

[4830-01-p]

Published June 21, 2006

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

TD 9268

RIN 1545-BF49

Information Returns Required with Respect to Certain Foreign Corporations and Certain Foreign-Owned Domestic Corporations.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations that provide guidance under sections 6038 and 6038A of the Internal Revenue Code. The final regulations under §1.6038-2 are revised to remove and replace obsolete references to a form and IRS offices. The temporary regulations clarify the information required to be furnished regarding certain related party transactions of certain foreign corporations and certain foreign-owned domestic corporations. The temporary regulations also increase the amount of certain penalties, and make certain other changes, to reflect the statutory changes made by the Taxpayer Relief Act of 1997 (TRA '97). The text of the temporary regulations also serves as the text of the proposed regulations set forth in this issue of the **Federal Register**.

DATES: Effective Date: These final and temporary regulations are effective June 21, 2006.

Applicability Date: Changes to §1.6038-2 are applicable June 21, 2006.

Sections 1.6038-2T(f)(11), (12), and 1.6038A-2T(b)(8) apply with respect to information

for annual accounting periods beginning on or after June 21, 2006. Section 1.6038-2T(k) applies June 21, 2006.

FOR FURTHER INFORMATION CONTACT: Kate Y. Hwa (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-2020. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **Background**

Section 6038 of the Internal Revenue Code (Code) requires a U.S. person to furnish, with respect to any foreign business entity which such person controls, certain information as prescribed by the Secretary. More specifically, section 6038(a)(1)(D) provides that the information to be furnished includes information relating to transactions between the foreign business entity and (i) such U.S. person, (ii) any corporation or partnership controlled by such U.S. person, and (iii) any U.S. person owning at the time the transaction takes place a 10 percent or greater interest in the foreign business entity.

Section 6038A requires certain foreign-owned domestic corporations to furnish certain information prescribed by the Secretary. In particular, section 6038A(a) requires a 25-percent foreign-owned domestic corporation to furnish information with respect to certain transactions between such corporation and certain related parties.

## **Explanation of Provisions**

The final regulations are revised to remove and correct obsolete references to a form and IRS offices. The temporary regulations conform the current final regulations to specific statutory changes and make other minor clarifications to those final regulations.

Section 1.6038-2 provides that each U.S. person, with respect to each foreign corporation such person controls, must furnish the required information on a Form 5471, "Information Return of U.S. Persons with Respect to Certain Foreign Corporations", (or, in the case of taxable years that ended before December 31, 1982, on a Form 2952,

"Information Return with Respect to Foreign Controlled Corporations"). Section 1.6038-2(f) sets forth the information that must be provided on the applicable form. The information that must be reported includes a summary showing the total amount of each of the types of transactions of the corporation specified in §1.6038-2(f)(11). In some cases, §1.6038-2(f)(11) requires reporting of sales and purchases of items. See §1.6038-2(f)(11)(i) (stock in trade) and (iii) (certain intangibles). In other cases, it requires reporting only of purchases. See §1.6038-2(f)(11)(ii) (tangible property other than stock in trade). The temporary regulations modify the rules of the final regulations to include the reporting of sales and purchases, instead of just purchases, of tangible property. The temporary regulations also modify the current rules to include the reporting of premiums paid, instead of just premiums received, for insurance or reinsurance. This consistent treatment of sales and purchases, and premiums paid and received, more fully implements the purpose of section 6038. It also conforms the rules in §1.6038-2 to analogous reporting rules. See §1.6038A-2(b)(3)(ii) (reporting requirements for foreign-owned domestic corporations).

It has come to the IRS' attention that some foreign corporations that use an accrual method of accounting may not be properly reporting the transactions described in §1.6038-2(f)(11). Accordingly, §1.6038-2T(f)(12) modifies the rules of the final regulations to clarify that foreign corporations that use an accrual method of accounting must report the summary of the total amount of the transactions described in §1.6038-2T(f)(11) on an accrual basis. To maintain conformity, §1.6038A-2(b)(8), which provides a similar rule for foreign-owned domestic corporations, has been similarly clarified.

Section 6038(b)(1), as amended by the TRA '97, provides for a \$10,000 penalty for failure to furnish the required information within the time prescribed under section 6038(a)(2). Section 6038(b)(2), as amended by the TRA '97, also provides for additional \$10,000 penalties (not to exceed a total of \$50,000) when there is a continuing failure to furnish the required information. Section 1.6038-2(k)(1) sets forth the dollar amounts of the penalty for failure to furnish the information required under section 6038. To conform to the statutory change made by the TRA '97, §1.6038-2(k)(1) has been amended to reflect the increased penalty amounts.

