

decedent's individual retirement account that is included in the estate's gross income as income in respect of a decedent under section 691(a). The entire \$900,000 is allocated to corpus under applicable local law. Both the separate share for the child's trust and the separate share for the surviving spouse may potentially be funded with the proceeds from the individual retirement account. Therefore, a portion of the \$900,000 gross income must be allocated to the trust's separate share. The amount allocated to the trust's share must be based upon the relative values of the two separate shares using a reasonable and equitable method. The estate is entitled to a deduction under section 661 for the portion of the \$900,000 properly allocated to the trust's separate share, and the trust must include this amount in income under section 662.

**Example 7 (i) Facts.** Testator, who dies in 2000, is survived by a spouse and three adult children. Testator's will divides the residue of the estate equally among the three children. The surviving spouse files an election under the applicable state's elective share statute. Under this statute, a surviving spouse is entitled to one-third of the decedent's estate after the payment of debts and expenses. The statute also provides that the surviving spouse is not entitled to any of the estate's income and does not participate in appreciation or depreciation of the estate's assets. However, under the statute, the surviving spouse is entitled to interest on the elective share from the date of the court order directing the payment until the executor actually makes payment. During the estate's 2001 taxable year, the estate distributes to the surviving spouse \$5,000,000 in partial satisfaction of the elective share and pays \$200,000 of interest on the delayed payment of the elective share. During that year, the estate receives dividend income of \$3,000,000 and pays expenses of \$60,000 that are deductible on the estate's federal income tax return.

(ii) **Conclusion.** The estate has four separate shares consisting of the surviving spouse's elective share and each of the three children's residuary bequests. Because the surviving spouse is not entitled to any estate income under state law, none of the estate's gross income is allocated to the spouse's separate share for purposes of determining that share's distributable net income. Therefore, with respect to the \$5,000,000 distribution, the estate is allowed no deduction under section 661, and no amount is included in the spouse's gross income under section 662. The \$200,000 of interest paid to the spouse must be included in the spouse's gross income under section 61. Because no distributions were made to any other beneficiaries during the year, there is no need to compute the distributable net income of the other three separate shares. Thus, the taxable income of the estate for the 2000 taxable year is \$2,939,400 (\$3,000,000 (dividend income) minus \$60,000 (expenses) and \$600 (personal exemption)). The estate's \$200,000 interest payment is a nondeductible personal interest expense described in section 163(h).

**Example 8.** The will of Testator, who dies in 2000, directs the executor to distribute the

X stock and all dividends therefrom to child A and the residue of the estate to child B. The estate has two separate shares consisting of the income on the X stock bequeathed to A and the residue of the estate bequeathed to B. The bequest of the X stock meets the definition of section 663(a)(1) and therefore is not a separate share. If any distributions, other than shares of the X stock, are made during the year to either A or B, then for purposes of determining the distributable net income for the separate shares, gross income attributable to dividends on the X stock must be allocated to A's separate share and any other income must be allocated to B's separate share.

**Example 9.** The will of Testator, who dies in 2000, directs the executor to divide the residue of the estate equally between Testator's two children, A and B. The will directs the executor to fund A's share first with the proceeds of Testator's individual retirement account. The date of death value of the estate after the payment of debts, expenses, and estate taxes is \$9,000,000. During 2000, the \$900,000 balance in Testator's individual retirement account is distributed to the estate. The entire \$900,000 is allocated to corpus under applicable local law. This amount is income in respect of a decedent within the meaning of section 691(a). The estate has two separate shares, one for the benefit of A and one for the benefit of B. If any distributions are made to either A or B during the year, then, for purposes of determining the distributable net income for each separate share, the \$900,000 of income in respect of a decedent must be allocated to A's share.

**Example 10.** The facts are the same as in *Example 9*, except that the will directs the executor to fund A's share first with X stock valued at \$3,000,000, rather than with the proceeds of the individual retirement account. The estate has two separate shares, one for the benefit of A and one for the benefit of B. If any distributions are made to either A or B during the year, then, for purposes of determining the distributable net income for each separate share, the \$900,000 of gross income attributable to the proceeds from the individual retirement account must be allocated between the two shares to the extent that they could potentially be funded with those proceeds. The maximum amount of A's share that could potentially be funded with the income in respect of decedent is \$1,500,000 (\$4,500,000 value of share less \$3,000,000 to be funded with stock) and the maximum amount of B's share that could potentially be funded with income in respect of decedent is \$4,500,000. Based upon the relative values of these amounts, the gross income attributable to the proceeds of the individual retirement account is allocated \$225,000 (or one-fourth) to A's share and \$675,000 (or three-fourths) to B's share.

**Example 11.** The will of Testator, who dies in 2000, provides that after the payment of specific bequests of money, the residue of the estate is to be divided equally among the Testator's three children, A, B, and C. The will also provides that during the period of administration one-half of the income from the residue is to be paid to a designated charitable organization. After the specific

bequests of money are paid, the estate initially has three equal separate shares. One share is for the benefit of the charitable organization and A, another share is for the benefit of the charitable organization and B, and the last share is for the benefit of the charitable organization and C. During the period of administration, payments of income to the charitable organization are deductible by the estate to the extent provided in section 642(c) and are not subject to the distribution provisions of sections 661 and 662.

**Par. 9.** Section 1.663(c)–6 is added to read as follows:

**§ 1.663(c)–6 Effective dates.**

Sections 1.663(c)–1 through 1.663(c)–5 are applicable for estates and qualified revocable trusts within the meaning of section 645(b)(1) with respect to decedents who die after December 28, 1999. However, for estates and qualified revocable trusts with respect to decedents who died after the date that section 1307 of the Tax Reform Act of 1997 became effective but before December 28, 1999, the IRS will accept any reasonable interpretation of the separate share provisions, including those provisions provided in 1999–11 I.R.B. 41 (see § 601.601(d)(2)(ii)(b) of this chapter). For trusts other than qualified revocable trusts, § 1.663(c)–2 is applicable for taxable years of such trusts beginning after December 28, 1999.

**Robert E. Wenzel,**

*Deputy Commissioner of Internal Revenue.*

Approved: December 13, 1999.

**Jonathan Talisman,**

*Acting Assistant Secretary for the Treasury.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Parts 1 and 602

[TD 8850]

RIN 1545–AV69

#### Information Reporting With Respect to Certain Foreign Partnerships and Certain Foreign Corporations

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations under section 6038 of the Internal Revenue Code relating to information reporting requirements for United States persons owning interests in controlled foreign partnerships (CFPs). This document also contains

amendments to the final regulations under section 6038 relating to the reporting requirements of U.S. shareholders of certain foreign corporations and amendments to the final regulations under section 6038B relating to the reporting requirements with respect to transfers of property to foreign partnerships and to foreign corporations.

**DATES: Effective Dates:** These regulations are effective December 29, 1999, except that § 1.6038B-2(a)(5) is effective January 1, 2000.

**Applicability Dates:** For dates of applicability, see §§ 1.6038-2(l), 1.6038-3(l), and 1.6038B-2(c)(4) and (j)(3).

**FOR FURTHER INFORMATION CONTACT:** Eliana Dolgoff, (202) 622-3860 (not a toll-free number).

#### **SUPPLEMENTARY INFORMATION:**

##### **Paperwork Reduction Act**

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control numbers 1545-1615, 1545-1617, and 1545-1317. Responses to these collections 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 it displays a valid control number assigned by the Office of Management and Budget.

