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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 8, 2000

Number: **200028030**
Release Date: 7/14/2000
CC:INTL:BR1
WTA-N-108937-00
UILC: 882.04-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE REQUEST FOR TECHNICAL ASSISTANCE

MEMORANDUM FOR ACTING CHIEF COMPLIANCE OFFICER
MC 4200 MSRO

FROM: W. Edward Williams
Senior Technical Reviewer CC:INTL:BR1

SUBJECT: Section 882(c)(2) - Delinquent Returns (Form 1120F)

This Technical Assistance responds to your memorandum dated April 7, 2000. Technical Assistance is not binding on Examination or Appeals. This document is not to be used or cited as precedent.

ISSUE(S):

1. What are the filing requirements of a foreign corporation engaged in a trade or business within the United States?

2. If a foreign corporation is engaged in a trade or business within the United States, what is the basis for and the rationale behind disallowing a foreign corporation's deductions and credits for failure to timely file a tax return?

3. If a foreign corporation is engaged in a trade or business within the United States and fails to file a tax return within the time prescribed by Treas. Reg. §1.882-4(a)(3)(i), under what circumstances will a waiver of the filing deadline be granted and, thus, deductions and credits allowed?

CONCLUSIONS

Issue 1

A foreign corporation engaged in trade or business in the United States at any time during the taxable year or which has income which is subject to taxation under subtitle A of the Code (relating to income taxes) must make a return on Form 1120-F within the time prescribed by section 6072 of the Code. If a foreign corporation is uncertain whether it is engaged in a trade or business in the United States, the foreign corporation may file a protective return by the deadline set forth in Treas. Reg. §1.882-4(a)(3)(i). On such return, the foreign corporation is not required to report any gross income as effectively connected with a United States trade or business or any deductions or credits. However, the foreign corporation must attach a statement indicating that the return is being filed to protect its right to claim deductions or credits should it be determined later that it was engaged in a U.S. trade or business. In addition, if a foreign corporation engaged in trade or business in the United States takes the position that it has no income subject to tax by reason of an income tax treaty obligation of the United States, it must file Form 8833 and attach it to a timely filed return, pursuant to section 6114, for purposes of disclosing this treaty-based position.

Issue 2

The disallowance of a foreign corporation's deductions and credits for failure to timely file a tax return was intended as a measure to encourage the timely filing of full and complete returns by foreign corporations, including therein all necessary information in connection with their credits, deductions and gross income from sources within the United States.

Issue 3

If a foreign corporation which is engaged in a trade or business within the United States fails to timely file a tax return, whether a waiver of filing deadlines will be granted will be based on an analysis of the facts and circumstances. A foreign corporation must establish not only that the circumstances surrounding the failure were rare and unusual but also must establish a good cause for such failure.

LAW AND ANALYSIS

Issue 1

Filing Requirements Generally

Pursuant to Section 6012(a)(2), an income tax return is required to be filed by every corporation subject to tax under subtitle A. Treas. Reg. §1.6012-2(g) requires that

> every foreign corporation which is engaged in trade or business in the United States at any time during the taxable year or which has income which is subject to taxation under subtitle A of the Code (relating to income taxes) shall make a return on Form 1120-F.

Thus, a foreign corporation that is engaged in a trade or business in the United States at any time during the taxable year is required to file a return on Form 1120-F even if, for example, (a) it has no income which is effectively connected with the conduct of a trade or business in the United States, (b) it has no income from sources within the United States, or (c) its income is exempt from income tax by reason of an income tax convention or any section of the Code. Treas. Reg. §1.6012-2(g).

Treas. Reg. §1.6012-2(g) also provides that

> if the foreign corporation has no gross income for the taxable year, it is not required to complete the return schedules but must attach a statement to the return indicating the nature of any exclusions claimed and the amount of such exclusions to the extent they are not readily determinable.

Section 6072(a) requires domestic corporations or foreign corporations having an office or place of business in the United States to file the income tax returns required under section 6012 on or before the fifteenth day of the third month following the close of the taxable year. Section 6072(c) provides that

> [r]eturns made by...foreign corporations (other than those having an office or place of business in the United States...) under section 6012 on the basis of a calendar year shall be filed on or before the 15th day of June following the close of the calendar year and such returns made on the basis of a fiscal year shall be filed on or before the 15th day of the 6th month following the close of the fiscal year.

