Circuit Court of Appeals reversed stating that the regulation in question should be given deference
- Reg. §1.6662-4(d)(3)(iii) provides that a Tax Court opinion is not considered to be overruled or modified by a court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals



# Protective Returns

## ***Adams Challenge (UK) Ltd. v. Comm’r, 156 T.C. 16 (2021)***

- IRS issued a Notice to FC in October 2013
- FC filed Form 1120-F in December 2013 for the 2011 tax year
- In April 2014, IRS prepared returns for the FC for the 2009 and 2010 tax years
  - In November 2014, IRS issued notice denying deductions and credits for 2009 and 2010 for failure to file returns
- FC petitioned the Tax Court in February 2015 and filed protective returns for 2009 and 2010 in February 2017
- FC argued that Reg. §1.882-4(a)(4) was invalid citing *Swallows Holding*
  - Ignored the Third Circuit’s holding because appeal of the case did not lie in the Third Circuit
- IRS requested the Tax Court overrule its prior opinion in *Swallows Holding*

# Protective Returns

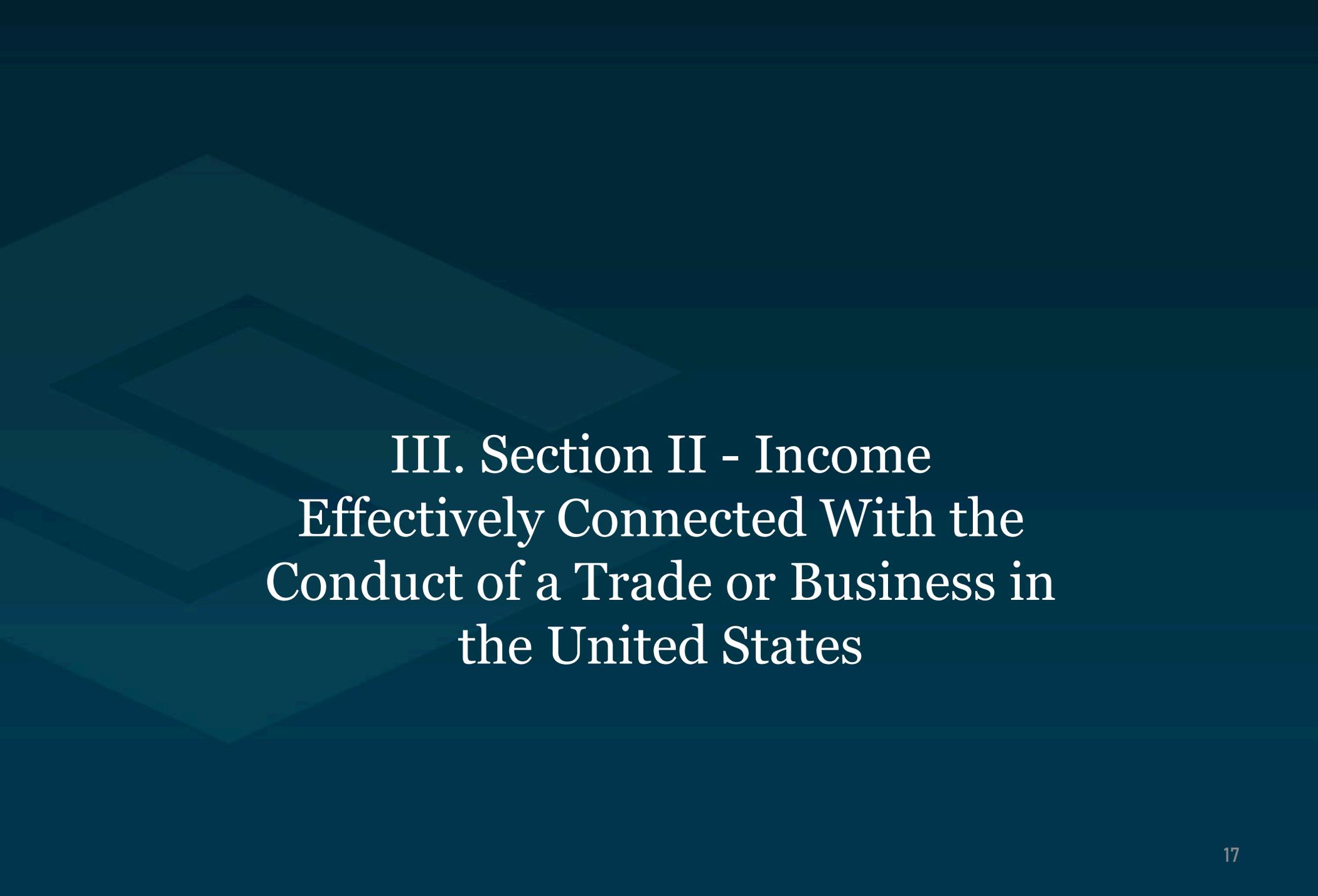
## ***Adams Challenge (UK) Ltd. v. Comm’r, 156 T.C. 16 (2021)***

- Tax Court (1) declined to allow the FC deductions or credits for the 2009 and 2010 tax years but also (2) denied IRS’s request to overrule the Tax Court’s opinion in *Swallows Holding*
- Tax Court did not address whether the reg was valid, rather looked at earlier case law and held that the statute implicitly incorporates a timing requirement
  - Tax Court held that FC failed to file its 2009 and 2010 tax returns before the IRS prepared returns on its behalf
- Further held that the U.S. – U.K. tax treaty did not override the statute under both the business profits article and the non-discrimination article

# Protective Returns

## Waiver

- Filing deadline may be waived if FC establishes it acted reasonably and in good faith. Reg. §1.882-4(a)(3)(ii)
- Factors in determining whether the FC acted reasonably and in good faith in failing to file a U.S. income tax return:
  - Whether the FC voluntarily identified itself to the IRS as having failed to file a U.S. income tax return before the IRS discovered the failure to file;
  - Whether the FC did not become aware of its ability to file a protective return by the deadline for filing a protective return;
  - Whether the FC had not previously filed a U.S. income tax return;
  - Whether the FC failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account its relevant experience and level of sophistication), the corporation was unaware of the necessity for filing the return;
  - Whether the FC failed to file a U.S. income tax return because of intervening events beyond its control; and
  - Whether other mitigating or exacerbating factors existed



### III. Section II - Income Effectively Connected With the Conduct of a Trade or Business in the United States

# ETOB and ECI

## Engaged in a U.S. Trade or Business

- Section 864(b) has special rules for the performance of services and trading in securities/commodities
- Otherwise, whether FC is ETOB based on judicial and administrative guidance
  - Based on the nature and extent of FC's U.S. economic activities
- Generally, FC is ETOB if its U.S. economic activities are “considerable... continuous, and regular”
  - Depends on the type and amount of U.S. activities
- FC activities must be of a type that is closely and directly related to the derivation of profit (although no profit need actually be generated) rather than being incidental, ministerial or clerical
- IRS generally will not issue rulings on whether FC is ETOB. Rev. Proc. 2022-7

