E. Recommendation: Information Reporting with Respect to Disregarded Entities

Present law requires no ongoing information reporting with respect to entities that are disregarded pursuant to a "check the box" election.[1107] Although the IRS is alerted of the existence and classification of each entity at the time the election is made, there is no regime of ongoing information reporting with respect to these entities. As a result, the IRS encounters considerable difficulty in keeping track of the various foreign entities in a company's structure and monitoring how these entities are being used in transactions. In Enron's case, the company filed 103 "check the box" elections in 1997, 191 in 1998, 151 in 1999, and 97 in 2000.[1108] After the year in which these elections were filed, the IRS would encounter great difficulty in monitoring how these entities were being used transactionally.

On the one hand, this lack of separate information reporting may be seen as appropriate, given that the entities are supposed to be "disregarded" for Federal tax purposes pursuant to the election. Nevertheless, it is also widely recognized that the application of the "check the box" regulations in the international setting has raised a number of issues that the IRS has an interest in monitoring. One example is the range of issues relating to the use of "hybrid entities" (foreign entities that are disregarded for U.S. Federal tax purposes but treated as separate taxable entities under foreign law).[1109] In addition, the IRS recently has focused some attention on the so-called "check and sell" practice, in which a "check the box" election is filed with respect to a lower-tier controlled foreign corporation in order to avoid the creation of subpart F income in connection with the sale of the stock of such corporation by a higher-tier controlled foreign corporation. The "check the box" election in these cases may convert what would have been a sale of stock (which generally creates subpart F income) into a sale of operating assets (which generally does not create subpart F income).[1110] Proposed regulations have been issued to restrict this practice, and the IRS appears to have been actively auditing the issue in the field.[1111] The existence of these and other issues relating to the use of "check the box" entities suggests that, although such entities are generally disregarded in terms of tax treatment, the IRS has an interest in monitoring their use.

The Joint Committee staff believes that a regime of annual information reporting with respect to entities disregarded pursuant to "check the box" elections would enhance the IRS's ability to administer the international tax rules and to identify and address specific issues that arise in applying the "check the box" regulations in the international area. The information to be reported could be similar to that required to be provided on Form 5471 with respect to controlled

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[1107] Treas. Reg. sec. 301.7701-1, *et seq.*

[1108] IRS Forms 8832 filed by Enron.

[1109] *See, e.g.*, Notice 98-11, 1998-6 I.R.B. 18; Notice 98-35, 1998-27 I.R.B. 35.

[1110] *See* sec. 954(c)(1)(B).

[1111] *See, e.g.*, Prop. Reg. sec. 301.7701-3(h) (Nov. 29, 1999); CCA 199937038; FSA 200046008; FSA 200049002.

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foreign corporations, and thus could include income-statement and balance-sheet information, as well as such other information as the Secretary of the Treasury may require. The statement also should include information about the entity's classification and tax treatment under the law of its country of organization.