The burden of complying with the collection of information required to be reported on Form 8865 is reflected in the burden for Form 8865.

The burden of complying with the collection of information required to be reported on Form 5471 is reflected in the burden for Form 5471.

The burden of complying with the collection of information required to be reported on Form 926 is reflected in the burden for Form 926.

The estimated annual burden per respondent of complying with the collection of information in § 1.6038-3(c)(1)(ii)(B) and (2)(ii)(B) varies from .5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer of the Department of the Treasury, Office of Information and

Regulatory Affairs, Washington, DC 20503.

Books or records relating to this 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**

On September 9, 1998, the IRS published in the **Federal Register** (63 FR 48144) proposed regulations relating to the reporting requirements under section 6038 of United States persons that are direct or indirect partners of CFPs. A public hearing on the proposed regulations was held on November 10, 1998, even though no requests to speak at the hearing were received. Though no comments were made at the hearing, written comments were received. After consideration of all of the written comments, the proposed regulations under section 6038 are adopted as revised by this Treasury decision. The revisions are discussed in the Summary of Public Comments and Explanation of Revisions section of this preamble. This document also contains amendments to certain other final regulations. These amendments are also discussed below.

##### **Summary of Public Comments and Explanation of Revisions**

###### *A. General Comments Regarding the Proposed Section 6038 CFP Regulations*

Some commentators suggested that the final regulations should exempt state and local government employee retirement plans from the section 6038 reporting requirements. The final regulations provide that trusts relating to state and local government employee retirement plans are not required to report under section 6038, unless required to do so in the instructions to Form 8865, "Return of U.S. Persons with Respect to Certain Foreign Partnerships."

One commentator asserted that the reasonable cause exception to the section 6038 penalties appears to apply only to failures to file Form 8865 and therefore would not protect a taxpayer who files an incomplete Form 8865 because the taxpayer was unable to obtain all the required information from the foreign partnership. The reasonable cause exception has been modified to make clear that it applies to both a failure to file Form 8865 and to a failure to submit all information required to be submitted.

Commentators requested that the final regulations provide that the section

6038 penalties do not apply when there is minor noncompliance with the reporting requirements under section 6038. The commentators expressed concern that taxpayers will be subject to penalties for small discrepancies in the information reported and suggested that the penalties apply only if there is a substantial failure to report the required information, or if materially false or inaccurate information is submitted. Because the IRS and Treasury believe adding such a standard might encourage taxpayers to submit incomplete Forms 8865, the standard was not added to the final regulations. A taxpayer may, nonetheless, avoid application of the section 6038 penalties because of minor noncompliance with the section 6038 reporting requirements by demonstrating reasonable cause. See § 1.6038-3(k)(4).

Commentators also requested that the IRS add additional, specific reasonable cause exceptions to the section 6038 penalties. For example, one commentator requested a specific exception be provided for controlling ten-percent partners (see definition in § 1.6038-3(a)(2)) that are unable to obtain all information required to be reported by controlling ten-percent partners. The final regulations do not contain additional, specific reasonable cause exceptions. Whether there is reasonable cause depends on all the facts and circumstances of the particular case. Any person who is unable to obtain information may apply for a reasonable cause determination specific to that person's situation.

Finally, a commentator asked that in the case of an affiliated group of corporations filing a consolidated income tax return, the final regulations not require the members to file separate Forms 8865 if one member of the group files Form 8865. The final regulations adopt this recommendation. The common parent corporation of an affiliated group of corporations filing a consolidated income tax return may file one Form 8865 on behalf of all other members of the group required to file Form 8865 pursuant to section 6038 with respect to a particular foreign partnership.

###### *B. Section 6038/Section 6031 Overlap*

Some commentators requested that the final regulations address the potential overlap between section 6031 and section 6038. In general, section 6031(e) provides that a foreign partnership must file Form 1065, "U.S. Partnership Return of Income," if it has gross income derived from sources within the United States or gross income that is effectively connected

with the conduct of a trade or business within the United States.

Section 6038 provides generally that a U.S. partner of a foreign partnership must file Form 8865 with respect to that partnership if the partner individually, or collectively with other ten-percent or greater U.S. partners, owns more than a fifty-percent interest in the partnership. Therefore, in some cases, both Forms 1065 and 8865 would be required to be filed with regard to the same partnership for the same tax year of the partnership. Although the two forms are not identical, and one is filed by the partnership while the other is filed by the relevant partners, the information required by the two forms is substantially the same.

Additionally, some confusion may result from the fact that the two forms contain similarly titled schedules. In particular, each form has a Schedule K-1 on which information about a partner's distributive share of partnership income, deductions, etc., is to be reported. The IRS is working to eliminate discrepancies between the two schedules. However, even if the discrepancies are eliminated, it is still possible the two schedules will not contain identical information because one schedule will be prepared by a partner and one will be prepared by the partnership.

In response to the comments that the overlap between section 6031 and section 6038 reporting will be burdensome to taxpayers when both sets of requirements apply, and to help avoid any confusion on the part of taxpayers with respect to which Schedule K-1 they should use to compute their tax liabilities, the final section 6038 regulations reduce the burden imposed by section 6038 in the case of an overlap. They provide that if a foreign partnership completes and files Form 1065, a U.S. person required to report under section 6038 must use a copy of the filed Form 1065, including the Schedules K-1, in conjunction with fulfilling the person's section 6038 reporting obligation. Specifically, the instructions to Form 8865 will state which schedules on Form 1065 are considered equivalent to schedules on Form 8865. A U.S. partner must attach to the partner's Form 8865 a copy of the Form 1065 schedules that are considered equivalent to the schedules the partner is required to complete on Form 8865 as a controlling fifty-percent partner (see definition in § 1.6038-3(a)(1)) or as a controlling ten-percent partner. A partner should not complete a schedule on Form 8865 when the partner attaches a copy of the equivalent Form 1065 schedule to its Form 8865.

Should a schedule on Form 8865 ask for information that is not required to be reported on the equivalent Form 1065 schedule, the partner is not required to report that information on its Form 8865 if a copy of the completed equivalent Form 1065 schedule is attached to its Form 8865. A partner attaching copies of schedules from Form 1065 to its Form 8865 must still complete the parts of Form 8865 that the person is required to complete as a controlling fifty-percent partner, or as a controlling ten-percent partner, and for which there is no equivalent Form 1065 schedule (for example, a partner must still complete the first page of Form 8865 and certain schedules on page two of the form).

An example of how a person will use a completed Form 1065 to fulfill its section 6038 filing obligation is as follows. Section 1.6038-3(g)(2)(iii) requires a controlling fifty-percent partner to report aggregate information about the partners' distributive shares of income, gain, losses, deductions and credits. Such information is reported on Schedule K of Form 8865. The same information is also required to be submitted on Schedule K of Form 1065. The instructions to Form 8865 will provide that Schedules K on Forms 1065 and 8865 are equivalent. Accordingly, if the partnership completes and files a Form 1065, a controlling fifty-percent partner filing Form 8865 must attach a copy of the Schedule K from the Form 1065 to the partner's Form 8865 and should not complete Schedule K on Form 8865. The partner must also attach all other Form 1065 schedules that are considered equivalent to Form 8865 schedules that the partner must complete as a controlling fifty-percent partner. Additionally, the partner must still complete page one of Form 8865 and Schedules A "Constructive Ownership of Partnership Interest," A-1 "Certain Partners of Foreign Partnership," A-2 "Affiliation Schedule," and N "Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities" of Form 8865.

