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Final Regulations Address Gain Recognition Agreements and Other Cross-Border Transfer Reporting

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On November 19, 2014, the U.S. Internal Revenue Service (IRS) and U.S. Treasury Department issued final regulations revising the reporting rules applicable to stock and property transfers under Internal Revenue Code sections 367 and 6038B, including section 367(a) gain recognition agreements (GRAs).¹ Most notably, the regulations provide common standards to address untimely and incomplete filings, including revised coordination of the sections 367 and 6038B rules. The regulations adopt, with amendments, proposed regulations issued on January 31, 2013 (the 2013 proposed regulations).²

The final regulations are effective for filings that are due on or after November 19, 2014, and requests for late or incomplete filing relief that are submitted on or after November 19, 2014.³

New Provisions in the Final Regulations

While the final regulations are generally consistent with the 2013 proposed regulations, the final regulations include several revisions and additions. Most notably:

- The final regulations expand the scope of the 2013 proposed regulations to include the filings under Treas. Reg. §§1.367(a)-2 and 1.367(a)-7.⁴
- The final regulations revise the extension of statute of limitations rules applicable in the event a taxpayer fails to comply in any material respect with the GRA or §1.367(e)-2 reporting requirements.⁵
- The final regulations expand the Form 926 information reporting required when a taxpayer files a GRA.⁶
- The final regulations permit taxpayers, in certain circumstances, to re-

¹ T.D. 9704, 79 Fed. Reg. 68763 (November 19, 2014).

² REG-140649-11, 78 Fed. Reg. 6772 (January 31, 2013).

³ Treas. Reg. §§1.367(a)-2(f)(4), 1.367(a)-3(g)(1)(x), 1.367(a)-7(j), 1.367(a)-8(r)(1)(i) and (3), 1.367(e)-2(g), and 1.6038B-1(g)(6).

⁴ Treas. Reg. §§1.367(a)-2(f) and 1.367(a)-7(e)(2).

⁵ Treas. Reg. §§1.367(a)-8(j)(8) and 1.367(e)-2(e)(4)(ii)(B).

⁶ Treas. Reg. §1.6038B-1(b)(2)(iv).

submit previously filed requests for relief (including requests that were denied) and thereby apply the regulations' new standards and procedures.⁷

- As anticipated, the preamble to the final regulations announces that the Deputy Commissioner (International), Large Business & International will revoke, effective on November 19, 2014,⁸ the Directive on Examination Action with Respect to Certain Gain Recognition Agreements (the Directive).⁹

Background

Section 367 moderates the application of the subchapter C nonrecognition rules to cross-border transactions. Section 367(a) and (e) address transfers of stock and other property by U.S. persons to foreign corporations (outbound transfers),¹⁰ and section 6038B contains notification requirements applicable to these transfers. Together, sections 367 and 6038B provide a regime of substantive and procedural requirements that must be met in order to apply the subchapter C rules to avoid current gain recognition in connection with an outbound transfer.

Filings Addressed

The final regulations address the following filings under sections 367(a), 367(e), and 6038B:

- The reporting requirements under §1.367(a)-2T(a), required when a U.S. person subject to section 367(a) transfers property to a foreign corporation for use in the active conduct of a foreign trade or business. The 2013 proposed regulations did not address this reporting;
- The reporting requirements under §1.367(a)-3(c)(6) and (7), required to be filed by certain domestic target corporations that are transferred to a foreign corporation under §1.367(a)-3(c);
- The reporting requirements under §1.367(a)-3T(d)(2)(vi)(B)(1)(ii) and (d)(2)(vi)(C), required to be filed by a domestic target corporation that is a party to certain indirect stock transfers under §1.367(a)-3(d)(1);
- The reporting requirements under §1.367(a)-7(c), required to be filed by a domestic corporation that transfers property to a foreign corporation in a section 361 exchange. The 2013 proposed regulations did not address this reporting;
- Gain recognition agreements and associated filings under §1.367(a)-8, required in connection with certain U.S. persons' transfers of stock or securities to a foreign corporation;
- The reporting requirements under §1.367(e)-2, required when a domestic or foreign corporation liquidates into a foreign parent corporation under section 367(e); and
- Form 926, which generally implements the section 6038B requirement for a U.S. person to report the transfer of property to a foreign corporation in a nonrecognition transfer.

Prior to the final regulations, a variety of rules applied to late or incomplete filings

⁷ Treas. Reg. §§1.367(a)-7(j) and 1.367(a)-8(r)(3).

⁸ 79 Fed. Reg. at 68765.

⁹ Directive on Examination Action With Respect to Certain Gain Recognition Agreements, LMSB-4-0510-017 (26 July 2010).

