TULSA CHAPTER OSCPA

International Tax Issues for Oklahoma Business

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A. REPORTING ISSUES

Note that the filing requirements for foreign items have various penalties for noncompliance, generally including criminal penalties.
IRS Offshore Voluntary Disclosure Program (OVDP) is streamlined by IR 2014-73, providing relief for taxpayers with unreported accounts who are "non-willful taxpayers."

1. Form TDF 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR") has changed to FinCEN Form 114 (Oct. 2013)

   Due June 30 where accounts exceed $10,000 in value at any time during the prior calendar year. Includes signature authority for an account owned by a third party (such as an employer) and includes accounts held by a legal entity where a U.S. person owns directly or indirectly more than 50% of the entity. U.S. tax returns also have a question to answer (e.g., Form 1040, Schedule B, Part III and Form 1120, Schedule N).

   Report maximum value: "The maximum value of an account is a reasonable approximation of the greatest value of currency or nonmonetary assets in the account during the calendar year."

   FBAR Hotline: 866-270-0733

   Required e-filing on BSA E-Filing System (Federal Crimes Enforcement Network/Bank Secrecy Act) at www.fincen.gov. Go to BSA efile lower left, then submit User Application.

   Preparers can file for clients; get authorization Form 114a signed by client.

   In March 2014, the IRS put a nice 11 page FBAR Reference Guide on its website.

2. Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation

3. Form 3520, Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

   a. Also Form 3520-A, Annual Information Return of Foreign Trust with U.S. Owner

   b. Gifts over $100,000 from a nonresident alien or foreign estate, or over $14,165 from a foreign corporation or partnership

4. Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations

   To report acquisition of a 10% or greater interest in a foreign corporation. An <u>imposing</u> form which, by itself, can discourage taxpayers from owning a foreign corporation due to extensive information requirements and serious penalties for non-reporting. The form enables the IRS to identify Subpart F income and potential intercompany pricing issues.

5. Form 5472, Information Return with Respect to a Foreign Corporation

   To report a corporation that is owned 25% or more by nonresident foreign shareholders or foreign entities.

6. Form 5713, International Boycott Report

   Boycott questionnaire where your activities may be only that you know that some of the goods you sell are going to Kuwait, Lebanon, Libya, Qatar, Saudi Arabia. Syria, United Arab Emirates or Yemen. Recent deletions are Bahrain and Oman. Countries are now actually **listed** in the instructions. (What a nice change!)

7. Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)

   Disclosure of tax return filing based on favorable treaty provisions. Treaty provisions generally override the I.R.C. and are generally to eliminate duplicate taxation. IRS Publication 901 is helpful.

8. Form 8858, Information Return of U,S. Persons with Respect to Foreign Disregarded Entities

9. Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships

   To report acquisition of a 10% or greater interest in a foreign partnership effective for partnership years ending on or after December 31, 2000.

10. Form 8938, Statement of Foreign Financial Assets

    Mandated by new I.R.C. Section 6038 D for years beginning after March 18, 2010 by HIRE Act of 2010 (P.L. 111-147). Attach to tax return when aggregate value of foreign financial assets exceeds $50,000. See Notice 2011-55. Required in addition to FBAR (Item #1 above).

B. STRUCTURE FOR A U.S. OWNED FOREIGN BUSINESS

1. Form 8832, Entity Classification Election

   Very useful in structuring a foreign business
   Legal entities not classified as corporations—See listing at Reg. 301.7701-2(b)(8)
   Now page 7 of instructions (Bad: AG or SA, Good: Gmbh or Limitada)
   If your entity is not on this list, you can elect treatment as a partnership or a disregarded entity (single owner) on Form 8832. File within 75 days after effective date. Late election relief is available under Rev. Proc. 2009-41. No user fee if reasonable cause exists.

2. The Importance of Properly Structuring Your Foreign Business

   The main pitfall to avoid is a foreign loss incurred by a foreign corporation which is a) not immediately usable by the U.S. owner and b) could ultimately become an unusable capital loss. For a U.S. corporation in this position, Sec. 165(g)(3), Rev. Rul. 70-489 and PLR 9403010 may offer a way to get an ordinary loss.

   Most recent item on this issue is a 2011 Chief Counsel Memo—AM2011-03 (8/26/11), where the U.S. corporate shareholder of a foreign entity was able to recognize a deductible loss under Section 165(g)(3) when its foreign subsidiary filed Form 8832 election to be a partnership.

3. Using a U.S. Entity to Own a Foreign Business

   Using a U.S. entity (LLC or corporate subsidiary) to own your foreign business is often the best structure for an individual and a corporate owner. A foreign corporation is usually a dangerous structure, often resulting in unusable losses or foreign tax credits which are not effectively utilized.

