

LB&I Process Unit

Unit Name	Allowance of Deductions and Credits on 1120-F Delinquent Returns	
Primary UIL Code	9421.01-04	Identification of a U.S. Trade or Business - Delinquent Returns

Library Level	Title
Knowledge Base	International
Shelf	Business Inbound
Book	Jurisdiction to Tax Business
Chapter	Identification of a U.S. Trade or Business or Permanent Establishment (PE)

Document Control Number (DCN)	INT-P-254
Date of Last Update	07/08/22

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Process Overview

Allowance of Deductions and Credits on 1120-F Delinquent Returns

- A Form 1120-F filer is entitled to reduce its gross income by deductions and credits (other than the credit provided under IRC 33 for tax withheld at source and the deduction for charitable contributions allowed under IRC 170, whether or not connected to effectively connected income (ECI)) only if its return is timely filed.
- For this purpose, a foreign corporation's return is timely if it is filed within 18 months after the return's due date under IRC 6072 or, if the corporation failed to file a return for the preceding tax year and the year in issue is not the first year for which a return is required to be filed, by the date that the IRS notifies the corporation that a return is due.
- Except as noted above, under IRC 882(c)(2) an untimely foreign corporation filer is not entitled to deductions and credits and the regulations thereunder and will be subject to tax under IRC 11 on its gross income at the rate provided for the applicable tax year.
- However, Treasury Regulation 1.882-4(a)(3)(ii) permits the filing deadline to be waived.
- This process unit explains the deadline waiver process.
- The Waiver Procedure Guideline is intended to assure that the waiver process is consistently applied to all Form 1120-F filers.
- If the filing deadline is waived, a foreign corporation late filing a Form 1120-F may reduce its gross income by deductions and credits to determine its taxable income.
- If a waiver is not granted the deductions and credits are (except as noted above) not allowable on a delinquent Form 1120-F.
- The foreign corporation must establish, based on the facts and circumstances, that it acted reasonably and in good faith in failing to timely file a return.

Detailed Explanation of the Process

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Analysis

- IRM 4.61.14, *International Examination Guidelines, Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver* (effective 06/08/2020), describes the waiver process. (This IRM section incorporates Interim Guidance Memorandum LB&I-04-0120-0003, originally issued as LB&I-04-0218-007, LB&I Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver Pursuant to Treas. Reg. 1.882-4(a)(3)(ii).)
- See also Treasury Regulation 1.882-4(a)(3)(ii) (last amended 03/03/2003). The provisions of this regulation are reflected in the guidance and procedures set forth in IRM 4.61.14. The regulation also includes helpful examples.
- Key analysis points:
 1. A foreign corporation shall not be granted a waiver unless it cooperates in the process of determining its income tax liability.
 2. Waiver request determinations are based on facts and circumstances.
 3. If an examiner determines that Form 1120-F was not timely filed as required under Treasury Regulation 1.882-4(a)(3)(i), the steps the IRS should take depends on whether the taxpayer has submitted a request for waiver pursuant to Treasury Regulation 1.882-4(a)(3)(ii).

Summary of Process Steps

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Process Steps

The consistent application of the law starts in the field. Established procedures for reviewing waiver requests ensure that the waiver procedures are in fact being applied consistently to all foreign corporations. Delinquent Form 1120-F filers may be more frequently identified now than in past years because the 1120-F Non-Filer Campaign has highlighted the issue and been tasked with identifying delinquent foreign corporations.

Step 1	Is the Form 1120-F a delinquent return?
Step 2	Is there a waiver request?
Step 3	Does the examination team recommend a waiver?
Step 4	Does the examination team recommend denial of the waiver?

Step 1: Is the Form 1120-F a Delinquent Return?

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Step 1

Is the Form 1120-F a delinquent return?

Considerations	Resources
<ul style="list-style-type: none">▪ Treasury Regulation 1.882-4(a)(3) provides the deadline for filing a timely return for purposes of IRC 882(c)(2).▪ Form 1120-F must be filed within 18 months of the due date set forth in IRC 6072 and the regulations thereunder. However, unless the year at issue is the first taxable year of the foreign corporation for which a return is required to be filed, if no return was filed for the preceding tax year, the return must be filed no later than the date on which the Internal Revenue Service mails a notice to the foreign corporation advising the corporation that the current year tax return has not been filed and that no deductions or credits may be claimed by the taxpayer.▪ Under IRC 6072 and regulations thereunder, the general filing date rules for foreign corporations with a U.S. office are:<ul style="list-style-type: none">– Returns made on the basis of the calendar year shall be filed on or before the 15th day of April following the close of the calendar year or,– Returns made on the basis of a fiscal year shall be filed on or before the 15th day of the fourth month following the close of the fiscal year.	<ul style="list-style-type: none">▪ Treas. Reg. 1.882-4(a)(3)▪ IRC 882(c)(2)▪ IRC 6072

