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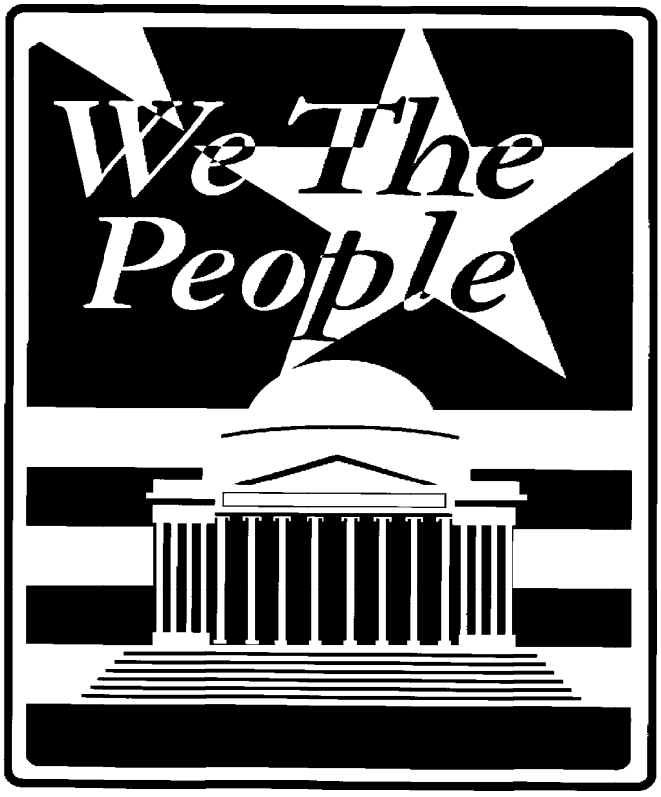
Internal Revenue Service

International Tax Information for Businesses

Contents



Introduction

This publication provides tax information for business conducted internationally. Because individual investors and governments now rely on new global markets to spur economic growth and provide financial security, international business transactions have increased rapidly. These transactions have complex and far-reaching tax consequences for Americans doing business in foreign countries and foreign investors doing business in the United States.

If you are an international business taxpayer, this publication will answer questions you might have about what your responsibilities are and what form to file. The publication addresses U.S. shareholders of a controlled foreign corporation and nonresident aliens owning a U.S. real property interest. Table 3 at the end of this publication lists tax forms required to report international transactions.

The publication provides an overview of a variety of topics that affect businesses involved in international transactions. It is not, however, a detailed explanation of the technical aspects of these tax situations.

We welcome your suggestions for future editions of this publication. Please send your ideas to:

Internal Revenue Service
Assistant Commissioner (International)
Attn: CP:IN:B
950 L'Enfant Plaza South, S.W.
Washington, DC 20024

We respond to many letters by telephone. Therefore, it would be helpful if you would include your area code and daytime phone number along with your return address.

Useful Items

You may want to see:

Publication

- ❑ **54** Tax Guide for U.S. Citizens and Resident Aliens Abroad
- ❑ **80** Circular SS–Federal Tax Guide for Employers in the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands
- ❑ **179** Circular PR–Federal Tax Guide for Puerto Rican Employers
- ❑ **514** Foreign Tax Credit for Individuals
- ❑ **515** Withholding of Tax on Nonresident Aliens and Foreign Corporations
- ❑ **516** Tax Information for U.S. Government Civilian Employees Stationed Abroad
- ❑ **519** U.S. Tax Guide for Aliens
- ❑ **570** Tax Guide for Individuals With Income From U.S. Possessions
- ❑ **597** Information on the United States—Canada Income Tax Treaty
- ❑ **686** Certification for Reduced Tax Rates in Tax Treaty Countries
- ❑ **901** U.S. Tax Treaties
- ❑ **1321** Special Instructions for Bona Fide Resident of Puerto Rico Who Must File a U.S. Individual Return

Ordering publications and forms. To order free publications and forms, call our toll-free telephone number 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Distribution Center nearest you.

Taxpayer assistance. If you live outside the United States, the IRS has full-time permanent staff at 13 U.S. Embassies and Consulates around the world. These offices maintain a supply of tax forms and publications. The staff can help you with account problems and answer your questions about notices and bills.

From January 1 through June 15 each year, taxpayer service representatives travel to many cities worldwide to assist taxpayers outside the United States. You may call your nearest U.S. Embassy, Consulate, or IRS office listed below to find out when and where assistance will be available. These IRS telephone numbers include the country or city codes required if you are outside the local dialing area. The Nassau and Ottawa numbers include the U.S. area codes.

Bonn, Germany	(49)	(228)	339-2119
Caracas, Venezuela	(58)	(2)	285-4641
London, England	(44)	(71)	408-8076
Mexico City, Mexico	(52)	(5)	211-0042 Ext. 3557
Nassau, Bahamas		(809)	766-5040
Ottawa, Canada		(613)	563-1834
Paris, France	(33)	(1)	4296-1202
Riyadh, Saudi Arabia	(966)	(1)	488-3800 Ext. 210
Rome, Italy	(39)	(6)	4674-2560
S'ao Paulo, Brazil	(55)	(11)	881-6511 Ext. 287
Singapore	(65)		338-0251 Ext. 247
Sydney, Australia	(61)	(2)	373-9194
Tokyo, Japan	(81)	(3)	3224-5466

If you need help or information about your federal tax liability and cannot get it from these sources, write to the Internal Revenue Service, Assistant Commissioner (International), Attn: CP:IN:C:TPS, 950 L'Enfant Plaza South, S.W., Washington, DC 20024.

U.S. Persons Doing Business Overseas

U.S. entities doing business overseas have many forms and structures. In addition to controlled foreign corporations (CFC), foreign sales corporations (FSC), and interest charge domestic international sales corporations (IC-DISC), there are partnerships, trusts, and self-employed individuals. This section takes a broad look at these entities and highlights relevant filing requirements and tax forms. Also included in this section are definitions and general provisions for possessions corporations.

Controlled Foreign Corporation (CFC)

One typical form of doing business outside the United States is through a corporation organized in a foreign country. The amount or value of the stock of the foreign corporation owned by U.S. persons determines whether the foreign corporation is a controlled foreign corporation (CFC).

A CFC means any foreign corporation if ***on any day*** during the foreign corporation's taxable year U.S. shareholders own ***more than 50%***of—

1) The total combined voting power of all voting stock, **OR**
2) The total value of all the stock.

There are special rules relating specifically to insurance income which lower the ownership percentage to ***more than 25%.***

A ***foreign corporation*** is any corporation not created or organized in the United States.

A ***U.S. shareholder*** is a U.S. person that owns 10% or more of the voting power of all classes of stock entitled to vote of the foreign corporation.

The term ***U.S. person*** means:

1) A citizen or resident of the United States,
2) A domestic partnership or corporation, or
3) Any estate or trust unless its income from sources outside the U.S. (other than income that is effectively connected with a U.S. trade or business) is not includable in gross income under U.S. tax law.

To determine whether a U.S person is a U.S. shareholder, the U.S. person will be considered to own stock that it owns—

1) Directly,
2) Indirectly through foreign entities, or
3) Constructively under certain rules that attribute stock ownership from one entity to another.

Are U.S. Shareholders Taxed on CFC Profits?

Under prior law, a U.S. shareholder would include in income only actual distributions from the foreign corporation. This rule was modified by the Revenue Act of 1962, which added complex Subpart F rules to the Code requiring U.S. shareholders to include in income their share of certain undistributed income of a CFC.

Income taxed under Subpart F rules. These rules are very complex and we recommend that you seek the advice of professionals for income taxed under Subpart F. However, the principal types of income of the CFC that could be included in the gross income of U.S. shareholders under the Subpart F rules include:

1) Passive investment income,
2) Income from the purchase of goods from, or sale to, certain related entities,
3) Income from the performance of services for or on behalf of certain related entities,
4) Certain types of shipping and oil-related income,
5) Insurance income from insuring risk located outside the CFC's country of incorporation, and
6) Income from bad conduct activities, such as participation in an international boycott, payment of illegal bribes and kickbacks, and income from a foreign country during any period that country is ''tainted'' under IRC 901(j).

In addition, the U.S. shareholders of a CFC are required to include in income their share of the CFC's increase in earnings invested in U.S. property.

Reporting requirements. A U.S. person who is a shareholder of a CFC is potentially liable for U.S. tax and required to keep records to establish the amount of gross income, credits,

deductions, or other income tax matters relating to business transactions between the CFC and the U.S. person and certain parties related to the U.S. person.

There are other situations that require you to separately report certain transactions to the IRS. Below is a list of some schedules that you should attach to your income tax return.

Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations,* is required to be filed under the circumstances listed below. File a separate Form 5471 for each CFC by the due date of your income tax return, including extensions. File two copies. Attach one to your income tax return. Send the other to the Internal Revenue Service Center, Philadelphia, PA 19255. Both civil and criminal penalties may apply for failure to file or report all the information required by the form. The penalty can be as much as $25,000 for each failure and/or the loss of foreign tax credits.

You must file Form 5471 if:

1) You are a U.S. person who owns ***more than*** 50% of a CFC.
2) You are an officer or director of a CFC and, since the last time a Form 5471 was filed, a U.S. person has acquired 5% or more in value of CFC stock, or acquires an additional 5% or more in value of CFC stock.
3) You are a U.S. person who—
   a) Acquires 5% or more stock in a CFC
   b) Acquires an additional 5 percent or more CFC stock,
   c) Owns 5% or more stock when the CFC is reorganized, or
   d) Disposes of sufficient CFC stock to reduce your personal interest below 5%.
4) You become a U.S. person while owning 5% or more of the CFC stock.
5) You own (on the last day of the foreign corporation's tax year) from 10 to 50% of stock in a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during any tax year of the foreign corporation.
6) You own (on the last day of the foreign corporation's tax year) any stock in a CFC that is a Captive Insurance Company.

Form 5713, *International Boycott Report,* is required if you are a U.S. person who owns 10 % or more of a CFC that has operations in or related to boycotting countries. For further discussion, see *International Boycotts,* later.

Form 1116, *Foreign Tax Credit,* or **Form 1118,** *Foreign Tax Credit–Corporations,* must be attached to your income tax return if you are a U.S. person and you paid or accrued foreign taxes during the tax year and elect the benefits of the foreign tax credit.

Note: If the foreign taxes claimed differ from the amount actually paid or due, you must notify the Service of the redetermination. See the Form 1116 and 1118 Instructions for details.

Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership,* must be filed under the circumstances shown below.