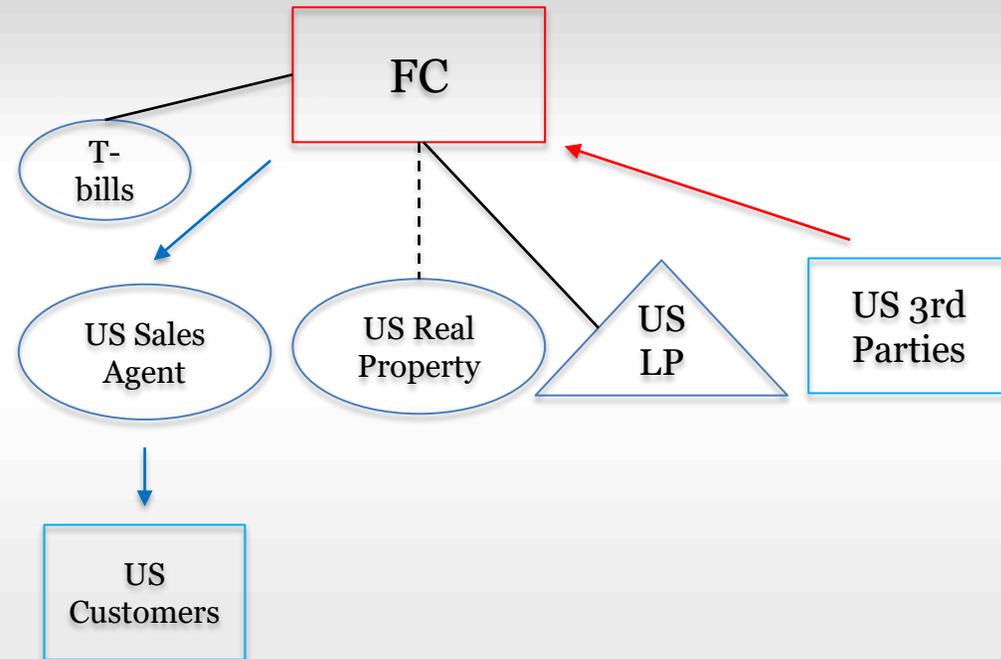


# ETOB and ECI

## Effectively Connected Income

- Section 864(c) provides that ECI includes:
  - Certain investment income if classified as ECI under “asset-use test” or “business-activities test”;
  - Other U.S. source income, as described in §864(c)(3); and
  - Certain foreign source income described in §864(c)(4)
- Section 864(c)(6) provides special rules relating to certain deferred payments
- Section 864(c)(7) provides special rules relating to certain property transactions
- Section 864(c)(8) provides that all or some portion of gains from the disposition of a partnership ETOB is treated as ECI
- Section 897 treats gains from the disposition of US RPIs as ECI

# ETOB and ECI



## Facts

- FC is a resident in a non-treaty jurisdiction
- FC sells goods to customers in the U.S. through a U.S. sales agent
- FC invests surplus cash in T-bills
- FC receives rental income from real estate located in the U.S.
  - In December, FC sells the real estate for a gain
- FC owns an interest in a U.S. partnership that is ETOB
- FC licenses patents to unrelated parties in the U.S.

# ETOB and ECI

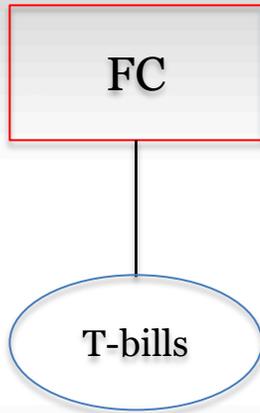


## Issues

- Is FC imputed the activities of its agent?
  - See *Lewenhaupt v. Comm'r*, 20 T.C. 151 (1953)
- What if US Sales Agent is an independent agent?
  - See *de Amodio v. Comm'r*, 34 T.C. 894 (1960), aff'd 299 F.2d 623 (3d Cir. 1962)
- What if title to goods passes to customers outside the U.S.?
  - See §§ 865(e)(2) and 864(c)(4)(B)(iii)



# ETOB and ECI

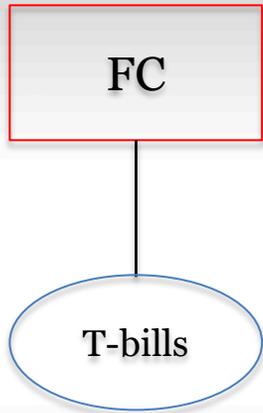


## Issues

- Section 864(c)(2)(A) and Reg. §1.864-4(c)(1) and (2) – Asset-Use Test
- U.S. source investment income is ECI if it is derived from assets used in, or held for use in, the conduct of a U.S. trade or business
  - Assets held for the principal purpose of promoting the present conduct of the U.S. trade or business
  - Assets acquired and held in the ordinary course of the U.S. trade or business; for example, an account or note receivable arising from the trade or business
  - Assets otherwise held in a “direct relationship” to the U.S. trade or business



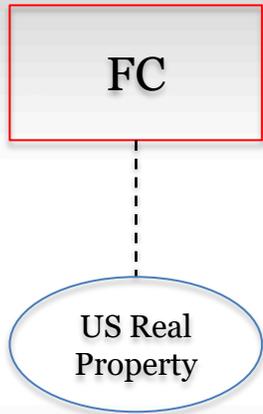
# ETOB and ECI



## Issues

- Is the asset needed in the U.S. trade or business?
  - The asset is held to meet the present needs of that trade or business (e.g., held to meet operating expenses of the trade or business) and not its anticipated future needs
  - Not held for present needs if the asset is held for the purpose of providing for (1) future diversification into a new trade or business, (2) expansion of trade or business activities conducted outside of the United States, (3) future plant replacement, or (4) future business contingencies
- See Reg §1.864-4(c)(2)(v), Ex. 1

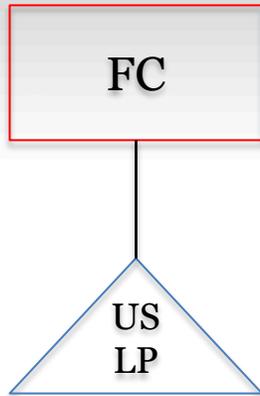
# ETOB and ECI



## Issues

- Does FC merely passively collect rent or does it actively manage the real property (e.g., arrange and negotiate leases, supervise repairs, involved in day-to-day management of the property, etc.)?
  - See business-activities test in §864(c)(2)(B) and Reg. §1.864-4(c)(1) and (3) discussed infra
- Section 882(d) – election to treat rental income as ECI
- Section 897 – Disposition of investment in US RPIs
- Section 1445 – Withholding on disposition of US RPIs

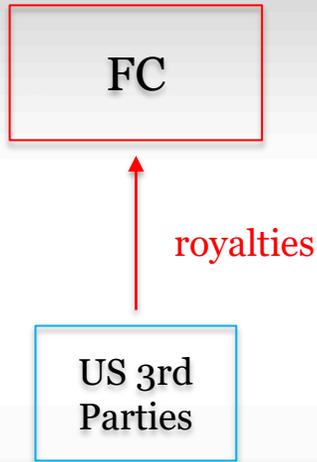
# ETOB and ECI



## Issues

- Section 875(1) – ETOB rules for partners in partnerships
- Section 1446 – withholding tax on foreign partner's share of ECI
- Section 864(c)(8) – Gain/loss of foreign persons from sale or exchange of certain partnership interests
- Section 1446(f) – special rules for withholding on dispositions of partnership interests

# ETOB and ECI



## Issues

- Section 864(c)(2)(B) and Reg. §1.864-4(c)(1) and (3) – Business-Activities Test
- U.S. source investment income is ECI if the activities of the U.S. trade or business are a “material factor” in the realization of the income
- Generally relevant for investment income that arises directly from the active conduct of the taxpayer’s U.S. trade or business
- See Reg. §1.864-4(c)(3)(ii), Ex. 2

# ETOB and ECI

## Step 1

- Determine whether FC is ETOB

## Step 2

- If FC is ETOB, then determine gross ECI

## Step 3

- Determine allowed deductions and credits
  - Deductions allowed to the extent they “are connected” with gross ECI
- Reg. §1.861-8 through -17 and -20 set forth detailed rules for allocating and apportioning deductions
- Reg. §1.882-5 provides rules for determining the interest deduction allowed to FC
- Reported on Schedule H

# ETOB and ECI

## General Rules

- First determine whether any of its deductions are “definitely related” to a particular “class,” or broad category of income
  - A deduction is “definitely related” to a class of gross income if it is incurred:
    - as a result of or incident to the activity; or
    - in connection with the property, from which the gross income is derived
  - Classes include compensation for services, gross income derived from business, gains derived from dealings in property, interest, rents, royalties and dividends

# ETOB and ECI

## General Rules

- If “definitely related,” then apportioned between the “statutory grouping” (i.e., ECI) and the “residual grouping” (i.e., non-ECI)
- Apportionment done “in a manner which reflects to a reasonably close extent the factual relationship between the deduction and the grouping”
  - E.g., gross sales or receipts, COGS, assets used, salaries paid, space utilized, time spent, etc.

