

Critical Reporting Obligation: Canadian-Owned U.S. Corporations and Disregarded Entities

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Canadian persons and entities owning a significant interest in a U.S. corporation or U.S. entity classified as a “disregarded entity” for U.S. federal income tax purposes should ensure they are compliant with IRS Form 5472 filing requirements to avoid substantial U.S. federal income tax penalties.

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” must be filed by: (i) any U.S. corporation which has a Canadian shareholder that owns, directly or indirectly, 25% or more of the voting power or value of that corporation; (ii) any U.S. entity classified as a “disregarded entity” for U.S. federal income tax purposes that has a Canadian owner; and (iii) any Canadian corporation engaged in a U.S. trade or business within the United States; provided, in each case, that a “reportable transaction” occurs.

The scope of “reportable transactions” requiring the filing of IRS Form 5472 is very broad, and generally includes, without limitation, capital contributions, intercompany debt financing arrangements and other transactions that have the potential to reduce U.S. federal income tax liabilities or result in assets being transferred to, or distributed from, the entities listed above.

The failure to file penalty for Form 5472 is \$25,000, which may be increased by an additional \$25,000 to the extent the Form is 90 days late. An additional \$25,000 penalty may be assessed each 30 days thereafter. The U.S. federal income tax rules implementing Form 5472 also require the maintenance of certain records in accordance with applicable regulations. The failure to maintain those records in the prescribed manner may also be assessed a penalty of \$25,000.

Certain Canadian owners of the entities listed above may also have IRS Form 5471 (a form similar to IRS Form 5472) or other reporting obligations, which may also be subject to significant failure to file penalties. The timely filing of these often overlooked IRS Forms is critical to avoiding substantial IRS penalties.

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