4. Subpart F Income—Sections 951—964

   Rules under which income of a U.S. owned foreign corporation is triggered as U.S. taxable income, such as investing in U.S. property (Section 956).

C. SALES FACTOR

Possible state apportionment benefit for export sales under 1982 California case: Appeal of Dresser. California and Oklahoma have a "Throwback Rule" under which sales shipped to other states are treated as in-state sales if the seller is exempt in the destination state. The Dresser decision held that Public Law 86-272 (exemption for sales solicitation activities) is not applicable to export sales, and the export sales were not treated as California sales. The same result should apply for Oklahoma purposes. Note the variance between 68 O.S. Sec. 2358 "...the taxpayer is not doing business in the state of the destination of the shipment" and the language on the sales portion of the "Apportionment Formula" section of the Oklahoma income tax return "(ii) Purchasers in a state or country where the corporation is not taxable."

Rule 710:50-17-71(1)(B) reads as follows: "**Throwback of Oklahoma sales.** If taxpayer is not doing business in the destination state of the shipment, then those sales of tangible personal property are considered to have situs in Oklahoma if the property is shipped from an office, warehouse, factory or other place of storage in Oklahoma."

D. FOREIGN TAX CREDITS (IRC SECTION 901)

Individual—Form 1116 (See IRS Publication 514)
Corporation—Form 1118

1. Deduction Alternative

   Annual election and you can amend for 10 years after filing

2. Limitations

   a. Percentage Limitation (Section 904(a)(C)(1):

      Foreign Taxable Income
      ------------------------------ X U.S. Tax
      Total Taxable Income

      This is an annual calculation, so excess credits can result if total taxable income is low or nil in a particular year. The same calculation is used to determine an AMT FTC.

   b. Baskets for Limitations

      (1) General Limitation (Wages and business income)—This is usually the problem area.

      (2) Passive Limitation (Rents, royalties, interest and dividends)

      (3) Other

3. Election to Accrue the Foreign Tax (Check the box)

   This can be beneficial to avoid the problem that occurs if there is foreign income In year 1 and the tax is paid in year 2. Alternatively, excess credit can be carried back 2 years.

4. Credits

   Deemed credits for a 10% or more corporate shareholder for proportionate share of foreign taxes paid by the foreign corporation on income distributed or deemed to be distributed to the U.S. shareholder (IRC Sections 902 and 960).

5. Untaxed Foreign Income

   Do not overlook untaxed foreign income such as income from exports. Simplest income calculation is the 50/50 method under Reg. 1.863-3(c). A similar possibility can apply to individuals with excess FTC who go on business trips out of the United States:

   Business Days Outside U.S.
   ---------------------------------- X Salary = Foreign Income
   Total Business Days

E. WTHHOLDING ON INCOME PAYMENTS TO FOREIGNERS (SEE IRS PUBLICATION 515)

1. Generally at 30% Rate

2. Reduced Treaty Rates (Payee to provide completed Form 1001). Same exercise for U.S. taxpayers. Submit Form 8802 to IRS ($35 fee) and get back Form 6166 certificate to submit to foreign payer.

3. Use Form 1042 for Deposits and give form 1042-S to payees (carbon copies like W-2 or 1099)

4. Withhold on income allocated to foreign partners using Forms 8804, 8805 and 8813 and maximum U.S. tax rate for "effectively connected" taxable income. Note K-1 question C regarding domestic/foreign partner.

F. IC-DISC FOR EXPORTERS—IRC SECTIONS 991—995

1. IC-DISC—Interest Charge Domestic International Sales Corporation

2. All About An IC-DISC

   a. Really cheap and easy to implement. Not at all exotic.

   b. A small interest charge domestic international sales corporation. Small means up to $10 million in export sales can qualify for <u>deferral</u>, but there is no limit on how much qualifies for the <u>real</u> benefit.

   c. If manufacturer is a C corporation, IC-DISC stock is owned by C corporation shareholders. The brother-sister structure can also be used by partnerships or S corporations, but usually the partnership or S corporation manufacturer will own the IC-DISC.

   d. IC-DISC is used to collect commissions on export sales by manufacturers and is tax exempt under IRC Section 991.

   e. Manufacturer gets a tax deduction and the IC-DISC pays out dividends to shareholders (individuals or pass-through entities which are also the owners of the manufacturers) which are presently taxed at only 15%.

f. The benefit applies to all shipments to foreign destinations. Shipments to United States destinations qualify if they proceed outside the United States without further work such as painting or assembly.

g. The IC-DISC is an older device, but has been given new life by

   (1) The 15% tax rate on dividends

   (2) The 2007 expiration of extraterritorial income exclusion (ETI—Form 8873) which was not available in conjunction with an IC-DISC.

h. Generally a greater benefit than ETI. Easy comparison using Form 8873 data.