<u>Option to File Protective Returns</u>

Treas. Reg. § 1.882-4(a)(3)(iv) provides a foreign corporation with the option to timely file a “protective return” if the corporation

> conducts limited activities in the United States in a taxable year which the foreign corporation determines does not give rise to gross income which is effectively connected with the conduct of a trade or business within the United States....

By filing this protective return within the time limits set forth under Treas. Reg. § 1.882-4(a)(3)(i) and described above, the foreign corporation protects its right to receive the benefit of allowable deductions and credits, and avoids any potential disallowance of deductions and credits that may arise by virtue of section 882(c)(2), if it is later determined that the corporation's original determination was incorrect. Id.

Treas. Reg. §1.882-4(a)(3)(iv) also provides that

> [o]n that timely filed [protective] return, the foreign corporation is not required to report any gross income as effectively connected with a United States trade or business or any deductions or credits but should attach a statement indicating that the return is being filed for the reason set forth in this paragraph (a)(3).

Should a foreign corporation determine that only a portion of the activities it conducts gives rise to income that is effectively connected with a United States trade or business, the foreign corporation must

> timely file a return for that taxable year to report the gross income determined to be effectively connected, or treated as effectively connected,...and the deductions and credits attributable to the gross income. In addition, the foreign corporation should attach to that return the statement described in this paragraph (a)(3) [sic] with regard to the other activities.

Treas. Reg. §1.882-4(a)(3)(iv).

Treaty-Based Positions

Treas. Reg. §882-4(a)(3)(iv) provides that a foreign corporation may follow the protective return procedure, set forth in Treas. Reg. §1.882-4(a)(3)(iv),

> if it determines initially that it has no U.S. tax liability under the provisions of an applicable income tax treaty. In the event the foreign corporation relies

> on the provision of an income tax treaty to reduce or eliminate the income subject to taxation, or to reduce the rate of tax, disclosure may be required pursuant to section 6114.

Treas. Reg. §301.6114-1(a)(1)(i) requires that, with certain exceptions, a taxpayer who takes a return position that any treaty of the United States overrules or modifies any provision of the Internal Revenue Code and thereby effects (or potentially effects) a reduction of any tax incurred at any time, to disclose such return position on a statement attached to such return.

Treas. Reg. §301.6114-1(b)(5)(i) provides that reporting is specifically required if a taxpayer takes the position that, under a treaty,

> [i]ncome that is effectively connected with a U.S. trade or business of a foreign corporation or a nonresident alien is not attributable to a permanent establishment or a fixed base of operations in the United States and, thus is not subject to taxation on a net basis....

Treas. Reg. §301.6114-1(d) provides as follows:

> (1) Returns due after December 15, 1997. When reporting is required under this section for a return relating to a taxable year for which the due date for filing (without extensions) is after December 15, 1997, the taxpayer must furnish information in accordance with paragraph (a) of this section, as an attachment to the return, a fully completed Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) or appropriate successor form....(2) Earlier returns. For returns relating to a taxable year for which the due date for filing (without extensions) is on or before December 15, 1997, the taxpayer must furnish information in accordance with paragraph (d) of this section in effect prior to December 15, 1997....

Treas. Reg. §1.6114-1(d), in effect prior to December 15, 1997, provides that the following information must be furnished as an attachment to the return:

> (1) Taxpayer's name, T.I.N. (if any), and address both in the country of residence and in the United States;

(2) name, T.I.N. (if available to the taxpayer), and address in the United States of the payor of the income (if fixed, determinable, annual, or periodical);

(3) a statement whether the taxpayer (if an individual) is a U.S. citizen or resident or (if a corporation) is incorporated in the United States;

(4) a separate statement of facts relied upon to support each separate position taken, including for each position:

(i) The nature and amount (or a reasonable estimate thereof) of gross receipts, each separate gross payment, each separate gross income item, or other item (as applicable) for which the treaty benefit is claimed,

(ii) an explanation of the position taken with a brief summary of the facts on which it is based,

(iii) the specific treaty provision relied upon,

(iv) the Code provision(s) overruled or modified, and

(v) the provision(s) of the limitation on benefits article (if any) in the treaty which the taxpayer relies upon to prevent application of that article.