Similarly, a controlling ten-percent partner must submit on Schedule K-1 of Form 8865 a statement of the income, gain, losses, deductions and credits allocated to the partner's direct interest in the partnership. See § 1.6038-3(g)(1)(i). The same information is also required to be reported on Schedule K-1 of Form 1065. Therefore, if the partnership completes and files Form 1065, the partner must attach to its Form 8865 a copy of its Schedule K-1 from the Form 1065 completed by the partnership and should not complete

Schedule K-1 on Form 8865. The partner is still required to complete the portions of pages one and two of Form 8865 applicable to controlling ten-percent partners, as well as Schedule N.

Another comment asserted that the proposed regulations imposed an excessive reporting burden on taxpayers and that they had the effect of nullifying the section 6031(e) limitation on reporting required of foreign partnerships. The comment suggested that the IRS require only those items specifically enumerated in section 6038(a)(1) to be reported under section 6038.

Section 6038 grants the IRS authority to require taxpayers to submit more than the items enumerated in section 6038(a)(1). Section 6038 provides that the Secretary may require the furnishing of any other information that is similar or related in nature to that specified in the first sentence of section 6038(a)(1), or which the Secretary determines to be appropriate to carry out the provision of Title 26. The IRS has determined that all of the information that the final section 6038 regulations require taxpayers to submit is necessary for the IRS to carry out the provisions of Title 26.

Additionally, as explained above, section 6031(e) and section 6038 differ with respect to whom they require to report and when the reporting obligation applies. Section 6031(e) applies only to the requirement that a Form 1065 be filed, to the application of the TEFRA partnership-level audit procedures, and to the requirement that a partnership report information about its operations, even when there is limited U.S. ownership in the partnership. In contrast, section 6038 requires certain U.S. partners to report information when the foreign partnership in which they own an interest has substantial U.S. ownership. Section 6031(e) was added to the Internal Revenue Code at the same time that section 6038 was amended to apply to CFPs. See Taxpayer Relief Act of 1997, Public Law 105-34, sections 1141-1142 (111 Stat. 983) (1997). Therefore, rather than intending section 6031(e) to limit the amount of information required to be reported pursuant to section 6038, Congress intended the two provisions to work together to ensure that the IRS receives sufficient information about foreign partnerships.

### C. Tiered Partnerships

Commentators requested that section 6038 reporting apply only to first-tier CFPs, *i.e.*, section 6038 reporting should only be required of U.S. persons with respect to foreign partnerships in which

they own a direct interest. However, section 6038(e)(3)(B) provides that rules similar to the rules of section 267(c) shall apply when determining whether a person owns a fifty-percent interest in a foreign partnership. Additionally, the statute does not require that a U.S. person own its interest in the CFP directly. Therefore, the final regulations require section 6038 reporting of United States persons whose ownership interests are entirely the result of constructive ownership from other persons.

Nevertheless, certain exceptions and modifications to this rule may apply. Persons that do not own direct interests may qualify for a reduced reporting obligation pursuant to the exception for constructive owners in § 1.6038-3(c)(2). Additionally, certain information required by the final section 6038 regulations must be submitted only if the partner owns a direct interest in the foreign partnership. For example, § 1.6038-3(g)(1)(i) provides that the person reporting under section 6038 must provide a statement of the income, gain, losses, deductions and credits allocated to that person's direct interest in the partnership. Accordingly, if a person is reporting under section 6038 but owns no direct interest in the partnership, that person will not have to submit information under § 1.6038-3(g)(1)(i). Finally, the final regulations require attribution from nonresident alien family members only if the person to whom the interest is being attributed already owns a direct or indirect (under the rules of section 267(c)(1) or (5)) interest in the partnership. See § 1.6038-3(b)(4).

#### *D. Failure To Recognize That an Arrangement Is a Partnership or That a Partnership Is a Foreign Partnership*

Commentators expressed concern that taxpayers might fail to report under section 6038 because they failed to recognize that their arrangement constituted a partnership. Additionally, if no entity is formed under foreign law, but a partnership is determined to exist, it may be difficult to determine whether the partnership is foreign or domestic. Some commentators recommended that the IRS exclude partnerships not formed under a foreign law statute from the reporting requirements, subject to an anti-abuse rule. The final regulations do not adopt this recommendation and additional guidance on these issues is beyond the scope of this document. They do, however, provide that the section 6038 reporting requirements do not apply to any United States person with respect to a foreign partnership that has validly elected (or is deemed to

have elected) to be excluded from the application of subchapter K. See § 1.6038-3(e). Additionally, a taxpayer that does not comply with section 6038 because it mistakenly concluded that its arrangement was not a partnership, or that it was not a foreign partnership, may apply for a reasonable cause determination. See § 1.6038-3(k)(4).

#### *E. Section 6038 (CFPs) Effective Date*

Section 1.6038-3 is applicable to CFP tax years ending on or after December 31, 2000. United States persons are not required to report under section 6038 for CFP tax years ending before December 31, 2000.

#### *F. Availability of Form 8865*

A United States person required to report information pursuant to section 6038 must do so by completing and filing Form 8865. A final version of Form 8865 will be released prior to January 1, 2000. Taxpayers will be able to download a copy of the form and its instructions from the IRS Internet website located at [www.irs.ustreas.gov](http://www.irs.ustreas.gov).

#### *G. Clarification of Section 6501(c)(8)*

Section 6501(c)(8) provides that in the case of information required to be reported under section 6038, 6038A, 6038B, 6046, 6046A, or 6048, the time for assessment of any tax imposed by Title 26 with respect to any event or period to which such information relates shall not expire before the date that is three years after the date on which the Secretary is furnished the information required to be reported under such section. Taxpayers have expressed uncertainty about the application of this rule in the context of a failure to properly report information required under sections 6038, 6038B, or 6046A, with respect to an interest in a foreign corporation or a foreign partnership, as applicable. The IRS and Treasury wish to clarify that if a U.S. person fails to comply with sections 6038, 6038B, or 6046A, the extended statute of limitations provided by section 6501(c)(8) shall apply only to the tax consequences related to the information required to be reported under the relevant reporting section and not to all transactions within the U.S. person's tax year at issue. For example, if a U.S. person with a calendar tax year fails to comply with section 6038 for a controlled foreign partnership's 2001 calendar tax year, section 6501(c)(8) will only extend the statute of limitations applicable to the U.S. person's 2001 tax year with respect to any tax consequences associated with the U.S. person's interest in the foreign

partnership during the partnership's 2001 tax year.

#### *H. Amendment to Final Section 6038 Foreign Corporation Regulations*

In order to reduce the burden that section 6038 imposes on taxpayers, this document also amends the final regulations under section 6038 applicable to shareholders of certain foreign corporations. The regulations provide that if a United States person does not own a direct or indirect interest in the foreign corporation, but is attributed an interest from a nonresident alien, the person is not required to report under section 6038. This amendment is effective for tax years of foreign corporations ending on or after December 29, 1999.

