



MASTERING FORM 5472

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TOPICS COVERED

- Overview and Background
- Key Terms and Definitions
- Filing Requirements
- Exceptions to Filing
- Completing the Form 5472
- Penalties and Remediation
- New Reporting Requirements for Foreign Owned DREs – Covered by Daniel

OVERVIEW AND BACKGROUND

- Form 5472 – Information Return of a 25% Foreign-Owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business
 - Reporting required under 6038A and 6038C
- Information reporting on transactions between related parties.
 - Provides the IRS data on related party transactions and pricing.
 - Focus on transactions that may affect the determination of US taxable income.
 - Also provides IRS data on payments of US sourced income that may be subject to withholding.
- International Tax Enforcement
 - Global efforts to combat base erosion, hybrid instruments - BEPS, CBCR, ATAD.
 - Cooperation between tax authorities (J5)
 - Push towards global transparency – FATCA, CRS
 - IRS LB&I Campaigns – Related Party Transactions Campaign, Form 1120-F Non-Filer Campaign, Inbound Distributor Campaign

BACKGROUND – ENFORCEMENT ENVIRONMENT

Inbound Distributor Campaign -

- “U.S. distributors of goods sourced from foreign-related parties have incurred losses or small profits on U.S. returns, which are not commensurate with the functions performed and risks assumed. In many cases, the U.S. taxpayer would be entitled to higher returns in arms-length transactions. LB&I has developed a comprehensive training strategy for this campaign that will aid revenue agents as they examine this IRC Section 482 issue. The treatment stream for this campaign will be issue-based examinations.”

KEY TERMS AND DEFINITIONS

- Reporting Corporation (“RC”):
 - 25% foreign owned US corporation (by vote or value).
 - Foreign corporation engaged in a US trade or business.
- 25% foreign owned corporation:
 - At least one direct or indirect 25% or greater foreign shareholder at any time during the year. Constructive ownership and attribution rules of 318 apply with modifications.
- Related Party includes:
 - A direct or indirect 25% foreign shareholder of the RC
 - Related person to RC or related person to 25% foreign shareholder of RC under 267(b) or 707(b)(1)
 - Any other person who is related under 482 or the regulations thereunder.
 - Does not include a corporation filing a consolidated return with RC.
 - Rules of 318 apply with same modifications.

KEY TERMS AND DEFINITIONS

- Direct 25% foreign shareholder – A foreign person that directly owns at least 25% of the stock by vote or value
- Ultimate indirect 25% foreign shareholder – 25% shareholders whose interests are not attributed through entity attribution to another 25% foreign shareholder.
 - Chain of entities – top entity or individual 25% foreign shareholder.
 - Ownership of stock of the RC is not attributed under the principles of 958(a) to any other 25% foreign shareholder.
- Foreign person
 - Individuals who are not citizens or residents of the US.
 - Individuals who are citizens or residents of a US possession but not otherwise a citizen or resident of the US.
 - Individuals do not include individuals filing joint return with US persons.
 - Foreign entities – foreign partnerships, corporations, trusts, and estates.
 - Foreign government or related entity engaged in a commercial activity under 892.

ATTRIBUTION AND RELATED PARTIES

- Modification to 318 attribution rules:
 - Stock attribution threshold from corporation to shareholder reduced to 10% instead of 50%.
 - No attribution from a foreign partners, beneficiaries, or shareholders to US partnerships, trusts, estates, or corporations
- Attribution under 318 overview:
 - From family (spouse, parents, children, grandchildren)
 - From partnerships, trust, estates, and corporations, proportionately.
 - To partnerships, trusts, and estates. To corporations where more than 50% owned.
- Related parties under 267 / 707 overview:
 - Members of family (also includes siblings)
 - Fiduciary of a trust and: the grantor, beneficiary, fiduciary or beneficiary of another trust with same grantor, corporation more than 50% owned by grantor.
 - A corporation and: individual owning more than 50% of stock, partnership or another corporation if same person owns more than 50% of each.
 - Partnership and: person owning more than 50%, another partnership in which same person owns more than 50%

KEY TERMS AND DEFINITIONS

- Reportable Transactions – Any transaction listed on Part IV page 2 of the Form 5472
 - Big picture – any transaction that affects taxable income of reporting corporation.
 - Includes transactions for which monetary consideration was the sole consideration (Part IV). Also includes transactions for which any part of the consideration was not monetary or less than full consideration was paid or received (Part VI).
 - Expanded reported for DREs (covered later).