1) You transfer property to a CFC as paid-in surplus or contributions to capital. Form 926 is due on the day you make the transfer and should be filed with the Internal Revenue Service Center where you are required to file your income tax return.
2) You transfer property to a CFC in an exchange described in section 367(a) or (d), or you elect to apply the principles similar to section 367 to the transfer.

Form 926 and attachments must be filed with the U.S. person's income tax return for the tax year in which the transfer is made. A dollar penalty equal to 25% of the gain realized on the transfer may be assessed if the information is not submitted as required.

Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons,* must be filed to report tax withheld on certain payments to the CFC or other foreign person. For further information, see *Withholding Taxes–Foreign Entities,* later.

Form 1122, *Authorization and Consent of Subsidiary Corporation to be Included in a Consolidated Income Tax Return,* must be provided by your CFC and attached to your income tax return. This benefit of having the CFC return as part of the domestic consolidated return is only available if you own 100% of a CFC organized in either Canada or Mexico and the CFC was incorporated solely to comply with local foreign country laws.

Form 8621, *Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund,* is required if you (the U.S. person) are a shareholder in a CFC that also meets the definition of a passive foreign investment company (PFIC). Attach Form 8621 to your income tax return and also send a copy to the Internal Revenue Service Center, Philadelphia PA 19255. For more information about the PFIC rules, get Form 8621 with instructions and see IRC sections 1291-1297.

Schedule PH (Form 1120), *U.S. Personal Holding Company (PHC) Tax,* is required for every CFC that is a personal holding company and liable for filing a U.S. income tax return. A penalty of 10 percent of the tax due may be assessed if a foreign corporation that is a PHC does not file Schedule PH as required, in addition to any other applicable penalties.

Foreign Sales Corporations

In an effort to encourage U.S. exports, the Tax Reform Act of 1984 (TRA) created the foreign sales corporation (FSC) and partially exempted its export income from U.S. tax. The FSC rules generally replaced the domestic international sales corporation (DISC) rules. IC-DISCs exist, however, for small taxpayers. Generally, these changes are effective for tax years beginning after 1984.

The TRA of 1984 replaced DISCs with FSC provisions to counter arguments from major trading partners that the DISC provisions constituted an illegal export subsidy under the General Agreement on Tariffs and Trade. FSCs are exempt from U.S. tax on a portion of export income. The exempt income is generally at least 15% of the combined taxable income (CTI) earned by the FSC and its related supplier from qualified exports.

A FSC is a corporation that has met **all** of the following tests:

1) It must be a corporation created or organized under the laws of a qualifying foreign country or a U.S. possession. A ***qualifying foreign country*** is a foreign country that meets the exchange of information requirements of the law. A ***U.S. possession*** is defined in the law to include Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands, but not Puerto Rico.
2) It must have no more than 25 shareholders at any time during the tax year.
3) It must not have preferred stock outstanding at any time during the tax year.
4) During the tax year, it must maintain an office in a qualifying foreign country or a U.S. possession and maintain a set of permanent books of account at that office. Also, it must maintain at a location in the United States the books and records required to sufficiently establish the amount of gross income, deductions, credits, or other matters required to be reported on its tax return.
5) At all times during the tax year, it must have at least one director who is not a resident of the United States.
6) It must not be a member, at any time during the tax year, of a controlled group of which a DISC is a member.
7) The FSC tax year must conform to the tax year of the principal shareholder who, at the beginning of the FSC's tax year, has the highest percentage of voting power.
8) It must have elected to be a FSC or a small FSC by filing Form 8279, *Election To Be Treated as a FSC or as a Small FSC,* at any time during the 90-day period immediately preceding the beginning of the taxable year or during the first 90 days of its taxable year if the FSC is a new corporation.

Small FSC. A small FSC is defined as a corporation that:

1) Has elected small FSC status and has kept it in effect for the tax year, and
2) Is not a member, at any time during the tax year, of a controlled group that includes a FSC (unless that other FSC is also a small FSC).

A small FSC is **exempt** from the foreign management and foreign economic process requirements (discussed below) for eligibility to treat a portion of its income as foreign trading gross receipts. Any foreign trading gross receipts of a small FSC for the tax year that exceed $5 million are not to be taken into account in determining its exempt foreign trade income. The $5 million limit is reduced if the small FSC has a short year. It may be reduced if the small FSC is a member of a controlled group that contains other small FSCs. See the instructions for Form 1120-FSC and Form 8279.

The following items discuss various aspects of the operational requirements of a FSC and must be used to determine the income reported by the FSC.

Foreign trading gross receipts (FTGR) are gross receipts of a FSC that has met certain foreign management and foreign economic process requirements. These receipts must be from the sale, lease, or rental of export property for use outside the United States or for an engineering or architectural services for a construction project located outside the United States.

FTGR do not include:

1) Certain excluded receipts (as defined in the tax law),
2) Investment income, or
3) Carrying charges.

Foreign management requirements. A FSC (other than a small FSC) is treated as having FTGR for the tax year only if the management of the FSC takes place outside the United States. These management activities include:

- Meetings of the board of directors and shareholders.
- Disbursement of cash dividends, outside legal and accounting fees, salaries of officers, and salaries or fees of directors out of the principal bank account.
- Maintaining the principal bank account at all times during the tax year.

Economic process requirements. A FSC (other than a small FSC) has FTGR from any transaction only if certain economic processes of that transaction take place outside the United States. Generally, a transaction will qualify if the FSC satisfies two requirements:

1) Participation outside the United States in the sales portion of the transaction, and
2) Satisfaction of either the 50% or 85% foreign direct cost test. See the Instructions for Form 1120-FSC and the Regulations for details.

The activities comprising these economic processes may be performed by the FSC or by any other person acting under contract with the FSC.

Export property is property that:

1) Is manufactured, produced, grown, or extracted in the United States by a person that is not a FSC,
2) Is held primarily for sale, lease, or rental by a FSC, or held primarily for sale, lease, or rental to a FSC by another party,
3) Is directly used or consumed outside the United States (destination test), and
4) Has a fair market value not more than 50% of which can be attributable to articles imported into the United States.

Certain excluded properties are listed in the tax regulations.

Foreign trade income (FTI) is the amount of income the FSC has earned from FTGR. This is determined on a transaction-by-transaction basis or by groups of transactions using the transfer pricing rules.

Transfer pricing rules. When a FSC buys export property from an unrelated party, the price the FSC pays is considered an arm's-length price. The FSC may simply use this price as its cost and calculate its FTI. However, if it buys from a related supplier, the FSC must use one of the following three pricing methods to determine its gross income:

- 23% combined taxable income (CTI) method.
- 1.83% foreign trade gross receipts (FTGR) method.
- Section 482 method which is based on the sales price actually charged. If the amount actually charged is not an arm's-length price, the IRS is authorized to reallocate income and expenses between the related parties to make the transaction reflect an arm's-length price.

The transfer pricing rules are lengthy and complex. For further information, refer to the Instructions for Schedule P (Form 1120-FSC) or consult the advice of a tax professional.

Exempt foreign trade income (FTI) is the portion of FTI that is exempt from U.S. tax. The amount is 30% of FTI unless administrative pricing rules are used, in which case the exempt portion is 15/23 of FTI. For details, see the instructions for Schedule P (Form 1120-FSC), *Transfer Price or Commission.*

How to make the election. To elect FSC or small FSC, Form 8279 must be filed at anytime during the 90-day period immediately preceding the beginning of the taxable year or, if the FSC is an existing corporation or the FSC is a new corporation, during the first 90 days of its first taxable year. A FSC or small FSC must file Form 1120-FSC.

Where to file. File Form 1120-FSC and Form 8279 with the Internal Revenue Service Center, Philadelphia, PA 19255.

When to file. File Form 1120-FSC by the 15th day of the 3rd month after the end of the tax year. To request an automatic 6-month extension of time to file Form 1120-FSC, file Form 7004, *Application for Automatic Extension of Time To File Corporation Income Tax Return.*

Who must sign. Any corporate officer authorized to sign must sign and date the return. See Instructions for Form 1120-FSC.

Domestic International Sales Corporations

U.S. corporations are taxed on worldwide income, whether derived from U.S. activities or export activities. However, many foreign corporations are often exempt from taxation in their home country. Without special U.S. tax provisions, many foreign competitors of U.S. companies would have significant advantages. To meet this competitive threat, the domestic international sales corporation (DISC) was created to allow deferral on a portion of a U.S. corporation's income and thereby reducing the comparative tax disadvantage.

Many of our trading partners argued that the DISC provisions constituted an illegal export subsidy under the General Agreement on Tariffs and Trade (GATT). Consequently, the 1984 Tax Reform Act terminated the DISC system of tax deferral and established transition rules for the distribution of earnings lodged in all DISCs. To replace the DISC, taxpayers were allowed to establish interest charge DISCs (IC-DISCs) or foreign sales corporations (FSCs).

Interest Charge Domestic International Sales Corporation

The 1984 Tax Reform Act (TRA) modified the domestic international sales corporation (DISC) system of tax deferral for U.S. exporters. Now interest must be paid on the income deferred. The rules that applied to DISCs prior to enactment of TRA of 1984 apply to the new IC-DISCs. However, there are several substantial changes. Beginning in 1985 and for each year thereafter, the IC-DISC can defer taxable income attributable to $10 million or less of qualified export receipts, provided its shareholders pay an interest charge on the tax that would otherwise be due if the deferred income were distributed. IC-DISC's taxable income attributable to qualified export receipts exceeding $10 million will be deemed distributed.

An IC-DISC is a corporation that meets the following requirements for the tax year:

1) It must be an eligible U.S. corporation.
2) At least 95% of its gross receipts must be qualified export receipts.
3) At least 95% of its gross assets must be qualified export assets. Assets are measured by their adjusted basis.
4) It must have only one class of stock, and the par or stated value of its outstanding stock must be at least $2,500 on each day of the tax year.
5) It must elect IC-DISC status and the election must be in effect for the tax year.

6) It must not be a member of a controlled group that also includes a foreign sales corporation (FSC).
7) It must keep separate books and records.

Ineligible corporations. To prevent doubling up of benefits, the following U.S. corporations are excluded from qualifying for IC-DISC status:

1) Tax-exempt organizations,
2) Personal holding companies,
3) Financial institutions,
4) Insurance companies,
5) Regulated investment companies, and
6) S corporations.