Section 6038(c)(4)(B) and §1.6038-2(k)(3) provide a reasonable cause exception for failure to furnish the information required under section 6038. Some questions have arisen regarding how one determines, after reasonable cause has been established, the time prescribed for furnishing the information under §1.6038-2(i) (time and place for filing return) and the 90-day period described in §1.6038-2(k)(1)(ii) (increase in penalty for continued failure after notification) and §1.6038-2(k)(2)(iv)(A) (reduction of foreign tax credit for continued failure after notice) . Two examples have been added in §1.6038-2T(k)(5) to illustrate the determination, after reasonable cause has been established under §1.6038-2(k)(3)(i), of the time for filing the Form 5471, and the beginning of the 90-day period.

The temporary regulations also modify the rules of the final regulations to include transactions between the foreign corporation and controlled partnerships, implementing a change made by section 1142 of the TRA '97.

Section 1.6038-2 of the regulations has been updated to remove references to obsolete Form 2952 and to reflect that the Director of Field Operations has replaced the district director and the Field Director has replaced the director of the service center.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-reference notice of proposed ruling making published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these final and temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Drafting Information**

The principal author of these regulations is Kate Y. Hwa, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects**

#### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### 26 CFR Part 602

Reporting and recordkeeping requirements.

## Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

#### **§1.6038-2 [Amended]**

Par. 2. Section 1.6038-2 is amended as follows:

1. Paragraph (f) introductory text is amended by removing the language “Form 2952 or” in the first sentence.
2. Paragraph (f)(11) and (k)(1) are revised.
3. Paragraph (f)(12) and (m) are added.
4. Paragraph (i) is amended by removing the language “Form 2952 or” in the first sentence, the second sentence, and the last sentence.
5. Paragraph (i) is also amended by removing the language “District directors and directors of service centers” and adding the language “Directors of Field Operations and Field Directors” in its place in the second sentence.
6. Paragraph (k)(2)(iv) is amended by removing the language “district director” and adding the language “Director of Field Operations” in its place in the first sentence.
7. Paragraph (k)(3)(i) is amended by removing the language “district director” and adding the language “Director of Field Operations” in its place in the first sentence.

The revisions and additions read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

\* \* \* \* \*

(f) \* \* \*

(11) [Reserved]. For further guidance, see §1.6038-2T(f)(11).

(12) [Reserved]. For further guidance, see § 1.6038-2T(f)(12).

\* \* \* \* \*

(k) \* \* \*

(1) [Reserved]. For further guidance, see §1.6038-2T(k)(1).

\* \* \* \* \*

(m) [Reserved]. For further guidance, see §1.6038-2T(m)

\* \* \* \* \*

Par. 3 Section 1.6038-2T is amended by revising paragraphs (e) through (m) to read as follows:

§1.6038-2T Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations (temporary).

\* \* \* \* \*

(e) through (f)(10) [Reserved]. For further guidance, see §1.6038-2(e) through (f)(10).

(f)(11) Transactions with certain related parties. (i) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the person required to file this return, any other corporation or partnership controlled by that person, or any United States



person owning at the time of the transaction 10 percent or more in value of any class of stock outstanding of the foreign corporation, or of any corporation controlling that foreign corporation--

(A) Sales and purchases of stock in trade;

(B) Sales and purchases of tangible property other than stock in trade;

(C) Sales and purchases of patents, inventions, models, or designs (whether or not patented), copyrights, trademarks, secret formulas or processes, or any other similar property rights;

(D) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(E) Commissions paid and commissions received;

(F) Rents and royalties paid and rents and royalties received;

(G) Amounts loaned and amounts borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (f)(11) that arise and are collected in full in the ordinary course of business);

(H) Dividends paid and dividends received;

(I) Interest paid and interest received; and

(J) Premiums paid and premiums received for insurance or reinsurance.

(ii) Special rule for banks. For purposes of this paragraph (f)(11), if the United States person is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term transactions shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, deposits in accounts between a foreign corporation,

controlled (within the meaning of paragraph (b) of this section) by a United States person, and a person described in this paragraph (f)(11) and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(12) Accrued payments and receipts. For purposes of the required summary under paragraph (f)(11) of this section, a corporation that uses an accrual method of accounting shall use accrued payments and accrued receipts for purposes of computing the total amount of each of the types of transactions listed.

(g) through (j)(3) [Reserved]. For further guidance, see §1.6038-2(g) through (j)(3).

