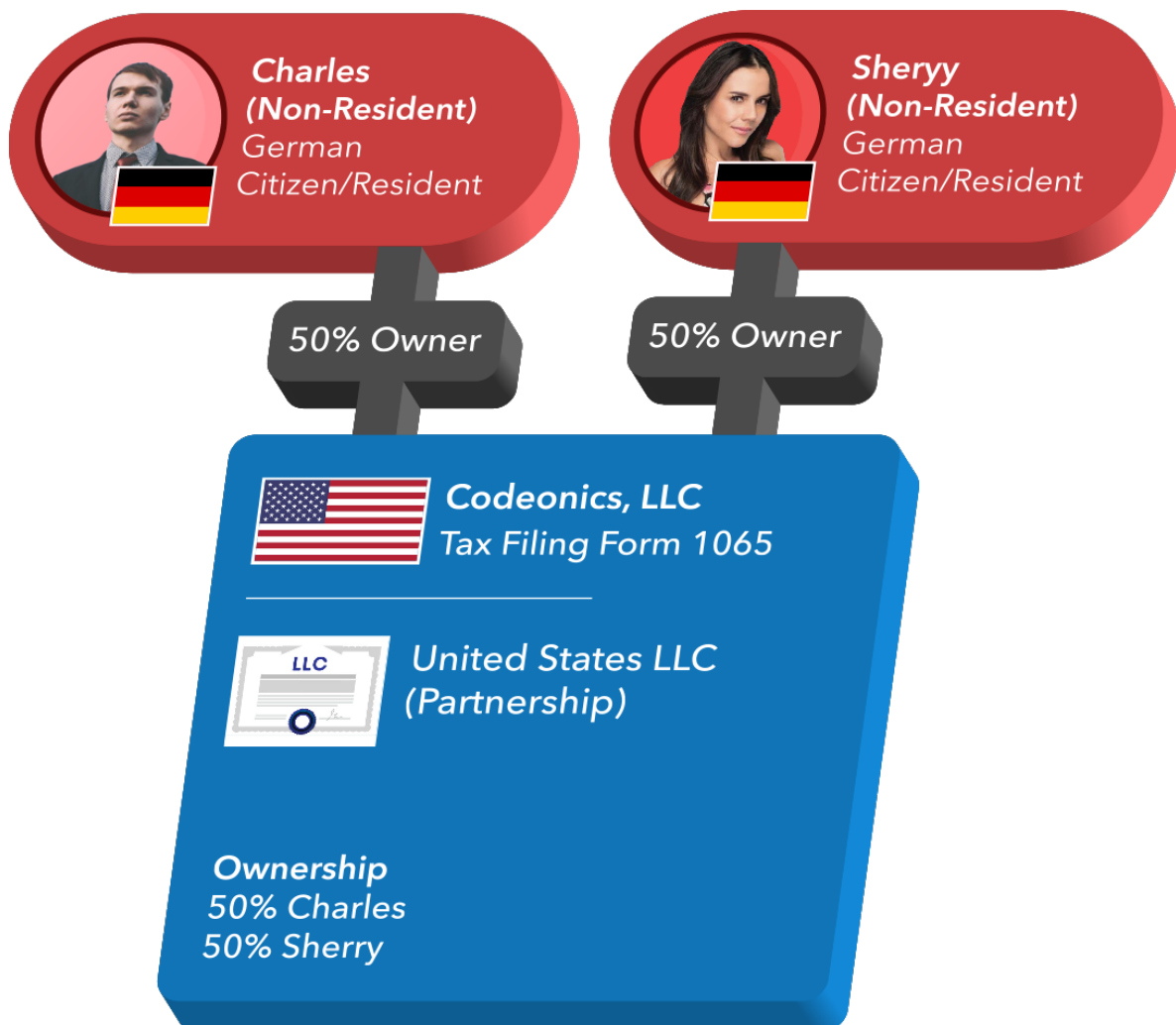


German LLC Partners (No USTOB/ECI) Reduced Withholding

Tax Structures of United States Foreign-Owned LLCs - Structure #4

Structure Summary

A multi-member LLC Partnership owned and operated by two non-resident aliens working in a foreign country is not subject to U.S. tax as they are each providing personal services abroad, have no Permanent Establishment in the U.S., and have no Effectively Connected Income.



German LLC Partners (No USTOB/ECI) Reduced Withholding

Structure Background

Codeonics, LLC is a United States Limited Liability Company which provides a mix of computer programming services for clients throughout the world, as well as sells web applications for user use. The LLC has two partners, Charles (a German citizen and resident) owning 50%, and Sherry (also a German citizen and resident) owning 50%. Each partner receives and contributes an equal portion of profit/loss and capital into the partnership.

Both partners work physically in Germany, providing personal services in computer programming. They maintain a permanent establishment in Germany and are not physically present in the United States. Their clients for programming services are based both in the United States and in foreign countries. The web applications are sold through a variety of digital marketplaces, and clients both in the United States and in foreign countries use the web applications for use.

Source and Taxation of Personal Services of Foreign Partners (Coding/Programming)

In regard to business income from personal services (coding/programming services), the source of income is based on the location where the service was performed. Per Internal Revenue Code §864, U.S. source income does not include the personal services for a non-resident alien individual not engaged in trade or business within the United States.