Step 1: Is the Form 1120-F a Delinquent Return? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns


Step 1

Considerations	Resources
<ul style="list-style-type: none"> ▪ Exception: <ul style="list-style-type: none"> – if a foreign corporation has a U.S. office and its fiscal year ends on June 30, then, for fiscal years beginning on or before December 31, 2025, the return is due the 15th day of the 3rd month after the end of the fiscal year (September 15th). – If the foreign corporation does not have a U.S. office, then 15th day of the 6th month following the close of the fiscal or calendar year as the due date is used instead of the 4th month. ▪ IRC 882(c)(2) does not address whether a foreign corporation is entitled to take into account its Cost of Goods Sold in computing its gross income. Only “below the line” expenses are disallowed under IRC 882(c)(2). See Treasury Regulation 1.61-3(a) (for a manufacturing, merchandising, or mining business, “gross income” includes the total sales, less the cost of goods sold) ▪ A delinquent filer may still claim the credit provided under IRC 33 for tax withheld at source and the deduction for charitable contributions allowed under IRC 170 (whether or not connected to ECI). ▪ If it is not delinquent, then the foreign corporation may apply deductions and credits against its Form 1120-F Part II effectively connected income to a U.S. trade or business. 	<ul style="list-style-type: none"> ▪ IRC 61 ▪ Treas. Reg. 1.61-1 to 22 ▪ IRC 861 – 864 ▪ <i>Swallows Holding, Ltd. v. Commissioner</i> - 515 F.3d 162 (2008) ▪ <i>Adams Challenge (UK) Ltd. v. Commissioner</i> - 154 T.C. 37 (2020) ▪ <i>Adams Challenge (UK) Ltd. v. Commissioner</i> - 157 T.C. 16 (2021)

Step 1: Is the Form 1120-F a Delinquent Return? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 1](#)


Considerations	Resources
 DECISION POINT: Determine whether the Form 1120-F is a delinquent return. <ul style="list-style-type: none">▪ If it is delinquent, proceed with the waiver process steps to determine if deductions and credits will be allowed as a reduction to gross income when determining taxable income.▪ If it is not delinquent, then proceed with regular audit steps to examine the gross income, deductions and credits and other items reported on the Form 1120-F.	

Step 2: Is There a Waiver Request?

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Step 2


Is there a waiver request?

Considerations	Resources
<ul style="list-style-type: none">▪ Treasury Regulation 1.882-4(a)(3)(ii) permits the Commissioner to waive the filing deadline and allow a foreign corporation to claim deductions and credits if the foreign corporation can establish, based on the facts and circumstances, that it acted reasonably and in good faith in failing to timely file a return.▪ Before 2018, no formal IRS process had previously been in place for processing and considering requests from taxpayers seeking the waiver of filing deadline.▪ The Waiver Procedure Guideline was started in 2018 to apply the waiver process consistently for all foreign corporations. <p> CAUTION: Do not discuss with a taxpayer either in advance of filing a return or in advance of considering a waiver request whether or not the waiver would be granted.</p>	<ul style="list-style-type: none">▪ IRM 4.61.14 - <i>International Examination Guidelines, Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver.</i>

Step 2: Is There a Waiver Request? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 2](#)

Considerations	Resources
<ul style="list-style-type: none">▪ Delinquent returns must be filed with the Ogden Campus (per the Form 1120-F filing instructions) for processing and not accepted by field groups.▪ This does not include returns & related returns that are under audit.▪ A waiver request may occur in response to an examination of a delinquent return. <p> DECISION POINT: Did the taxpayer provide a waiver request?</p> <ul style="list-style-type: none">▪ If yes, continue with the waiver process steps.▪ If no, provide the taxpayer with a Waiver Procedure Information Letter and continue with the examination. Return to the waiver process if the taxpayer provides a waiver request later in response to the letter.	<ul style="list-style-type: none">▪ IRM Exhibit 4.61.14-4 - <i>Wording to Use With Waiver Procedure Information Letter</i>▪ IRM 4.61.14.1.3

Step 3: Does Examination Team Recommend a Waiver?

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Step 3

Does the examination team recommend a waiver?