3. Requirements for Setting Up an IC-DISC

   a. Regular corporation incorporated in Oklahoma with $3,000 in par value stock

   b. Federal employer number (Form SS-4)

   c. Bank account in name of new IC-DISC with at least $2,500 in funds at all times

   d. File an election on Form 4876-A within 90 days after formation. Be sure to use certified mail for this.

   e. Execute a commission agreement between the manufacturer and the IC-DISC. This should be brief since the contract requirement in Regulation 1.993-1(b) states that "Any agreement, oral or written, which constitutes a contract at law, satisfies the contractual requirement of this paragraph."

   f. Compute and pay commissions with actual cash transfers within 60 days of year-end. The payment needs to be a reasonable estimate and may be corrected by September 15 filing date.

4. Relevant Regulations

   a. 1.993(b)—Commission agreement.

   b. 1.993-2(d)(2)—Commission receivable is a trade receivable if paid in accordance with 1.994-1(e)(3) and (5).

   c. 1.993-6(e)—Commission transactions. IC-DISC is on same accounting method as the related supplier.

d. 1.994-1(e)(3)—Payment of commission within 60 days of the IC-DISC year-end. Needs to be a "reasonable estimate." Safe harbor is 50% of final calculation.

e. 1.994-1(e)(5)—Procedure for adjustment

f. 1.994-2—Marginal costing rules

g. Proposed Regulation 1.995(f)-1—Covers interest charge on deferred tax liability (Form 8404). This form is a real pain, but the amounts are usually quite minor, which is good because Form 8404 is <u>never</u> filed when due.

5. Section 994—Sample Calculation

$40 million in sales, $5 million exported and $4 million taxable income for manufacturer:

a. 50-50 Method—Taxable income from exports using simple percentage would be $500,000, commission $250,000. Tax savings for shareholder of S corporation manufacturer would be 20% (35-15%) of commission= $50,000.

b. 4% Method--$200,000 commission

c. Section 482 calculation based on actual prices requires a lot more effort (See Regulation 1.994-2).

6. Fancy Stuff

a. IC-DISC shares issued to children of shareholders of manufacturer probably constitute gifts.

b. IC-DISC shares might be issued to an IRA. Not recommended.

c. Taxable income measurement using Section 482 method under Section 994(a)(3).

7. Other Information Available on IC-DISC

a. Articles in Tax Advisor (AICPA), September 2004, Pages 542-544 and **ESPECIALLY** CPA Focus (OSCPA), January/February 2009, Pages 28-31: "The Mummy Enters Through the Back Door"

b. Internal Revenue Service Branch 6, International (CC:INTL:B06)
(202) 317-6939

c. IC-DISC is heavily marketed by Alliant Group and Export Assist. Both firms have extensive marketing materials available.

d. The IRS released a GREAT 50-page guide in 2012 which can be found on their website: www.irs.gov. Search "IC-DISC" and the third item is "IC-DISC Audit Guide."

G. WORKING OUTSIDE THE U.S.

1. IRS Publication 54—Tax Guide for U.S. Citizens and Resident Aliens Abroad Form 2555, Foreign Earned Income Exclusion ($97,600 for 2013) for bona fide residence or for physical presence for 330 days out of any period of 12 consecutive months

   PLR 201420015 (5/16/14) has a nice summary of the rules for late filing of Form 2555.

2. Oklahoma has a slightly more liberal rule contained in 68 O.S. Section 2353.4. which is 550 days out of the U.S. in any 24-month period.
   It is possible to qualify for an Oklahoma exclusion and not a federal exclusion, or an exclusion which is larger (no dollar limit) for Oklahoma.

H. FOREIGN ACCOUNT TAX COMPLIANCE ACT ("FATCA")

IRC Sections 1471 – 1474: Withholding of 30% U.S. tax on payments to foreign entities – Report on IRS Forms 1042, 1042-S and 8966 entity's requested classification for all of the years the entity intended the requested election to be effective and no inconsistent tax or information returns have been filed during any of the tax years.

3. The entity has reasonable cause for its failure to timely make the entity classification election.

4. Three years and 75 days from the requested effective date of the eligible entity's classification election have not passed.

Affected person. An affected person is either:

- with respect to the effective date of the eligible entity's classification election, a person who would have been required to attach a copy of the Form 8832 for the eligible entity to its federal tax or information return for the tax year of the person which includes that date; or
- with respect to any subsequent date after the entity's requested effective date of the classification election, a person who would have been required to attach a copy of the Form 8832 for the eligible entity to its federal tax or information return for the person's tax year that includes that subsequent date had the election first become effective on that subsequent date.

