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U.S. Effectively Connected Income (ECI) and SMLLC Tax Filing Issues

1. What is ECI?

Under the Internal Revenue Code, a foreign corporation/ Non-resident Alien (NRA) that carries on a trade or business in the United States is subject to U.S. income tax at the same progressive rates as U.S. corporations/citizens, but only with respect to effectively connected income (ECI) with its U.S. trade or business.

When a foreign person (corporation, individual) engages in a **trade or business within the United States (USTB)**, all income from sources within the United States connected with the conduct of that trade or business is considered to be Effectively Connected Income (ECI).

2. Trade or Business within the U.S. and Dependent Agent

The term “trade or business within the United States (USTB)” is not fully defined in the Code or Treasury regulations. Usually, you are considered to be engaged in a U.S. trade or business when you perform personal services in the United States at any time within the taxable year. Relevant court cases and rulings state that continuous business contacts with the U.S. are usually required in order for a foreign corporation/NRA to be engaged in a USTB. Generally, the activities by the taxpayer directly or through a **dependent agent**, must be regular, substantial and continuous in order to be “engaged in a trade or business” (USTB). That means, even when you are not directly engaged in a U.S. trade or business, you could be deemed to be engaged in a U.S. trade or business as the result of regularly selling into the United States through a US office, an employee, dependent agents.

A dependent agent is an individual or company, whether or not an employee of the foreign enterprise, who is not an independent agent. If a non-resident alien /foreign corporation has at least one dependent agent in the U.S., a non-resident alien /foreign corporation is considered to have an office or fixed place of business in the U.S. and thus “engaged in a trade or business within U.S.”.

A dependent agent is basically a person who works for you so closely that the dependent agent’s actions can be said to be an extension of your own actions. The example of the dependent agent is your employees (or contractors) who exclusively work for you.

Overall, U.S. source income that is effectively connected with a U.S. trade or business (USTB) is connected with the fact that the foreign corporation has a fixed base place/permanent establishment of business in the U.S. (i.e. it has some sort of permanent office, factory, base of operation, dependent agent etc., in the U.S. from which it generates its U.S. income). Foreign source income is generally not treated as Effectively Connected Income (ECI), but there are a few exceptions. Under IRC §864(c)(4)(B), certain items of foreign source income are treated as Effectively Connected Income (ECI) if such income is attributable to an office or other fixed place of business in the U.S.

3. Definition of Independent Agent

In contrast to dependent agent, **independent agent** is not considered as the “engaged in a trade or business in U.S.” and is not subject to U.S. tax. Under the Treas. Reg. 1.864-7(d), an independent agent is both legally and economically independent of the foreign enterprise. It is a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business in that capacity. For example, Amazon has their own business going on, and you are just one of Amazon’s many clients. Therefore, Amazon is an independent agent.

Under Treas. Reg. 1.864-7(d), the agent is not an independent agent if such agent (i) has the authority to negotiate and conclude contracts in the name of the NRA or foreign corporation, and regularly exercises that authority, or (ii) has a stock of merchandise belonging to the non-resident alien individual or foreign corporation from which orders are regularly filed on behalf of such alien individual or foreign corporation.

For example, Eric Inc, a Hong Kong company, plans to sell products into the U.S. market through the Amazon’s fulfillment service. Eric Inc buys products and has them shipped to Amazon’s warehouses in the U.S., and Amazon employees package the products and ship to customers. For this case, Eric Inc has no physical presence in the U.S. and the Amazon is not a dependent agent, so Eric Inc is not “engaged in a trade in the United States” and not considered as Effectively Connected Income (ECI), and thus not subject to US tax on income from selling products into the U.S.

4. Foreign-owned SMLLC Tax Filing Issues

A single-member LLC (SMLLC) is treated as a “disregarded entity” (DE), and the LLC’s income should be passed through to the owner’s federal tax return. For the case of foreign-owned U.S. DE, which is wholly owned by a foreign person, although the entity itself has no income tax liability, it is still required to file a pro forma Form 1120 with Form 5472 attached by the due date. The only information required to be completed on Form 1120 is the name and address of the foreign-owned U.S. DE and items B and E on the first page.

For the foreign owner, if the U.S. DE has no office or other fixed place of business directly or through the dependent agent within the U.S., the foreign owner may NOT have Effectively Connected Income (ECI) and NOT subject to the U.S. tax liability. Otherwise, the foreign owner must file the Form 1120F (foreign corporation) or 1140NR (Non-resident Alien) to report their income received within the U.S. effectively connected with the conduct of the trade or business.

<https://www.irs.gov/individuals/international-taxpayers/effectively-connected-income-eci>
https://www.irs.gov/pub/int_practice_units/USBCUP_14_2_01.pdf

https://www.irs.gov/pub/default_path_no_value/treat_016_07_02.pdf

<https://www.irs.gov/instructions/i5472#idm139816470384736>

<https://www.law.cornell.edu/cfr/text/26/1.864-7>

<https://www.law.cornell.edu/uscode/text/26/864>

<https://oandgaccounting.com/amazon-foreign-sellers-irs-taxes-and-1099-k-reporting/>

<https://ustax.bz/non-us-entrepreneurs/>

<https://oandgaccounting.com/amazon-foreign-sellers-irs-taxes-and-1099-k-reporting/>

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