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Memorandum

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to: Area Counsel (Retailers, Food, Pharmaceuticals & Healthcare)
(Large & Mid-Size Business)
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from: Steven A. Musher, Associate Chief Counsel (International) CC:INTL

subject: Reporting Requirements Under Section 6038B

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

When a transfer described in section 367(a) is made by a partnership, which in turn is owned by other entities, e.g., partnerships, C corporations, S corporations or trusts or estates, is the partnership, the entities that own it, or their partners/shareholders/beneficiaries required to file Form 926?

CONCLUSIONS

A partnership is not required to file Form 926. The partners are required to file Form 926. However, if the partner is itself a partnership, its partners are generally required to file Form 926. Corporations, trusts and estates are generally required to file Form 926.

FACTS

A domestic partnership (Partnership 2) transferred \$1 million (cash) to a foreign corporation, in exchange for stock in the foreign corporation, in a transaction meeting the requirements of section 351. Alternatively, Partnership 2 transferred tangible property with a fair market value of \$1 million that will be used in the active conduct of a trade or business in a foreign country.

The partnership had the following partners: an individual, A, a trust, a domestic partnership (Partnership 1), and an S corporation. Partnership 1's partners included domestic corporations. The shares of the S corporation are held by an individual, B and a trust.

LAW AND ANALYSIS

Section 6038B(a) states that each U.S. person who transfers property to a foreign corporation in (among other exchanges) a section 351 exchange shall furnish to the Secretary such information regarding the exchange as the Secretary may require in regulations. The time and manner for providing the information shall be prescribed by the Secretary in said regulation. Section 6038B(c) provides a penalty for failure to furnish the information required by section 6038B(a) in the amount of 10% of the fair market value of the property transferred at the time of the exchange. The penalty is limited to \$100,000, unless the penalty was due to intentional disregard. In addition, the penalty shall not apply if the U.S. person shows the failure to furnish the required information is due to reasonable cause, and not to willful neglect.

Reg. §1.6038B-1(b) states that generally Form 926 must be used for reporting pursuant to section 6038B. In addition, §1.6038B-1(b) states that for purposes of determining a U.S. transferor that is subject to section 6038B, the rules of §§1.367(a)-1T(c) and 1.367(a)-3(d) shall apply with respect to a transfer described in section 367(a).

A special rule for transfers of cash is included in §1.6038B-1(b)(3). A U.S. person that transfers cash to a foreign corporation in a transfer described in section 6038B(a)(1)(A) (which includes an exchange under section 351) must report the transfer if the amount of cash transferred by such person or related persons (determined under section 267(b)(1) through (3) and (10) through (12)) in the 12 month period ending on the date of the transfer exceeds \$100,000.

Reg. §1.367(a)-1T(c)(3) states that if a partnership (whether foreign or domestic) transfers property to a foreign corporation in an exchange described in section 367(a)(1) (i.e., including an exchange under section 351), then a U.S. person that is a partner in the partnership shall be treated as having transferred a proportionate share of the property in an exchange described in section 367(a)(1). A U.S. person's proportionate

share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

Under §1.367(a)-1T(d)(1), the term “U.S. person” includes those persons described in section 7701(a)(30). Reg. §1.367(a)-1T(d)(1) further states that the term includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust other than a foreign estate or trust.

Reg. §1.367(a)-1T(c)(4) states, in part, that in general, for purposes of section 367(a), a transfer of property by an estate or trust shall be treated as a transfer by the entity itself, and not as an indirect transfer by its beneficiaries. In the case of a grantor trust, the transfer of a portion or all the assets of a trust is considered to be a transfer by any U.S. person who is treated as the owner of any such portion or all of the assets of the trust under sections 671 through 679.

In this situation, Partnership 2 entered into a transaction whereby it transferred cash in excess of \$100,000 to a foreign corporation in exchange for stock in a transaction qualifying for nonrecognition treatment under section 351. For purposes of section 367(a), Reg. §1.367(a)-1T(c)(3) treats a transfer of property by a partnership in a section 367(a) exchange as a transfer by the partners of their proportionate share of the property. Accordingly, the partners of Partnership 2 are treated as having transferred their proportionate shares of the cash, or alternatively, the tangible property, which was transferred by Partnership 2 .