Gross receipts test. At least 95% of the IC-DISC's gross receipts for the tax year must be qualified export receipts. The primary source of qualified receipts, whether the DISC operates on a buy-sell or a commission basis, is export sales. Gross receipts consist of the total receipts from the sale, lease, or rental of inventory or other property held for sale, lease, or rental, and gross income from all other sources. Gross receipts do not exclude exempt income. A commission IC-DISC includes the gross receipts of its principal for the test.

Qualified export receipts. These include receipts from the following sources:

1) Gross receipts from the disposition of export property–that is, the inventory of U.S.-produced property held for export,
2) Gross receipts from the lease or rental of export property used outside the United States,
3) Gross receipts from related and subsidiary services–including transportation, installation, and maintenance–performed in connection with those transactions,
4) Gain from dispositions of qualified export assets that are not export property,
5) Dividends from a related foreign export corporation (defined below),
6) Interest on obligations that are qualified export assets, e.g., producer's loans,
7) Gross receipts from architectural or engineering services for foreign construction projects (actual or contemplated), and
8) Gross receipts for management services rendered to an unrelated IC-DISC.

Nonqualifying export receipts. The purpose of the IC-DISC is to encourage exports. However, certain sales do not generate qualified export receipts. These are sales that are not for export, or sales of nonqualifying property such as:

- Receipts from property sold or leased for ultimate use in the United States,
- Receipts from sales under certain U.S. subsidy programs,
- Receipts from sales of property to, or performance of services for, the U.S. government under a buy-American requirement, and
- Receipts from sales or services to a related IC-DISC.

Gross assets test. At least 95% of the IC-DISC's assets at the end of the year must be qualified export assets. This test is based on the assets' adjusted basis. Since it is made once a year on the last day of the IC-DISC's fiscal year, failure to meet the test for the rest of the year is not determinative.

Qualified export assets. This is the total of the following:

1) Export property (generally, inventory items of U.S.-produced property sold for export),
2) Operating assets used primarily in the sale, lease, handling, packaging, etc. of export property, or furnishing qualified architectural or engineering services, or managing another IC-DISC,
3) Certain account receivables arising from qualified export transactions,
4) Money, bank deposits, and other temporary investments needed for working capital,
5) Obligations related to producer's loans,
6) Stock or securities of a related foreign export corporation,
7) Certain obligations issued, guaranteed, or insured by the Export-Import Bank or Foreign Credit Insurance Association from which the obligations arose,
8) Obligations of a U.S. corporation financing export sales under an agreement with the Export-Import Bank, and
9) U.S. bank deposits at year's end in excess of reasonable working capital, if invested in qualified export assets within a reasonable time after the end of the year.

Export property is property manufactured, produced, grown, or extracted in the United States by a person other than the IC-DISC. The IC-DISC must hold the property for sale or lease. In addition, the property must be used or consumed abroad. No more than 50% of the value of its components can be attributed to imports.

Export property does not include property manufactured by the IC-DISC. That doesn't prevent the IC-DISC from packaging or doing minor assembly. However, if the value added is at least 20% of the cost of goods sold, the IC-DISC will be considered a manufacturer.

Excluded export property includes the following:

1) Property leased or rented by the IC-DISC for use by a member of the same controlled group of corporations.
2) Intangibles, such as patents, models, trademarks, copyrights (but not films or master recording tapes), franchises, and goodwill. A copyrighted book, as distinguished from the copyright, can be a qualified export asset, as can mass-produced computer software without a right of reproduction.
3) Property not in sufficient supply to meet the needs of the U.S. economy, if the President so proclaims, during the proclamation period.
4) Products whose export is prohibited or curtailed to protect the U.S. economy under the Export Administration Act.
5) Products for which a deduction for depletion is allowable.

Intercompany pricing rules. Special intercompany pricing rules apply when the IC-DISC buys its inventory of export items from a related company (including its parent). These rules, which apply to commission and buy-sell IC-DISCs, avoid the complexity of fixing an arm's-length price in accordance with the rules of section 482 of the Internal Revenue Code, and encourage operations as an IC-DISC. The transfer price for intercompany sales or a commission, in case of a commission DISC, is an amount which does not exceed the greatest of the following:

1) 4% of qualified export receipts plus 10% of export promotion expenses,
2) 50% of the combined taxable income (CTI) of the IC-DISC and the related supplier from the entire transaction plus 10% of the export promotion expenses, and
3) Taxable income based on the actual sales price, but subject to section 482 adjustments.

No loss rule. For both the 4% and the 50-50 methods, income generally may not be allocated to the IC-DISC to the extent the allocation causes the supplier to realize a loss on the sale. For both the 50-50 method and the no loss rule, you must determine the CTI from the transaction.

Note: Under the 4% method, there is a special no loss rule which permits the DISC to obtain worldwide profit. For this purpose, you must use the rules for figuring costs of goods sold (including full absorption costing) and the procedures for expense apportionment.

Export promotion expenses are expenses which must be incurred by the DISC to promote export sales. They include 50% of freight charges for U.S. owned and operated ships and aircraft if that use is not required by law or regulation. State and foreign income taxes are not included as export promotion expenses.

Tax on IC-DISC Shareholders

An IC-DISC shareholder must take into account both actual and deemed distributions received from the IC-DISC. An ***actual*** distribution to a shareholder is a distribution of money or property. A ***deemed*** distribution is a form of constructive dividend in which a shareholder is treated as if it received part of the DISC's undistributed earned income. The dividend income is reported on the shareholder's tax return.

The IC-DISC can defer taxable income of $10 million or less of qualified export receipts for the tax year. A shareholder of the IC-DISC

must pay an interest charge based on the tax that would otherwise be due if the deferred income were distributed. For the shareholder's tax year, this amount is the excess of the tax liability for the year computed as if the shareholder's portion of the deferred DISC income is included in income minus the shareholder's actual tax liability for the year. Generally, the deferred DISC income is the accumulated DISC income at the beginning of the tax year minus the amount by which actual distributions from accumulated DISC income exceed the present year's DISC income. For IC-DISC shareholders whose tax year is different from that of the IC-DISC, deferred DISC income is measured from the tax year of the IC-DISC ending within the shareholder's preceding tax year. However, in general, this will not occur since the IC-DISC's taxable year must conform to the taxable year of its principal shareholder. See Form 8404, *Computation of Interest Charge on DISC-Related Deferred Tax Liability.*

The rate of interest imposed on the deferred tax liability is the average investment yield of U.S. Treasury bills with 52-week maturities that were auctioned during the one-year period ending on September 30 of the calendar year that includes the shareholder's tax year. The rate is published every year by the IRS in the Internal Revenue Bulletin. Taxable income of the IC-DISC attributable to qualified receipts exceeding $10 million will be deemed distributed.

How To Make the Election

A corporation must elect IC-DISC status by filing Form 4876-A, *Election To Be Treated as an Interest Charge DISC,* with the Internal Revenue Service Center where it files Form 1120-IC-DISC, *Interest Charge Domestic International Sales Corporation Return.* An officer who is authorized to sign for the corporation must sign the form.

Time to elect. A corporation electing IC-DISC status for its first tax year must file Form 4876-A within 90 days after the beginning of the tax year. However, an existing corporation must file the form within the 90-day period immediately preceding the first day of the tax year.

Consent. For the election to be valid, every shareholder who is a shareholder on the first day of the corporation's tax year for which the election is effective must consent. Shareholders give their consent on the bottom of the Form 4876-A. Once the consent is made, it is binding on the shareholders and new shareholders.

IC-DISC return. An IC-DISC must file Form 1120-IC-DISC. Any corporate officer authorized to sign for the corporation must sign the form. The form must be filed by the 15th day of the 9th month after the tax year ends. No extension of time to file is allowed. It must be filed with the Internal Revenue Service Center where the common parent files. The IC-DISC should provide Schedule K to shareholders notifying them of distributions and deferred accumulated earnings.

Shareholder return. A shareholder must file Form 8404, *Computation of Interest Charge on DISC-Related Deferred Tax Liability,* when it files its U.S. income tax return for the tax year ending with or including the end of the IC-DISC's tax year for which the deferred income is reported.

Note: The regular tax return extension does not apply to Form 8404.

No consolidated return. An IC-DISC or former IC-DISC may not file a consolidated return with the group of which it is a member.

Records. An IC-DISC must furnish such information to its shareholders and to the Treasury Department and keep such records as may be required by regulations.

An individual must pay the interest charge by the 15th day of the 4th month following the close of his or her tax year. A corporation must pay the interest charge by the 15th day of the 3rd month following the close of its tax year. To compute the interest charge, individual and corporate taxpayers should file Form 8404.

U.S. Citizens and Resident Aliens Abroad

U.S. citizens and resident aliens who are outside the United States (and its possessions) have the ***same*** requirements to file tax returns as anyone living in the United States. Income from ***worldwide*** sources must be considered when determining if a federal tax return must be filed.

Income Earned Abroad

You may qualify for an exclusion from tax of up to $70,000 in income earned while working abroad. However, you must file a tax return to claim it. In general, foreign earned income is income received for services you perform in a foreign country. You also may be able to claim an exclusion or a deduction from gross income for your reasonable housing costs that are over a certain base amount. Generally, you will qualify for these benefits if your ***tax home*** (defined below) is in ***a foreign country,*** or countries, throughout your period of bona fide foreign residence or physical presence and you are one of the following:

1) A U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes a complete tax year, or
2) A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, or
3) A U.S. citizen or a U.S. resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

Tax home. Generally, your tax home is the general area of your main place of business, employment, or post of duty where you are permanently or indefinitely engaged to work. You are not considered to have a tax home in a foreign country for any period during which your abode (the place where you regularly live) is in the United States. However, being temporarily present in the United States or maintaining a dwelling there does not necessarily mean that your abode is in the United States. For details, see Publication 54.

Exclusion of foreign earned income. If your tax home is in a foreign country and you meet either the bona fide residence test or the physical presence test, you can choose to exclude from gross income a limited amount of your foreign earned income. Your income must be for services performed in a foreign country during your period of foreign residence or presence, whichever applies. You cannot, however, exclude the pay you receive as an employee of the U.S. Government or its agencies. You cannot exclude pay you receive for services abroad for Armed Forces exchanges, officers' messes, etc., operated by the U.S. Army, Navy, or Air Force.

Credits and deductions. If you claim the exclusion, you cannot claim any credits or deductions that are related to the excluded income. Thus, you cannot claim a foreign tax credit or deduction for any foreign income tax paid on the excluded income. Nor can you claim the earned income credit if you claim the exclusion. Also, ***for IRA purposes,*** the excluded income is not considered compensation and, for figuring deductible contributions when you are covered by an employer retirement plan, is included in your modified adjusted gross income.