# ETOB and ECI

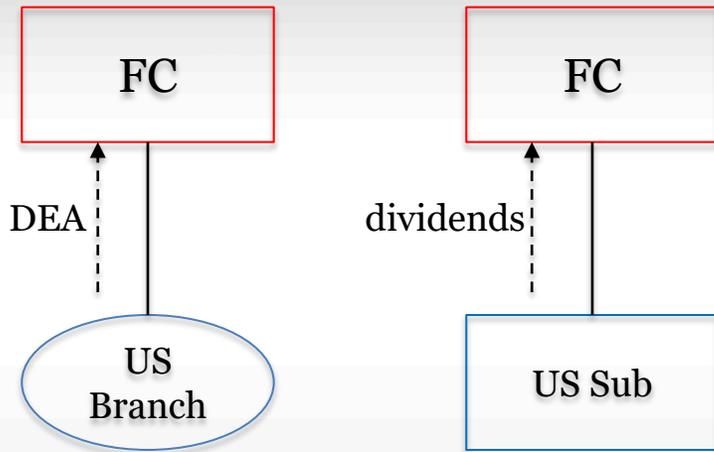
## General Rules

- If deduction is not definitely related to a particular class of gross income, then apportioned between ECI and non-ECI based on the ratio of gross income
- Special rules apply to
  - R&E (See Reg. §1.861-17)
  - Stewardship (See Reg. §1.861-8(e)(4))
  - Legal and accounting fees (See Reg. §1.861-8(e)(5))
  - Income Taxes (See Reg. §1.861-8(e)(6))
  - Losses on sale, exchange or other disposition of property (See Reg. §1.861-1 and §1.865-2)



## IV. Section III – Branch Profits Tax and Tax on Excess Interest

# Branch Profits Tax (“BPT”)



## Overview

- Creates U.S. tax parity between FC U.S. branches and FC U.S. subsidiaries
- Dividends from US Sub generally subject to 30% withholding (or lower treaty rate)
- Dividend equivalent amount (“DEA”) of US branch subject to 30% BPT (or lower treaty rate)



# Branch Profits Tax (“BPT”)

## General Rules

- BPT applies to effectively connected earnings and profits (“ECE&P”) to the extent such ECE&P is not reinvested in a U.S. trade or business
- 30% BPT (unless reduced by treaty) applies to the DEA
- DEA is the foreign corporation’s ECE&P for the tax year adjusted downward (but not below zero) to reflect increases in “U.S. net equity” and adjusted upward to reflect decreases in U.S. net equity
- Essentially imposes BPT on current ECE&P that is not retained and reinvested in branch assets and is deemed to be repatriated back to the home office
- Upward adjustments of the DEA may not exceed the foreign corporation’s accumulated ECE&P at the end of the prior taxable year
  - Similar concept as the §301(c) ordering rules with some differences
  - BPT also incorporates a “nimble dividend” concept similar to actual dividends

# Branch Profits Tax (“BPT”)

## Example Based off Reg. §1.884-1(b)(4) Ex. 4

- FC 2021 U.S. Net Equity: \$1,000
- FC 2021 ending accumulated ECE&P: \$0
- FC 2022 current ECE&P: \$100
- FC 2022 U.S. Net Equity: \$1,040
- FC 2022 DEA = \$60 (\$100 current ECE&P - \$40 increase in U.S. Net Equity)
  - Accumulated ECE&P at the beginning of 2023: \$40 (\$100 accumulated ECE&P - \$60 DEA)
- FC 2023 current ECE&P: \$125
- FC 2023 U.S. Net Equity: \$990
- FC 2023 DEA = \$165 (\$125 current ECE&P + lesser of (a) \$50 (decrease in U.S. Net Equity) or (b) \$40 (accumulated ECE&P at the end of the prior year))



# Branch Profits Tax (“BPT”)

## Example Based off Reg. §1.884-1(b)(4) Ex. 6

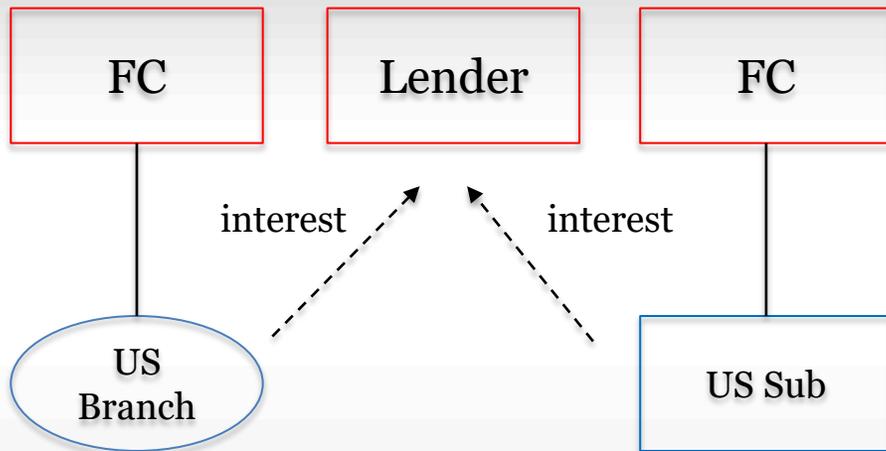
- FC 2020 ECE&P deficit: (\$100)
- FC 2021 ECE&P deficit: (\$100)
- FC 2022 ECE&P: \$90
- FC’s U.S. net equity for 2021 and 2022: \$2,000
- DEA = \$90 = current EC&P with no adjustments since no changes in net equity

# Branch Profits Tax (“BPT”)

## Branch Terminations

- BPT generally does not apply if FC completely terminates all U.S. trade or business activities
- Reg. §1.884-2T(a)(2)
  - The FC must cease to have any U.S. assets;
  - Neither the FC nor any related corporation may reinvest in a U.S. trade or business within three years;
  - The FC must have no ECI for three years from the end of the termination year; and
  - FC attaches a waiver of the period of limitations to its tax return
- If FC fails to completely terminate all of its U.S. trade or business, then FC subject to BPT (with interest) for the tax year and all later tax years under normal rules, taking into account any reduction in U.S. net equity resulting from the reduction in U.S. assets

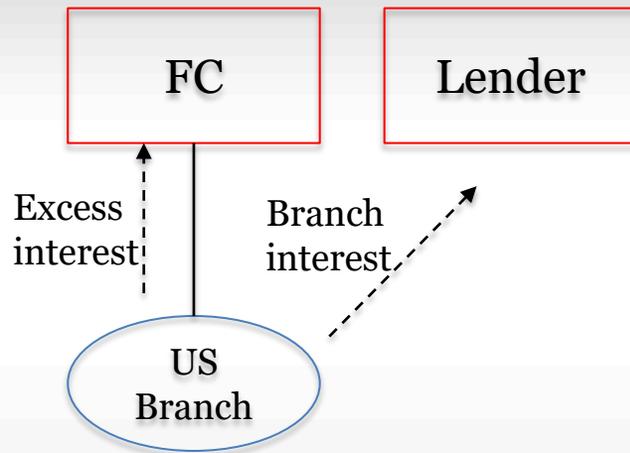
# Branch Interest Tax



## Overview

- Interest paid by the US branch generally treated as if paid by a U.S. corporation so generally subject to U.S. withholding. IRC §884(f)(1)(A)
- “Branch interest” = interest paid on:
  - “U.S. booked liabilities” +
  - Liabilities “specifically identified” on the foreign books (for non-banks) +
  - Accrued but unpaid interest that FC elects to treat as paid
- If 80% of FC’s assets are U.S. assets, then all of FC’s interest generally treated as branch interest

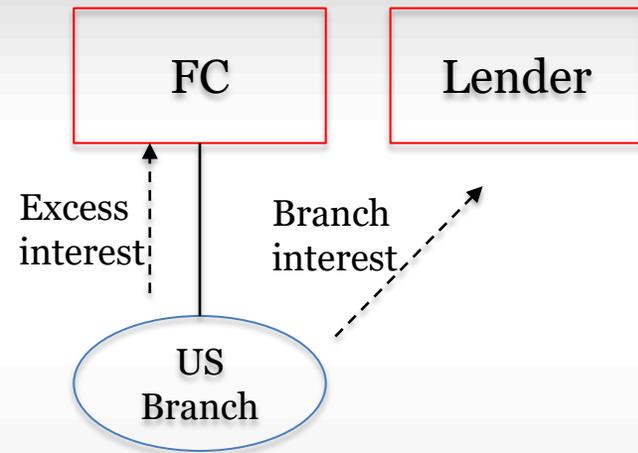
# Branch Interest Tax



## Overview

- Excess interest when FC interest allocated to US Branch under Reg. §1.882-5 is greater than branch interest
- Excess interest is treated as if paid by a U.S. subsidiary to FC on the last day of the year
- Excess interest is subject to a 30% (unless reduced under a treaty) tax under IRC §881(a) and is reported on Form 1120-F Section III Part II
- Special rules for foreign banks

# Branch Interest Tax



## Overview

- Under Reg. §1.882-5, \$300 of FC interest is allocated to US Branch
- US Branch has branch interest of \$200
- Excess interest is \$100 (= \$300 - \$200)
- Branch interest to Lender subject to 30% U.S. withholding tax (unless reduced by treaty or an exception applies)
- Excess interest deemed paid to FC included on FC Form 1120-F and subject to 30% U.S. tax (unless reduced by treaty)

