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Form 1120-F – US Protective Income Tax Return: Securing Deductions against US Gross Income

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With the proliferation of digitalization in the global economy, many foreign businesses are accessing the US market online with minimal physical presence. In many instances, foreign companies selling to US consumers may have offices in the US that perform limited marketing or back office functions. But this can have tax consequences for Form 1120-F.

There is often uncertainty as to whether a company's US operations lead to them being considered as engaged in a US trade or business. The determination of US trade or business status is often facts-and-circumstances based and should be considered on a case-by-case basis. Common to all cases is that a foreign corporation that sells products or services to customers in the US, employs personnel in the US, or owns US assets, may be at risk of creating a US trade or business, explain the experts from Marcum LLP.

How to Deal with Tax Form 1120-F

The US Internal Revenue Service (IRS) requires foreign corporations that are engaged in a US trade or business to report their income and deductions connected with that US trade or business on US tax Form 1120-F. If a foreign corporation fails to file Form 1120-F on time, the IRS may prohibit the foreign corporation from claiming deductions and credits in the event that it is later determined that the foreign corporation was deemed to be engaged in a US trade or business. As a result, the foreign corporation would be subject to income tax at a rate of 21 percent on its gross income, as opposed to net income after deductions.

US Forms 1120-F and SS-4

Foreign companies in the United States need to consider certain tax details and provide information about their business. Avoid pitfalls and use expert

local knowledge. You can find the forms here:

Form 1120-F: <https://www.irs.gov/pub/irs-prior/f1120f-2018.pdf>

Form SS-4: <https://www.irs.gov/pub/irs-pdf/fss4.pdf>

Under US tax regulations a foreign corporation with limited activities in the United States, which determines that its activities do not give rise to a trade or business, may file Form 1120-F for the tax year. That way, it can protect its right to receive the benefit of deductions and credits in the event it is later determined that it is so engaged. This filing is informally referred to as a “Protective Income Tax Return.” Marcum’s advisers recommend that every foreign corporation with some presence in the US, even if limited, should consider filing a protective income tax return to secure its ability to claim deductions against US gross income.



Check what trade or business status your company has in the United States, because this determines the tax procedure

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IRS Initiative

The IRS has announced a new initiative called “Form 1120-F Non-Filer Campaign”. Under this campaign, the IRS has gathered data on foreign companies indicating that these companies are doing business in the US and should be filing Form 1120-F to report their US connected trade or business income. The IRS has indicated that it will use external data sources to identify foreign corporations that have not complied with US filing obligations.

How, and through what means, the IRS is collecting its data is not entirely clear. However, given the expansion of the digital economy and easy access to information, it is certainly prudent to assume that the IRS has significant amounts of data at its disposal. As such, foreign companies should be aware of their filing obligations and consider filing protective returns if they have not already done so.

Recommended Action

Foreign corporations that have some US presence and sell products or services to US companies should review their US filings to determine whether a protective US tax return was filed and if not, whether it is appropriate to file one, **say the experts**. The filing of a US income tax return requires taxpayers to apply for and obtain a US employer identification number (EIN). EIN applications may be submitted by filling out Form SS-4. This form can be submitted to the IRS via phone, fax or US mail.

For further information please contact:

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