Amount excludable. If your tax home is in a foreign country and you qualify under either the bona fide residence test or physical presence test for all of 1993, you can exclude your foreign income earned during the year up to $70,000. However, if you qualify under either test for only part of the year, you must reduce ratably the $70,000 maximum based on the number of days within the tax year you qualified under one of the two tests.

Housing amount. If your tax home is in a foreign country and you meet either the bona fide residence test or the physical presence test, you may be able to claim an exclusion or a deduction from gross income for a housing amount.

A ***housing amount*** is the excess, if any, of your allowable housing expenses for the tax year over a ***base amount.*** Allowable housing expenses are the reasonable expenses (such as rent, utilities other than telephone charges, and real and personal property insurance) paid or incurred during the tax year by you, or on your behalf, for your foreign housing and that of your spouse and dependents if they lived with you. You can include the rental value of housing provided by your employer in return for your services. You can also include the allowable housing expenses of a second foreign household for your spouse and dependents if

they did not live with you because of dangerous, unhealthy, or otherwise adverse living conditions at your tax home. Housing expenses, for this purpose, do not include the cost of home purchase or other capital items, wages of domestic servants, or deductible interest and taxes.

The ***base amount*** for 1993 is $8,737 or $23.94 per day. To figure your base amount if you are a calendar year taxpayer, multiply $23.94 by the number of days in your period of foreign residence or presence, whichever applies, that are within the tax year.

Exclusion. You can exclude your housing amount from income to the extent it is from employer-provided amounts. Employer-provided amounts are any amounts paid to or for you by your employer, including your salary, housing reimbursements, and the fair market value of pay given in the form of goods and services.

If you claim the exclusion, you cannot claim any credits or deductions related to excluded income, including a credit or deduction for any foreign income tax paid on the excluded income.

Foreign Income Taxes

A limited amount of the foreign income tax you pay can be credited against your U.S. tax liability or deducted in figuring taxable income on your U.S. income tax return. It is usually to your advantage to claim a credit for foreign taxes rather than to deduct them. A credit reduces your U.S. tax liability, and any excess may be carried back and carried forward to other years. A deduction only reduces your taxable income and may be taken only in the current year. You must treat all foreign income taxes by the same method. You generally cannot deduct some foreign income taxes and take a credit for others.

Tax credit. If you choose to credit foreign taxes against your tax liability, complete Form 1116, *Foreign Tax Credit,* and attach it to your U.S. income tax return. Do not include the foreign taxes paid or accrued as withheld income taxes on line 54 of Form 1040.

Limit. Your credit cannot be more than the part of your U.S. income tax liability allocable to your taxable income from sources outside the United States. So, if you have no U.S. income tax liability, or if all your foreign income is exempt from U.S. tax, you will not be able to claim a foreign tax credit.

If the foreign taxes you paid or incurred during the year exceed the limit on your credit for the current year, you can carry back the unused foreign taxes as credits to 2 prior tax years and then carry forward any remaining unused foreign taxes to 5 later tax years.

Foreign taxes paid on excluded income. You cannot claim a credit for foreign taxes paid on amounts excluded from gross income under the foreign earned income exclusion or the housing amount exclusion, discussed earlier.

Deduction. If you choose to deduct all foreign income taxes on your U.S. income tax return, itemize the deduction on Schedule A (Form 1040). You cannot deduct foreign taxes paid on income you exclude from your U.S. income tax return.

More information. The foreign tax credit and deduction, their limits, and the carryback and carryover provisions are discussed in detail in Publication 514, *Foreign Tax Credit for Individuals.*

Filing Requirements

The U.S. filing requirements for U.S. citizens and resident aliens in foreign countries are generally the same as those for citizens and residents living in the United States. Your age, marital status, gross income, whether you are blind, and whether you can be claimed as a dependent by another taxpayer determine whether you must file a U.S. federal income tax return. To determine if you meet the gross income requirement for filing purposes, you must include all income you receive from foreign sources as well as your U.S. income. It does not matter that:

- The income is paid in foreign money, or
- The foreign country imposes an income tax on that income, or
- The income is excludable under the foreign earned income exclusion, discussed earlier.

Self-employed persons. You must file a U.S. income tax return if you had $400 or more of net earnings from self-employment, regardless of your age. ***You must pay self-employment tax on your self-employment income even if it is excludable as foreign earned income in figuring your income tax.*** Net earnings from self-employment include the income earned both in a foreign country and in the United States.

Possessions Corporations

Possessions corporations may operate to obtain the benefits of section 936 in all U.S. possessions including the U.S. Virgin Islands. However, the overwhelming majority of possessions corporations are operating in Puerto Rico.

Possessions corporations must have:

1) Filed a valid Form 5712, *Election To Be Treated as a Possessions Corporation Under Section 936*,
2) Derived 80% or more of their gross income from sources in a U.S. possession during the applicable period immediately before the tax year ended, and
3) Derived 75% or more of their gross income from the active conduct of a trade or business in a U.S. possession during the applicable period immediately before the tax year ended. In 1976 the amount was 50%. This amount increased over the years to 75%.

Applicable period. This is generally the shorter of 36 months or the period when the corporation actively conducted a trade or business in the U.S. possession.

Ineligible corporations. These include a domestic international sales corporation (DISC) or a former DISC, or a corporation that owns stock in a DISC, former DISC, foreign sales corporation (FSC), or a former FSC.

Possession tax credit. A possessions corporation is allowed a credit against its U.S. tax liability equal to the portion of its tax that is attributable to:

1) The taxable income from non-U.S. sources from the active conduct of a U.S. trade or business within a U.S. possession, and
2) The qualified possession source investment income.

The credit is not allowed against the following taxes:

1) Environmental tax
2) Tax on accumulated earnings
3) Personal holding company tax
4) Additional tax for recovery of foreign expropriation losses
5) Tax increase on early disposition of investment credit property
6) Tax on certain capital gains of S corporations
7) Recapture of low income housing credit

Election of cost sharing or profit split method. A possessions corporation may elect either the cost sharing or profit split method of computing taxable income with respect to a certain possession product. The corporation must use Form 5712-A, *Election and Verification of the of the Cost Sharing or Profit Split Method Under Section 936(h)(5),* to show that it has a ''significant business presence'' in the possession. It does this by meeting either a direct labor test or a value added test. In addition, if the corporation is electing the profit split method, it must certify that the possession product was manufactured in the possession.

How To File

Form 5712. This form must be filed by the due date (including extensions) of the first return to which the election is to apply. The election applies to the first tax year for which the election was made and each taxable year thereafter as long as the domestic corporation qualifies under section 936(a) or the election is revoked. The election may not be revoked for the taxpayer's first 10 taxable years without the consent of the IRS. After 10 years, a revocation does not require the consent of the IRS. This form is filed separately from the corporation's regular income tax return. File it by the due date of the first return to which the election applies. File it with the Internal Revenue Service Center, Philadelphia, PA 19255.

Form 5712-A. If the corporation has elected the cost sharing or profit split method, Form 5712-A must be completed for each possession product or group of products for which the corporation has made the election. This form

must be completed each year to determine if the corporation has a significant business presence in the possession. Form 5712-A is attached to Schedule P (Form 5735), *Allocation of Income and Expenses Under Section 936(h)(5).*

Form 5735. Each corporation that has elected to be treated as a possessions corporation must attach Form 5735, *Possessions Corporation Tax Credit Allowed Under Section 936,* to its income tax return for each year that the election is in effect. This form is used to figure the possessions corporation tax credit under section 936. The credit is deducted from the regular corporate income tax.

Foreign Persons Doing Business in the United States

This section addresses the responsibilities of foreign corporations operating through branches or other forms in the United States, foreign controlled corporations (FCC), foreign partners in U.S. partnerships, foreign beneficiaries of estates and trusts, foreign investment in U.S. real property, and nonresident aliens working in the United States. Emphasis is placed on the treatment of foreign source income, effectively connected income, and filing requirements.

Foreign Corporations

A foreign corporation, for U.S. tax law purposes, is any corporation not organized under the laws of the United States, any state, or the District of Columbia. A corporation organized in a U.S. possession, such as Guam, is considered a foreign corporation, unless certain conditions detailed in IRC section 881(b) are met.

Income earned by a foreign corporation is subject to U.S. income tax under two circumstances. Net income effectively connected with a U.S. trade or business is taxed at graduated rates. Gross U.S. source income not effectively connected with a U.S. trade or business (U.S. source investment income) is taxed at a 30% rate. However, tax treaties often specify a lower rate on non-effectively connected income or exempt income that is effectively connected but not attributable to a permanent establishment.

Sourcing of Income

The term ''sourcing of income'' refers to where income is treated as earned for purposes of the Code. The source of income is important in the taxation of foreign corporations because most foreign source income of foreign corporations is not subject to U.S. tax. Only a few types of foreign source effectively connected income of foreign corporations are subject to tax.

The rules governing the sourcing of income are found in IRC sections 861 through 865 and their regulations. A summary of the general provisions follows. However, these general provisions are subject to certain exceptions, so check the Code and Regulations.

Effectively Connected Income

IRC section 864(c) contains the rules for determining if income is effectively connected with a U.S. trade or business. There are different rules for U.S. and foreign source income. U.S. source income is separated into two categories, periodic income and other income. Periodic income is only considered to be effectively connected if it is effectively connected with a U.S. trade or business. Other income is considered effectively connected if the taxpayer has a trade or business. The term ''U.S. trade or business'' is defined in the Internal Revenue Code and the Regulations. Its interpretation depends on the facts and circumstances involved.

Periodic income includes gains or losses on the sale of capital assets. It also includes fixed or determinable annual or periodic gains, profits, and income. Examples of this type of income include:

- Interest and dividends
- Rents and royalties
- Salaries, wages, and fees
- Gains and losses on sale of capital assets

The Code prescribes two tests to help determine if periodic income is effectively connected—the ''Asset Use'' and the ''Business Activity'' tests. The ''Asset Use'' test looks to see if the asset that generated the income is used in the U.S. trade or business. If it is, then the income is effectively connected. The ''Business Activity'' test tries to determine if the U.S. trade or business was a material factor in the realization of the income. If it is, then the income is effectively connected.

Foreign source income can only be effectively connected if the foreign corporation has an office or fixed place of business in the United States. The U.S. office must be a material factor in earning the income. Only the following types of income that are from foreign sources can be considered effectively connected.