Thus, a foreign corporation engaged in a trade or business in the United States at any time during the taxable year or which has income which is subject to taxation under subtitle A of the Code (relating to income taxes) is required to file a Form 1120-F. If the corporation determines that it has no income effectively connected with a United States trade or business, the foreign corporation may file a protective return and attach a statement to the form indicating that the return is being filed to protect its right to claim deductions and credits. If a foreign corporation determines that it has no income subject to tax by reason of an income tax treaty obligation of the United States, it must file Form 8833 and attach it to a timely filed return for purposes of disclosing its treaty-based position.

Although there is no specific authority on point, a foreign corporation which files a Form 8833 with respect to a treaty-based position and attaches Form 1120-F to the

Form 8833, but does not indicate on the Form 1120-F that it is being filed as a "protective return" under Treas. Reg. §1.882-4(a)(3), should be considered to have complied with the protective return requirements of Treas. Reg. §1.882-4(a)(3).

The pertinent form(s) must be filed before the 15th day of the third month following the close of its taxable year if the foreign corporation has an office or place of business within the United States, or before the 15th day of the sixth month following the close of its taxable year if it does not.

Issue 2

Prior to 1990, the basis for denial of otherwise allowable deductions and credits for the failure of a foreign corporation to timely file a return was case law interpreting section 882(c)(2). In 1990, final Treasury Regulations were promulgated which included a timely filing requirement in order for a foreign corporation to get the benefit of its deductions and credits and, thus, the basis for denial of such deduction and credits is now regulatory. The rationale behind both the case law and the Treasury Regulations is the same; that is, to encourage the timely filing of full and complete returns by foreign corporations. Both the case law and the Treasury Regulations interpret section 882(c)(2) as requiring a foreign corporation to *timely* file a full and complete return in order to claim otherwise allowable deductions and credits. The Treasury Regulations provide an objective test to determine whether or not a foreign corporation has timely file its return.

Section 882(c)(1) permits a foreign corporation to claim allowable deductions and credits to the extent gross income is effectively connected with the conduct of a United States trade or business. Section 882(c)(2) allows a foreign corporation to receive the benefit of otherwise allowable deductions only if it files or causes to be filed a true and accurate return. Section 882(c)(2) provides that

> [a] foreign corporation shall receive the benefit of the deductions and credits allowed to it in this subtitle only by filing or causing to be filed with the Secretary a true and accurate return, in the manner prescribed by subtitle F, including therein all the information which the Secretary may deem necessary for the calculation of such deductions and credits.

Section 882(c)(2) has its genesis in section 233 of the Revenue Act of 1928, which provided that

> [a] foreign corporation shall receive the benefit of the deductions and credits allowed to it in this title only by filing or causing to be filed with the collector a true and accurate return...in the manner prescribed in this title.

Case Law

In interpreting section 233, courts have held that there is a “terminal point” after which a taxpayer can no longer claim the benefit of deductions by filing a return. See Taylor Securities, Inc. v. Commissioner, 40 B.T.A. 696, 703 (1939); Blenheim Co., Ltd. v. Commissioner, 125 F.2d 906 (4th Cir. 1942), aff’g 42 B.T.A. 1248 (1940). In Taylor Securities, the Board of Tax Appeals held as follows:

> [W]e are unable to conclude that in enacting section 233...it was the intention of Congress that delinquent returns filed by a foreign corporation after the respondent’s determination should constitute the returns required as a prerequisite to the allowance of the credits and deductions ordinarily allowable to the corporations.... In view of such a specific prerequisite it is inconceivable that Congress contemplated by that section that taxpayers could wait indefinitely to file returns and eventually when the respondent determined deficiencies against them they could then by filing returns obtain all the benefits to which they would have been entitled if their returns had been timely filed. Such a construction would put a premium on tax evasion, since a taxpayer would have nothing to lose by not filing a return as required by statute.

40 B.T.A. 696, 703. This position was adopted by the Fourth Circuit in Blenheim Co., Ltd. v. Commissioner, 125 F.2d 906 (4th Cir. 1942), aff’g 42 B.T.A. 1248 (1940). In Blenheim, the Fourth Circuit noted that

> the situation is pregnant with possibilities of tax evasion. In express recognition of this fertile danger to the orderly administration of the income tax as applied to foreign corporations, Congress conditioned its grant of deductions upon the timely filing of true, proper and complete returns. [Emphasis added.]

