

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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to: Joanne Zhang  
International Examiner  
Examination Group 1312

from: Peter C. Rock  
General Attorney (San Francisco)  
(Large & Mid-size Business)

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subject:

Failure to timely file annual certifications and waivers in connection with a gain recognition agreement.

This memorandum responds to your request for assistance dated February 24, 2004.  
This advice may not be used or cited as precedent.

LEGEND

US Co. =  
Anytown USA =  
F1 Co. =  
Australian =  
Year 1 =  
Year 2 =  
Year 3 =  
Year 4 =  
Year 5 =  
Year 7 =  
Year 9 =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =

Date 6 =  
 Summer or Fall =  
 Big CPA Firm =  
 F2 Co. =  
 X =  
 Y =  
 Z =  
 1,000D =

ISSUE

Can the District Director provide an extension of time for the filing of annual waivers and annual certifications required to be filed in connection with an I.R.C. § 367 gain recognition agreement when a taxpayer has good cause for its failure to timely file?

CONCLUSION

The District Director may grant an extension for the filing of annual certifications and annual waivers in compliance with an I.R.C. § 367 gain recognition agreement where the failure to file was due to reasonable cause and not willful neglect because a taxpayer: (1) reasonably relied on a qualified tax representative; (2) voluntarily disclosed its failure to timely comply with the terms of its gain recognition agreement; and (3) there was no gain triggering disposition of the transferred corporation’s stock within the term of the agreement.

FACTS

\_\_\_\_\_ is a United States corporation with registered address at \_\_\_\_\_, an \_\_\_\_\_ owned common stock in \_\_\_\_\_ entity. On \_\_\_\_\_, \_\_\_\_\_ contributed \_\_\_\_\_ shares of \_\_\_\_\_ common stock to \_\_\_\_\_ in \_\_\_\_\_ exchange for \_\_\_\_\_ shares of \_\_\_\_\_’s common stock. \_\_\_\_\_ is an \_\_\_\_\_ company. \_\_\_\_\_’s ownership interest in \_\_\_\_\_ was approximately \_\_\_\_\_ % after the exchange.

On its Federal income tax return (Form 1120) for the taxable year ended \_\_\_\_\_, \_\_\_\_\_ included Form 8838, “Consent to Extend the Time to Assess Tax Under Section 367 – Gain Recognition Agreement.” On Form 8838, \_\_\_\_\_ consented to extend the statute of limitation for assessment of tax on the exchange of \_\_\_\_\_ shares for the \_\_\_\_\_ shares of \_\_\_\_\_ stock until \_\_\_\_\_, \_\_\_\_\_. Also, included in the tax return was a three-page agreement entitled “Gain Recognition Agreement Under Treasury Regulation § 1.367(a)-8.” Paragraph (v) of the Gain

Recognition Agreement Under Treasury Regulation § 1.367(a)-8 states, “the transferor will file a certification statement with its tax return for each of the five years subsequent to the year of the filing of this agreement.” This gain recognition agreement was signed under the penalties of perjury by \_\_\_\_\_’s President.

\_\_\_\_\_ sold \_\_\_\_\_ common shares of \_\_\_\_\_ in \_\_\_\_\_ of \_\_\_\_\_ and reported \$ \_\_\_\_\_ gain from the sale on its \_\_\_\_\_ Federal income tax return. Transcripts show the \_\_\_\_\_ Federal Income tax return was filed on \_\_\_\_\_, \_\_\_\_\_. The taxpayer also attached a copy of the Gain Recognition Agreement Under Treasury Regulation § 1.367(a)-8 to its Federal income tax return for the \_\_\_\_\_ taxable year; however, the taxpayer did not include an annual certification or annual waiver of the statute of limitations with its \_\_\_\_\_ tax return.

\_\_\_\_\_’s representative, \_\_\_\_\_, notified the Internal Revenue Service in a telephone conversation on \_\_\_\_\_, \_\_\_\_\_ that \_\_\_\_\_ failed to comply with the gain recognition agreement regulations. \_\_\_\_\_ sent a letter dated \_\_\_\_\_, \_\_\_\_\_, stated that \_\_\_\_\_ had “inadvertently failed to file annual certifications under IRC § 367(a) for each of its taxable years \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_.” Enclosed in the letter were annual certifications for taxable years \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, signed under penalties of perjury by \_\_\_\_\_’s President and dated \_\_\_\_\_, \_\_\_\_\_. \_\_\_\_\_ has only filed one waiver to the statute of limitations to date, the Form 8838, “Consent to Extend the Time to Assess Tax Under Section 367 – Gain Recognition Agreement” originally filed with its \_\_\_\_\_ Federal income tax return. \_\_\_\_\_ claims it relied on \_\_\_\_\_ to properly prepare its Federal income tax returns for taxable years \_\_\_\_\_ through \_\_\_\_\_. This reliance resulted in \_\_\_\_\_’s inadvertent failure to file annual certifications and annual waivers. \_\_\_\_\_ requested that the Internal Revenue Service accept each late filed annual certification as timely filed because it had reasonable cause for the failure to file due to its reliance and \_\_\_\_\_. \_\_\_\_\_ claims it also has reasonable cause for failing to file annual waivers. To date, \_\_\_\_\_ has not filed any of the annual waivers for taxable years \_\_\_\_\_ through \_\_\_\_\_.