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# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

Alison N. Dougherty, J.D., LL.M., CPA

Managing Member  
Googolplex Tax Services, LLC

October 24, 2022

## Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

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# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

- I. Who should file Form 1120-F
  - A. Protective Returns
  - B. Treas. Reg. § 1.882-4 along with *Adams Challenge (UK) Ltd. v. Commissioner* and *Swallows Holdings, Ltd. v. Commissioner*
- II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States
  - A. FDAP withholding and when FDAP income reporting is required
- III. Section II – Income Effectively Connected with the Conduct of a Trade or Business in the United States
  - A. Engaged in a U.S. trade or business
    - 1. Activities conducted by a foreign corporation through a U.S. partnership
  - B. Income effectively connected to a U.S. trade or business
- IV. Section III – Branch Profits Tax and Tax on Excess Interest
  - A. Calculating and reporting the Branch Profits Tax
- V. Form 8833, *Treaty-Based Return Position Disclosure under Section 6114 or 7701(b)*
  - A. When treaty-based return position disclosure is required and certain key exceptions to reporting
  - B. Limitations on Benefits Article
- VI. Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*
  - A. Information generally required
  - B. Exceptions from filing
  - C. Filing obligation for Foreign-Owned U.S. Disregarded Entities

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## **II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States**

### **A. FDAP withholding and when FDAP income reporting is required**

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

Form 1120-F (2021) Page **3**

**Additional Information** (continued from page 2)

	Yes	No		Yes	No
<b>FF</b> Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year (see instructions)?			<b>HH</b> During the tax year, did the corporation dispose of an interest in a partnership that directly or indirectly engaged in a trade or business within the United States?		
<b>GG</b> Does the corporation satisfy <b>one or more</b> of the following (see instructions)?			<b>II</b> Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund?		
<b>(1)</b> The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.			If "Yes," enter amount from Form 8996, line 15		
<b>(2)</b> The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than \$26 million and the corporation has business interest expense.					
<b>(3)</b> The corporation is a tax shelter and the corporation has business interest expense.					

If "Yes," to any, complete and attach Form 9990.

**SECTION I—Income From U.S. Sources Not Effectively Connected With the Conduct of a Trade or Business in the United States.**—Do not report items properly withheld and reported on Form 1042-S. See instructions.

Report all gross transportation income subject to 4% tax on line 9. Report other column (a) income items only if not properly withheld and reported on Form 1042-S. The rate of tax on these gross income items is 30% or such lower rate specified by tax treaty. No deductions are allowed against these types of income. Enter treaty rates where applicable. **If the corporation is claiming a lower treaty rate, also complete item W on page 2.** If multiple treaty rates apply to a type of income (for example, subsidiary and portfolio dividends or dividends received by disregarded entities), attach a statement showing the amounts, tax rates, and withholding for each.

Name of treaty country, if any ▶

	(a)	(b)	(c)	(d)	(e)
Class of income (see instructions)	Gross amount	Rate of tax (%)	Amount of tax liability	Amount of U.S. income tax paid or withheld at the source	
<b>1</b> Interest					
<b>2a</b> Dividends (excluding payments received by QDDs in their equity derivatives dealer capacity)					
<b>2b</b> Dividend equivalents (excluding payments received by QDDs in their equity derivatives dealer capacity)					
<b>3</b> Rents					
<b>4</b> Royalties					
<b>5</b> Annuities					
<b>6</b> Gains from disposal of timber, coal, or domestic iron ore with a retained economic interest (attach supporting statement)					
<b>7</b> Gains from sale or exchange of patents, copyrights, etc.					
<b>8</b> Fiduciary distributions (attach supporting statement)					
<b>9</b> Gross transportation income (see instructions)		<b>4</b>			
<b>10</b> Other items of income					
<b>11</b> Total. Enter here and on line 1, page 1					
<b>12</b> Total. Enter here and include on line 5i, page 1					

**13** Is the corporation fiscally transparent under the laws of the foreign jurisdiction with respect to any item of income listed above?  Yes  No

If "Yes," attach a statement that provides the information requested above with respect to each such item of income.

Form **1120-F** (2021)

## Form 1120F, page 3, Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

**SECTION I—Income From U.S. Sources Not Effectively Connected With the Conduct of a Trade or Business in the United States**—Do not report items properly withheld and reported on Form 1042-S. See instructions.

Report all gross transportation income subject to 4% tax on line 9. Report other column (a) income items only if not properly withheld and reported on Form 1042-S. The rate of tax on these **gross** income items is 30% or such lower rate specified by tax treaty. No deductions are allowed against these types of income. Enter treaty rates where applicable. **If the corporation is claiming a lower treaty rate, also complete item W on page 2.** If multiple treaty rates apply to a type of income (for example, subsidiary and portfolio dividends or dividends received by disregarded entities), attach a statement showing the amounts, tax rates, and withholding for each.

Name of treaty country, if any ►

	(a) Class of income (see instructions)	(b) Gross amount	(c) Rate of tax (%)	(d) Amount of tax liability	(e) Amount of U.S. income tax paid or withheld at the source
1	Interest . . . . .				
2a	Dividends (excluding payments received by QDDs in their equity derivatives dealer capacity) . . . . .				
2b	Dividend equivalents (excluding payments received by QDDs in their equity derivatives dealer capacity) . . . . .				
3	Rents . . . . .				
4	Royalties . . . . .				
5	Annuities . . . . .				
6	Gains from disposal of timber, coal, or domestic iron ore with a retained economic interest (attach supporting statement) . . . . .				
7	Gains from sale or exchange of patents, copyrights, etc. . . . .				
8	Fiduciary distributions (attach supporting statement) . . . . .				
9	Gross transportation income (see instructions)		<b>4</b>		
10	Other items of income . . . . .				
	.....				
11	Total. Enter here and on line 1, page 1 . . . . .				
12	Total. Enter here and include on line 5i, page 1 . . . . .				

13 Is the corporation fiscally transparent under the laws of the foreign jurisdiction with respect to any item of income listed above?  Yes  No  
If "Yes," attach a statement that provides the information requested above with respect to each such item of income.

Form **1120-F** (2021)

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States

### A. FDAP withholding and when FDAP income reporting is required

- I.R.C. § 1442 provides for a 30% U.S. nonresident withholding tax on the payment to a foreign corporation of certain types of gross U.S. source income that is not effectively connected with a U.S. trade or business.
- U.S. source fixed or determinable annual periodical (FDAP) gains, profits, and income paid to a foreign corporation
- Per IRC § 1441(b), this includes interest (other than original issue discount as defined in IRC § 1273), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, gains described in IRC § 631(b) or (c), amounts subject to tax under IRC § 871(a)(1)(C), and gains subject to tax under IRC § 871(a)(1)(D).
- U.S. federal Form 1042 and 1042-S reporting to the IRS by the U.S. withholding agent
- U.S. withholding agent withholds and deposits the U.S. tax
- Foreign corporation payee receives the payment net of U.S. tax
- U.S. withholding agent issues the Form 1042-S to the foreign corporation to report gross U.S. source FDAP income and U.S. nonresident tax withheld
- 30% U.S. nonresident withholding tax rate can be reduced under a U.S. income tax treaty with the foreign corporation's country of residence but reduced treaty rate should be claimed and reflected on Form 1042-S

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## **II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States**

### **A. FDAP withholding and when FDAP income reporting is required**

- What is U.S. source FDAP income?
- Apply the U.S. federal source rules
- Non-ECI interest, dividends, rents, royalties, payments for independent contractor services performed in the United States
- FDAP income and capital gains can be ECI

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States

### A. FDAP withholding and when FDAP income reporting is required

Type of Income	General Rule (*Exceptions May Apply)
Interest	*Usually sourced to the residence of the obligor, i.e., the issuer/borrower of the loan obligation
Dividends	*Usually sourced to the residence of the corporation paying the dividend
Rents	Sourced to the location of the property
Royalties	Sourced to the location of the property or where the property is utilized
Gains from sale or exchange of real property	Sourced to the location of the property
Income from the sale of tangible property - purchased inventory for resale	Sourced to the location of the sale
Income from the sale of tangible property - manufactured inventory	Sourced based on the place of production

- U.S. federal source rules determine whether different types of income are U.S. source or foreign source
- General rules may apply but check exceptions

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## **II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States**

### **A. FDAP withholding and when FDAP income reporting is required**

- FDAP income and capital gains can be ECI
- Asset-use test – FDAP and capital gains are ECI if such items are derived from assets used in, or held for use in, the conduct of U.S. trade or business. For example, the following items are ECI.
  - Income earned on a trade or note receivable acquired in the conduct of the U.S. trade or business.
  - Interest income earned from the temporary investment of funds needed in the U.S. trade or business.
- Business-activities test – FDAP and capital gains are ECI if the activities of the U.S. trade or business were a material factor in the realization of the passive income items.