#### *I. Amendments to Final Section 6038B Regulations Applicable to Transfers of Property to Foreign Partnerships*

On February 5, 1999, the IRS published in the **Federal Register** final regulations under section 6038B relating to the information reporting requirements for certain contributions of property by United States persons to foreign partnerships. See 64 FR 5713. This document makes several amendments to those final regulations. Each amendment either reduces the burden that section 6038B imposes on taxpayers, or does not affect the burden imposed by section 6038B.

First, the amount of information required to be submitted by a person reporting a transfer of property to a foreign partnership is reduced. Rather than submit the names and addresses of all the foreign partnership's partners, the person reporting the transfer (the transferor) must provide only the names and addresses of the United States partners that owned a ten-percent or greater direct interest in the foreign partnership during the transferor's tax year in which the reportable transfer occurred, and the names and addresses of any other United States or foreign persons that were direct partners in the partnership during that tax year and that were related to the transferor under section 6038B during that tax year. A person who transferred solely cash and who did not own a ten-percent or greater interest after the transfer is still not required to report the names and addresses of any of the foreign partnership's other partners. This amendment applies to tax years of U.S. persons required to report under section 6038B beginning on or after January 1, 2000.

Second, this document changes the time for filing Form 8865 to report a transfer to a foreign partnership in

certain instances. Currently, § 1.6038B-2(a)(5)(ii) provides that if a United States person required to report a transfer to a foreign partnership is also required to report pursuant to section 6038 for the period in which the transfer occurred, then the United States person must report the transfer on the Form 8865 completed for the partnership's tax year in which the transfer occurred. This document deletes the section 6038B/section 6038 overlap rule, so that a United States person must always report with its tax return for a particular tax year all of its section 6038B transfers that took place during that year, regardless of whether any of the transfers occurred during a period for which section 6038 reporting is also required. This amendment applies to tax years of U.S. persons required to report under section 6038B beginning on or after January 1, 2000.

The following example illustrates this amendment. Assume the tax year of *FPS*, a foreign partnership, ends on Sept 30. *US*, a United States person and calendar year taxpayer, owns a sixty-percent interest in *FPS* and therefore is a controlling fifty-percent partner of *FPS*. Accordingly, *US* must report under section 6038 with respect to *FPS*. On October 15, 2001, *US* transfers property to *FPS* in a section 721 transaction. *US* is required to report this transfer under section 6038B because *US* owns at least a ten-percent interest in the partnership immediately after the transfer. See § 1.6038B-2(a)(1)(i). Under the existing section 6038B regulations, *US* is required to report the October 15, 2001 property transfer on the Form 8865 for *FPS*'s tax year ending September 30, 2002, that will be filed with *US*'s 2002 income tax return.

Under the amendments to section 6038B contained in this document, *US* must attach to its 2001 income tax return a Form 8865 on which is reported the October 15, 2001 property transfer and information about *FPS* for *FPS*'s tax year ending September 30, 2001. Assuming *US* is also a controlling fifty-percent partner during *FPS*'s tax year ending September 30, 2002, when *US* files its 2002 income tax return, *US* must attach to that return Form 8865 on which is reported information about *FPS* for *FPS*'s tax year ending September 30, 2002. *US* should not report the October 15, 2001, property transfer on the Form 8865 filed with *US*'s 2002 income tax return.

The third and final amendment to the section 6038B regulations provides an additional opportunity for United States persons to timely report certain transfers to foreign partnerships. Even if not reported in accordance with the rules

provided in § 1.6038B-2(a)(5) or (j)(1) or (2), a transfer to a foreign partnership that occurred before January 1, 2000, will nevertheless be considered timely reported if the transferor reports it on a Form 8865 attached to an amended tax return for the transferor's tax year in which the transfer occurred, provided such amended return is filed no later than September 15, 2000.

Additionally, since issuing the section 6038B regulations in February 1999, certain tax-exempt organizations have contacted the IRS and Treasury to request that they be specifically excluded from the obligation under section 6038B to report their property transfers to foreign partnerships. The IRS and Treasury invite comments regarding the extent to which section 6038B reporting should be required of tax-exempt organizations.

#### *J. Amendment to Final Section 6038B Regulations Applicable to Transfers of Property to Foreign Corporations*

This document makes one amendment to the final section 6038B regulations governing the reporting requirements with respect to transfers to foreign corporations. The amendment reduces the burden that section 6038B imposes on taxpayers.

Pursuant to § 1.367(a)-3(c)(8), section 367(a) does not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of § 1.83-6(d)(1). Section 1.83-6(d)(1) provides that if a shareholder of a corporation transfers property to an employee of such corporation in consideration of services performed for the corporation, the transaction is considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the latter corporation to the employee.

The final regulations under section 6038B do not contain an exception to the reporting requirements that corresponds to the rule in § 1.367(a)-3(c)(8). Therefore, a transfer by a domestic corporation of its stock or securities to an employee of the domestic corporation's foreign subsidiary may be excluded from the application of section 367(a), yet still reportable under section 6038B. This document provides that such a transfer is not required to be reported under section 6038B if the transfer is considered to be to a foreign corporation solely by reason of § 1.83-6(d)(1) and the fair market value of the property transferred did not exceed \$100,000.

This amendment is effective as if it had been included in TD 8770 (63 FR 33550), and therefore applies to transfers occurring on or after July 20, 1998.

#### **Special Analyses**

It has been determined that these final regulations are 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 final regulations. It is hereby certified that the collections of information contained in these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the number of small entities that will be required to file the form is not substantial. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations were 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 Eliana Dolgoff, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and the 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 parts 1 and 602 are amended as follows:

#### **PART 1—INCOME TAXES**

**Par. 1.** The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*  
Section 1.6038-2 also issued under 26 U.S.C. 6038.

Section 1.6038-3 also issued under 26 U.S.C. 6038. \* \* \*

**Par. 2.** In § 1.367(a)-3, paragraph (c)(8) is amended by adding a sentence

to the end of the paragraph to read as follows:

**§ 1.367(a)-3 Treatment of transfers of stock or securities to foreign corporations.**

\* \* \* \* \*

(c) \* \* \*  
(8) \* \* \* The transfer may still, however, be reportable under section 6038B. See § 1.6038B-1(b)(2)(i)(A)(4) and (b)(2)(i)(B)(4).

\* \* \* \* \*

**Par. 3.** Section 1.6038-2 is amended as follows:

1. A sentence is added to the end of paragraph (j)(2)(i)(C).

2. Paragraph (l) is added.

The revised and added provisions 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.**

\* \* \* \* \*

(j) \* \* \*  
(2) \* \* \*  
(i) \* \* \*  
(C) \* \* \* (For a rule regarding attribution from a nonresident alien, see paragraph (l) of this section).

\* \* \* \* \*

(l) *Other persons excepted from filing.* For tax years of foreign corporations ending on or after December 29, 1999, any person required to furnish information under this section with respect to a foreign corporation does not have to furnish that information if the following conditions are met—

(1) Such person does not own a direct or indirect interest in the foreign corporation; and

(2) Such person is required to furnish information solely by reason of attribution of stock ownership from a nonresident alien(s) under paragraph (c) of this section.