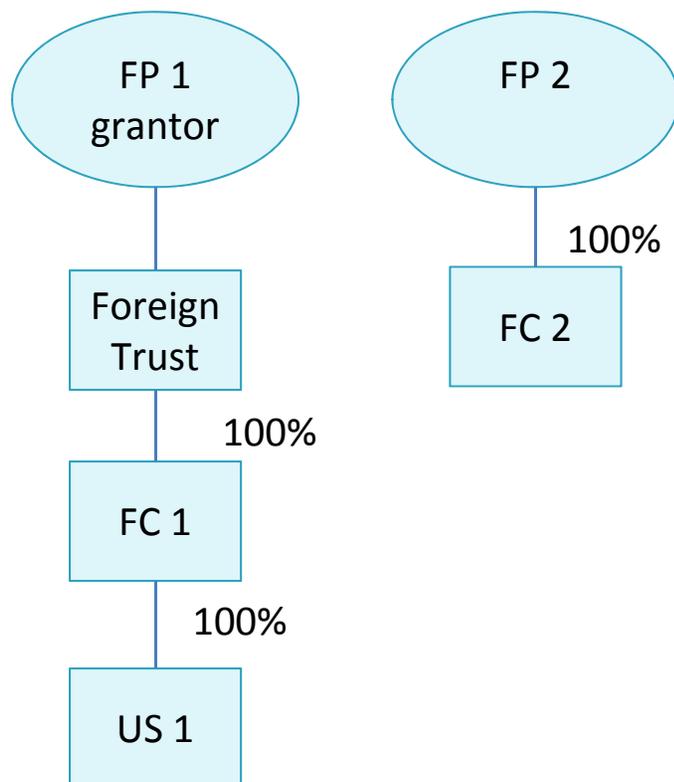
KEY TERMS AND DEFINITIONS

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 <input type="checkbox"/>	
1	Sales of stock in trade (inventory)
2	Sales of tangible property other than stock in trade
3	Platform contribution transaction payments received
4	Cost sharing transaction payments received
5a	Rents received (for other than intangible property rights)
b	Royalties received (for other than intangible property rights)
6	Sales, leases, licenses, etc., of intangible property rights (e.g., patents, trademarks, secret formulas)
7	Consideration received for technical, managerial, engineering, construction, scientific, or like services
8	Commissions received
9	Amounts borrowed (see instructions) a Beginning balance <input type="text"/> b Ending balance or monthly average <input type="checkbox"/>
10	Interest received
11	Premiums received for insurance or reinsurance
12	Other amounts received (see instructions)
13	Total. Combine amounts on lines 1 through 12
14	Purchases of stock in trade (inventory)
15	Purchases of tangible property other than stock in trade
16	Platform contribution transaction payments paid
17	Cost sharing transaction payments paid
18a	Rents paid (for other than intangible property rights)
b	Royalties paid (for other than intangible property rights)
19	Purchases, leases, licenses, etc., of intangible property rights (e.g., patents, trademarks, secret formulas)
20	Consideration paid for technical, managerial, engineering, construction, scientific, or like services
21	Commissions paid
22	Amounts loaned (see instructions) a Beginning balance <input type="text"/> b Ending balance or monthly average <input type="checkbox"/>
23	Interest paid
24	Premiums paid for insurance or reinsurance
25	Other amounts paid (see instructions)
26	Total. Combine amounts on lines 14 through 25

FILING REQUIREMENTS

- Subject to exceptions every **reporting corporation** must file a Form 5472 if it had a **reportable transaction** with a foreign or domestic **related party**.
- A reporting corporation files a separate Form 5472 for each related party that it had reportable transactions with.
- Consolidated filings - Corporations that are members of a group with a consolidated filing can file a consolidated Form 5472
- Separate form each related party outside of the group with reportable transactions.
- Parent attaches schedule stating which members are reporting corporations and which members are included in consolidated filing.
- Members are not required to join consolidated filings.
- Form 5472 is filed with the reporting corporation's income tax return by the due date including extensions.

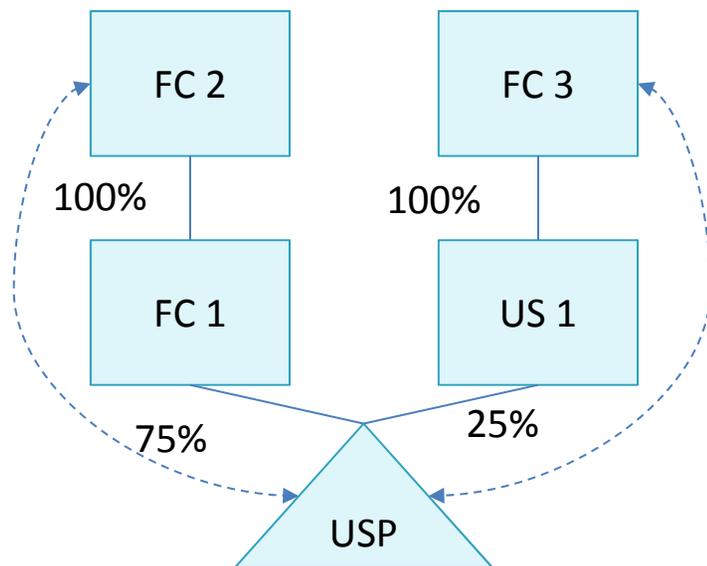
EXAMPLE – DEFINITIONS, ATTRIBUTION, FILING REQUIREMENTS