(k) Failure to furnish information--(1) Dollar amount penalty--(i) In general. If any person required to file Form 5471 under section 6038 and this section fails to furnish any information described in paragraphs (f) and (g) of this section within the time prescribed by paragraph (i) of this section, such person shall pay a penalty of \$10,000 for each annual accounting period of each foreign corporation with respect to which such failure occurs.

(ii) Increase in penalty for continued failure after notification. If a failure described in paragraph (k)(1)(i) of this section continues for more than 90 days after the date on which the Director of Field Operations mails notice of such failure to the person required to file Form 5471, such person shall pay a penalty of \$10,000, in addition to the penalty imposed by section 6038(b)(1) and paragraph (k)(1)(i) of this section, for each 30-day period (or a fraction of) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038(b)(2) and this paragraph (k)(1)(ii) shall be limited to a maximum of \$50,000 for each failure.

(k)(2) through (k)(4) [Reserved]. For further guidance, see §1.6038-2(k)(2) through (k)(4).

(k)(5) Illustrations. [Reserved]. For further guidance, see §1.6038-2(k)(5).

Examples 1 and 2. [Reserved]. For further guidance, see §1.6038-2(k)(5)

Examples 1 and 2.

Example 3. A, a US person, owns 100 percent of the stock of FC. On April 15, 2008, A timely filed its 2007 income tax return but did not file Form 5471 with respect to FC's 2007 annual accounting period. On June 1, 2008, the Director of Field Operations mailed a notice to A of A's failure to file Form 5471 for 2007 with respect to FC. On August 1, 2008, A submits a written statement asserting facts for reasonable cause for failure to file the 2007 Form 5471 for FC. Based on A's statement and discussions with A, the Director of Field Operations agrees that A had reasonable cause for failure to file FC's 2007 Form 5471 and determined that it is reasonable for A to file FC's 2007 Form 5471 by September 15, 2008. The time prescribed for furnishing information under paragraph (i) of this section is September 15, 2008, and the 90-day period described under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section begins on that same date. Thus, if A files a completed Form 5471 by September 15, 2008, A is not subject to the penalties under paragraphs (k)(1) and (k)(2) of this section. If A does not file a completed Form 5471 by December 14, 2008, in addition to the penalties under paragraphs (k)(1) and (k)(2) of this section, A will also be subject to the penalties for continued failure under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section.

Example 4. The facts are the same as in Example 3 except A submits the written statement to the Director before a notice of failure to furnish information is mailed to A. The notice is mailed to A on September 7, 2008. Under these facts, the time prescribed for furnishing information under paragraph (i) of this section is September 15, 2008, and the 90-day period after mailing of notice of failure under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section begins on that same date.

(l) through (l)(2) [Reserved]. For further guidance, see §1.6038-2(l) through (l)(2).

(m) Effective dates. (1) Except as otherwise provided, this section applies with respect to information for annual accounting periods beginning on or after June 21, 2006. Paragraph (d) of this section applies to taxable years ending after October 22,

2004. Paragraphs (k)(1) and (k)(5), Examples 3 and 4, of this section apply June 21, 2006.

(2) The applicability of paragraphs (f)(11), (f)(12), (k)(1), and (k)(5), Examples 3 and 4, of this section will expire on or before June 19, 2009.

Par. 4. Section 1.6038A-2 is amended by revising paragraph (b)(8) to read as follows:

§1.6038A-2 Requirement of return.

\* \* \* \* \*

(b) \* \* \*

(8) [Reserved]. For further guidance, see §1.6038A-2T(b)(8).

\* \* \* \* \*

Par. 5. Section 1.6038A-2T is amended by adding paragraphs (b)(8) and (h) to read as follows:

§1.6038A-2T Requirement of return (temporary).

\* \* \* \* \*

(b)(8) Accrued payments and receipts. For purposes of this section, a reporting corporation that uses an accrual method of accounting shall use accrued payments and accrued receipts for purposes of computing the total amount of each of the types of transactions listed in this section.

\* \* \* \* \*

(h) Effective date. (1) Except as otherwise provided, for effective dates for this section for certain reporting corporations, see §1.6038A-1(n). Paragraph (b)(8) of this

section applies with respect to information for annual accounting periods beginning on or after June 21, 2006.

(2) The applicability of paragraph (b)(8) of this section will expire on or before June 19, 2009.

PART 602 -- OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. Section 602.101(b) is amended adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

---

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6038-2.....	1545-2020 1545-1617
* * * * *	

---

/s/ Mark E. Matthews  
Deputy Commissioner for Services and Enforcement.

Approved: June 13, 2006

/S/ Eric Solomon  
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).