**Par. 4.** Section 1.6038-3 is added to read as follows:

**§ 1.6038-3 Information returns required of certain United States persons with respect to controlled foreign partnerships (CFPs).**

(a) *Persons required to make return—*

(1) *Controlling fifty-percent partners.* The term *controlling fifty-percent partner* means a United States person that controlled (as defined in paragraph (b)(1) of this section) the foreign partnership at any time during the partnership's tax year (as defined in paragraph (b)(8) of this section). Except as provided in paragraph (c), (d), or (e) of this section, for each tax year of a foreign partnership during which the partnership has one or more controlling fifty-percent partners, each controlling fifty-percent partner must complete and

file Form 8865, "Return of U.S. Persons With Respect To Certain Foreign Partnerships," containing the information described in paragraph (g) of this section.

(2) *Controlling ten-percent partners.* If at any point during a foreign partnership's tax year (as defined in paragraph (b)(8) of this section) a United States person owned a ten-percent or greater interest in the partnership while the partnership was controlled by United States persons owning ten-percent or greater interests, such United States person is a controlling ten-percent partner. See paragraph (b)(1) of this section for the definition of control. However, a United States person is not a controlling ten-percent partner with respect to a particular foreign partnership for a particular tax year of the foreign partnership if at any point during that year the partnership had a controlling fifty-percent partner, as defined in paragraph (a)(1) of this section. Except as provided in paragraph (c), (d), or (e) of this section, for each tax year of a partnership during which the partnership has controlling ten-percent partners, each controlling ten-percent partner must complete and file Form 8865 containing the information described in paragraph (g)(1) of this section.

(3) *Separate returns for each partnership.* A United States person required to report under this paragraph (a) must file a separate Form 8865 for each foreign partnership with respect to which the person is a controlling fifty-percent partner or a controlling ten-percent partner.

(b) *Ownership determinations and definitions—*(1) *Control.* Control of a foreign partnership is ownership of more than a fifty-percent interest in the partnership.

(2) *Fifty-percent interest.* A fifty-percent interest in a partnership is an interest equal to fifty percent of the capital interest in such partnership, an interest equal to fifty percent of the profits interest in such partnership, or an interest to which fifty percent of the deductions or losses of such partnership are allocated.

(3) *Ten-percent interest.* A ten-percent interest in a partnership is an interest equal to ten percent of the capital interest in such partnership, an interest equal to ten percent of the profits interest in such partnership, or an interest to which ten percent of the deductions or losses of such partnership are allocated.

(4) *Constructive ownership rules.* For purposes of determining an interest in a partnership, the constructive ownership rules of section 267(c) (other than

section 267(c)(3)) apply, taking into account that such rules refer to corporations and not to partnerships. However, an interest will be attributed from a nonresident alien under the family attribution rules of section 267(c)(2) and (4) only if the person to whom the interest is attributed owns a direct or indirect (under the rules of 267(c)(1) or (5)) interest in the foreign partnership.

(5) *Determination of amount of interest.* Whether a person owns a fifty-percent interest, or a ten-percent interest, as described in paragraphs (b)(2) and (3) of this section, is determined for each tax year of the foreign partnership by reference to the agreement of the partners relating to such interests during that tax year.

(6) *Definition of United States person.* The term *United States person* is defined in section 7701(a)(30).

(7) *Definition of a foreign partnership.* A foreign partnership is a partnership described in section 7701(a)(5).

(8) *Tax year of a foreign partnership.* The tax year of a foreign partnership is determined under section 706.

(9) *Examples.* The rules of paragraph (a) of this section and this paragraph (b) are illustrated by the following examples:

*Example 1. Sole U.S. partner does not own more than a fifty-percent interest.* No United States person owns any interest (directly or constructively) in *FPS*, a foreign partnership whose tax year under section 706 is the calendar year. On January 1, 2001, *US*, a United States person with the calendar year as its tax year, contributes property to *FPS* in exchange for a 40% interest in a section 721 transaction. No United States persons acquire directly or constructively any other interests in *FPS* during *FPS*'s 2001 tax year. *US* is not a controlling fifty-percent partner during *FPS*'s 2001 tax year. *US* did not own during that tax year, either directly or constructively, more than a 50% interest in the partnership under paragraphs (b)(2) and (4) of this section. Also, *US* is not a controlling ten-percent partner; although *US* owned a 10% or greater interest, *US* persons owning at least 10% interests did not control *FPS*. Therefore, *US* does not have to file with its 2001 income tax return a Form 8865 with respect to *FPS* under section 6038. (But see section 6038B for the reporting obligations of *US* with respect to its transfer of property to *FPS* and section 6046A for the reporting obligation of *US* with respect to its acquisition of an interest in *FPS*. See also § 1.6046A-1(e)(1) regarding the overlap between sections 6038B and 6046A).

*Example 2. Controlling ten-percent partners.* Assume the same facts as in *Example 1*. In addition, on January 1, 2002, *US1*, a United States person unrelated to *US* and a calendar year taxpayer, purchases a 15% interest in *FPS* from a foreign partner of *FPS*. Neither *US* nor *US1* is a controlling fifty-percent partner during *FPS*'s 2002 tax



year because neither one owns more than a 50% percent interest in *FPS* during that year. However, *US* and *US1* are controlling ten-percent partners for that year because each owns at least a 10% interest (*US* owns a 40% interest and *US1* owns a 15% interest) and together they control *FPS* because collectively they own more than a 50% interest in *FPS*. As controlling ten-percent partners, under section 6038, each is required to file a Form 8865 with its 2002 income tax return. (*US1* must also report its acquisition of the 15% interest in *FPS* under section 6046A on its Form 8865 filed with its 2002 income tax return.)

**Example 3. Constructive ownership rules.** Assume the same facts as in *Example 2*. In addition, on January 1, 2003, *US2*, a United States person and the brother of *US*, purchases 50% of the stock of *FC*, a foreign corporation. *FC* owns a 20% interest in *FPS*. Thus, under sections 6038(e)(3) and 267(c)(1), *US2* indirectly owns a 10% interest in *FPS* (10% is *US2*'s proportionate share of *FC*'s 20% interest in *FPS*), and under sections 6038(e)(3) and 267(c)(2), *US2* is attributed *US*'s 40% interest. Additionally, *US* directly owns a 40% interest in *FPS* and is attributed *US2*'s 10% interest pursuant to section 6038(e)(3) and section 267(c)(2). Therefore, *US2* is considered to own a 50% interest (10% indirectly and 40% from *US*) in *FPS*, and *US* is considered to own a 50% interest in *FPS* (40% directly and 10% from *US2*). *FPS* has no controlling fifty-percent partners, because neither *US*, *US1*, nor *US2*, owns a greater than 50% interest. However, *US*, *US1*, and *US2* are each controlling ten-percent partners and each must file Form 8865 pursuant to section 6038 for *FPS*'s 2003 tax year ending December 31, 2003. Each must attach Form 8865 to its tax return for its 2003 tax year.

**Example 4. Controlling fifty-percent partners.** Assume the same facts as in *Example 3*. In addition, on June 1, 2004, *US* acquires an additional 1% direct interest in *FPS*. *US* is now a controlling fifty-percent partner of *FPS*, because *US* owns a 41% interest directly and a 10% interest constructively from *US2*. *US2* is also a controlling fifty-percent partner, because *US2* owns 10% indirectly and 41% constructively from *US*. Both *US* and *US2* are required to file Form 8865 containing all the information required to be submitted by controlling fifty-percent partners. (But see paragraph (c)(1) of this section, which contains filing exceptions when there are multiple controlling fifty-percent partners). *US1* is no longer a controlling ten-percent partner because *FPS* now has at least one controlling fifty-percent partner, and *US1* does not qualify as a controlling fifty-percent partner. Therefore, *US1* is not required to file Form 8865 under section 6038.

