New Form 926: Return by a U.S. Transferor of Property to a Foreign Corporation

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U.S. taxpayers must always be vigilant when engaging in transactions with foreign entities, especially with related foreign corporations. Taxpayers must not only correctly calculate their control and income associated with the foreign corporation, they must also satisfy all the informational reporting requirements imposed by the Internal Revenue Code. One such transaction, subject to information reporting by Sec. 6038B, is a transfer of property by a U.S. person to the foreign corporation. To fulfill this reporting obligation, the U.S. taxpayer must complete Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. This article will focus briefly on the history and purpose of this form, followed by a description of changes that were made effective beginning in December 2008.

History and Purpose of Form 926 and Sec. 6038B

Sec. 6038B was added to the Code as part of the Deficit Reduction Act of 1984.[1] As it was originally enacted, Sec. 6038B required any U.S. person who transferred property to a foreign corporation to report that transfer to the extent prescribed in the regulations. At that time, Sec. 6038B imposed a penalty of 25% of any gain recognized on the exchange unless the failure was due to reasonable cause, not willful neglect. Thus, there could be no penalty on transfers of cash or on property whose basis equaled or exceeded its fair market value. As a result, taxpayers making these transfers saw no need to report such transactions. The Taxpayer Relief Act of 1997 remedied this situation for the IRS by adding a 10% penalty on the amount of the fair market value of any property transferred.[2] Therefore, taxpayers could no longer avoid reporting transfers of any type of property to a foreign corporation. The penalty is limited to $100,000 unless there is intentional disregard of the filing requirements.[3]

Form 926 has always been the means by which to report transfers to a foreign corporation. When a U.S. person[4] transfers, or is deemed to transfer, property to a foreign corporation in specified nonrecognition transactions (whether or not the property has appreciated), the U.S. person must complete Form 926 and attach it to that year's income tax return. For cash contributions, the form is required for cash transfers exceeding $100,000 over a 12-month period or if the cash transfer results in the transferor holding more than 10% of the total voting power or total value of the foreign corporation immediately after the transfer.

Information required to be reported includes descriptions of assets transferred (such as type and basis) and a description of the transaction that was used to transfer the assets. Transactions that trigger a filing include transfers to a controlled subsidiary under Sec. 351, transfers in liquidation to a foreign parent under Sec. 332, transfers to a foreign corporation in a tax-free reorganization, and transfers of a foreign corporation in a spin-off under Sec. 355.

What is the overall purpose of this requirement? By requiring such information to be included on the form, the Service is able to assess a taxpayer's compliance with Sec. 367, which generally requires the current recognition of gain on transfers of appreciated property (whether personal or intangible) to a foreign corporation unless an exception applies. With regard to certain outbound stock transfers, the exceptions for gain recognition found in the Sec. 367(a) regulations may require that a gain recognition agreement (GRA) be filed with the IRS. Where a GRA is filed by the taxpayer for a transfer, there may be no need to also file Form 926, but the taxpayer should always be advised to consult with a professional on this matter.

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1 Deficit Reduction Act of 1984, P.L. 98-369, Section 131(d)(1), prior to amendment by the Taxpayer Relief Act of 1997, P.L. 105-206, Section 1144.

2 Sec. 6038B(c)(1).

3 Sec. 6038B(c)(3).

4 "U.S. person" is used here to include an individual citizen or resident as well as domestic corporations, estates, and trusts (Sec. 7701(a)(30)).

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Changes to Form 926

Recently, in an attempt to prevent taxpayers from hiding assets offshore or earning unreported income overseas (highlighted by the current case against UBS), the IRS has made international tax enforcement a priority. It is not uncommon for taxpayers to fail to comply with international reporting requirements, usually because they are unaware of the myriad burdens imposed. As a result, on July 3, 2008, the IRS released a draft revision to Form 926, which was issued in final form in February 2009 (with an official revision date of December 2008). The changes made to the form were substantial, and taxpayers should be aware that going forward, a much greater amount of information is required when filing a Form 926.

Prior to the new form's release, Form 926 consisted of three parts. Part I asked for information identifying the transferor of property, Part II requested information on the identity of the transferee (i.e., if it is a CFC, how it is classified under local law, etc.), and Part III requested details about the transfer itself, including the date, the type of property transferred, a classification of the transaction (i.e., under which Code section), and whether any intangible property was also transferred. Also required was a supplemental statement to be attached to the form, on which the transferor needed to include such items as descriptions of the transfer, the consideration received by the transferor, and the property transferred.

The new Form 926 expands Part III, Information Regarding Transfer of Property, to ensure that information stated on the form is consistent with the information reported on Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations. The more detailed Part III could also alert the IRS that Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), filings may be required in cases where cash transfers are reported. It is worth noting that Part III of the form still requires filers to disclose additional information required by the regulations in regard to the properties being transferred in the supplemental information section or on a separate attachment.

The new Form 926 has added a Part IV, Additional Information Regarding Transfer of Property. This part provides for substantially more information to be included on the face of the form itself. For example, the form now requires a transferor to report:

- If there was gain recognition under Sec. 904(f) foreign loss rules;
- If there was foreign exchange gain under Sec. 987;
- If there was recapture under Sec. 1503(d) and related regulations on dual consolidated losses;
- If there was any transfer of stock, securities, or assets used in a trade or business that are excepted from current U.S. tax on the transfer; and
- The taxpayer's interest in the foreign corporation before and after the transfer.

Conclusion

As the 2008 filing season wraps up and the fourth quarter begins, the new Form 926 deserves attention. Furthermore, assuming that the Offshore Voluntary Disclosure Program is not extended (at the time of this writing it was scheduled to expire on September 23), the opportunity to address any prior-year compliance failures with respect to Forms 926 in a structured manner is also rapidly coming to a close. In this new era of increasing IRS resources, heavy penalties for noncompliance, and greater demands for transparency, practitioners should keep in mind that additional time and attention are necessary when completing this form.

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EditorNotes

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