PENALTY INCREASED FOR FAILURE TO TIMELY FILE FORM 5472

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The Tax Cuts and Jobs Act was enacted on December 22, 2017 and made several headline-worthy changes to us federal income tax laws. Other changes are buried in the legislation, such as the drastic increase in the penalty for failure to file in a timely manner an IRS form 5472, "Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business." For tax years beginning after December 31, 2017, the Act increased the penalty to $25,000 from $10,000 for each return that must be filed.

In general, a reporting corporation that engages in a reportable transaction with a foreign or domestic related party must file form 5472. A reporting corporation includes a 25 percent foreign-owned us corporation and a foreign corporation engaged in a US trade or business. However, it is notable that a foreign corporation that has no PE in the United States under an income tax treaty (such as a Canco under the Canada-us income tax treaty) is not a reporting corporation if it timely files IRS form 8833, "Treaty-Based Return Position Disclosure." Reportable transactions generally include monetary and certain non-monetary transactions (such as sales, purchases, rents, interest, and loans) between the reporting corporation and the foreign owner or between the reporting corporation and any US or foreign related party. Thus, for example, if a Canco wholly owns a US corporation and the US corporation pays interest to the Canco, the US corporation must file form 5472 to report the interest paid to the Canco.

In December 2016, the IRS issued final regulations that extended the form 5472 reporting requirement to US-disregarded entities that had a single foreign owner (such as a US singlemember LLC). The foreign-owned US-disregarded entity generally must file form 5472 to report transactions with its sole owner or other affiliates, as if it were a US corporation. For such disregarded entities, the final regulations expanded the definition of reportable transactions to include amounts paid or received in connection with the formation, dissolution, acquisition, or disposition of the entity, including contributions to or distributions from the entity. This new reporting requirement applied to taxable years beginning on or after January 1, 2017.

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The IRS recently updated form 5472 and its instructions to reflect the changes imposed by the final regulations of December 2016. Because US-disregarded entities generally do not have a US income tax-filing requirement, US-disregarded entities subject to this new reporting requirement must go through additional administrative hurdles in order to comply with the new form 5472 filing requirement. For example, a US-disregarded entity subject to this filing requirement must obtain a US employer identification number (EIN), which can be a difficult process if the foreign owner does not already have a US taxpayer identification number. Moreover, the form 5472 instructions provide that foreign-owned US-disregarded entities must attach the form 5472 to a pro forma form 1120 ("U.S. Corporation Income Tax Return"), meaning that those entities must now file a US income tax return (that is, the pro forma form 1120).

The IRS automatically imposes the penalty when a form 5472 is filed late. Because a reporting corporation must file a separate form 5472 to report reportable transactions with respect to each related party, the number of penalties imposed on a reporting corporation that fails to file the required forms in a timely manner can quickly add up. The penalty, however, can be abated if the reporting corporation demonstrates that its failure to timely file the required forms was due to reasonable cause. Notably, there is a relaxed reasonable-cause standard for "small" corporations (gross receipts are $20 million or less) that have limited presence in, and contact with, the United States.

Because of the onerous and yet automatic penalty for the late filing of a form 5472, a Canadian corporation with US operations and a US corporation with Canadian owners must evaluate potential form 5472 filing requirements. If that form must be filed, it is imperative that filing be timely. The extension of form 5472 reporting requirements to US-disregarded entities is likely of less relevance to Canadians, considering that they often avoid owning US LLCs for other tax reasons, but a Canadian adviser to the Canadian who does own a US LLC should also keep this new filing requirement on the radar.