**Example 5. Constructive ownership from a nonresident alien.** *US*, a United States person, does not own directly or constructively an interest in *FPS*, a foreign partnership. The tax year of *FPS* is the calendar year. *NRA*, a nonresident alien, is the mother of *US*. In 2002, *NRA* acquires a 55% interest in *FPS*. Because *US* owns neither a direct nor a constructive interest in *FPS* under sections 6038(e)(3) and 267(c)(1)

or (5), *NRA*'s interest is not attributed to *US* under sections 6038(e)(3) and 267(c)(2). If in 2003 *NRA* becomes a United States person, *NRA*'s interest will be attributed to *US*. However, *US* is excused from filing Form 8865 if *US* satisfies the requirements of the constructive owners exception in paragraph (c)(2) of this section. In 2003, *NRA* is a controlling fifty-percent partner and must file a Form 8865 under section 6038 for *FPS*'s 2003 tax year.

(c) *Exceptions when more than one United States person is required to file Form 8865 pursuant to section 6038—*

(1) *Multiple controlling fifty-percent partners—*(i) *In general.* If, with respect to the same foreign partnership for the same tax year, more than one United States person is a controlling fifty-percent partner, then in lieu of each controlling fifty-percent partner filing a separate Form 8865, only one Form 8865 from one of the controlling fifty-percent partners is required, provided all of the requirements of paragraph (c)(1)(ii) of this section are satisfied. A person that is a controlling fifty-percent partner solely because of an interest to which deductions or losses are allocated may file the single return only if there is no United States person that is a controlling fifty-percent partner by reason of an interest in capital or profits.

(ii) *Requirements—*(A) The person undertaking the filing obligation must file Form 8865 with that person's income tax return in the manner provided by Form 8865 and the accompanying instructions. The return must contain all of the information that would have been required to be reported by this section if each controlling fifty-percent partner had filed its own Form 8865.

(B) Any controlling fifty-percent partner not filing Form 8865 must file with its income tax return a statement titled "Controlled Foreign Partnership Reporting" containing the following information—

(1) A statement that the person qualified as a controlling fifty-percent partner, but is not submitting Form 8865 pursuant to the multiple controlling fifty-percent partners exception;

(2) The name, address, and taxpayer identification number (if any) of the foreign partnership of which the person qualified as a controlling fifty-percent partner;

(3) A representation that the filing requirement has been or will be satisfied;

(4) The name and address of the person filing the single return;

(5) The Internal Revenue Service Center where the single return is required to be filed; and

(6) Any additional information that Form 8865 and the accompanying instructions require.

(iii) *Penalties.* If the requirements listed in paragraph (c)(1)(ii) of this section are not satisfied, a United States person that did not file a Form 8865 pursuant to this paragraph will be subject to the penalties in paragraph (k) of this section, unless the reasonable cause provision in paragraph (k)(4) of this section is satisfied.

(2) *Certain constructive owners excepted from furnishing information—*

(i) *In general.* A United States person that does not own a direct interest in the foreign partnership and that is required to file Form 8865 under this section solely by reason of constructive ownership from a United States person(s) pursuant to paragraph (b)(4) of this section (an indirect partner) is not required to file Form 8865 if all of the requirements listed in paragraph (c)(2)(ii) of this section are met.

(ii) *Requirements—*(A) The United States person(s) whose interest the indirect partner constructively owns reports all the information such person(s) is required to submit under this section, unless such person also is required to file solely by reason of constructive ownership from a United States person(s) pursuant to paragraph (b)(4) of this section, or another person reports the information pursuant to paragraph (c)(1) of this section.

(B) The indirect partner files with its income tax return a statement titled "Controlled Foreign Partnership Reporting" containing the following information—

(1) A representation that the indirect partner was required to file Form 8865, but is not doing so pursuant to the constructive owners exception;

(2) The names and addresses of the United States persons whose interests the indirect partner constructively owns;

(3) The name and address of the foreign partnership with respect to which the indirect partner would have had to have filed Form 8865 but for this exception; and

(4) Any additional information that Form 8865 and the accompanying instructions require.

(iii) *Penalties.* A United States person that pursuant to this paragraph (c)(2) does not file a return will be subject to the penalties in paragraph (k) of this section if the requirements listed in paragraph (c)(2)(ii) of this section are not satisfied, unless such failure is due to reasonable cause, as defined in paragraph (k)(4) of this section.

(iv) *Overlap with multiple controlling fifty-percent partners exception—*(A) If a

United States person qualifies for both the exception in paragraph (c)(1) of this section and the exception in this paragraph (c)(2), such person may only utilize the multiple controlling fifty-percent partners exception in paragraph (c)(1) of this section to avoid filing Form 8865.

(B) *Example.* The following example illustrates the operation of this paragraph (c)(2)(iv):

*Example.* US is a U.S. citizen. US owns 100% of the stock of DC, a domestic corporation. DC owns a 60% direct interest in FPS, a foreign partnership. DC and US are the only U.S. persons that own interests directly or constructively in FPS. DC owns directly a greater than 50% interest in FPS. US constructively owns DC's interest pursuant to sections 6038(e)(3) and 267(c)(1). Therefore, both DC and US are controlling fifty-percent partners. US qualifies for both the exception in paragraph (c)(1) of this section (multiple controlling fifty-percent partners) and the exception in paragraph (c)(2) of this section (constructive owner exception). US may only utilize the paragraph (c)(1) exception to avoid its filing obligation. Accordingly, DC may file a single Form 8865 on behalf of US and itself. However, that form must contain all the information that would have been submitted had DC and US each submitted a separate Form 8865.

(3) *Members of an affiliated group of corporations filing a consolidated return.* If one or more members of an affiliated group of corporations filing a consolidated return are required under section 6038 to file a Form 8865 for a particular foreign partnership, the common parent corporation may file one Form 8865 on behalf of all of the members of the group required to report under section 6038. Except with respect to group members who also qualify under the exception in paragraph (c)(2) of this section, the Form 8865 must contain all the information that would have been required to be submitted if each group member were required to file its own Form 8865.

(d) *Exception for certain trusts.* Trusts relating to state and local government employee retirement plans are not required to report under this section, unless the instructions to Form 8865 provide otherwise.

(e) *Reporting under this section not required with respect to partnerships excluded from the application of subchapter K.* The reporting requirements of this section will not apply to any United States person in respect of an eligible partnership as described in § 1.761-2(a) if such partnership has validly elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified

in § 1.761-2(b)(2)(i), or such partnership is deemed to have elected to be excluded from all of the provisions of subchapter K of chapter 1 of the Internal Revenue Code in accordance with the provisions of § 1.761-2(b)(2)(ii).

(f) *Period covered by return.* The information required under this section must be furnished for the tax year of the foreign partnership ending with or within the United States person's tax year. See section 706 for rules regarding tax years of partnerships.