As a result, the compensation for programming services performed in Germany is not U.S. source income.

No U.S. Trade or Business & Effectively Connected Income (ECI)

There is no legal definition of what constitutes a “U.S. Trade or Business”; however, case law has indicated that a business that is “considerable, continuous, and regular” meets that definition. No treasury regulation suggests that the use of a Limited Liability Company solely triggers a U.S. trade or business.

As the income sourced from the business does not physically operate, market, or perform services in the United States and therefore is not determined to conduct a trade or business in the U.S., resulting in Effectively Connected Income (ECI) per Treasury Regulation §1.355-3.

Internal Revenue Code §875, Partnerships; beneficiaries of estates and trusts, does not apply as there are no other partners engaged in a U.S. Trade or business.

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Royalty Income (Taxed at 0% for Germany)

For the use of copyrighted software (either used as a web application subscription, or one time purchase), royalties are sourced where the property was used⁵ per Internal Revenue Code § 861.

Based on the Tax Treaty rate of Royalties earned for application used in the United States, residents of Germany are taxed at a flat rate of 0%¹.

Royalties for applications used by foreign customers is not U.S. source income.

Reduced Foreign Partnership Withholding

Foreign partners are subject to a flat withholding based on their allocable share of the LLC Net Income per Internal Revenue Code §1446 - Withholding of tax on foreign partners' share of effectively connected income.

However, this withholding can be reduced by filing 8804-C, Certificate of Partner-Level Items to Reduce Section 1446 Withholding, based on certification of Effectively Connected Income.

Monetary Transactions & Accounting

1. Codeonics, LLC generates \$240,000 of Net Income during the year, based on the following:
 - Coding Services to U.S. Customer + \$150,000
 - Coding Services to Foreign Customers + \$100,000
 - Application Sales U.S. Royalties + \$50,000
 - Application Sales Foreign Royalties + \$20,000
 - Administrative Expenses - \$80,000

U.S. Tax Filing Compliance

2. **Form 1065, Schedule K-1, Form 8804/8805.** The tax return for the LLC is prepared, Form 1065, A U.S. Return of Partnership Income, to include Schedule K-1, and Forms

¹ <https://www.irs.gov/individuals/international-taxpayers/nonresident-aliens-source-of-income>

German LLC Partners (No USTOB/ECI) Reduced Withholding

8804/8805. However, as there is no Effectively Connected Income shown Form 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax reports \$0 of U.S. ECI allocable to both foreign partners.

3. **Reduction in Foreign Partner Withholding.** Form 8804-C, Certificate of Partner-Level Items to Reduce Section §1446 Withholding, is filed to the partnership to reduce the withholding for each foreign partner.
4. **Form 1040NR (Charles).** On his personal tax return Form 1040, U.S. Individual Income Tax Return Allen reports \$0 of Effectively Connected Income, and claims the 0% flat tax of Royalties on Form 8833, Treaty-Based Return Position Disclosure Under Section §6114 or §7701(b).
5. **Form 1040NR (Sherry).** On her personal tax return Form 1040, U.S. Individual Income Tax Return Allen reports \$0 of Effectively Connected Income and claims the 0% flat tax of Royalties on Form 8833, Treaty-Based Return Position Disclosure Under Internal Revenue Code §6114 or §7701(b).

German LLC Partners (No USTOB/ECI) Reduced Withholding

Summarized Tax Returns and Financial Statements

1

Income Statement Codeonics, LLC

Coding Services (U.S. Customers)	\$150,000
Coding Services (Foreign Customers)	\$100,000
Application Sales (U.S. Royalties)	\$50,000
Application Sales (Foreign Royalties)	\$20,000
Administrative Expenses	- \$80,000
Net Income	\$240,000

2

Form 1065 Codeonics, LLC U.S. Partnership Tax Return

Coding Services (U.S. Customers)	\$150,000
Coding Services (Foreign Customers)	\$100,000
Application Sales (U.S. Royalties)	\$50,000
Application Sales (Foreign Royalties)	\$20,000
Administrative Expenses	- \$80,000
Net Income	\$240,000

3

Form 8804/8804-C

Reduction in Foreign Partner Withholding
(on Effectively Connected Income)

ECI **\$0**

4

Form 1040NR Charles

Ordinary Income/ECI	\$0
Schedule NEC	
Total U.S. Source Royalty Income	\$25,000
Royalty FDAP Withholding (Germany)	0%
U.S. Tax	\$0

Form 8832 Tax Treaty Exclusion

5

Form 1040NR Sherry

Ordinary Income/ECI	\$0
Schedule NEC	
Total U.S. Source Royalty Income	\$25,000
Royalty FDAP Withholding (Germany)	0%
U.S. Tax	\$0

Form 8832 Tax Treaty Exclusion

German LLC Partners (No USTOB/ECI) Reduced Withholding

Resulting Tax Implications

As a result of this structure and the facts and circumstances outlined, each foreign partner's U.S. taxable income is \$0. There is no U.S. Trade or Business with a Permanent Establishment, and the flat tax for Royalties is 0% for German residents.