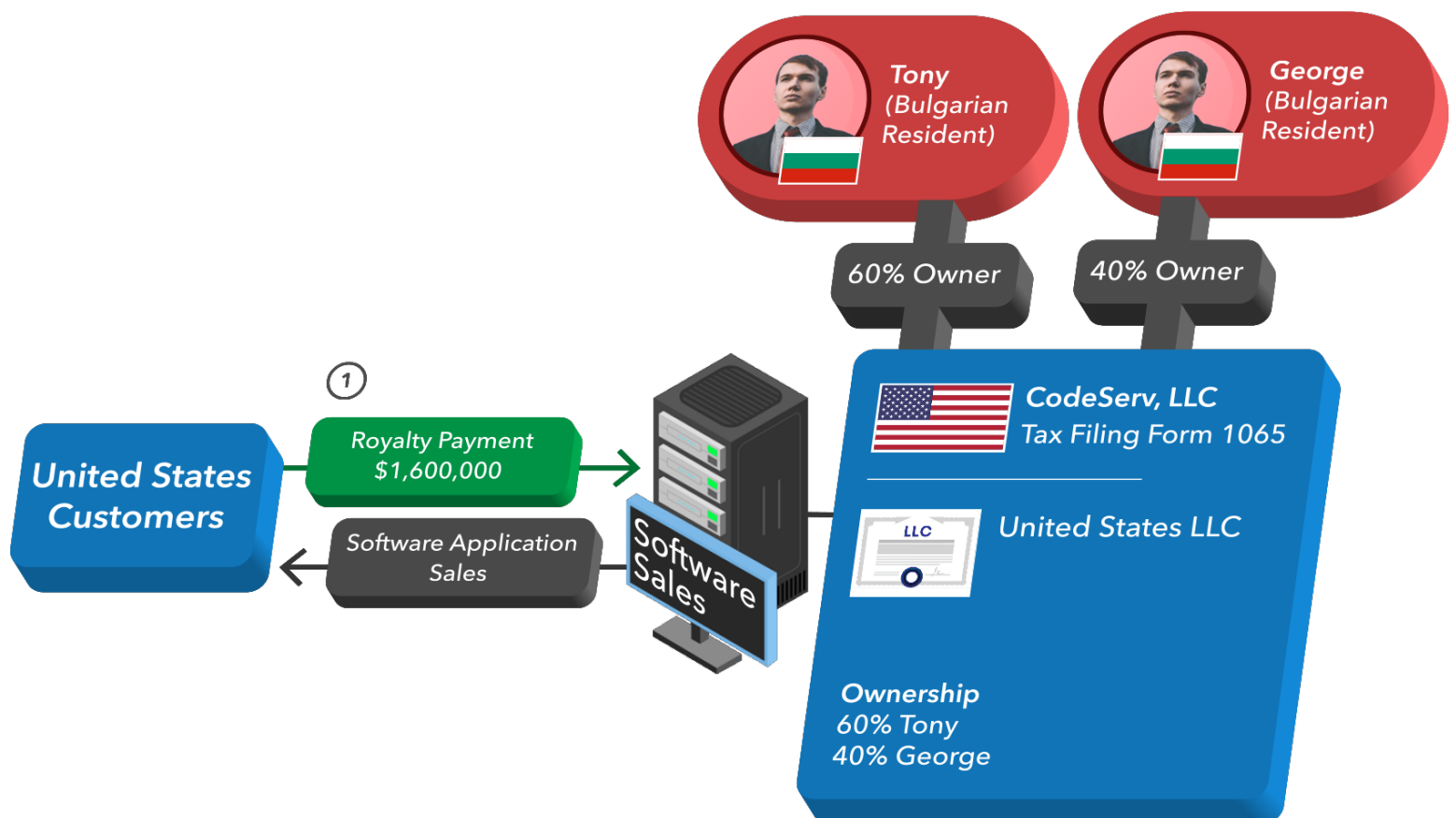# Bulgarian NRA LLC Partnership Software Sales

Tax Structures of United States Foreign-Owned LLCs - Structure #3

Structure Summary

Two Non-Resident Alien Partners of a Limited Liability Company receive royalties from U.S. customers, which are subject to a special 5% tax treaty withholding rate. This structure occurs when non-resident aliens receive royalties from U.S. sources.

Structure Background

CodeServ, LLC is a United States Limited Liability Company that sells software to U.S. customers. Both Tony and George are Bulgarian citizens and residents, as well as the owners of CodeServ, LLC. Tony owns 60%, and George owns 40%.

Both maintain offices in Bulgaria and are not physically present in the United States. As a Multi-Member LLC, CodeServ, LLC is classified as a Partnership for Federal tax purposes.

Source and Taxation of Royalty Income (Software)

For the use of copyrighted software (whether as a web application subscription or a one-time purchase), royalties are sourced based on the location where the property was used, as per Internal Revenue Code §861. Therefore, software sold to U.S. customers is a U.S. source of royalty income.

Based on the Tax Treaty rate for royalties earned in the United States, residents of Bulgaria are taxed at a flat rate of 5%.

No Trade or Business & Effectively Connected Income (ECI)

As the LLC does not physically operate in a particular state nor sell physical goods directly to clients, and therefore was not determined to conduct a trade or business in the U.S., resulting in Effectively Connected Income (ECI) per Treasury Regulation §1.355-3.

Monetary Transactions

1. CodeServ, LLC sells software totaling $1,600,000, all of which are to U.S. customers using the software in the United States.

U.S. Tax Filing Compliance

2. **Form 1065 (CodeServ, LLC).** On its Income Statement and related Form 1065, U.S. Return of Partnership Income CodeServ, LLC reports a Net Income of $1,600,000.

3. **Form 1042 (CodeServ, LLC).** Withholding tax applies for dividends paid to non-residents per Internal Revenue Code §1441. In this structure, at tax treaty rate of 5% applies to residents of Bulgaria for Royalties. As a result, $80,000 is withheld from dividends ($1,600,000 x 5%). The withholding is recorded and paid on Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.

4. **Form 1040NR (Tony).** As an owner of a Partnership LLC (issuing a Schedule K-1, Tony files Form 1040NR, U.S. Nonresident Alien Income Tax Return, to report the royalty income of $960,000 taxed at 5% rate, or a $48,000 withholding tax. As the tax has

already been withheld at the source, there is no tax due. [This tax return is shown on the chart]

5. **Form 1040NR (George).** As an owner of a Partnership LLC (issuing a Schedule K-1, George files Form 1040NR, U.S. Nonresident Alien Income Tax Return, to report the royalty income of $640,000 taxed at 5% rate, or a $32,000 withholding tax. As the tax has already been withheld at the source, there is no tax due. [This tax return is not shown on the chart but follows the same principle as Tony's Form 1040NR]

Summarized Tax Returns and Financial Statements

④

Form 1040NR   **(Tony)**

Schedule NEC

Total U.S. Source Royalty Income	$960,000
Royalty FDAP Withholding (Bulgaria)	5%
Withholding Tax	$48,000
Tax Liability	$48,000
Tax Due	**$0**

②

Form 1065   **CodeServ, LLC Partnership Tax Return**

Software Sales to U.S. Customers (U.S. Royalties)	**$1,600,000**
Net Income	**$1,600,000**

③

Form 1042   **CodeServ, LLC**

U.S Source Royalties

$1,600,000 x 5% = $80,000 Tax

Resulting Tax Implications

As a result of this structure, the U.S. tax liability of CodeServ, LLC (and by extension, each non-resident partner) is $80,000 for Fixed Determinable and Periodic income related to Royalties.