

Captive insurance update



IRS increases examination activity of Forms 1120F in 2012

January 25, 2012

Alert 12 - 01

As previously brought to your attention in our Alert 11-07 (dated October 17, 2011) the IRS has created the Large Business and International Division (“LB&I”) as a means to improve its administration of international tax issues. Alert 11-07 discussed one of its initiatives that involve the IRS administration of U.S. trade or business and permanent establishment (“PE”) issues. There now appears to be a coordinated effort by LB&I to examine many more Forms 1120-F, U.S. Income Tax Return of a Foreign Corporation.

The increase in examinations is occurring for various reasons. Firstly, the IRS has recently established a Compliance Initiative Project (“CIP”) for Forms 1120-F in order to determine if the level of compliance for 1120-F filers is adequate. This project is arising from concern within LB&I’s International division that there has been an increase in income shifting and inbound financing by foreign entities. The second reason for the increase in Forms 1120-F being selected for review is the IRS has placed a greater emphasis on the examination of U.S. trade or business and PE cases, as discussed in greater detail in Alert 11-07. Accordingly, Forms 1120-F filed on a ‘protective’ basis are also being selected for examination.

Observation

Due to the increased probability of an IRS examination, taxpayers that file Form 1120-F – both regular and ‘protective’ – should be aware of their potential exposure, the issues agents can raise and should also be prepared to understand the authority the IRS has to request documents and records located in a foreign country.

It is not clear whether Forms 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, filed on a ‘protective’ basis are also included in this increased IRS examination activity; however, due to the reasons behind the increased examinations of Forms 1120-F, ‘protective’ Form 1120-PC filers should understand their U.S. trade or business and PE tax risks and be prepared to comply with the IRS requests noted above.

For additional information, please contact the following individual or your usual contact at PwC:

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