¹⁰ §367(e) also addresses certain transfers between foreign corporations. See Treas. Reg. §1.367(e)-2(c) (addressing distributions of property in "foreign to foreign" section 332 liquidations).

under section 367(a), 367(e), and 6038B, and to taxpayers' attempts to correct these filings. As described below, the final regulations institute a more cohesive regime for both the IRS and taxpayers to address these issues.

If the section 367 filing requirements are not satisfied, the property transfer may be subject to current gain recognition. Section 6038B supplements this consequence with a penalty equal to ten percent of the fair market value of the transferred property, up to \$100,000, unless a failure to comply was due to intentional disregard. The section 6038B penalty does not apply if the U.S. transferor demonstrates that the failure to comply was due to reasonable cause and not willful neglect.

Section 367 Revisions

The final regulations revise the Treasury Regulations under section 367(a) and (e) to state common standards applicable to untimely or incomplete filings, and to make other changes. The most significant revisions are as follows:

- The standard applicable to taxpayers seeking to avoid gain recognition by remedying untimely or incomplete GRA filings is revised from proof that the failure to comply was “due to reasonable cause and not willful neglect” to proof that the failure “was not willful.”¹¹ The preamble to the 2013 proposed regulations explain this change by stating that “the existing reasonable cause standard, given its interpretation under the case law, may not be satisfied by U.S. transferors in many common situations even though the failure was not intentional and not due to willful neglect. Based on the current operation of the section 367(a) GRA regulation the [IRS and Treasury Department] believe that full gain recognition under section 367(a)(1) should apply only if a failure to timely file an initial GRA or a failure to comply with the section 367(a) GRA regulations with respect to an existing GRA is willful.”¹²
- “Willful” is to be interpreted consistently with its meaning in the context of other civil penalties,¹³ and includes a failure due to gross negligence, reckless disregard, or willful neglect, determined based on all the facts and circumstances.¹⁴ The regulations contain specific examples applying the willful standard to GRAs, illustrating:
 - An isolated oversight that is not willful;¹⁵
 - A taxpayer’s course of conduct that is relevant to the willfulness determination;¹⁶
 - A knowing omission of material information that is willful;¹⁷ and
 - A knowing, willful decision to not file a GRA¹⁸
- The final regulations revise the IRS procedures for processing requests for late filing relief. In particular, the regulations remove the current 120-day deadline for the IRS to process a request for relief.¹⁹ The preamble to the

¹¹ Treas. Reg. §1.367(a)-8(p)(1).

¹² 78 Fed. Reg. at 6774.

¹³ The preamble to the 2013 proposed regulations cites §6672 as an example. 78 Fed. Reg. at 6774.

¹⁴ Treas. Reg. §1.367(a)-8(p)(1).

¹⁵ Treas. Reg. §1.367(a)-8(p)(3) Example 1.

¹⁶ Treas. Reg. §1.367(a)-8(p)(3) Example 2.

¹⁷ Treas. Reg. §1.367(a)-8(p)(3) Example 3.

¹⁸ Treas. Reg. §1.367(a)-8(p)(3) Example 4.

¹⁹ See Treas. Reg. §1.367(a)-8(p)(1), as in effect prior to TD 9704. In addition, the final regulations revise the language describing the requirement that taxpayers request relief shortly after discovering a missed or incomplete filing. The prior regulations refer to a U.S.

2013 proposed regulations explains that “the IRS and the Treasury Department do not believe that the IRS’s processing time with respect to a relief request should be determinative of whether a U.S. transferor has satisfied its obligations under the section 367(a) GRA regulations.”²⁰

- The final regulations provide guidance addressing when a GRA is considered timely filed and what gives rise to a failure to comply with the GRA requirements in a material respect. A GRA is timely filed only when every document that is required to be filed as part of the GRA is timely filed and completed in all material respects.²¹ An example illustrates the “completed in all material respects” requirement, providing that the standard is not met where a taxpayer omits the fair market value or the tax basis of the transferred stock.²²
- Consistent with the 2013 proposed regulations, the final regulations apply the “not willful” and “complete in all material respects” standards and the new procedures for requesting late filing relief to the filings under §§1.367(a)-3(c), 1.367(a)-3(d), and 1.367(e)-2.²³ The final regulations extend the scope of the 2013 proposed regulations to also apply the “not willful” standard and new procedures for requesting late filing relief to the filings under §§1.367(a)-2 and 1.367(a)-7.²⁴
- GRAs must now contain language agreeing that a failure to comply in any material respect with the GRA rules extends the statute of limitations on assessment for the year when gain is required to be reported until the close of the third full taxable year ending after the date the taxpayer furnishes the omitted information.²⁵ The final regulations state similar statute of limitations rules that are applicable to the §1.367(e)-2 disclosures.²⁶

Section 6038B revisions

The final regulations revise the integration and coordination of the section 6038B filings and penalty provisions with the §367 rules.