Considerations	Resources
<ul style="list-style-type: none"> ▪ Form 1120-F Waiver Procedure Guidelines and Waiver Summary Analysis are written instructions on the formal waiver procedures and how to document analysis of a waiver request. ▪ Field examiners are responsible for providing the review and analysis of a foreign corporation's waiver request and recommending whether to grant or deny the waiver request based generally on the 6 factors in the regulation (see next slide). ▪ The Waiver Summary Analysis will be provided to Cross Border Activities (CBA) Director of Field Operations (DFO). ▪ The Waiver Committee gets the analysis only if the waiver is denied by the examination team or later by the CBA DFO, though the CBA DFO may provide the Waiver Committee the analysis if an opinion is sought before a denial decision is made. ▪ The CBA DFOs have been delegated the authority to make final determinations regarding waiver requests. ▪ The examination team is required to consider six factors when evaluating whether the foreign corporation, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return timely. 	<ul style="list-style-type: none"> ▪ IRM Exhibit 4.61.14-2 - <i>Flowchart of Waiver Request Processing</i>

Step 3: Does Examination Team Recommend a Waiver? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns



[Step 3](#)

Considerations	Resources
<ul style="list-style-type: none">▪ The six factors are set forth in Treas. Reg. 1.882-4(a)(3)(ii)(A)-(F). They are:<ol style="list-style-type: none">1. Whether the corporation voluntarily identifies itself to the IRS as having failed to file a U.S. income tax return before the IRS discovers the failure to file.2. Whether the corporation did not become aware of its ability to file a protective return (as described in Treas. Reg. 1.882-4 (a)(3)(vi)) by the deadline for filing a protective return.3. Whether the corporation had not previously filed a U.S. income tax return.4. Whether the corporation failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account its relevant experience and level of sophistication), the corporation was unaware of the necessity for filing the return.5. Whether the corporation failed to file a U.S. income tax return because of intervening events beyond its control.6. Whether other mitigating or exacerbating factors existed (note need cooperation with the corporation).	<ul style="list-style-type: none">▪ Treas. Reg. 1.882-4(a)(3)(ii)(A) to (F)

Step 3: Does Examination Team Recommend a Waiver? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 3](#)

Considerations	Resources
<p> CONSULTATION: The examination team may contact the Jurisdiction to Tax Practice Network for assistance with the decision process.</p> <p> DECISION POINT: Did the examination team, along with concurrence from the Territory Manager, decide to recommend to the CBA DFO an acceptance of the waiver request?</p> <ul style="list-style-type: none">▪ If yes, prepare the Waiver Request Package (see the next slide) and continue with Step 3 of the waiver process.▪ If no, prepare the Waiver Request Package (see the next slide) and skip ahead to Step 4 of the waiver process presented in this practice unit.	<ul style="list-style-type: none">▪ Jurisdiction to Tax Business Knowledge Management site

Step 3: Does Examination Team Recommend a Waiver? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 3](#)

Considerations	Resources
<ul style="list-style-type: none">▪ Prepare the Waiver Request Package for routing to the CBA DFO. The Waiver Request Package includes the administrative file including, but not limited to:<ol style="list-style-type: none">1. The Waiver Summary Analysis (see IRM Exhibit 4.61.14-1).2. The taxpayer's request for waiver and any supplements thereto.3. Any Information Document Requests (IDR)s or other requests for information related to the request for waiver issued by the examination team to the taxpayer or third-parties.4. The responses to any such IDRs and requests for information.5. A Form 886-A, protest and rebuttal, if any.6. Documentation to support that the procedures are followed (as outlined in IRM 4.61.14).	<ul style="list-style-type: none">▪ Audit Tool - Waiver Summary Analysis

Step 3: Does Examination Team Recommend a Waiver? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 3](#)

Considerations	Resources
<ul style="list-style-type: none">▪ The CBA DFO will consider the Waiver Request Package and either seek additional information or decide to accept or deny the deadline waiver request.<ul style="list-style-type: none">– If the decision is to accept, then the conclusion will be routed to the examination team who will via writing inform the taxpayer of the decision.– If the decision is leaning towards denial, the CBA DFO may consult with a Waiver Committee (see next slide).<ul style="list-style-type: none">▪ If consulted, the Waiver Committee will consider the deadline waiver request and provide a recommendation to accept or deny the request to the CBA DFO.▪ The CBA DFO will make the final decision.<ul style="list-style-type: none">– The conclusion will be routed to the examination team who will via writing inform the taxpayer of the decision.– If the decision is to grant the waiver, then the examination team may proceed with the audit including examining the deductions and credits from the Form 1120-F.– If the decision is to deny the waiver, then the examination team can disallow the deduction and credit amounts from the Delinquent Form 1120-F and examine only the gross income items (including cost of goods sold).	