1) Rents or royalties
2) Interest and dividends (banks, financial institutions, and stock or security traders only)
3) Sale of inventory (except if property is for use outside the United States and a foreign office materially participated in the sale)
4) Insurance premium income (no requirement for office in United States)

The determination of whether a foreign corporation has an office or fixed place of business in the United States is based on all relevant facts and circumstances. A foreign corporation is considered to have a place of business if it maintains an office, factory, mine, store, or other fixed place of business in the United States. In certain circumstances, the office of a corporate agent can be considered as an office or fixed place of business of the foreign corporation.

Many tax treaties provide an exclusion for income earned by a foreign corporation in the United States. The treaty exclusion usually requires that the foreign corporation not have a permanent establishment in the United States. The term ''permanent establishment'' is defined in the treaty. To qualify for treaty benefits, the foreign corporation must be a resident of a country which has a tax treaty with the United States.

Deductions and credits. IRC section 882(c) allows only those deductions and credits associated with effectively connected income. A foreign corporation must file a timely, true, and accurate return to claim deductions and credits.

If a foreign corporation has both effectively and non-effectively connected income, it must allocate its deductions between the two. The rules for allocating deductions are contained in section 1.861-8 of the Regulations.

The regulations provide that any expense definitely related to effectively connected income may be deducted. Expenses definitely related to non-effectively connected income cannot be deducted. Expenses definitely related to both effectively and non-effectively connected income, and expenses that are not

Table 1. **Summary of Income Source Rules**

Type of Income:	Source Determined By:
Compensation for personal services	Where services are performed
Interest and Dividends	Residence of payor
Rents	Where property is located
Royalties	Where property is used
Sale of inventory property	Where property is sold
Sale of personal property (other than inventory property)	Tax home of seller
Sale of real property	Where property is located

definitely related to any class of gross income generally are treated as definitely related and allocable to all gross income. Similarly, if a deduction is not definitely related to any gross income, it must be apportioned ratably between the statutory grouping(s) of gross income and the residual groupings as defined in sections 1.861-8(a)(4) and 1.861-8(c)(3) of the Regulations.

Special rules govern the interest expense deduction for foreign corporations. The computation in section 1.882-5 is used to determine the allowable deduction. It uses an allocation method based on the average balance of assets during the year that generate effectively connected income.

Foreign corporations are allowed a credit for taxes paid on foreign source effectively connected income. However, foreign income taxes imposed on U.S. source income are not allowed as a credit if the foreign country would not tax the income but for the fact that the foreign corporation was created, organized, or domiciled in that country.

Tax on Non-Effectively Connected Income

A foreign corporation which has U.S. source income that is not effectively connected is taxed at 30% on a gross basis. No deductions are allowed in computing taxable income. This tax may be reduced or eliminated under a tax treaty.

Interest on deposits in U.S. banks and portfolio interest are exempt from this tax. The exemption is available only to foreign corporations and nonresident aliens. If the interest income is effectively connected, the exemption is not available.

Real Property Income

IRC section 882(d) states that a foreign corporation that receives certain types of non-effectively connected income from U.S. real property may elect to treat that income as effectively connected. This allows for a deduction of related expenses and the use of the graduated tax rates.

The election can be made any time before the expiration of the statute of limitations for filing a claim. This period is usually three years after the due date of the return. The election may be revoked during the same period. The election can only be made for years in which income from U.S. real property is received. Once made, the election is effective for all subsequent years. All U.S. real property interests owned by the foreign corporation are covered by the election. Once the statute of limitations expires on the year the election was first made, it may be revoked only with the consent of the Internal Revenue Service.

The types of real property income eligible for this election are:

1) Gains from a sale or exchange
2) Rents
3) Royalties from natural resource deposits
4) Gains from disposal of timber, coal, or iron ore with a retained interest.

IRC section 897 classifies all gains from the sale of U.S. real property interests by nonresident aliens or foreign corporations as effectively connected income. This applies even if no election under IRC section 882(d) is made.

Filing Requirements

Form 1120-F must be filed with the Internal Revenue Service Center, Philadelphia, PA 19255 by the 15th day of the 6th month after the end of the foreign corporation's tax year, if the foreign corporation does not maintain an office or place of business in the United States. Such foreign corporation may use Form 7004 to request an automatic 6-month extension of time to file.

If a foreign corporation maintains an office or place of business in the United States, it must file Form 1120-F by the 15th day of the 3rd month after the end of its tax year. A corporation operating in this manner may get a 3-month extension by attaching a statement (as described in section 1.6081-5) to its Form 1120-F.

To file an amended Form 1120-F, file Form 1120-F with ''AMENDED RETURN'' written across the top of the first page.

Foreign corporations that have effectively connected income must file a tax return. Corporations that earned only non-effectively connected income do not have to file a return if the tax on the income has been fully paid through withholding by the payor. If the corporation is due a refund or owes tax, a return must be filed.

Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.* A foreign corporation that is engaged in a trade or business in the United States at any time during a taxable year may be required to provide certain information to the Internal Revenue Service on Form 5472.

A penalty of $10,000 will be assessed on any reporting corporation that fails to file Form 5472 when due and in the manner prescribed. The penalty also applies for failure to maintain records as required by Regulations section 1.6038A-3.

If the failure continues for more than 90 days after notification by the IRS, an additional penalty of $10,000 will apply with respect to each related party for which a failure occurs for each 30-day period (or part of a 30-day period) during which the failure continues after the 90-day period ends.

Treaty-based positions. For filing requirements for taxpayers claiming a treaty-based position, see *Tax Treaties,* later.

Foreign Controlled U.S. Corporations

The past decade has seen a dramatic increase in foreign investment in the United States. Many foreign companies have established a significant U.S. presence and have set up U.S. subsidiaries (foreign controlled corporations) to carry out their business operations.

A foreign controlled corporation (FCC) is any corporation incorporated in the United States where at least 25% of the total voting power of all classes of stock of the corporation entitled to vote or the total value of all classes of stock of the corporation is owned by one foreign person. A foreign person is defined as any foreign corporation, partnership, individual, estate, or trust (see Form 1120 instructions for definition).

Filing Requirements

Each FCC, unless specifically exempt or dissolved, must file a tax return. This is true even if it had no taxable income for the year and regardless of the amount of gross income for the year. The income tax returns for FCCs are:

- Form 1120, *U.S. Corporation Income Tax Return*
- Form 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts*
- Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*
- Form 1120-RIC, *U.S. Income Tax Return for Regulated Investment Companies*

Due date of return. If an FCC's income tax return is made on a calendar year basis, it must be filed by March 15 following the close of the tax year. If an FCC uses a fiscal year, its return must be filed by the 15th day of the 3rd month following the close of its fiscal year. A corporation can receive an automatic 6-month extension of time for filing its return by filing Form 7004.

Where to file. An FCC files its income tax return with the Internal Revenue Service Center serving the area where the principal office for keeping its books and records is located.

Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business,* is used to report information relating to transactions between an FCC and any party related to the FCC or its foreign owner. An FCC must file a Form 5472 if it engaged in any reportable transactions. There are some specific situations where FCCs do not have to file (see the Form 5472 instructions). Attach Form 5472 to the FCC's corporate income tax return. File a duplicate copy of each Form 5472 (at the same time as the original) with the Internal Revenue Service Center, Philadelphia, PA 19255.

Nonresident Aliens Doing Business in the United States

Nonresident aliens are taxed on their U.S. source income (and on certain foreign source income that is effectively connected with a trade or business in the United States). However, special rules apply to taxing the income of nonresident aliens, depending on whether the income is from investments or from business activities such as performing personal

services in the United States. Investment income is taxed at a flat rate of 30% of gross income, unless the rate is reduced by an income tax treaty. Business income is taxed on a net basis (income minus any allowable deductions) at the graduated rates that apply to U.S. citizens or residents.

Trade or Business in the United States

Whether you are engaged in a trade or business in the United States depends on the nature of your activities. To determine whether you are engaged in a trade or business in the United States, and get more information on other trade or business activities, see Publication 519, *U.S. Tax Guide for Aliens.*

What Income is Taxed

Nonresident aliens generally are taxed only on income from sources in the United States.

Taxable income from U.S. sources includes, but is not limited to:

1) Wages, salaries, commissions, fees, tips, etc., for services performed in the United States,
2) Interest (with certain exceptions) and dividends,
3) Rents and royalties,
4) Profits or losses from the sale of merchandise within the United States,
5) Gains and losses from the sale of certain property, and
6) Certain gambling winnings.

Foreign Source Income

Under limited circumstances, you must treat the following kinds of foreign source income as effectively connected with a trade or business in the United States.

1) Rents and royalties,
2) Dividends or interest from the conduct of certain businesses, and
3) Income, gain or loss from the sale of certain property.

For a review of these circumstances and additional information about foreign source income, see Publication 519.

Tax on Effectively Connected Income

If you receive income that is effectively connected with a U.S. trade or business, that income is taxed at the same rates that apply to U.S. citizens and resident aliens after allowable deductions. For exceptions and additional information on taxation of effectively connected income, see Publication 519.

What Tax Forms You May Need

If you are a nonresident alien and you must file an income tax return, use Form 1040NR, *U.S. Nonresident Alien Income Tax Return.*

You also may need to file Form 1040–ES(NR), *U.S. Estimated Tax for Nonresident Alien Individuals.*

Before leaving the United States, you may have to file Form 1040-C, *U.S. Departing Alien Income Tax Return,* or Form 2063, *U.S. Departing Alien Income Tax Statement.*

These forms are discussed in Publication 519.

When and Where to File

If you are an employee and you receive wages subject to U.S. income tax withholding, file Form 1040NR by the 15th day of the 4th month after your tax year ends. If your tax year is the 1993 calendar year, your return is due April 15, 1994. (If you have not previously established a tax year other than the calendar year, you ***must*** use the calendar year as your tax year.)

If you did not receive wages subject to U.S. income tax withholding, Form 1040NR is due by the 15th day of the 6th month after your tax year ends. For the 1993 calendar year, file your return by June 15, 1994.

Form 1040NR must be sent to the Internal Revenue Service Center, Philadelphia, PA 19255, U.S.A.

When to file for deductions and credits. To get the benefit of deductions or certain credits, you must timely file a true and accurate Form 1040NR. For information on what is considered timely for this purpose, see chapter 7 in Publication 519.

Penalties. The law provides penalties (in addition to the tax) for filing your tax return late and for late payment of any tax due. However, a penalty will not be charged if you can show that you had reasonable cause for filing your return or paying any tax due after the due date.