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States

### A. FDAP withholding and when FDAP income reporting is required

- Reporting on Form 1120-F Section I is only for U.S. source income that is not ECI and which was not properly withheld upon and reported on the Form 1042-S to the foreign corporation
- Consider Form 1042-S reporting from a U.S. partnership or a foreign partnership with U.S. source FDAP income subject to U.S. nonresident withholding tax
  - A foreign corporation partner's share of undistributed Schedule K-1 and K-3 FDAP income for the current tax year is not subject to U.S. nonresident withholding tax until the following year when the U.S. federal Form 1065 partnership tax return is filed
  - This can create a timing mismatch since the foreign corporation may technically be required to report the income and corresponding U.S. tax on the Form 1120-F for its current tax year when the Form 1042-S is not received for that year
  - How to resolve the timing issue?
  - Query: Is the "lag method" permissible?

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## **II. Section I – Income from U.S. Sources Not Effectively Connected with the Conduct of a Trade or Business in the United States**

### **A. FDAP withholding and when FDAP income reporting is required**

- Example #1 – U.S. subsidiary corporation pays a dividend out of E&P to its foreign corporation shareholder and Form 1042-S is issued
  - Form 1120-F Section I reporting not required
  - What if the foreign corporation can qualify for a reduced U.S. tax rate under a treaty and it was not reported on the Form 1042-S?
- Example #2 – U.S. partnership reports undistributed U.S. source FDAP income on a Form 1065 Schedule K-1 and K-3 issued to a foreign corporation partner and Form 1042-S is not issued for the current tax year but will be issued for the following tax year
  - Form 1120-F Section I reporting technically may be required



Preparing Form 1120-F for Foreign Corporations: 2021 Revisions,  
ECI, Protective Claims, and Branch Profits Tax

***V. Form 8833, Treaty-Based Return Position Disclosure  
under Section 6114 or 7701(b)***

**A. When treaty-based return position disclosure is required and  
certain key exceptions to reporting**

**B. Limitations on Benefits Article**

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

**Form 8833**  
 (Rev. December 2021)  
 Department of the Treasury  
 Internal Revenue Service

**Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)**  
 Attach to your tax return.  
 Go to [www.irs.gov/Form8833](http://www.irs.gov/Form8833) for the latest information.

OMB No. 1545-1354

Attach a separate Form 8833 for each treaty-based return position taken. Failure to disclose a treaty-based return position may result in a penalty of \$1,000 (\$10,000 in the case of a C corporation) (see section 6712).

Name \_\_\_\_\_ U.S. taxpayer identifying number \_\_\_\_\_ Reference ID number, if any (see instructions) \_\_\_\_\_

Address in country of residence \_\_\_\_\_ Address in the United States \_\_\_\_\_

Check one or both of the following boxes as applicable.

- The taxpayer is disclosing a treaty-based return position as required by section 6114
- The taxpayer is a dual-resident taxpayer and is disclosing a treaty-based return position as required by Regulations section 301.7701(b)-7

**Note:** If the taxpayer is a dual-resident taxpayer and a long-term resident, by electing to be treated as a resident of a foreign country for purposes of claiming benefits under an applicable income tax treaty, the taxpayer will be deemed to have expatriated pursuant to section 877A. For more information, see the instructions.

Check this box if the taxpayer is a U.S. citizen or resident or is incorporated in the United States

1 Enter the specific treaty position relied on:  
 a Treaty country \_\_\_\_\_  
 b Article(s) \_\_\_\_\_

2 List the Internal Revenue Code provision(s) overruled or modified by the treaty-based return position \_\_\_\_\_

3 Name, identifying number (if available to the taxpayer), and address in the United States of the payor of the income (if fixed or determinable annual or periodical). See instructions. \_\_\_\_\_

4 List the provision(s) of the limitation on benefits article (if any) in the treaty that the taxpayer relies on to prevent application of that article \_\_\_\_\_

5 Is the taxpayer disclosing a treaty-based return position for which reporting is specifically required pursuant to Regulations section 301.6114-1(b)?  Yes  No  
 If "Yes," enter the specific subsection(s) of Regulations section 301.6114-1(b) requiring reporting \_\_\_\_\_  
 Also include the information requested in line 6.

6 Explain the treaty-based return position taken. Include a brief summary of the facts on which it is based. Also, list the nature and amount (or a reasonable estimate) of gross receipts, each separate gross payment, each separate gross income item, or other item (as applicable) for which the treaty benefit is claimed \_\_\_\_\_

For Paperwork Reduction Act Notice, see the instructions. Cat. No. 14899L Form 8833 (Rev. 12-2021)

- **\$10K Penalty for not filing the Form 8833 when required with a foreign corporation's Form 1120-F**
- To claim a treaty position, the foreign corporation must be a resident of the treaty country and qualify for treaty benefits under the Limitation on Benefits Article of the treaty
- Common Form 8833 treaty-based return position disclosures with a foreign corporation's Form 1120-F:
  - Treaty reduces U.S. branch profits tax rate
  - Foreign corporation does not have a U.S. PE
  - U.S. source ECI is not attributable to a U.S. PE
  - Treaty modifies amount of business profits attributable to a U.S. PE
  - Treaty reduces U.S. tax rate on FDAP income not reported on a Form 1042-S
  - Treaty reduces U.S. tax rate on gains from sale of U.S. real property
  - Treaty resources income

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

- **U.S. Treas. Reg. § 301.6114-1(b) Form 8833 is required to report the following treaty-based return positions:**
  - A nondiscrimination provision of the treaty prevents the application of an otherwise applicable IRC provision, other than with respect to making an election under IRC § 897(i)
  - A treaty reduces or modifies the taxation of gain or loss from the disposition of a U.S. real property interest
  - A treaty reduces or modifies the branch profits tax (IRC § 884(a)) or the tax on excess interest (IRC § 884(f)(1)(B))
  - A treaty exempts from tax or reduces the rate of tax on dividends or interest paid by a foreign corporation that are U.S.-sourced under IRC § 861(a)(2)(B) or § 884(f)(1)(A)
  - A treaty exempts from tax or reduces the rate of tax on fixed or determinable annual or periodical (FDAP) income that a foreign person receives from a U.S. person, but only if:
    - ❑ 1. The amount is not properly reported on Form 1042-S and the foreign person is:
      - (a) a controlled foreign corporation (as defined in IRC § 957) in which the U.S. person is a U.S. shareholder (as defined in IRC § 951(b));
      - (b) a foreign corporation that is controlled by a U.S. person within the meaning of IRC § 6038;
      - (c) a foreign corporation that is a 25-percent shareholder of the U.S. person under IRC § 6038A; or
      - (d) a foreign related party, as defined under IRC § 6038A(c)(2)(B);
    - ❑ 2. The foreign person is related to the payor under IRC § 267(b) or IRC § 707(b) and receives income exceeding \$500,000, in the aggregate, from the payor and the treaty contains a limitation on benefits article; **OR**
    - ❑ 3. The treaty imposes additional conditions for the entitlement of treaty benefits (for example, the treaty requires the foreign corporation claiming a preferential rate on dividends to meet ownership percentage and ownership period requirements).
  - Income effectively connected with a U.S. trade or business of a taxpayer is not attributable to a permanent establishment or a fixed base in the United States
  - A treaty modifies the amount of business profits of a taxpayer attributable to a permanent establishment or a fixed base in the United States
  - A treaty alters the source of any item of income or deduction (unless the taxpayer is an individual)
  - A treaty grants a credit for a foreign tax which is not allowed by the Code
  - The residency of an individual is determined under a treaty and apart from the IRC

