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One Shade of GRA: Proposed Regulations Foreshadow the End of the GRA Directive and Provide That “Available Upon Request” Is a “Willful Failure”

On January 30, Treasury and the IRS issued proposed regulations relating to the proper filing of gain recognition agreements (GRAs) and other related compliance obligations (the Proposed Regulations). As a general matter, a U.S. person that is a 5% or greater shareholder of a corporation is required to file a GRA with the IRS on the transfer of the corporation's stock to a foreign corporation or as a result of certain asset transfers by the corporation, and the GRA must include information on the basis and fair market value of the property transferred. Historically, many taxpayers have filed GRAs indicating that this information is “available upon request.” The Proposed Regulations treat a GRA filed with “available upon request” statements as a “willful failure” to comply with the GRA requirements and, as a result, subject the taxpayer to full gain recognition on the transfer as well as potential penalties.

An IRS Industry Director [Directive](#) from July 2010 (the Directive) provides relief to taxpayers that timely filed GRAs but did not provide basis or fair market value information as required under the current regulations or otherwise did not satisfy a reasonable cause standard. However, the Directive is effective only until “further notice.” With the issuance of the Proposed Regulations, which do not provide relief for such filings, taxpayers that have filed GRAs that state that basis and fair market value information is “available on request” should consider availing themselves of the Directive as soon as possible.

In brief, the Proposed Regulations address or amend the current rules and practice primarily by:

- Clarifying what constitutes a properly filed GRA and the relief available to a taxpayer that fails to comply with the GRA requirements;
- Providing coordination between the GRA rules under section 367(a) and the filing requirements under section 6038B;
- Modifying the reporting requirements under section 367(e)(2) for liquidations so that they are consistent with the reporting requirements under sections 367(a) and 6038B; and
- Including similar rules with respect to other filing requirements under section 367(a).

Modified GRA Filing Requirements

The Proposed Regulations modify and clarify the existing GRA filing requirements under section 367(a) by explaining what constitutes a failure to comply with the GRA rules and what procedures are available for a taxpayer to obtain relief for a failure to comply.

Under the current regulations, a taxpayer that fails to satisfy all of the GRA requirements may not be required to recognize the realized gain on an outbound transfer if the taxpayer can demonstrate that the failure was due to reasonable cause and not willful neglect. Moreover, the Directive provides that a taxpayer that cannot satisfy the reasonable cause standard may seek relief if the taxpayer files a complete and accurate GRA, extends the statute of limitations with respect to the gain for three years from the date that the accurate GRA is filed, and files an amended return for the year in which the failure occurred.

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The Proposed Regulations relax the reasonable cause standard and provide that taxpayers can obtain relief so long as the failure is not willful. Willfulness in this context would be determined consistently with other civil penalties (e.g., cases of gross negligence, reckless disregard, or willful neglect). In this regard, Treasury and the IRS stated that they believe that the existing reasonable cause standard prevents many taxpayers from obtaining relief for unintentional failures. Notably, however, a GRA that provides that information is “available upon request” is not considered to be complete in all material respects under the Proposed Regulations and is considered to be a “willful failure” that is not eligible for relief.

In determining whether there has been a failure to comply, the Proposed Regulations clarify that a GRA is “timely filed” when it, along with all necessary documentation, is filed with the taxpayer’s timely filed return for the year of the transfer and is completed in all material respects. The Proposed Regulations contain examples illustrating the meaning of “completed in all material respects.”

In order to obtain relief for failing to comply with the GRA requirements, the Proposed Regulations provide that a taxpayer must file an amended return for the tax year with respect to which the failure is relevant that includes the information that otherwise should have been included if there was no failure. Furthermore, the Proposed Regulations require the taxpayer seeking relief to file the amended return promptly upon becoming aware of the failure. The taxpayer also must include a written statement explaining the reason for the failure to comply and file a Form 8838 (Consent to Extend the Time to Assess Tax Under Section 367 – Gain Recognition Agreement) extending the period of limitations on assessment. These requirements are very similar to those set forth in the Directive.

Under the current regulations, when a taxpayer files a request for relief, the request is deemed to satisfy the requirements for establishing reasonable cause if the IRS does not respond to the request within 120 days. The Proposed Regulations eliminate the 120-day period for the IRS to respond to requests for relief.

Coordinating Section 367(a) and Section 6038B

The Proposed Regulations also address the relationship between the GRA filing requirements under section 367(a) and the reporting requirements under section 6038B.

The Proposed Regulations would require taxpayers that otherwise file GRAs with respect to outbound transfers of stock or securities to file Forms 926 (Return by a U.S. Transferor of Property to a Foreign Corporation) with respect to those transfers. Previously, a taxpayer that made an outbound transfer of stock or securities and properly filed a GRA was not required to file a Form 926 for that transfer. Under the new requirement, however, only Parts I and II of Form 926 are required to be completed if a GRA is filed with respect to the transfer.

In addition, the Proposed Regulations clarify that, when a taxpayer fails to file a proper GRA or an annual certification, or when a taxpayer fails to comply with the GRA rules in any material respect, the taxpayer not only may be required to recognize gain under section 367(a), but also may be subject to penalties under section 6038B. Notably, the current standards under sections 367(a) and 6038B are different. Specifically, the consequences for failing to comply under section 367(a) are conditioned on willfulness, while the penalties under section 6038B for failing to comply are based on a reasonable cause standard. Under the Proposed Regulations, a failure to comply has the same meaning for purposes of the GRA rules under section 367(a) and the regulations under section 6038B; however, the current reasonable cause standard continues to apply to U.S. transferors seeking relief from the section 6038B penalty.

Modified Reporting Requirements Under Section 367(e)(2)

As a general matter, section 367(e)(2) conditions nonrecognition treatment for complete liquidations of subsidiaries into foreign corporations on compliance with certain reporting requirements described in the regulations promulgated under that provision. Consistent with the changes made by the Proposed Regulations with respect to transfers subject to section 367(a), the Proposed Regulations apply the same standards and procedures for relief to the filings required under section 367(e)(2). In addition, the Proposed Regulations clarify that the information that must be reported for liquidating distributions of property that are subject to section 367(e)(2) includes the fair market value and basis of the distributed property.

Changes to Other Filing Requirements

As a final matter, the Proposed Regulations also address certain other filing requirements under Treas. Reg. § 1.367(a)-3. In this regard, the Proposed Regulations clarify that the same standards and procedures for relief with respect to GRAs apply to those statements as well.



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