(g) *Contents of return—(1) Information required to be submitted by controlling fifty-percent partners and controlling ten-percent partners.* All controlling fifty-percent partners and all controlling ten-percent partners must submit the following information on Form 8865 in the form and manner and to the extent prescribed by Form 8865 and its instructions—

(i) A statement of the income, gain, losses, deductions and credits allocated to the direct interest in the partnership of the person reporting under section 6038;

(ii) A list of all partnerships (foreign or domestic) in which the foreign partnership owned a direct interest, or owned a constructive interest of ten percent of more under the rules of section 267(c)(1) or (5), during the partnership's tax year for which the Form 8865 is being filed;

(iii) Information about all foreign entities that were disregarded as entities separate from their owner under §§ 301.7701-2 and 301.7701-3 that were owned by the foreign partnership during the partnership's tax year for which the Form 8865 is being filed;

(iv) A summary of the transactions that took place during the partnership's tax year between the partnership and the person filing the return, between the partnership and any other partnership of which the person filing the return is a controlling fifty-percent partner, and between the partnership and any corporation controlled (under section 6038(e)(2) and the regulations thereunder) by the person filing the return; and

(v) Any other information that Form 8865 or its accompanying instructions require to be submitted.

(2) *Additional information required to be submitted by controlling fifty-percent partners.* In addition to the information required pursuant to paragraph (g)(1) of this section, controlling fifty-percent partners must also submit the following information in the form and manner and to the extent required by Form 8865 and its instructions—

(i) A list of the names, addresses and tax identification numbers (if any) of

each United States person that owned a direct interest of ten percent or more in the partnership during the partnership's tax year, and of each United States and foreign person whose interests in the partnership the controlling fifty-percent partner constructively owned under paragraph (b)(4) of this section during the partnership's tax year;

(ii) A list of transactions between the partnership and any United States person owning at the time of the transaction at least a 10-percent direct interest (as defined in paragraph (b)(3) of this section) in the foreign partnership;

(iii) A statement of the aggregate of the partners' distributive shares of items of income, gain, losses, deductions and credits;

(iv) A statement of income, gain, losses, deductions and credits allocated to each United States person holding a direct interest in the foreign partnership of ten percent or more; and

(v) Any other information Form 8865 or its accompanying instructions require controlling fifty-percent partners to submit.

(h) *Method of reporting.* Except as otherwise provided on Form 8865 or the accompanying instructions, all amounts required to be furnished on Form 8865 must be expressed in United States dollars. All statements required on or with Form 8865 pursuant to this section must be in English.

(i) *Time and place for filing return—(1) In general.* Form 8865 must be filed with the United States person's income tax return on or before the due date (including extensions) of that return. If the United States person is not required to file an income tax return for its tax year with which or within which the foreign partnership's tax year ends, but is required to file an information return for that year (for example, Form 1065, "U.S. Partnership Return of Income," or Form 990, "Return of Organization Exempt from Income Tax"), the Form 8865 must be filed with the United States person's information return filed on or before the due date (including extensions) of that return.

(2) *Duplicate return.* If required by the instructions to Form 8865, a duplicate Form 8865 (including attachments and schedules) must also be filed.

(j) *Overlap with section 6031—(1) In general.* A partner may be required to file Form 8865 under this section and the foreign partnership in which it is a partner may also be required to file a Form 1065 under section 6031(e) for the same partnership tax year. However, if a foreign partnership completes and files Form 1065, the United States partner must use a copy of the relevant



parts of Form 1065 to fulfill certain of its filing obligations under section 6038. Specifically, instead of completing the Form 8865 schedules that the person would otherwise be required to complete as a controlling fifty-percent or a controlling ten-percent partner, the person must instead attach to its Form 8865 copies of the relevant schedules from Form 1065 that the instructions to Form 8865 state are considered equivalent to schedules on Form 8865. Should a schedule on Form 8865 ask for information that is not required to be reported on the equivalent Form 1065 schedule, the partner is not required to report that information on its Form 8865 if a copy of the completed equivalent Form 1065 schedule is attached to its Form 8865. A person attaching copies of schedules from Form 1065 to its Form 8865 must still complete the parts of Form 8865 that the person is required to complete as a controlling fifty-percent partner, or a controlling ten-percent partner, and for which there is no equivalent Form 1065 schedule (for example, the first page of Form 8865).

(2) *Example.* The following example illustrates the application of this paragraph (j):

*Example.* US, a United States citizen, owns a 55% interest in FPS, a foreign partnership and calendar year taxpayer. Because US owns more than a 50% interest in FPS, US is a controlling fifty-percent partner of FPS and must file a Form 8865 with respect to FPS. During 2001, FPS earns gross income that is effectively connected with the conduct of a trade or business within the United States. Therefore, pursuant to section 6031(e)(2)(B), FPS must file Form 1065 for its 2001 tax year. If FPS completes and files Form 1065, US must use copies of the relevant schedules from Form 1065 to complete US's Form 8865 for FPS's 2001 tax year. If FPS instead had a September 30 tax year pursuant to section 706, then US must attach to its Form 1040 for US's 2001 tax year a Form 8865 completed with respect to FPS's tax year ending September 30, 2001. If FPS filed a Form 1065 for its tax year ending September 30, 2001, then US must use that Form 1065 to fulfill in part its reporting obligations under section 6038 by attaching the relevant schedules from the Form 1065 to US's Form 8865.

(k) *Failure to comply with reporting requirement—(1) In general.* Any United States person required to file Form 8865 under Section 6038 and this section that fails to comply (as defined in paragraph (k)(2) of this section) with the reporting requirements of this section, will be subject to the penalties described in paragraph (k)(3) of this section.

(2) *Failure to comply.* A failure to comply is separately determined for each foreign partnership for which a United States person has a section 6038 reporting obligation. A failure to comply

with the requirements of section 6038 includes the following—

(i) The failure to report at the proper time and in the proper manner any information required to be reported under the rules of this section; or

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section.

(3) *Penalties.* A United States person that fails to comply (as defined in paragraph (k)(2) of this section) with the reporting requirements of this section must pay the following penalties, subject to the reasonable cause exception in paragraph (k)(4) of this section:

(i) *Dollar amount penalty—(A) \$10,000 penalty.* A penalty of \$10,000 shall be imposed for each tax year of each foreign partnership with respect to which a failure to comply occurs.

(B) *Increase in penalty.* If a failure to comply with the applicable reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the Commissioner or the Commissioner's delegate mails notice of the failure to the United States person required to file Form 8865, the person must pay an additional penalty of \$10,000 for each 30-day period (or fraction thereof) during which the failure continues after the 90-day period has expired.

(C) *Limitation.* The additional penalty imposed on any United States person by section 6038(b)(2) and paragraph (k)(3)(i)(B) of this section is limited to a maximum of \$50,000 for each partnership for each tax year with respect to which the failure occurs.

(ii) *Penalty of reducing foreign tax credit—(A) Effect on foreign tax credit.* Failure to comply with the reporting requirements of section 6038 and this section may cause a reduction of foreign tax credits under section 901 (taxes of foreign countries and of possessions of the United States). In applying section 901 to a United States person for any tax year with or within which its foreign partnership's tax year ended, the amount of taxes paid (and deemed paid under sections 902 and 960) by the United States person will be reduced by 10 percent if the person fails to comply. However, no tax deemed paid under section 904(c) will be reduced under the provisions of this paragraph (k)(3)(ii).

(B) *Reduction for continued failure.* If a failure to comply with the reporting requirements of section 6038 and this section continues for more than 90 days after the date on which the Commissioner or the Commissioner's delegate mails notice of the failure to the person required to file Form 8865,

then the amount of the reduction in paragraph (k)(3)(ii)(A) of this section will be 10 percent, plus an additional 5 percent for each 3-month period (or fraction thereof) during which the failure continues after the 90-day period has expired.