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

- **U.S. Treas. Reg. § 301.6114-1(c) Form 8833 reporting is waived for the following treaty-based return positions:**
    - A treaty reduces or modifies the taxation of income derived by an individual from dependent personal services, pensions, annuities, social security, and other public pensions, as well as income derived by artists, athletes, students, trainees, or teachers
    - A Social Security Totalization Agreement or Diplomatic or Consular Agreement reduces or modifies the income of a taxpayer
    - A treaty exempts a taxpayer from the excise tax imposed by IRC § 4371, but only if certain conditions are met (for example, the taxpayer has entered into an insurance excise tax closing agreement with the IRS)
    - A treaty exempts from tax or reduces the rate of tax on FDAP income, if the beneficial owner is an individual or governmental entity
    - A partnership, trust, or estate has disclosed a treaty position that the partner or beneficiary would otherwise be required to disclose
    - Unless modified by the Form 8833 instructions, a treaty exempts from tax or reduces the rate of tax on FDAP income that is properly reported on Form 1042-S and the amount is received by a:
      - a. Related party (within the meaning of IRC § 6038A(c)(2)) from a reporting corporation within the meaning of IRC § 6038A(a) (a domestic corporation that is 25% foreign owned and required to file Form 5472);
      - b. Beneficial owner that is a direct account holder of a U.S. financial institution or qualified intermediary, or a direct partner, beneficiary, or owner of a withholding foreign partnership or trust, from that U.S. financial institution, qualified intermediary, or withholding foreign partnership or withholding foreign trust (whether the Form 1042-S reporting is on a specific payee or pooled basis);
- OR**
- c. Taxpayer that is not an individual or a State, if the amounts are not received through an account with an intermediary or with respect to an interest in a partnership or a simple or grantor trust, and if the amounts do not total more than \$500,000 for the tax year.

Preparing Form 1120-F for Foreign Corporations: 2021 Revisions,  
ECI, Protective Claims, and Branch Profits Tax

- VI. Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business***
  - A. Information generally required**
  - B. Exceptions from filing**
  - C. Filing obligation for Foreign-Owned U.S. Disregarded Entities**

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

**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)

Department of the Treasury Internal Revenue Service

For tax year of the reporting corporation beginning ... and ending ...

Note: Enter all information in English and money items in U.S. dollars.

OMB No. 1545-0123

Go to [www.irs.gov/Form5472](http://www.irs.gov/Form5472) for instructions and the latest information.

**Part I Reporting Corporation** (see instructions). All reporting corporations must complete Part I.

**1a** Name of reporting corporation  
Number, street, and room or suite no. (if a P.O. box, see instructions.)  
City or town, state, and ZIP code (if a foreign address, see instructions.)

**1b** Employer identification number

**1c** Total assets \$

**1d** Principal business activity ▶

**1e** Principal business activity code ▶

**1f** Total value of gross payments made or received reported on this Form 5472. See instructions.

**1g** Total number of Forms 5472 filed for the tax year

**1h** Total value of gross payments made or received reported on all Forms 5472. See instructions.

**1i** Total number of Parts VIII attached to Form 5472

**1j** Country of incorporation

**1k** Total number of Parts VIII attached to Form 5472

**1l** Country of incorporation

**1m** Date of incorporation

**1n** Country(ies) under whose laws the reporting corporation files an income tax return as a resident

**1o** Principal country(ies) where business is conducted

**2** Check here if, at any time during the tax year, any foreign person owned, directly or indirectly, at least 50% of (a) the total voting power of all classes of the stock of the reporting corporation entitled to vote, or (b) the total value of all classes of stock of the reporting corporation.

**3** Check here if the reporting corporation is a foreign-owned domestic disregarded entity (foreign-owned U.S. DE) treated as a corporation for purposes of section 6038A. See instructions.

**Part II 25% Foreign Shareholder** (see instructions)  
Check here if any direct (or ultimate indirect) 25% foreign shareholder listed in Part II is a surrogate foreign corporation under section 7874(a)(2)(B).

**4a** Name and address of direct 25% foreign shareholder

**4b(1)** U.S. identifying number, if any

**4b(2)** Reference ID number (see instructions)

**4b(3)** Foreign taxpayer identification number (FTIN), if any (see instructions)

**4c** Principal country(ies) where business is conducted

**4d** Country of citizenship, organization, or incorporation

**4e** Country(ies) under whose laws the direct 25% foreign shareholder files an income tax return as a resident

**5a** Name and address of direct 25% foreign shareholder

**5b(1)** U.S. identifying number, if any

**5b(2)** Reference ID number (see instructions)

**5b(3)** FTIN, if any (see instructions)

**5c** Principal country(ies) where business is conducted

**5d** Country of citizenship, organization, or incorporation

**5e** Country(ies) under whose laws the direct 25% foreign shareholder files an income tax return as a resident

**6a** Name and address of ultimate indirect 25% foreign shareholder

**6b(1)** U.S. identifying number, if any

**6b(2)** Reference ID number (see instructions)

**6b(3)** FTIN, if any (see instructions)

**6c** Principal country(ies) where business is conducted

**6d** Country of citizenship, organization, or incorporation

**6e** Country(ies) under whose laws the ultimate indirect 25% foreign shareholder files an income tax return as a resident

**7a** Name and address of ultimate indirect 25% foreign shareholder

**7b(1)** U.S. identifying number, if any

**7b(2)** Reference ID number (see instructions)

**7b(3)** FTIN, if any (see instructions)

**7c** Principal country(ies) where business is conducted

**7d** Country of citizenship, organization, or incorporation

**7e** Country(ies) under whose laws the ultimate indirect 25% foreign shareholder files an income tax return as a resident

For Paperwork Reduction Act Notice, see instructions.

Cat. No. 49987Y

Form 5472 (Rev. 12-2021)

## Form 5472 filing requirement

1. Reporting corporation
  - a. U.S. C corporation with a 25% direct or indirect foreign shareholder
  - b. Foreign corporation engaged in a U.S. trade or business
  - c. U.S. disregarded entity with a foreign owner (e.g., U.S. SMLLCs)
    - ❖ Tax years beginning on or after 1/1/2017
    - ❖ Tax years ending on or after 12/13/2017
2. Reportable transaction
  - a. Accruals and payments
  - b. Commercial business transactions
  - c. Only for U.S. DRE: capital contributions and earnings distributions
3. Related party
  - a. 25% direct or indirect foreign shareholder of the reporting corporation
  - b. Any person related to the reporting corporation under IRC § 267(b) or 707(b)(1)
  - c. Any person related to a 25% foreign shareholder of the reporting corporation under IRC § 267(b) or 707(b)(1)
  - d. Any other person who is related to the reporting corporation within the meaning of IRC § 482 and the related regulations

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

**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)

Department of the Treasury Internal Revenue Service

OMB No. 1545-0123

For tax year of the reporting corporation beginning ... and ending ...

Note: Enter all information in English and money items in U.S. dollars.

Go to [www.irs.gov/Form5472](http://www.irs.gov/Form5472) for instructions and the latest information.

**Part I Reporting Corporation** (see instructions). All reporting corporations must complete Part I.

**1a** Name of reporting corporation  
Number, street, and room or suite no. (if a P.O. box, see instructions.)  
City or town, state, and ZIP code (if a foreign address, see instructions.)

**1b** Employer identification number

**1c** Total assets \$

**1d** Principal business activity ▶

**1e** Principal business activity code ▶

**1f** Total value of gross payments made or received reported on this Form 5472. See instructions. \$

**1g** Total number of Forms 5472 filed for the tax year

**1h** Total value of gross payments made or received reported on all Forms 5472. See instructions. \$

**1i** Check here if this is a consolidated filing of Form 5472

**1j** Check here if this is the initial year for which the U.S. reporting corporation is filing a Form 5472

**1k** Total number of Parts VIII attached to Form 5472

**1l** Country of incorporation

**1m** Date of incorporation

**1n** Country(ies) under whose laws the reporting corporation files an income tax return as a resident

**1o** Principal country(ies) where business is conducted

**2** Check here if, at any time during the tax year, any foreign person owned, directly or indirectly, at least 50% of (a) the total voting power of all classes of the stock of the reporting corporation entitled to vote, or (b) the total value of all classes of stock of the reporting corporation

**3** Check here if the reporting corporation is a foreign-owned domestic disregarded entity (foreign-owned U.S. DE) treated as a corporation for purposes of section 6038A. See instructions

**Part II 25% Foreign Shareholder** (see instructions)  
Check here if any direct (or ultimate indirect) 25% foreign shareholder listed in Part II is a surrogate foreign corporation under section 7874(a)(2)(B).