Step 3: Does Examination Team Recommend a Waiver? (cont'd)

Allowance of Deductions and Credits on 1120-F Delinquent Returns

[Step 3](#)

Considerations	Resources
<ul style="list-style-type: none">▪ The composition of Waiver Committee includes:<ul style="list-style-type: none">- CBA PN Program Manager- One CBA Territory Manager and one CBA Team Manager<ul style="list-style-type: none">▪ Assigned from a different CBA DFO's area than the current case's area▪ Providing advisory roles are:<ul style="list-style-type: none">- Counsel (for legal support to the Waiver Committee and DFOs)- Treaty Assistance and Interpretation Team (TAIT) (for assistance on treaty cases involving taxpayers claiming treaty benefits on an ad hoc basis)	

Step 4: Does Examination Team Recommend Denial of Waiver?

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Step 4

Does the examination team recommend denial of the waiver?

Considerations	Resources
<ul style="list-style-type: none"> ▪ If the examination team recommends denial of waiver, forward the Waiver Request Package to the Waiver Committee. ▪ The Waiver Committee will forward their recommendation to the CBA DFO. <ul style="list-style-type: none"> – The Waiver Committee will ensure that, regardless of the type of business conducted, all recommendations for denial of waivers will be evaluated by an independent committee and handled consistently. ▪ The CBA DFO may request additional information or clarification from the Waiver Committee and/or the examination team prior to making his or her determination. ▪ The CBA DFO makes a final determination whether to grant or deny waiver. <ul style="list-style-type: none"> – The conclusion will be routed to the examination team who will via writing inform the taxpayer of the decision. – If the decision is to grant the waiver, then the examination team may proceed with the audit including examining the deductions and credits from the Form 1120-F. – If the decision is to deny the waiver, then the examination team can disallow the deduction and credit amounts from the Delinquent Form 1120-F and examine only the gross income items (including cost of goods sold). 	<p>Refer to Step 3 of this unit for information on the Waiver Request Package and on the Waiver Committee.</p>

Other Considerations / Impact to Audit

Allowance of Deductions and Credits on 1120-F Delinquent Returns	
Considerations	Resources
<ul style="list-style-type: none"> ▪ A Form 1120-F may be reporting only items in Section 1 from income from U.S. sources not effectively connected with a U.S. trade or business. No deductions are allowed against this type of income. A deadline waiver is not necessary. 	<ul style="list-style-type: none"> ▪ IRC 861 - <i>Income from Sources within the United States</i>
<ul style="list-style-type: none"> ▪ Although the term “trade or business within the United States” (USTB) statutorily includes the performance of personal services within the United States (see IRC 864(b)) and certain defined activities of a Nonresident Alien (NRA) or foreign corporation do not give rise to a USTB, the term is not fully defined in the Code or regulations, and, in general, whether a USTB exists turns on all relevant facts and circumstances. A taxpayer that is not engaged in (or deemed to be engaged in) a USTB will not report ECI. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.864-2(e)
<ul style="list-style-type: none"> ▪ An applicable income tax treaty may limit the U.S. taxation of a foreign corporation’s U.S. trade or business income (ECI) to its income that is attributable to a permanent establishment within the United States. 	<ul style="list-style-type: none"> ▪ IRC 894

Index of Referenced Resources

Allowance of Deductions and Credits on 1120-F Delinquent Returns

IRC 61

IRC 861 – 864

IRC 882(c)(2)

IRC 894

IRC 6072

Treas. Reg. 1.61-1 to 22

Treas. Reg. 1.864-2(e)

Treas. Reg. 1.882-4

IRM 4.61.14

Adams Challenge (UK) Ltd. v. Commissioner - 154 T.C. 37 (2020)

Adams Challenge (UK) Ltd. v. Commissioner - 156 T.C. 16 (2021)

Swallows Holding, Ltd. v. Commissioner - 515 F.3d.162 (2008)

Jurisdiction to Tax Business Knowledge Management site

Training and Additional Resources

Allowance of Deductions and Credits on 1120-F Delinquent Returns

Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none">▪ <i>1120F Waiver Process</i> - 2018 Saba Meeting
Issue Toolkits	<ul style="list-style-type: none">▪ Audit Tool - 1120-F Best Practices from Field Examiners▪ Audit Tool - Waiver Summary Analysis

Glossary of Terms and Acronyms

Term/Acronym	Definition
CBA	Cross Border Activities
DFO	Director of Field Operations
ECI	Effectively Connected Income
IDR	Information Document Request
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
LB&I	Large Business & International
NRA	Nonresident Alien
TAIT	Treaty Assistance and Interpretation Team
USTB	U.S. Trade or Business

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
9422	<i>General Deductions of a Foreign Corporation Engaged in U.S. Trade or Business (Non Treaty)</i>
9422	<i>Gross Effectively Connected Income (ECI) of a Foreign Corporation (Non-Treaty)</i>
9422	<i>Fundamentals of Gross Effectively Connected Income / Non-Treaty</i>