(C) *Limitation on reduction.* The amount of the reduction under paragraphs (k)(3)(ii)(A) and (B) of this section for each failure to furnish information required under this section will not exceed the greater of \$10,000, or the gross income of the foreign partnership for its tax year with respect to which the failure occurred.

(D) *Offset for dollar amount penalty imposed.* The total amount of the reduction which, but for this paragraph (k)(3)(ii)(D), may be made under this paragraph (k)(3)(ii) with respect to any separate failure, may not exceed the maximum amount of the reductions that may be imposed, reduced (but not below zero) by the dollar amount penalty imposed by paragraph (k)(3)(i) of this section with respect to the failure.

(4) *Reasonable cause limitation.* The time prescribed for filing a complete Form 8865, and the beginning of the 90-day period after the Commissioner or the Commissioner's delegate mails notice under paragraphs (k)(3)(i)(B) and (ii)(B) of this section, will be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information. The United States person may show reasonable cause by providing a written statement to the Commissioner's delegate having jurisdiction over the person's return to which the Form 8865 should have been attached, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause will be determined by the Commissioner, or the Commissioner's delegate, under all the facts and circumstances.

(5) *Statute of limitations.* For exceptions to the limitations on assessment in the event of a failure to provide information under section 6038, see section 6501(c)(8).

(l) *Effective date.* This section applies to tax years of a foreign partnership ending on or after December 31, 2000.

**Par. 5.** Section 1.6038B-1 is amended as follows:

1. The heading is revised.
2. The first three sentences of paragraph (b)(1)(i) are removed and four sentences are added in their place.
3. Paragraph (b)(2)(i)(A)(4) is added.
4. Paragraph (b)(2)(i)(B)(3) is revised.
5. Paragraph (b)(2)(i)(B)(4) is added.
6. Paragraph (g) is revised.

The added and revised provisions read as follows:

**§ 1.6038B-1 Reporting of certain transfers to foreign corporations.**

\* \* \* \* \*

(b) \* \* \* (1) \* \* \* (i) *Reporting procedure.* Except for stock or securities qualifying under the special reporting rule of paragraph (b)(2) of this section, and certain exchanges described in section 354 (listed below), any U.S. person that makes a transfer described in section 6038B(a)(1)(A), 367(d) or (e), is required to report pursuant to section 6038B and the rules of this section and must attach the required information to Form 926, "Return by Transferor of Property to a Foreign Corporation." For special rules regarding cash transfers made in tax years beginning after February 5, 1999, see paragraphs (b)(3) and (g) of this section.

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), and the rules of § 1.367(a)-1T(c) shall apply with respect to a transfer described in section 367(d). Additionally, if in an exchange described in section 354, a U.S. person exchanges stock of a foreign corporation in a reorganization described in section 368(a)(1)(E), or a U.S. person exchanges stock of a domestic or foreign corporation for stock of a foreign corporation pursuant to an asset reorganization described in section 368(a)(1)(C), (D), or (F), that is not treated as an indirect stock transfer under section 367(a), then the U.S. person exchanging stock is not required to report under section 6038B. \* \* \*

\* \* \* \* \*

(2) \* \* \*

(i) \* \* \*

(A) \* \* \*

(4) The transfer is considered to be to a foreign corporation solely by reason of § 1.83-6(d)(1) and the fair market value of the property transferred did not exceed \$100,000; or

(B) \* \* \*

(3) The transferor properly reported the income from the transfer on its timely-filed (including extensions) Federal income tax return for the taxable year that includes the date of the transfer; or

(4) The transfer is considered to be to a foreign corporation solely by reason of § 1.83-6(d)(1) and the fair market value of the property transferred did not exceed \$100,000.

\* \* \* \* \*

(g) This section applies to transfers occurring on or after July 20, 1998,

except for transfers of cash made in tax years beginning on or before February 5, 1999, which are not required to be reported under section 6038B, and except for paragraph (e) of this section, which applies to transfers that are subject to §§ 1.367(e)-1(f) and 1.367(e)-2(e). See § 1.6038B-1T for transfers occurring prior to July 20, 1998. See also § 1.6038B-1T(e) in effect prior to August 9, 1999 (as contained in 26 CFR part 1 revised April 1, 1999), for transfers described in section 367(e) that are not subject to §§ 1.367(e)-1(f) and 1.367(e)-2(e).

**Par. 6.** Section 1.6038B-2 is amended as follows:

1. Paragraph (a)(5) is revised.

2. Paragraph (c)(4) is revised.

3. Paragraph (c)(6) is amended by removing the period at the end and adding "; and" in its place.

4. Paragraph (j)(1) introductory text is amended by revising the first sentence.

5. Paragraph (j)(3) is added.

The revised and added provisions read as follows:

**§ 1.6038B-2 Reporting of certain transfers to foreign partnerships.**

(a) \* \* \*

(5) *Time for filing Form 8865.* The Form 8865 on which a transfer is reported must be attached to the transferor's timely filed (including extensions) income tax return for the tax year that includes the date of the transfer. If the person required to report under this section is not required to file an income tax return for its tax year during which the transfer occurred, but is required to file an information return for that year (for example, Form 1065, "U.S. Partnership Return of Income," or Form 990, "Return of Organization Exempt from Income Tax"), the person should attach the Form 8865 to its information return.

\* \* \* \* \*

(c) \* \* \*

(4) The names and addresses of the other partners in the foreign partnership, unless the transfer is solely of cash and the transferor holds less than a ten-percent interest in the transferee foreign partnership immediately after the transfer. However, for tax years of U.S. persons beginning on or after January 1, 2000, the person reporting pursuant to section 6038B (the transferor) must provide the names and addresses of each United States person that owned a ten-percent or greater direct interest in the foreign partnership during the transferor's tax year in which the transfer occurred, and the names and addresses of any other United States or foreign persons that were direct partners in the foreign partnership

during that tax year and that were related to the transferor during that tax year. See paragraph (i)(4) of this section for the definition of a related person;

\* \* \* \* \*

(j) \* \* \* (1) *In general.* Except as otherwise provided in this section, this section applies to transfers made on or after January 1, 1998. \* \* \*

\* \* \* \* \*

(3) *Special rule for transfers made before January 1, 2000.* Even if not reported in accordance with the rules provided in paragraph (a)(5) of this section, or paragraph (j) (1) or (2) of this section, a transfer that occurred before January 1, 2000 will nevertheless be considered timely reported if the transferor reports it on a Form 8865 attached to an amended tax return for the transferor's tax year in which the transfer occurred, provided such amended return is filed no later than September 15, 2000.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

**Par. 7.** The authority citation for part 602 continues to read as follows:

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

**Par. 8.** In § 1.602.101, paragraph (b) is amended by revising the entries for § 1.6038-2, § 1.6038(B)-1, and § 1.6038B-2 and adding an entry in numerical order to the table 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 .....	1545-1617
* * * * *	* * * * *
1.6038-3 .....	1545-1617
* * * * *	* * * * *
1.6038B-1 .....	1545-1617
* * * * *	* * * * *
1.6038B-2 .....	1545-1617
* * * * *	* * * * *

Approved: December 9, 1999.

**Robert Wenzel,**

*Deputy Commissioner of Internal Revenue.*

**Jonathan Talisman,**

*Acting Assistant Secretary of the Treasury.*

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