Estimated Tax Payment: Form 1040–ES(NR)

You may have taxable income from which no U.S. income tax is withheld. Or the amount of tax withheld is not enough to cover the amount of income tax that you estimate you will owe at the end of the year. If this is true, and if you have income effectively connected with a trade or business in the United States, you may have to pay estimated tax. An addition to the tax is charged if you underpay your estimated tax.

Income connected with a trade or business includes pay received as an employee that is subject to withholding. It does not, however, include pay subject to withholding at a flat 30% rate or lower treaty rate.

Generally, there will be no addition to the tax for the underpayment of estimated tax if the total income tax to be withheld from your 1994 income is at least:

1) 90% of the tax to be shown on your 1994 U.S. income tax return, or
2) 100% of the tax shown on your 1993 U.S. income tax return (if your 1993 return covered all 12 months of the year).

Note: If less than two-thirds of your gross income for 1993 or 1994 is from farming or fishing and your adjusted gross income for 1993 (Form 1040NR, line 31) was more than $150,000 ($75,000 if you are married filing separately for 1994), substitute 110% for 100% in (2) above.

Also, there will be no addition to the tax if the tax due (after subtracting withheld tax) for 1994 is less than $500.

When to pay. You must make your first payment of estimated tax by the due date for filing the previous year's Form 1040NR, or, if after that date, when you first become liable for payment of estimated tax.

For more information, refer to the instructions for Form 1040–ES(NR), *U.S. Estimated Tax for Nonresident Alien Individuals,* and see *Estimated Tax Form 1040–ES(NR)* in Publication 519.

Note: If you expect to be a resident of Puerto Rico during the entire year, use Form 1040–ES or Form 1040–ES(Espa'nol) to make your payments.

Other Business Considerations

This section covers withholding and employment taxes, and addresses information returns, tax treaties, certifications, and boycott provisions. This section is designed to make the reader aware of other aspects of international taxation not specifically discussed elsewhere in the publication.

Foreign Investment in U.S. Real Property

Foreign persons receiving income from investments in U.S. real property are taxed on that income. This income generally consists of rents and interest and is subject to a 30% tax on the gross receipts. This 30% tax is required to be withheld by the payor. If investment income is effectively connected with a U.S. trade or business, or an election is made to treat it as effectively connected, it will not be subject to withholding and will be subject to graduated tax rates. For the choices in treating U.S. real property income and additional information on the taxation of U.S. real property income, see Publication 519.

If a foreign person disposes of a U.S. real property interest, the gain received from this disposition is considered effectively connected with a U.S. trade or business. This gain is subject to tax at graduated tax rates and the transaction is generally subject to 10% withholding on the amount realized. This 10% withholding may be reduced, and in some cases eliminated, if certain conditions are met. See *Withholding Certificates,* below.

In certain situations, withholding may not be required at all. For a discussion of these situations, see Publication 515, *Withholding of*

Tax on Nonresident Aliens and Foreign Corporations, and section 1.1445-2 of the Regulations.

Withholding Certificates

The amount required to be withheld from the disposition of a U.S. real property interest can be adjusted pursuant to a withholding certificate issued by the IRS. The transferee (buyer) or transferor (seller) may request a withholding certificate. Form 8288-B is used for this purpose. For additional information regarding withholding certificates, see Publication 515.

Reporting and Paying the Tax

Transferees must use Forms 8288 and 8288-A to report and pay over to the IRS any tax withheld on the acquisition of U.S. real property interests. These forms generally must also be used by corporations, partnerships, estates, and trusts required to withhold tax on distributions and other transactions involving U.S. real property interests.

Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests.* The tax withheld on the acquisition of a U.S. real property interest from a foreign person is reported and paid using Form 8288. You must file Form 8288 by the 20th day after the date of the transfer with the FIRPTA Unit, Internal Revenue Service Center, Philadelphia, PA 19255.

Form 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests.* Each transferor or distributee must be notified of the amount of withholding tax paid to the IRS. Form 8288-A is used for this purpose. Attach copies A and B to Form 8288. IRS will stamp copy B and send it to the person subject to withholding. Copy C is for your records.

Other returns required. You must report the disposition of a U.S. real property interest on Schedule D with Form 1040NR (1120-F if a foreign corporation). You may be entitled to a refund if amounts withheld by the transferee exceed the tax due on the disposition. If a foreign corporation maintains an office or place of business in the United States, the foreign corporation must report the disposition of a U.S. real property interest on Form 1120-F by the due date of that form.

Penalties Under section 6651, penalties apply for failure to file Form 8288 when due and pay withholding when due. This penalty is generally imposed on the transferee at 5% of the tax per month, up to a maximum penalty of 25%. In addition, if you are required but fail to withhold tax under section 1445, the tax and interest may be collected from you. Further, under section 7202, you may be subject to a penalty of up to $10,000 for willful failure to collect and pay over the tax. Corporate officers or other responsible persons may be subject to a penalty under section 6672 equal to the amount that should have been withheld and paid over to IRS.

Withholding Taxes—Foreign Entities

Foreign entities and nonresident aliens are subject to tax on U.S. source income that is not effectively connected with a U.S. trade or business. The tax rate is 30%, unless modified by a tax treaty.

All persons who make payments of income to nonresident aliens, foreign partnerships, foreign estates, foreign trusts, or foreign corporations must withhold this tax. If they do not, they may be personally liable for the tax that should be withheld. Furthermore, an ''addition to tax'' of up to 75% may be imposed, together with other penalties.

Withholding Agent

A withholding agent is any person required to withhold the tax. This may be an individual, trust, estate, partnership, corporation, government agency, association, or tax-exempt foundation whether foreign or domestic. Withholding agents include U.S. citizens and residents. They also include foreign nominees and fiduciaries that are residents of treaty countries and must withhold additional U.S. tax under tax treaty provisions. Generally, if you pay or convey the item of U.S. source income to an alien entity or individual, or to the entity or individual's foreign or domestic agent, you are liable for the tax and must withhold.

Withholding Exemptions and Reductions

You should withhold any required tax if facts indicate that the individual, or the fiduciary, to whom you are to pay the income is a nonresident alien. However, in some cases, the nonresident alien may be entitled to an exemption from withholding or reduced rate of withholding.

Evidence of residence. You do not have to withhold tax if an individual gives you a written statement stating that he or she is a resident or citizen of the United States and you have no reason to believe otherwise. An alien may file this statement with you by using Form 1078, *Certificate of Alien Claiming Residence in the United States.* This statement should be kept with your records and not filed with the IRS.

A U.S. bank that pays income subject to withholding may decide whether to accept an individual's proof of U.S. citizenship or residence given through a foreign bank to which income is paid. If the U.S. bank accepts this proof, it will not be liable for payment of tax if later it is shown that the individual was a nonresident alien. If it accepts the proof, the U.S. bank must file Form 1042-S showing the name, address, identification number, and the particular securities of the actual owner, and indicating that it is relying on proof submitted by the foreign bank as its basis for not withholding.

Partnerships and corporations. You may rely on a written statement from a partnership or corporation claiming that it is not foreign as proof that the partnership or corporation is domestic and not subject to withholding tax. It must contain the entity's employer identification number, the address of its U.S. office or place of business, and the signature of a member of the partnership or the signature and official title of the corporate officer. This statement should be kept with your records and not filed with the IRS.

Withholding on income effectively connected with a trade or business in the United States. Generally, you do not need to withhold tax on income if:

1) The income is effectively connected with the conduct of a trade or business in the United States,
2) The income is includible in the recipient's gross income, and
3) A statement claiming exemption, such as Form 4224, has been filed by the person entitled to the income.

This **no withholding rule** applies to income for services performed by a foreign partnership or foreign corporation. The no withholding rule does **not** apply to any of the following:

1) Effectively connected taxable income of a partnership that is allocable to its foreign partners.
2) Income from the disposition of a U.S. real property interest.
3) Compensation for personal services performed by an individual.
4) Payments to a foreign corporation for services if all of the following apply:
   a) The foreign corporation otherwise qualifies as a personal holding company for income tax purposes,
   b) The foreign corporation receives amounts under a contract for personal services of an individual whom the corporation has no right to designate, and
   c) 25% or more in value of the outstanding stock of the foreign corporation at some time during the tax year is owned, directly or indirectly, by or for an individual who has performed, is to perform or may be designated as the one to perform, the services called for under the contract.

Income Subject to Withholding

IRC section 1441(b) details the items of income which require withholding. Generally, all U.S. source income received by a non-U.S. person is subject to withholding. The types of income include but are not limited to the following:

- Interest and dividends
- Rents and royalties
- Salaries, wages, and other compensation
- Premiums, annuities, and pensions
- Certain scholarships and grants

Income which is effectively connected with a U.S. trade or business of the recipient is exempt from withholding. The recipient must file Form 4224, *Exemption From Withholding of Tax on Income Effectively Connected With the Conduct of a Trade or Business in the United States,* with the payor to exempt this income from withholding. The recipient of effectively connected income must file a tax return reporting the income.

Foreign source income is not subject to withholding. IRC section 1441(c) lists other income items excluded from withholding.

Amount Withheld

The amount withheld should be 30% of gross income unless a treaty provides otherwise. Withholding agents are liable for the tax if they do not properly withhold. They must withhold on income paid to all foreign persons. A written statement from the recipient that he or she is a citizen or resident of the United States may be relied upon by the payor of the income as proof that the recipient is a citizen or resident of the United States. In this case, no withholding is required.

Income may be subject to reduced withholding under a tax treaty. The foreign person can reduce the amount that must be withheld by providing the withholding agent with Form 1001, *Ownership, Exemption, or Reduced Rate Certificate.* Upon receipt, the withholding agent may begin withholding at the reduced rate.

Certain wages paid to residents of Mexico and Canada are not subject to withholding. They must file a statement with the withholding agent to qualify for the exemption from withholding. See Publication 515 for more information.

Filing Requirements

Withholding agents must file Form 1042 and Form 1042-S. Form 1042 is the withholding agent's return showing amounts of income paid and taxes withheld. A copy of Form 1042-S is sent to the recipient showing the amount of income received and tax withheld.

Withholding agents must file Form 1042 and the associated Forms 1042-S by the March 15th after the close of the calendar year. These forms must be filed on a calendar year basis, regardless of the withholding agent's tax year.

Form 1042 is a summary of all income paid and tax withheld on persons subject to withholding. It must be prepared in duplicate. The original should be filed with the Philadelphia Service Center and the copy retained by the withholding agent. All amounts should be stated in U.S. dollars.