**4a** Name and address of direct 25% foreign shareholder

**4b(1)** U.S. identifying number, if any

**4b(2)** Reference ID number (see instructions)

**4b(3)** Foreign taxpayer identification number (FTIN), if any (see instructions)

**4c** Principal country(ies) where business is conducted

**4d** Country of citizenship, organization, or incorporation

**4e** Country(ies) under whose laws the direct 25% foreign shareholder files an income tax return as a resident

**5a** Name and address of direct 25% foreign shareholder

**5b(1)** U.S. identifying number, if any

**5b(2)** Reference ID number (see instructions)

**5b(3)** FTIN, if any (see instructions)

**5c** Principal country(ies) where business is conducted

**5d** Country of citizenship, organization, or incorporation

**5e** Country(ies) under whose laws the direct 25% foreign shareholder files an income tax return as a resident

**6a** Name and address of ultimate indirect 25% foreign shareholder

**6b(1)** U.S. identifying number, if any

**6b(2)** Reference ID number (see instructions)

**6b(3)** FTIN, if any (see instructions)

**6c** Principal country(ies) where business is conducted

**6d** Country of citizenship, organization, or incorporation

**6e** Country(ies) under whose laws the ultimate indirect 25% foreign shareholder files an income tax return as a resident

**7a** Name and address of ultimate indirect 25% foreign shareholder

**7b(1)** U.S. identifying number, if any

**7b(2)** Reference ID number (see instructions)

**7b(3)** FTIN, if any (see instructions)

**7c** Principal country(ies) where business is conducted

**7d** Country of citizenship, organization, or incorporation

**7e** Country(ies) under whose laws the ultimate indirect 25% foreign shareholder files an income tax return as a resident

For Paperwork Reduction Act Notice, see instructions. Cat. No. 49987Y Form 5472 (Rev. 12-2021)

- Form 5472 filing requirement – Reporting corporation ownership attribution rules
- The constructive ownership rules of IRC § 318 apply with the following modifications to determine if a corporation is 25% foreign owned.
- Substitute “10%” for “50%” in IRC § 318(a)(2)(C).  
For attribution from corporations: A 10% or greater shareholder of the corporation owns proportionately what the corporation owns in another corporation.
- Do not apply IRC § 318(a)(3)(A), (B), and (C), so as to consider a U.S. person as owning stock that is owned by a foreign person. For attribution to entities, downward attribution from a foreign person is not applicable.

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

Form 5472 (Rev. 12-2021) Page 2

**Part III Related Party** (see instructions). All reporting corporations must complete this question and the rest of Part III. Check applicable box: Is the related party a  foreign person or  U.S. person?

**8a** Name and address of related party

**8b(1)** U.S. identifying number, if any **8b(2)** Reference ID number (see instructions) **8b(3)** FTIN, if any (see instructions)

**8c** Principal business activity **8d** Principal business activity code

**8e** Relationship—Check boxes that apply:  Related to reporting corporation  Related to 25% foreign shareholder  25% foreign shareholder

**8f** Principal country(ies) where business is conducted **8g** Country(ies) under whose laws the related party files an income tax return as a resident

**Part IV Monetary Transactions Between Reporting Corporations and Foreign Related Party** (see instructions)  
**Caution:** Part IV must be completed if the "foreign person" box is checked in the heading for Part III. If estimates are used, check here.

9	Sales of stock in trade (inventory)	9
10	Sales of tangible property other than stock in trade	10
11	Platform contribution transaction payments received	11
12	Cost sharing transaction payments received	12
13a	Rents received (for other than intangible property rights)	13a
b	Royalties received (for other than intangible property rights)	13b
14	Sales, leases, licenses, etc., of intangible property rights (for example, patents, trademarks, secret formulas)	14
15	Consideration received for technical, managerial, engineering, construction, scientific, or like services	15
16	Commissions received	16
17	Amounts borrowed (see instructions) a Beginning balance b Ending balance or monthly average	17b
18	Interest received	18
19	Premiums received for insurance or reinsurance	19
20	Loan guarantee fees received	20
21	Other amounts received (see instructions)	21
22	Total. Combine amounts on lines 9 through 21	22
23	Purchases of stock in trade (inventory)	23
24	Purchases of tangible property other than stock in trade	24
25	Platform contribution transaction payments paid	25
26	Cost sharing transaction payments paid	26
27a	Rents paid (for other than intangible property rights)	27a
b	Royalties paid (for other than intangible property rights)	27b
28	Purchases, leases, licenses, etc., of intangible property rights (for example, patents, trademarks, secret formulas)	28
29	Consideration paid for technical, managerial, engineering, construction, scientific, or like services	29
30	Commissions paid	30
31	Amounts loaned (see instructions) a Beginning balance b Ending balance or monthly average	31b
32	Interest paid	32
33	Premiums paid for insurance or reinsurance	33
34	Loan guarantee fees paid	34
35	Other amounts paid (see instructions)	35
36	Total. Combine amounts on lines 23 through 35	36

**Part V Reportable Transactions of a Reporting Corporation That Is a Foreign-Owned U.S. DE** (see instructions)  
Describe on an attached separate sheet any other transaction as defined by Regulations section 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, and check here.

**Part VI Nonmonetary and Less-Than-Full Consideration Transactions Between the Reporting Corporation and the Foreign Related Party** (see instructions)  
Describe these transactions on an attached separate sheet and check here.

Form 5472 (Rev. 12-2021)

- Form 5472, page 2, Part III report the name, address, identifying information for U.S. or foreign related party
- Only report specific amounts on Form 5472, page 2, Part IV if payment or accrual with respect to a foreign related party
- Reportable transactions of reporting corporations including U.S. disregarded entities with foreign related parties are reported on Form 5472, page 2, Part IV
- U.S. disregarded entities also report other transactions in connection with the formation, acquisition disposition, dissolution of the U.S. DRE per U.S. Treas. Reg. § 1.482-1(i)(7) including capital contributions and distributions on Form 5472, page 2, Part V on attached statement
- Form 5472, page 2, Part VI reports nonmonetary transactions and transactions for less than full monetary consideration (\*Could attract IRS scrutiny)

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

Form 5472 (Rev. 12-2021) Page **3**

**Part VII Additional Information.** All reporting corporations must complete Part VII.

37 Does the reporting corporation import goods from a foreign related party?  Yes  No

38a If "Yes," is the basis or inventory cost of the goods valued at greater than the customs value of the imported goods?  Yes  No

b If "Yes," attach a statement explaining the reason or reasons for such difference.

c If the answers to questions 37 and 38a are "Yes," were the documents used to support this treatment of the imported goods in existence and available in the United States at the time of filing Form 5472?  Yes  No

39 During the tax year, was the foreign parent corporation a participant in any cost sharing arrangement (CSA)?  Yes  No

40a During the tax year, did the reporting corporation pay or accrue any interest or royalty for which the deduction is not allowed under section 267A? See instructions.  Yes  No

b If "Yes," enter the total amount of the disallowed deductions \$ \_\_\_\_\_

41a Does the reporting corporation claim a foreign-derived intangible income (FDII) deduction (under section 250) with respect to amounts listed in Part IV?  Yes  No

b If "Yes," enter the amount of gross income derived from sales, leases, exchanges, or other dispositions (but not licenses) of property to the foreign related party that the reporting corporation included in its computation of foreign-derived deduction eligible income (FDDEI). See instructions. \$ \_\_\_\_\_

c If "Yes," enter the amount of gross income derived from a license of property to the foreign related party that the reporting corporation included in its computation of FDDEI. See instructions. \$ \_\_\_\_\_

d If "Yes," enter the amount of gross income derived from services provided to the foreign related party that the reporting corporation included in its computation of FDDEI. See instructions. \$ \_\_\_\_\_

42 Did the reporting corporation have any loan to or from the related party, to which the safe-haven rate rules of Regulations section 1.482-2(a)(2)(i)(B) are applicable, and for which the reporting corporation used a rate of interest within the safe-haven range of Regulations section 1.482-2(a)(2)(i)(B)(1) (100% to 130% of the AFR for the relevant term)?  Yes  No

43a Did the reporting corporation make at least one distribution or acquisition (as defined by Regulations section 1.385-3) during the tax year or, during the period beginning 36 months before the date of the respective acquisition or distribution and ending 36 months afterward, did the reporting corporation issue or refinance indebtedness owed to a related party?  Yes  No

b If the answer to question 43a is "Yes," provide the following:

(i) The amount of such distribution(s) and acquisition(s) \$ \_\_\_\_\_

(ii) The amount of such related party indebtedness \$ \_\_\_\_\_

**Part VIII Cost Sharing Arrangement (CSA)**

Note: Complete a separate Part VIII for each CSA in which the reporting corporation was a participant during the tax year. Report all amounts in U.S. dollars. (See instructions.)