- US 1 is a reporting corporation because it is a US corporation with a 25% foreign shareholder.
- FC 1 is a direct 25% foreign shareholder
- FP 1, Foreign Trust, and FC 1 are 25% foreign shareholders and related parties.
- FP 1 is an ultimate indirect 25% shareholder.
- If FP 1 is FP 2's parent then FP 2 and FC 2 are also 25% foreign shareholders and related parties.
- If there is a reportable transaction between US 1 and any related party then US 1 must file a Form 5472.
- If there is a reportable transaction between US 1 and each related party then US 1 must file 5 Forms 5472.
- If there are no reportable transactions between US 1 and any related party then US 1 is not required to file Form 5472.

EXAMPLE – PARTNER IN A PARTNERSHIP

Example from 1.6038A-1



- USP is engaged in a US trade or business.
- USP has reportable transactions with FC 2 and FC 3.
- The transactions that USP enters into are attributed to FC 1 and US 1.
- FC 1 is considered to be engaged in a US trade or business by being a partner in a partnership.
- Both FC 1 and US 1 are reporting corporations that must file Form 5472.
- FC 1 must report its 75% share of transactions with FC 2 and US 1 must report its 25% share of transactions with FC 3.

EXCEPTIONS TO FILING

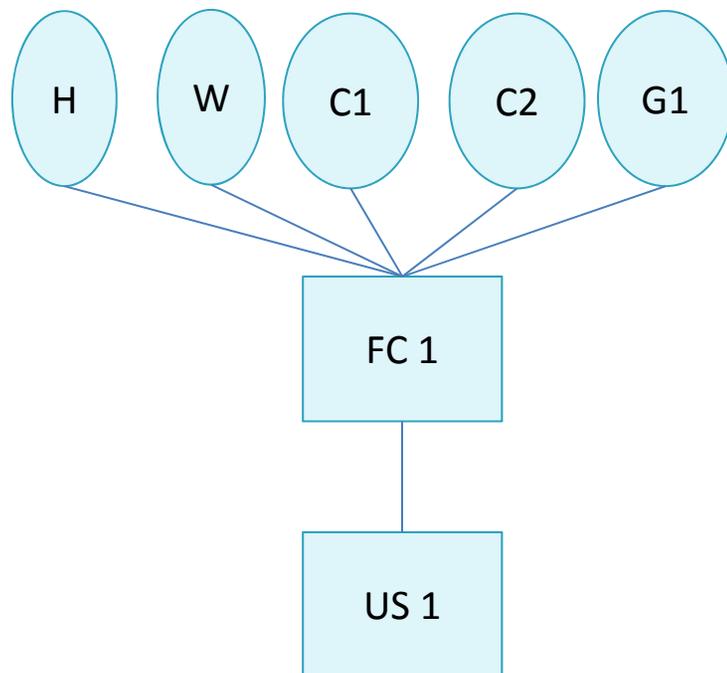
- I. No reportable transactions.
- II. US person controlling foreign related corporation files Form 5471 and reports all reportable transactions on Schedule M (does not apply to DRE).
- III. Related corporation qualifies as a foreign sales corporation for the tax year and files Form 1120-FSC (does not apply to DRE).
- IV. Foreign corporation that does not have a PE in the US and timely files Form 8833.
- V. Foreign shipping and airline companies that are exempt under 883 that comply with related reporting requirements.
- VI. Neither the reporting corporation or related party are US persons and the transactions do not generate any US source gross income or ECI or any expenses, losses, or deductions that are attributed to such income.

COMPLETING THE FORM 5472

- Identifying information – Parts I, II, and III
 - All reporting corporations complete Part I and Part III to identify reporting corporation and related party respectively.
 - 25% foreign owned US corporations also complete Part II to identify direct and ultimate 25% foreign shareholders.
 - Report direct and ultimate foreign shareholders.
 - Regulations imply that all direct and indirect 25% foreign shareholders should be reported.
 - Rev Proc 91-55 limits reporting. Form is consistent.