To the extent the partners of Partnership 2 are U.S. persons, section 367(a) applies. Generally, section 6038B and the regulations thereunder require a U.S. person to give notice to the Service through filing Form 926 of a transfer subject to section 367(a). The regulations under section 6038B apply the rules of the regulations under section 367(a) in determining the U.S. transferor that is subject to the reporting requirements of section 6038B. In this manner the same party that ultimately transfers the property under section 367(a) must report the transfer under section 6038B. Accordingly, Partnership 2 is not required to file Form 926.

QUESTIONS AND ANSWERS

(1) Is Partnership 1 or its partners required to file under section 6038B?

Partnership 1 is not required to file under section 6038B. Reg. §§ 1.6038B-1(b) and 1.367(a)-1T(c)(3) impose the filing requirement on the partners of the transferring partnership (Partnership 2). Reg. §1.367(a)-1T(c)(3) will then be applied iteratively to the section 367(a) transfer which Partnership 1, as a partner in Partnership 2, is treated as having made. Accordingly, Partnership 1's partners are treated as having transferred their proportionate share of the cash, or alternatively the tangible property, which Partnership 1 is treated as having transferred to the foreign corporation under

Reg. §1.367(a)-1T(c)(3). Partnership 1's partners may be required to file Form 926, assuming the partners are domestic, and are not partnerships.

(2) Is the penalty for failure to comply with limited to \$100,000 for each partner of Partnership 1 which failed to comply, or limited to \$100,000 in total?

The penalty for failure to comply with section 6038B and the regulations thereunder is imposed on each partner which failed to comply in the amount of 10% of the partner's proportionate share of the transfer. The penalty on each partner which failed to comply with section 6038B and the regulations thereunder is limited to \$100,000, unless the failure to comply was due to intentional disregard of section 6038B. §1.6038B-1(f)(ii).

(3) Is the above result changed if either Partnership 1 or 2 is a TEFRA partnership, i.e., a partnership as the term is defined in section 6231(a)(1)?

No. Reg. §1.367(a)-1T(c)(3) applies any time a partnership (whether foreign or domestic) transfers property to a foreign corporation. It applies to all partnerships.

(4) Is the filing requirement then imposed on both the general and limited partners of the partnership (unless the partner is itself a partnership)?

Yes. The requirement of §1.367(a)-1T(c)(3) applies to both general and limited partners of the transferring partnership (or of a partnership which is treated as being the transferor, since it is a partner in the transferring partnership). Reg. §1.6038B-1(b) then imposes a filing requirement on the same partners.

(5) Is the filing requirement imposed on the C corporation, one of the partners of Partnership 1, or its shareholders?

The filing requirement is imposed on the C corporation, since it is included in the definition of U.S. person, and there is no provision in Reg. §1.367(a)-1T (or any other regulation) removing the filing requirement from it, and imposing the filing requirement on its shareholders.

(6) Is the filing requirement imposed on the S corporation, or its shareholders?

The filing requirement is imposed on the S corporation, since it is included in the definition of U.S. person, and there is no provision in Reg. §1.367(a)-1T (or any other regulation) removing the filing requirement from it, and imposing the filing requirement on its shareholders.

(7) Is the filing requirement imposed on the trust or its beneficiaries?

Under Reg. §1.367(a)-1T(c)(4)(i), unless the trust is a grantor trust, the trust itself, and not its beneficiaries, is considered to be the transferor. Therefore, under Reg. §1.6038B-1(b)(1)(i), which applies the rules of Reg. §1.367(a)-1T(c) for purposes of determining the U.S. transferor that is subject to section 6038B, the trust, rather than its beneficiaries, may be required to file Form 926. This rule applies to all trusts (i.e., simple and complex trusts) other than grantor trusts.

In the case of a grantor trust, the parties that are treated as owning the assets of the trust will be required to file, as regards the transfer of those assets.

Please call (202) 622-3860 if you have any further questions.