44 Provide a brief description of the CSA with respect to which this Part VIII is being completed.

45 During the course of the tax year, did the reporting corporation become a participant in the CSA?  Yes  No

46 Was the CSA in effect before January 5, 2009?  Yes  No

47 What was the reporting corporation's share of reasonably anticipated benefits for the CSA? % \_\_\_\_\_

48a Enter the total amount of stock-based compensation deductions claimed by the reporting corporation \$ \_\_\_\_\_

b Enter the total amount of deductions for the tax year for stock-based compensation that was granted during the term of the CSA and, at date of grant, is directly identified with, or reasonably allocable to, the intangible development activity under the CSA. \$ \_\_\_\_\_

c Was there any stock-based compensation granted during the term of the CSA to individuals who performed functions in business activities that generate cost shared intangibles that was not treated as directly identified with, or reasonably allocable to, the intangible development activity?  Yes  No

48b Enter the total amount of intangible development costs for the CSA \$ \_\_\_\_\_

b Enter the amount of intangible development costs allocable to the reporting corporation based on the reporting corporation's reasonably anticipated benefits share \$ \_\_\_\_\_

**Part IX Base Erosion Payments and Base Erosion Tax Benefits Under Section 59A** (see instructions)

50 Amounts defined as base erosion payments under section 59A(c) \$ \_\_\_\_\_

51 Amount of base erosion tax benefits under section 59A(c)(2) \$ \_\_\_\_\_

52 Amount of total qualified derivative payments as described in section 59A(f) made by the reporting corporation \$ \_\_\_\_\_

53 Reserved for future use

Form **5472** (Rev. 12-2021)

- **Form 5472, page 3, Part VII Additional Information – Pay attention**
  - Import of goods from related party
  - Cost Sharing Arrangement (U.S. Treas. Reg. § 1.482-7)
  - Payment or accrual of interest or royalty expense subject to IRC § 267A disallowance
  - IRC § 250 FDII deduction (U.S. C corporation)
  - Intercompany related party debt with IRC § 482 safe-haven interest rate
  - Issuance or refinance of intercompany related party debt
  - U.S. Treas. Reg. § 1.385-3 distribution or acquisition
- **Part VIII Cost Sharing Arrangement (CSA)**
- **Part IX IRC § 59A Base Erosion and Anti-Abuse Tax (BEAT) Reporting**

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

- **Form 5472 Reporting exceptions – A reporting corporation is not required to file Form 5472 if any of the following apply.**

1. It had no reportable transactions of the types listed in Parts IV and VI of the form and, in the case of a reporting corporation that is a foreign-owned U.S. disregarded entity, also had no reportable transactions of the type listed in Part V of the form.

2. A U.S. person that controls the foreign related corporation files Form 5471 for the tax year to report information under IRC § 6038. To qualify for this exception, the U.S. person must complete Schedule M (Form 5471) showing all reportable transactions between the reporting corporation and the related party for the tax year. This exception does not apply to foreign-owned U.S. disregarded entities.

3. The related corporation qualifies as a foreign sales corporation for the tax year and files Form 1120-FSC. This exception does not apply to foreign-owned U.S. disregarded entities.

4. It is a foreign corporation that does not have a permanent establishment in the United States under an applicable income tax treaty and timely files Form 8833.

5. It is a foreign corporation all of whose gross income is exempt from taxation under IRC § 883 and it timely and fully complies with the reporting requirements of IRC §§ 883 and 887.

6. Both the reporting corporation and the related party are not U.S. persons as defined in IRC § 7701(a)(30) and the transactions will not generate in any tax year:

- a. Gross income from sources within the United States or income effectively connected, or treated as effectively connected, with the conduct of a trade or business within the United States; or
- b. Any expense, loss, or other deduction that is allocable or apportionable to such income.

**Note.** Exception 6 does not apply to foreign-owned U.S. disregarded entities.

## Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

- **Form 5472 Reporting for U.S. members of consolidated group filing a U.S. federal Form 1120 consolidated corporate income tax return**
- If a reporting corporation is a member of an affiliated group filing a U.S. federal Form 1120 consolidated corporate income tax return, U.S. Treas. Reg. § 1.6038A-2 may be satisfied by filing a U.S. federal consolidated Form 5472. The common parent must attach to Form 5472 a schedule stating which members of the U.S. affiliated group are reporting corporations under IRC § 6038A, and which of those members are joining in the consolidated filing of Form 5472. The schedule must show the name, address, and employer identification number (EIN) of each member who is including transactions on the consolidated Form 5472.
- **Note.** A member is not required to join in filing a consolidated Form 5472 just because the other members of the group choose to file one or more Forms 5472 on a consolidated basis.

# Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

## ▪ **Form 5472 Reporting penalties:**

- \$25K USD penalty for the failure to file each Form 5472 for a reporting corporation per year
  - ❑ Separate Form 5472 required for each related party
- \$25K USD penalty for substantially incomplete Form 5472
  - ❑ Substantially incomplete Form 5472 = failure to file
- Each member of a group of corporations filing a U.S. federal Form 1120 consolidated corporate income tax return is a separate reporting corporation subject to a separate \$25K USD penalty and each member is jointly and severally liable.
- **Continuation penalty:** Additional \$25K USD penalty if the failure to file Form 5472 continues for more than 90 days after notification by the IRS. This penalty applies with respect to each related party for which a failure occurs for each 30-day period (or part of a 30-day period) during which the failure continues after the 90-day period ends.
- Criminal penalties under IRC §§ 7203, 7206, and 7207 also may apply for failure to submit information or for filing false or fraudulent information.

## Preparing Form 1120-F for Foreign Corporations: 2021 Revisions, ECI, Protective Claims, and Branch Profits Tax

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## Alison N. Dougherty, J.D., LL.M., CPA Managing Member, Googolplex Tax Services, LLC

Alison N. Dougherty provides U.S. tax reporting, compliance, consulting, planning, and structuring solutions to U.S. and foreign corporations, partnerships, LLCs, individuals, and trusts. Alison specializes in U.S. international tax reporting and compliance with the preparation and review of the U.S. federal Forms 5471, 926, 8992, 8993, 5472, 8865, 8858, 8621, 8804, 8805, Schedules K-2 and K-3, 1116, 1118, 1042, 1042-T, 1042-S, 8832, 8833, 2555, 3520, 3520-A, 5713, 1120-F, 1040-NR, 8288, 8288-A, 8288-B, 8233, 8840, 8843, 8854, 8938, and FBAR. She has extensive experience working with U.S. businesses and individuals with outbound activities in foreign countries. She has also worked with foreign companies and nonresident individuals with inbound activities in the United States. She has significant experience with U.S. nonresident withholding tax, foreign partnership withholding tax, and FIRPTA withholding tax. She has managed U.S. tax compliance and advisory client engagements for U.S. C corporations, S corporations, partnerships, LLCs, U.S. individuals, U.S. trusts, foreign corporations, foreign partnerships, foreign LLCs, nonresident individuals, and foreign trusts.

Alison is a CPA and a tax attorney with more than 15 years of combined experience in public accounting, the practice of law, and corporate industry. Alison was previously a tax partner in a large regional public accounting firm in the Washington, DC area. She has served clients in various industries including technology, U.S. government contracting, commercial services, telecommunications, real estate, investment partnerships, commodities, high net worth individuals, and family offices. She has also served as a technical resource to other CPAs, accountants, tax professionals, public accounting firms, attorneys, and law firms.

Alison is focused on simplifying and making the U.S. international tax reporting process efficient and cost-effective for U.S. taxpayers and tax professionals. Her business goals include developing proprietary U.S. international tax reporting software applications to provide leading-edge technology driven solutions.

### Education:

AICPA U.S. International Tax Certificate, January 1, 2021  
Master of Laws (LL.M.) in Securities and Financial Regulation, conferred with academic distinction,  
Georgetown University Law Center, May 23, 2004  
Master of Laws (LL.M.) in Taxation, University of Denver College of Law, August 11, 2000  
Juris Doctor, University of Denver College of Law, August 13, 1999  
Bachelor of Arts in Foreign Language (French), Virginia Commonwealth University, May 20, 1995



Email: [adougherty@googolplextax.com](mailto:adougherty@googolplextax.com)  
Telephone: (301) 857-7611