EXAMPLE – REPORTING DIRECT AND ULTIMATE FOREIGN SHAREHOLDER

Example from Rev Proc 91-55



- US 1 is a reporting corporation because it is a US corporation with a 25% foreign shareholder.
- FC 1 owns 100% of US 1 and is a direct 25% foreign shareholder
- Individual owners of FC1 own 20% each, are all foreign people, and family members H – Husband, W – Wife, C1/C2 - child 1 and child 2, G1 - grandchild.
- Under attribution rules of 318 each of the individuals are 25 percent foreign shareholders. Their interests are not attributed to another person under 958(a).
- Report FC 1 as a direct foreign shareholder. Report any two individuals on Form 5472 as ultimate indirect foreign shareholders. Include an attachment identifying remaining individuals as ultimate foreign shareholders.

COMPLETING THE FORM 5472

- Transactions with Foreign Related Parties – Parts IV, VI
 - Parts IV and VI are completed for transactions with foreign related parties.
 - Not required for transactions with domestic related parties.
 - Part IV – Only monetary consideration is paid or received.
 - Part VI – Nonmonetary consideration or less than full consideration.
- Amounts ‘paid’ or ‘received’ are reported according to the RC’s method of accounting.
 - Accrual basis RC uses accrued amounts to report on the Form 5472.
- Reporting in USD. A schedule showing the FX rates used should be attached.
- Reasonable Estimates – When amounts are not determinable reasonable estimates may be used for monetary transactions. Reasonable estimate 75%-125%
- Relief for small amounts – For transactions less than \$50,000 the amount may be reported as “50,000 or less”
- Amounts borrowed and loaned – Report either beginning and ending balances or monthly average balance.

COMPLETING THE FORM 5472

- Part VI – Transactions must be described in a statement attached to Form 5472. Statement should include information to determine nature and monetary value including:
 - Description of all property, rights, or obligations transferred (including monetary).
 - Description of all services performed.
 - Reasonable estimate of the fair market value of all properties and services exchanged if possible. Otherwise some other reasonable indicator of value.

COMPLETING THE FORM 5472

- Additional Information – Part VII
 - Must be completed by all reporting corporations.
 - Highlights two transfer pricing issues which are
 - Tax/customs value discrepancies Part IV – see §1059A
 - Cost sharing arrangements – see Reg § 1.482-7

RECORDS AND MAINTENANCE

- Reporting corporations must maintain records relevant to determining the treatment of transactions with related parties.
- If records are not properly maintained and furnished to the IRS upon request then:
 - IRS may determine what the appropriate deductions should be based on their own knowledge.
 - Penalties may also apply. Same as missed form.
- ‘Small corporation’ and de minimis value exception:
 - Less than \$10mil in gross receipts or
 - Aggregate of RC’s reportable transactions with foreign related parties are less than \$5mil **and** 10 percent of US gross income.
 - Subject to general record keeping and maintenance requirements.

PENALTIES AND REMEDIATION

- Penalties for failure to file penalty and/or failure to maintain records under 6038A.
- For years beginning before 12/31/17
 - \$10,000 failure to file penalty for each late or incomplete Form 5472
 - If not filed within 90 days after IRS notice of failure an additional \$10,000 penalty (per related party for which a failure occurs) is charged for each 30-day period, or fraction thereof.
- After 12/31/17 – Penalty increased to \$25,000.
- IRC §6501(c)(8) – Will keep the statute of limitations open indefinitely on the entire return.

PENALTIES AND REMEDIATION

- Penalties may be waived if reasonable cause can be shown.
- Reasonable cause – Where taxpayer can demonstrate that failures to file are due to reasonable cause and not due to willful neglect.
- The regulations under Reg §1.6038A-4 contain unique rules for reasonable cause:
 - IRS instructed to “apply the reasonable cause exception liberally” to a corporation with less than \$20mil in gross receipts, limited presence in the US, no knowledge of the filing requirements, and compliant with requests related to the Form 5472.
 - Reliance on information available where Taxpayer does not or did not know that it was owned by a 25 percent foreign shareholder.
- Ordinary business care and prudence standard.

PENALTIES AND REMEDIATION

- Reliance on a professional advisor constitutes reasonable cause where special training is required – *US v. Boyle*
- *Neonatology Assocs., P.A.* – confirms that taxpayers may rely on a professional advisor and establishes three factors for reliance:
 - The advisor was a competent professional with sufficient expertise to justify reliance.
 - The taxpayer provided necessary and accurate information to the adviser.
 - The taxpayer actually relied in good faith on the adviser's judgement.
- Reliance on a professional advisor continues to be upheld – See *James v. US*
- Complexity is a factor that should be considered – IRM, Court cases – *Congdon v. US*, *Dillin v. Commissioner*



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