For details on the requirement to attach a copy of Form 8832, see Rev. Proc. 2009-41 and the instructions under *Where To File*.

To obtain relief, file Form 8832 with the applicable IRS service center listed in *Where To File*, earlier, within 3 years and 75 days from the requested effective date of the eligible entity's classification election.

If Rev. Proc. 2009-41 does not apply, an entity may seek relief for a late entity election by requesting a private letter ruling and paying a user fee in accordance with Rev. Proc. 2013-1, 2013-1 I.R.B. 1 (or its successor).

Line 11. Explain the reason for the failure to file a timely entity classification election.

Signatures. Part II of Form 8832 must be signed by an authorized representative of the eligible entity and each affected person. See *Affected Persons*, earlier. The individual or individuals who sign the declaration must have personal knowledge of the facts and circumstances related to the election.

Foreign Entities Classified as Corporations for Federal Tax Purposes:

American Samoa—Corporation
Argentina—Sociedad Anonima
Australia—Public Limited Company
Austria—Aktiengesellschaft
Barbados—Limited Company
Belgium—Societe Anonyme
Belize—Public Limited Company
Bolivia—Sociedad Anonima
Brazil—Sociedade Anonima
Bulgaria—Aktsionerno Druzhestvo
Canada—Corporation and Company
Chile—Sociedad Anonima
People's Republic of China—Gufen Youxian Gongsi
Republic of China (Taiwan)—Ku-fen Yu-hsien Kung-szu
Colombia—Sociedad Anonima S.A.
Costa Rica—Sociedad Anonima
Croatia—Dionicko Drustvo
Cyprus—Public Limited Company
Czech Republic—Akciova Spolecnost
Denmark—Aktieselskab
Ecuador—Sociedad Anonima or Compania Anonima
Egypt—Sharikat Al-Mossahamah
El Salvador—Sociedad Anonima
Estonia—Aktsiaselts
European Economic Area/European Union—Societas Europaea
Finland—Julkinen Osakeyhtio/Publikt Aktiebolag
France—Societe Anonyme
Germany—Aktiengesellschaft A.G.
Greece—Anonymos Etairia
Guam—Corporation
Guatemala—Sociedad Anonima
Guyana—Public Limited Company
Honduras—Sociedad Anonima
Hong Kong—Public Limited Company
Hungary—Reszvenytarsasag
Iceland—Hlutafelag
India—Public Limited Company
Indonesia—Perseroan Terbuka
Ireland—Public Limited Company
Israel—Public Limited Company
Italy—Societa per Azioni
Jamaica—Public Limited Company
Japan—Kabushiki Kaisha
Kazakstan—Ashyk Aktsionerlik Kogham
Republic of Korea—Chusik Hoesa
Latvia—Akciju Sabiedriba
Liberia—Corporation
Liechtenstein—Aktiengesellschaft
Lithuania—Akcine Bendroves
Luxembourg—Societe Anonyme
Malaysia—Berhad
Malta—Public Limited Company
Mexico—Sociedad Anonima
Morocco—Societe Anonyme
Netherlands—Naamloze Vennootschap
New Zealand—Limited Company
Nicaragua—Compania Anonima
Nigeria—Public Limited Company
Northern Mariana Islands—Corporation
Norway—Allment Aksjeselskap
Pakistan—Public Limited Company
Panama—Sociedad Anonima
Paraguay—Sociedad Anonima
Peru—Sociedad Anonima
Philippines—Stock Corporation
Poland—Spolka Akcyjna
Portugal—Sociedade Anonima
Puerto Rico—Corporation
Romania—Societe pe Actiuni
Russia—Otkrytoye Aktsionernoy Obshchestvo
Saudi Arabia—Sharikat Al-Mossahamah
Singapore—Public Limited Company
Slovak Republic—Akciova Spolocnost
Slovenia—Delniska Druzba
South Africa—Public Limited Company
Spain—Sociedad Anonima
Surinam—Naamloze Vennootschap
Sweden—Publika Aktiebolag
Switzerland— Aktiengesellschaft
Thailand—Borisat Chamkad (Mahachon)
Trinidad and Tobago—Limited Company
Tunisia—Societe Anonyme
Turkey—Anonim Sirket
Ukraine—Aktsionerne Tovaristvo Vidkritogo Tipu
United Kingdom—Public Limited Company
United States Virgin Islands—Corporation
Uruguay—Sociedad Anonima
Venezuela—Sociedad Anonima or Compania Anonima

CAUTION *See Regulations section 301.7701-2(b)(8) for any exceptions and inclusions to items on this list and for any revisions made to this list since these instructions were printed.*

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Recordkeeping	2 hr., 46 min.
Learning about the law or the form	3 hr., 48 min.
Preparing and sending the form to the IRS	36 min.

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