Form 1042-S notifies the recipient of the amount of income received and tax withheld. Unless you are filing 250 or more Forms 1042-S, the originals are sent with Form 1042 to the Philadelphia Service Center. A copy should be retained by the withholding agent. If the withholding agent receives a Form 1001 or 4224 to reduce withholding, it does not have to be sent with Forms 1042 and 1042-S.

If income payments are made to a foreign person during the year, Forms 1042 and 1042-S must be filed even though some items of income do not require withholding. However, both forms are required even if no taxes were withheld.

Deposits of withheld taxes are governed by Regulation section 1.6302-2. These rules provide for deposits to be made at the end of any month when the total accumulated withheld taxes are more than $200. If the total for the year is less than $200, the deposit should be made with Form 1042. If the withholding agent accumulates more than $2,000 per week, he or she must make deposits on a weekly basis.

Partnership Withholding on Effectively Connected Income

A foreign or domestic partnership that has income effectively connected with a U.S. trade or business (or income treated as effectively connected) must pay a withholding tax on the effectively connected taxable income that is allocable to its foreign partners. A publicly traded partnership must withhold tax on actual distributions of effectively connected income, unless it chooses to withhold on effectively connected income allocable to its foreign partners. This withholding tax does not apply to income that is **not** effectively connected with the partnerships's U.S. trade or business. Income that is not effectively connected income is subject to withholding tax at 30% or a lower treaty rate.

Who Must Withhold

The partnership, or a withholding agent for the partnership, must pay the withholding tax. A partnership that is required to pay the withholding tax but fails to do so, may be liable for the payment of the tax, and any applicable penalties and interest.

Foreign partner. The partnership must determine whether a partner is a foreign partner subject to withholding. A foreign partner can be a nonresident alien individual, foreign corporation, foreign partnership, or foreign estate or trust.

A partnership may rely on a partner's certification of non-foreign status and assume that a partner is not a foreign partner if the partner submits a certification to the partnership that:

1) States that the partner is not a foreign person,
2) Gives the partner's name, U.S. taxpayer identification number, and address,
3) States that the partner will notify the partnership within 60 days of a change to foreign status, and
4) Is signed under penalties of perjury.

Sample certifications are contained in section 5.04 of Revenue Procedure 89-31, 1989-1 C.B. 895.

Amount of Withholding Tax

The withholding tax that a partnership is required to pay for the partnership's tax year is based on its effectively connected taxable income that is allocable to its foreign partners for that tax year.

The amount of a partnership's effectively connected taxable income that is allocable to a foreign partner is the foreign partner's distributive share of the partnership's gross effectively connected income reduced by the partner distributive share of partnership deductions for the year. For information on effectively connected income and how to figure a partner's distributive share of income and deductions, see the *Instructions for Forms 8804, 8805, and 8813.*

The payments of withholding tax required to be made during a partnership's tax year are to be reported on Form 8813 and paid over to IRS (in U.S. currency). A partnership must generally pay to IRS a portion of its estimated annual section 1446 payment for each foreign partner by the 15th day of the fourth, sixth, ninth, twelfth months of the partnership's tax year for U.S. income tax purposes. Any additional amounts determined to be due are generally to be paid with the filing of Form 8804.

Tax rate. The withholding tax rate on a partner's share of effectively connected income is 35% for a partner taxed as a corporation, and 39.6% for all other partners, such as individuals, partnerships, and estates. See the *Instructions for Forms 8804, 8805, and 8813,* for additional information.

Employment Taxes

This section addresses employment taxes for individuals who reside in the United States and abroad. All employers who withhold income tax or social security taxes must file Form 941, *Employer's Quarterly Federal Tax Return.*The full amount of social security taxes and withheld federal income tax must be reported on that form.

Individuals who live and work overseas may file Form 673 with their U.S. employer to request that the employer withhold little or no tax. Generally, these employees know that they will meet the requirements of section 911 of the Internal Revenue Code and their foreign earned income will be exempt from U.S. taxation. If a person is self employed, he or she will be subject to the self-employment tax even if the income is exempt.

Nonresident aliens who are self employed are not subject to self-employment tax.

Federal unemployment tax. The Federal Unemployment Tax Act (FUTA) provides for payment of unemployment compensation to workers who have lost their jobs. Most employers pay both a federal and state unemployment tax. Report federal unemployment tax on Form 940 (or 940EZ), *Employer's Annual Federal Unemployment (FUTA) Tax Return.*

Social security and Medicare taxes. The Federal Insurance Contribution Act (FICA)

provides for a federal system of old age, survivors, disability, and hospital insurance. The social security tax finances the old age, survivors, and the disability insurance. The Medicare tax finances the hospital insurance.

Social security and Medicare taxes are levied on both the employer and employee. In addition to the employer's portion of the tax, the employer must collect and submit the employee's portion.

International social security agreements. The Internal Revenue Code (IRC) grants an exemption from taxes imposed by the Federal Insurance Contributions Act (FICA) if an individual's earnings are subject to taxes or contributions for similar purposes under the social security system of a foreign country that has an International Social Security Agreement (referred to as a totalization agreement) with the United States. Section 1401(c) of the code grants a similar exemption from the taxes imposed under the Self-Employment Contributions Act (SECA). Employees and employers exempted from FICA taxes and self-employed persons exempted from SECA taxes under the provisions of a totalization agreement are exempted from both the portions of the tax related to retirement, survivors, and disability insurance and the portion related to Medicare. The United States has totalization agreements in effect with the countries listed below:

Country	Date Entered Into Force
Austria	11/1/90
Belgium	7/1/84
Canada	8/1/84
Finland	11/1/92
France	7/1/88
Germany	12/1/79
Ireland	9/1/93
Italy	11/1/78
Luxembourg	11/1/93
Netherlands	11/1/90
Norway	7/1/84
Portugal	8/1/89
Spain	1/1/87
Sweden	1/1/87
Switzerland	11/1/80
United Kingdom	1/1/85

Totalization agreements eliminate dual social security coverage, the situation that occurs when a person from one country works in another country and is required to pay social security taxes to both countries on the same earnings. Each agreement includes rules that assign a worker's coverage to the country where the worker has the greater economic attachment.

The rules that apply to employed persons generally eliminate dual coverage under the laws of the United States and the other country. They do so by maintaining the employee's coverage under the system of the country where the work is performed and exempting the employee from coverage and taxation in the other country.

Special rules apply, however, to employees who are transferred by their employers in one country to work in the other country for a temporary period. With the exception of the agreement with Italy, each totalization agreement provides that such employees will continue to be covered under the system of the country from which they are sent and are exempt from coverage and taxation in the host country.

The agreements also contain rules applicable to persons whose self-employment earnings would be subject to coverage under the laws of both countries. They generally provide that self-employed workers are covered in the country where they reside.

Under the agreement with Italy, coverage of expatriate employees and self-employed workers is determined based on the workers' nationality.

Information on the totalization agreements listed above, including texts of those agreements, may be requested by writing to the Social Security Administration, Office of International Policy, P.O. Box 17741, Baltimore, MD 21235; or by calling (410) 965-3545 (not a toll-free number).

Employer identification number. The employer identification number (EIN) is a 9-digit number issued by the Internal Revenue Service. The EIN identifies the tax accounts of employers with and without employees. If you have not requested a number, apply on Form SS-4, *Application for Employer Identification Number.* Forms are available at Internal Revenue Service or Social Security Administration offices.

Employer. Generally, an employer is a person or organization for whom a worker performs services as an employee. An employer usually gives a worker the tools and a place to work and has the right to fire a worker.

Employees. Generally, employees can be defined either under common law or under special statutes for special purposes. For a further explanation, see Publication 15.

Filing requirements. Returns should be filed with the Internal Revenue Service Center for your area. However, returns with foreign addresses, including APO/FPO addresses, should be filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

Federal Tax Deposits for taxpayers living outside the United States must be mailed to:

Federal Reserve Bank of Philadelphia
P.O. Box 66
Philadelphia, PA 19105

The deposit requirements are explained in Publication 15, Circular E, *Employer's Tax Guide.*

Information returns. Employers and other payors of income are required to furnish information returns to the recipients of the income and to the Internal Revenue Service Center where they file their original return.

Publication 15 (Circular E) contains a chart ''Guide to Information Returns.'' Please use that chart to determine the correct form to use. Instructions for completing and filing information returns are in the chart.

Tax Treaties

The United States has income tax treaties (conventions) with a number of foreign countries. Income tax treaties are negotiated by the Treasury Department. Once the treaty has been signed, it is forwarded to the President of the United States for approval. If the President approves it, the treaty is sent to the U.S. Senate for its advice and consent. Once approved by the Senate, the treaty is returned to the President for ratification. After ratification by the other country, the instruments of ratification are exchanged and the treaty becomes law.

Under these treaties, residents of foreign countries are taxed at a reduced rate or are exempt from income taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income.

However, if the treaty does not cover a particular kind of income, or if there is no treaty between the foreign country and the United States, the rules for taxing the income under the Internal Revenue Code apply.

The benefits provided by an income tax treaty are generally on the basis of residence for income tax purposes.

Tax treaties reduce the U.S. taxes on residents of foreign countries (non-resident

Table 2. **Employment Tax Forms**

Form	Due Date
Form 940 or 940–EZ	January 31
Forms 941 and 942	April 30, July 31, October 31, and January 31
Copy A of all Forms 1099–R with Form 1096	February 28
Form 8027	February 28
Form W–3 (file with SSA and include Copy A of all Forms W–2)	February 28

aliens). With certain exceptions, they ***do not reduce*** the U.S. taxes of U.S. citizens or residents (including resident aliens). U.S. citizens and residents are subject to U.S. income tax on their worldwide income. But, because treaty provisions generally are reciprocal (i.e., apply to both treaty countries), a U.S. citizen or resident who receives income from a treaty country may refer to the tax treaty to see if it might affect the tax to be paid to that foreign country.

Publication 901, *U.S. Tax Treaties,* contains information as to whether a tax treaty between the United States and a particular country offers a reduced rate of, or possibly a complete exemption from, U.S. income tax for residents of that particular country. That publication has tables that show the countries that have income tax treaties with the United States, the tax rates on different kinds of income, and the kinds of income that are exempt from tax.

Objectives

One of the main purposes of an income tax treaty is to prevent international double taxation. International double taxation occurs when more than one country taxes the same income. Income tax treaties prevent double taxation by allowing one of the countries to tax a particular item of income based on certain basic principles. In some cases, however, both countries are given the right to tax. The right of taxation may be given to the country:

1) That is the source of income,
2) Of which the recipient is a resident, or
3) Of which the recipient is a citizen.