## ISSUE

Can the District Director provide an extension of time for the filing of annual waivers and annual certifications required to be filed in connection with an I.R.C. § 367 gain recognition agreement when a taxpayer has good cause for its failure to timely file?

## LAW AND ANALYSIS

For the tax year at issue ( \_\_\_\_\_ ), Treas. Reg. § 1.367(a)-3T(g)(1) provides that a transfer of stock will not be subject to section 367(a)(1) of the Code if (1) the transferor complies with the reporting requirements of section 6038B and any regulations thereunder; and (2) the transferor files an agreement to recognize gain if the transferee corporation disposes of the stock at a later date. In filing a gain recognition agreement, the transferor must agree to file with its income tax return for each of the five taxable years following the taxable year of the transfer a certification that the stock or securities

transferred have not been disposed by the transferee in a transaction that is considered to be a disposition. Treas. Reg. § 1.367(a)-3T(g)(5)(i). The transferor also must agree to file with its income tax return for each of the eight taxable years following the year of transfer a waiver of the period of limitations on assessment. Treas. Reg. § 1.367(a)-3T(g)(5)(ii).

A gain recognition agreement must be attached to, and filed by, the due date of, the information return required under [section 6038B](#) of the Code (Form 926). § 1.6038B-1T(b)(1). Form 926 must be filed with the transferor's tax return for the taxable year that includes the date of the transfer. See Temp. Reg. §§ 1.367(a)-3T(g)(2) and 1.6038B-1T(b)(1). Certain penalties apply if a taxpayer fails to comply with the reporting requirements of [section 6038B](#) of the Code and the regulations thereunder. A failure to comply with the [section 6038B](#) requirements includes a failure to report at the proper time and in the proper manner any required material information. Temp. Reg. § 1.6038B-1T(f)(1) and (2).

Temp. Reg. § 1.6038B-1T(f)(3) provides that the penalties provided in § 1.6038B-1T(f)(1) will not apply if a transferor shows that a failure to comply with the reporting requirements was due to reasonable cause and not willful neglect. The determination of whether a failure to file in a timely manner, or materially comply, was due to reasonable cause shall be determined by the District Director under all the facts and circumstances. Temp. Reg. § 1.6038B-1T(f)(3). A transferor may do so by providing a written statement to the District Director having jurisdiction of the taxpayer's return for the year of the transfer, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause is determined by the District Director under all the facts and circumstances. While the regulations under I.R.C. § 6038B specifically refer to the filing of the initial gain recognition agreement (on Form 926), we believe that Temp. Reg. § 1.6038B-1T(f)(1) extends to all subsequent required filings with respect to the gain recognition agreement.

If the District Director determines        failed to file the annual waivers and annual certifications in connection with the filing of its gain recognition agreement,        will be required to recognize gain and pay a penalty under section 6038B, unless the District Director permits an extension to file the annual waivers and annual certifications on the grounds that        's failure to timely file was due to reasonable cause and not willful neglect. See Treas. Reg. § 1.6038B-1T(f)(3).

Where a taxpayer (1) relies on its qualified representative; (2) voluntarily disclosed its failure to comply with the terms of a gain recognition agreement; and (3) there was no gain triggering disposition of the transferred corporation's stock within the term of the agreement, the District Director may reasonably conclude the taxpayer's failure to timely file annual waivers and annual certifications are due to reasonable cause and not willful neglect and permit an extension for filing.        relied on       , one of the big four accounting firms.        failed to properly complete        's Federal income tax returns for the        thorough        taxable years.        voluntarily notified the Internal Revenue Service it failed to timely file annual waivers and annual certifications. For these

reasons we find that the District Director may reasonably conclude        has reasonable cause for its failure to timely file the annual waivers and annual certifications for the        through        taxable years and        's failure was not caused by willful neglect. Therefore, the District Director may grant an extension for the filing of the annual waivers and annual certifications.

If the District Director provides an extension, the annual certifications already provided to the Internal Revenue Service will be accepted as timely filed. However,        has not submitted any annual waivers to date. If        fails to submit annual waivers for taxable years        through        within the time allotted by the District Director,        will be required to recognize gain and pay a penalty per Treas. Reg. §§ 1.6038B-1T(f)(1)(i) and (ii).

### CONCLUSION

The District Director may grant an extension for the filing of annual certifications and annual waivers in compliance with an I.R.C. § 367 gain recognition agreement where the failure to file was due to reasonable cause and not willful neglect because a taxpayer: (1) reasonably relied on a qualified tax representative; (2) voluntarily disclosed its failure to timely comply with the terms of its gain recognition agreement; and (3) there was no gain triggering disposition of the transferred corporation's stock within the term of the agreement.

Please contact Peter Rock  
further assistance.

if you have any further questions or need

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