

# FOREIGN OWNED, SINGLE-MEMBER L.L.C.'S: PROPOSED REGULATIONS IMMINENT?

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## Tags

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According to a statement made by Treasury Deputy Assistant Secretary for International Tax Affairs Robert Stack, the I.R.S. will soon publish proposed regulations that will treat foreign owned, single-member limited liability companies (“L.L.C.’s”) as corporations for U.S. reporting purposes. The proposed regulations are the first step in an initiative, under the Treasury’s 2015-2016 Priority Guidance Plan, to write regulations and other guidance to treat disregarded entities as corporations for purposes of reporting and record-keeping under Code §6038A and related provisions.

## BACKGROUND

L.L.C.’s are formed under state laws, which generally do not require that the state have the knowledge of the L.L.C.’s owners in order for the company to be formed. Under current Federal tax law, a single-member L.L.C. is not recognized as an entity separate from its owner, unless the owner elects to treat the entity as a corporation by filing Form 8832. Most states treat L.L.C.’s in a similar manner.

Because a single-member L.L.C. is a disregarded entity, no reporting obligations apply to the entity itself. The L.L.C.’s income and assets are treated as being owned by the single member and are subject to the reporting obligations applicable to that member. Therefore, unless there is sufficient nexus to the U.S. – through business activities or offices – the L.L.C. is not subject to reporting or tax in the U.S., and in certain circumstances, the entity will not even have a U.S. tax identification number.

Taking advantage of this treatment, a common practice involves incorporating a company offshore in a location where there is no tax, such as the Bahamas, and having the foreign corporation form a U.S. L.L.C. The L.L.C. will typically have the same name as the offshore company, so that it appears to be one and the same. To the unwary, assets owned by the U.S. L.L.C. – both in and outside the U.S. – appear to be owned by a U.S. entity. However, because U.S. tax rules treat the foreign company as the owner, no reporting is due in the U.S., and no income is taxed in the U.S. – unless it is from U.S. sources. This abusive structure results in, for example, a Bahamian company that has the guise of as a U.S. entity but is free from U.S. tax and free from the inconvenience of U.S. reporting obligations. According to Mr. Stack, these entities “can pose a tax transparency risk” and can “be used to dodge non-U.S. taxes, or to shield the true beneficial owners of a foreign bank account.”

## FORTHCOMING REGULATIONS

Once finalized, the new regulations will shut down this use of an L.L.C. in international structures. The regulations will allow the I.R.S. to require information returns from foreign owned, single-member L.L.C.’s, which at the very least, will be required to provide a tax identification number. Thus, the entities will be forced to disclose their

owners. It is anticipated that the information reporting requirements will be similar to those included in Schedule K of a corporate tax return (Form 1120), which generally reports ownership of other entities, including foreign or domestic partnerships and certain distributions made by the company.

The proposed regulations are part of a broader attempt to change the framework of reporting to enable the I.R.S. to obtain information on the beneficial ownership of certain single-member L.L.C.'s. The the need to improve beneficial ownership reporting was apparent in a November 2013 peer review by the O.E.C.D.'s Global Forum on Transparency and Exchange of Information for Tax Purposes, according to which F.A.T.F. (Financial Action Task Force) rated the U.S. as non-compliant with respect to beneficial ownership recommendations.

Because the income tax treatment of single-member L.L.C.'s is not expected to change, it is anticipated that these regulations will help prevent non-U.S. tax avoidance by allowing the I.R.S. to respond to requests about the entities from other tax authorities under U.S. tax treaties and tax information exchange agreements