When both countries have the right to tax under these principles, double taxation may be eased through a foreign tax credit allowed by the country of citizenship or residence. Also, if an individual is a U.S. citizen or resident, U.S. tax law provides a limited exclusion for income earned for services performed abroad. For more information, see Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.*

Other purposes of income tax treaties include:

1) Providing for exchange of information and mutual assistance,
2) Curbing tax avoidance practices,
3) Encouraging international commerce and investment, and
4) Increasing educational and cultural exchanges with other countries.

To achieve these purposes, tax treaties contain a wide variety of provisions including tax exemptions, reductions in tax rates, tax deductions or credits, rules on allocation of income and expenses between related taxpayers, and provisions for the exchange of information.

Definitions

Certain terms are common in tax treaties. However, their exact meanings vary from treaty to treaty. The definitions that follow are, therefore, general definitions that may not give the exact meaning intended by a particular treaty. The terms ***fixed base*** and ***permanent establishment*** generally mean a fixed place of business, such as an office, factory, warehouse, or mining site, through which an enterprise carries on its business.

Another principle is that the right to tax the income of a so-called ''permanent establishment''is given to the country in which the establishment is located and generally applies to persons who engage in business activities.

Competent Authority

The tax conventions provide for the designation of a competent authority from each country who is responsible for administering and resolving problems under the treaty. The Assistant Commissioner (International) is the U.S. Competent Authority and the address is Internal Revenue Service, Assistant Commissioner (International), 950 L'Enfant Plaza South, S.W., Washington, DC 20024.

Certifications. The United States has tax treaties with many countries that reduce or eliminate the tax on certain types of income received from sources within the foreign treaty country by citizens, domestic corporations, and residents of the United States.

Generally, to prove entitlement to the benefits of the treaty, the applicant must provide a U.S. Government certification that a U.S. tax return was filed.

The taxing authorities of Italy and Spain do not accept the certification of filing a tax return as valid proof of a U.S. residence. If a certification for Spain or Italy is needed, the applicant must submit with the request for a certification a signed statement to the IRS under penalties of perjury that states the following:

1) The applicant is a U.S. resident individual or corporation,
2) The applicant does not have a permanent establishment in Italy or Spain (specify the country),
3) The applicant's permanent street address, and
4) The applicant's state of incorporation (for corporations only).

Procedures for certifications. Certification must be obtained from the Office of the Director of the Service Center where the applicant's latest income tax return was filed. While there are no special tax forms for making the request, it must include the applicant's name, social security number, tax return form number, and tax period for which certification is requested.

If there is no treaty with the foreign country, certification forms are not applicable since there will be no reduced withholding. For additional information, see Publication 686, *Certification for Reduced Tax Rates in Tax Treaty Countries.*

If a taxpayer takes a position that any U.S. tax is reduced or potentially reduced by a U.S. treaty (a treaty-based position), the taxpayer generally must disclose that position on a U.S. tax return. If the taxpayer is otherwise not required to file a tax return because it owes no tax, a return still has to be filed reporting the taxpayer's treaty-based position. This disclosure requirement does not apply to a reduced rate of withholding tax on income that is not connected with a U.S. trade or business, such as dividends, interest, rents, or royalties. It also does not apply to a reduced rate of tax on pay received for services performed as an employee, including pensions, annuities, and social security. See Section 6114 of the Internal Revenue Code.

If a taxpayer (other than a corporation) fails to disclose a treaty-based position that reduces the U.S. tax, a $1,000 penalty may have to be paid. Corporations may be subject to a $10,000 penalty for each failure. See Section 6712 of the Internal Revenue Code.

International Boycotts

Section 999 of the Internal Revenue Code defines how a U.S. person participates or cooperates in an international boycott and includes definitions of terms used to determine boycotting issues. In some cases, activities may not be considered to be boycott related if the taxpayer:

1) Participates in a boycott that U.S. law, regulation, or executive order sanctions for participation or cooperation.
2) Complies with a prohibition on importing goods produced in any country that is the object of an international boycott.
3) Complies with a prohibition imposed by a country on the export of products obtained in such country to any country that is the object of an international boycott.

Section 999 penalizes companies who enter into secondary boycotts (Company A, in order to do business with Country X, agrees not to do business with Country Y and its nationals) and tertiary boycotts (Company A, in order to do business with Country X, agrees not to do business with companies that have had business operations with Country Y.)

The boycott provisions allow for:

1) The reduction in foreign tax credits.
2) Increase in Subpart F income.
3) Reduction of Foreign Sales Corporation benefits and IC-DISC benefits.
4) A penalty for willful failure to report boycott activities (not more than $25,000, or imprisonment of not more than one year, or both).

For a list of countries that require or may require participation in or cooperation with an international boycott, see Publication 514, *Foreign Tax Credit for Individuals.*

Filing requirements. Form 5713 should be filed with the annual tax return and is due by

the due date of the return, including extensions. Form 5713 is filed with the income tax return and an additional copy is sent to the Internal Revenue Service Center, Philadelphia, PA 19255.

Form 5713 must be filed if a person:

1) Has operations in, with, or related to a boycotting country or a national or company of a boycotting country,
2) Is a member of a controlled group that has such operations,
3) Is a U.S. shareholder of a foreign corporation (greater than 10%) that has such operations,
4) Is a partner in a partnership that has such operations,
5) Is treated as the owner of a trust that has such operations,
6) Is one of the above and receives a request, which it follows up, to participate in or cooperate with an international boycott, or
7) Agrees to such a boycott request.

Table 3. **List of Federal Tax Forms**

Some of the federal tax forms required for a domestic entity doing business ove rseas and a foreign entity doing business in the United States are listed below. See Publication 509, *Tax Calendars for 1994.*

If You Are—	Use Form—	Due—
A U.S. citizen or resident alien wanting to exclude income earned abroad from income tax withholding	673	To your U.S. employer
A U.S. entity that transferred property to a foreign partnership, corporation, estate or trust	926	On the day of the transfer Also file Form 926 with your income tax return if IRC sec. 6038B applies
A foreign entity who is a beneficial owner of income subject to withholding	1001	Depending on the type of income to which this form applies as specified on the form
A nonresident alien with wages subject to withholding	1040NR	By the 15th day of the 4th month after end of tax year
A nonresident alien without wages subject to withholding	1040NR	By the 15th day of the 6th month after end of tax year
A withholding agent for fixed or determinable, annual or periodic income paid to a nonresident alien or foreign corporation	1042 1042-S	By the 15th day of the 3rd month after end of tax year
An individual, estate or trust claiming a foreign tax credit	1116	By the due date of Form 990-T, 1040, 1040NR, or 1041 including extensions
A corporation claiming a foreign tax credit	1118	By the due date of your corporate income tax return including extensions
A foreign corporation engaged in a U.S. business	1120-F	15th day of 3rd month if the corporation has an office or place of business in the U.S. 15th day of 6th month if the corporation does ***not*** have an office or place of business in the U.S.
A foreign corporation that is a personal holding company (sec. 542)	1120-F Schedule PH (Form 1120)	By the due date of Form 1120-F
A foreign sales corporation	1120-FSC	By the 15th day of the 3rd month after end of tax year
An IC-DISC	1120-IC-DISC	By the 15th day of the 9th month after end of tax year
A subsidiary corporation desiring to be included in a consolidated income tax return	1122	By the due date of Form 1120 or related corporation
A U.S. citizen or resident alien claiming the foreign earned income exclusion, housing exclusion, or foreign housing deduction	2555	By the due date of Form 1040 including extensions
A U.S. person who creates a foreign trust or transfers money or property to a foreign trust	3520	By the 90th day after creation of or transfer of any money or property to a foreign trust
A U.S. person who directly or indirectly transfers property to a foreign trust that has 1 or more U.S. beneficiaries	3520-A	By the 15th day of the 4th month following the end of the transferor's or grantor's tax year
A foreign person or business and want to obtain an exemption from withholding of tax on certain income	4224	To the withholding agent
A corporation wanting to be taxed as an IC-DISC	4876-A	Within 90 days after the beginning of the 1st tax year or for years other than the 1st tax year, during the 90-day period immediately preceding the final day of that year
A U.S. person who owns stock in a controlled foreign corporation	5471	In duplicate by the due date of your federal income tax return including extensions
A domestic corporation that is 25% foreign-owned or a foreign corporation engaged in a U.S. trade or business	5472	By the due date of your corporate income tax return including extensions
A domestic corporation electing to be treated as possessions corporation	5712	By the due date of the first return (including extensions) to which the election applies
Electing the cost sharing method or the profit split method as a possessions corporation	5712-A	With Schedule P (Form 5735)

Table 3. *(Continued)*

If You Are—	Use Form—	Due—
A member of a controlled group that has operations, a U.S. shareholder, a partner in a partnership that has operations or treated as the owner of a trust that has operations in a boycotting country or with the government, corporation, or national of a boycotting country	5713	In duplicate by the due date of your individual, partnership, corporate, or trust tax return
A domestic corporation that has elected to be treated as a possessions corporation	5735	With corporate tax return each year the election is in effect
A corporation requesting a 6-month extension of time to file its tax return	7004	By the due date of the corporate income tax return
A nonresident alien claiming exemption from withholding on compensation for independent personal services	8233	To be submitted to the withholding agent
A foreign corporation electing to be treated as a FSC or a small FSC	8279	1st year–within 90 days after the beginning of that tax year. Other years–during the 90 days immediately preceding the first day of that tax year
Acquiring a U.S. real property interest from a foreign individual or business	8288 8288-A	By the 20th day after the date of transfer
Applying for a reduction in, or elimination of, withholding on the disposition of a U.S. real property interest by foreign person	8288-B	By the date of transfer
A U.S. person owning stock in a passive foreign investment company	8621	By the due date of your federal income tax return
A partnership with effectively connected income allocable to a foreign partner	8804 8805	By the 15th day of the 4th month after tax year ends (15th day of the 6th month if all partners are nonresident aliens)
A U.S. partnership paying taxes on effectively connected income allocable to a foreign partner	8813	On or before the 15th day of the 4th, 6th, 9th, and 12th months of the partnership's tax year
A person who takes a treaty-based return position	8833	By the due date of your U.S. income tax return
A nonresident alien who meets the exception to the substantial presence test because you have a closer connection to a foreign country or countries	8840	By the due date of Form 1040NR
A nonresident alien who meets the exception to the substantial presence test because you have a medical condition or are a teacher, trainee, student, or athlete and meet certain requirements	8843	By the due date of Form 1040NR

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