- The §6038B penalty applies to a failure to comply in any material respect with the GRA, section 367(a), or the section 367(e) outbound transfer reporting rules.²⁷ While the “completed in all material respects” standard follows the final section 367 regulations, the new “not willful” standard is not extended to section 6038B reporting. Instead, the current “reasonable cause and not willful neglect” standard remains in place.²⁸ As a result, the final regulations contemplate a class of noncompliance that falls between the two standards: missed or incomplete filings that satisfy the not willful

transferor requesting relief “as soon as” becoming aware of the omission; the final regulations replace “as soon as” with “promptly after.”

²⁰ 78 Fed. Reg. at 6774.

²¹ Treas. Reg. §1.367(a)-8(d)(1).

²² Treas. Reg. §1.367(a)-8(p)(3) Example 3.

²³ Treas. Reg. §§1.367(a)-3(f) and 1.367(e)-2(f).

²⁴ Treas. Reg. §§1.367(a)-2(f) and 1.367(a)-7(e)(2). Previously, Treas. Reg. §1.367(a)-7T(e) provided late filing relief under the reasonable cause standard. T.D. 9615 (March 6, 2013). In conjunction with issuing Treas. Reg. §1.367(a)-7(e)(2), TD 9704 removes Treas. Reg. §1.367(a)-7T.

²⁵ Treas. Reg. §1.367(a)-8(c)(2)(iii) and (j)(8). The prior regulations as well as the 2013 proposed regulations extended the statute of limitations until the close of the third full taxable year after the IRS “receives actual notice of the failure to comply from the U.S. transferor.” Treas. Reg. §1.367(a)-8(j)(8), as in effect prior to TD 9704; Prop. Treas. Reg. §1.367(a)-8(j)(8), 78 Fed. Reg. at 6777.

²⁶ Treas. Reg. §1.367(e)-2(b)(2)(i)(C)(1), (iii)(D), and (e)(4)(ii)(B).

²⁷ Treas. Reg. §1.6038B-1(b)(1)(i). In the context of GRA filings, the preamble to the 2013 proposed regulations refers to this provision as a clarification. 78 Fed. Reg. at 6774.

²⁸ Treas. Reg. §1.6038B-1T(f)(3); see also §6038B(c)(2).

test, but fail reasonable cause and are thus subject to the section 6038B penalty (but not section 367 gain recognition). In this regard the preamble to the 2013 proposed regulations states that “[t]he IRS and Treasury Department believe that the penalty imposed by section 6038B generally should be sufficient to encourage proper reporting and compliance.”²⁹

- The final regulations revise the coordination of Form 926 and GRA filings. §1.6038B-1(b)(2) formerly provided that a U.S. transferor that properly files a GRA does not have to file the Form 926. Consistent with the 2013 proposed regulations, the final regulations eliminate this exemption and require that a U.S. transferor that executes a GRA *also* complete a Form 926. The final regulations augment this provision in the 2013 proposed regulations, adding that this Form 926 must, *inter alia*, state the fair market value, adjusted tax basis, and gain recognized with respect to the transferred stock or securities.³⁰

Effective Dates

The final regulations are effective for filings that are due on or after November 19, 2014, and for requests for late or incomplete filing relief that are submitted on or after November 19, 2014.³¹ In two instances, including under the GRA rules, the final regulations specifically provide that taxpayers may re-submit under the final regulations a request for relief that was submitted before November 19, 2014, provided that the statute of limitations on assessment has not expired for any tax year to which the request relates.³² Where a taxpayer submits or resubmits a request for relief regarding a filing that was due before November 19, 2014, other applicable provisions of the final regulations apply (for example, the requirement to submit a Form 926 with a GRA).³³ Finally, the preamble to the final regulations announces that the Deputy Commissioner (International), Large Business & International will revoke the Directive, effective on November 19, 2014, explaining that the Directive was a temporary measure and that TD 9704 “provides comprehensive guidance that is intended to ensure compliance with the GRA provisions”.³⁴

²⁹ 78 Fed. Reg. at 6774.

³⁰ Treas. Reg. §1.6038B-1(b)(2)(iv). The final regulations also modify the information that must be reported in connection with a transfer under §367(e)(2). Treas. Reg. §1.6038(e)-1(e)(4).

³¹ Treas. Reg. §§1.367(a)-2(f)(4), 1.367(a)-3(g)(1)(x), 1.367(a)-7(j), 1.367(a)-8(r)(1)(i), §1.367(e)-2(g), and §1.6038B-1(g)(6).

³² Treas. Reg. §§1.367(a)-7(j) and 1.367(a)-8(r)(3). As the preamble to the final regulations describes: “§1.367(a)-8(r)(3) of these final regulations provides a procedure under which U.S. transferors may resubmit certain previously filed requests (including requests that were denied).” T.D. 9704, 79 Fed. Reg. at 68764.

³³ Treas. Reg. §1.6038B-1(g)(6).

³⁴ T.D. 9704, 79 Fed. Reg. at 68765.

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