125 F.2d at 909.

The court held that the

> terminal date, which the Board of Tax Appeals first adopted in Taylor Securities v. Commissioner, 1939, 40 B.T.A. 696, is directed against those foreign corporations which instead of being induced voluntarily to advise the Commissioner of their domestic operations, might find their interests best served by filing no return whatever, and then waiting until such time, if any, as the Commissioner discovers their existence and acquires sufficient information about their income on which to base a return.

125 F.2d at 910.

The Blenheim court further held that

> the conclusion that the preparation of a return by the Commissioner a reasonable time after the date it was due terminates the period in which the taxpayer may enjoy the privileges of receiving deductions by filing its own return, is consistent not only with the intention of Congress as evidenced by the legislative history of section 233, but also with considerations of sound administrative procedure....

125 F.2d at 910.

Although section 233 was subsequently reenacted as section 882(c) of the Internal Revenue Code of 1954, the substance and language of section 233 were carried forward into the current section 882(c)(2). In Espinosa v. Commissioner, 107 T.C. 146, 152 (1996), the Court discussed the policy behind section 882(c)(2). The court held that

> while section...882(c)(2) contain[s] no explicit time limit,...the policy behind [this] provision dictates that there is some cutoff point or terminal date after which it is too late to submit a tax return and claim the benefit of deductions.... The prior case law established the terminal date as a mechanism designed to ensure that section...882(c)(2) would have the in terrorem effect that Congress intended.

107 T.C. at 157.

Pre-1990 Regulations

Prior to July 31, 1990, Treas. Reg. §1.882-4(b)(1) provided that a resident foreign corporation would receive the benefit of the deductions and credits allowed to it with respect to income tax, only if it “files or causes to be filed ... a true and accurate return of its total income received from all sources within the United States.” The regulation required a foreign corporation to file an income tax return without imposing a timely filing requirement in order to be entitled to deductions.

However, while section 882(c)(2) and the pre-1990 regulations thereunder do not explicitly impose a requirement of timeliness, the courts, as discussed above, have generally held that at "some point there exists a terminal date, after which a taxpayer can no longer claim the benefit of deductions by filing a return." Blenheim Co. v. Commissioner, 125 F.2d 906, 910 (4th Cir. 1942); Espinosa v. Commissioner, 107 T.C. 146, 156 (1996); Taylor Sec., Inc. v. Commissioner, 40 B.T.A. 696, 703 (1939). A return filed after this "terminal point" was deemed untimely and deductions disallowed under section 882(c)(2).

Post-1990 Regulations.

On July 31, 1989, the Treasury issued proposed regulations under section 1.882-4 in order to ensure that the income tax returns of foreign corporations were filed in a timely manner. The proposed regulations focused on establishing specific due dates for foreign corporations to file their returns. A failure to file within the prescribed period would result in a disallowance of deductions and credits.

On December 11, 1990, the final regulations were published under Treas. Reg. § 1.882-4 effective for taxable years ending after July 30, 1990. Thus, for taxable years ending after July 30, 1990, Treas. Reg. §1.882-4 sets forth specific deadlines for the filing of returns by a foreign corporation. The preamble to the current Treas. Reg. §1.882-4 provides that the timely filing requirement is justified because of the different administrative and compliance concerns that are present with respect to foreign corporations that are not present with domestic corporations.

Treas. Reg. §1.882-4(a)(2) provides, in part, that

> a foreign corporation shall receive the benefit of the deductions and credits otherwise allowed to it with respect to the income tax, only if it timely files or causes to be filed,...in the manner prescribed by subtitle F, a true and accurate return of its taxable income which is effectively connected...for the

> taxable year with the conduct of a trade or business in the United States by that corporation. [Emphasis added.]

Treas. Reg. §1.882-4(a)(3)(i) provides that, for taxable years ending after July 31, 1990, whether a return for a particular taxable year is considered filed on a timely basis will depend on whether the foreign corporation filed a return for the immediately preceding taxable year –

> If a return was filed for that immediately preceding taxable year, or if the current taxable year is the first taxable year of the foreign corporation for which a return is required, the current year's return must be filed within 18 months of the due date as set forth in section 6072 and the regulations under that section, for filing the return for the current taxable year....

Treas. Reg. §1.882-4(a)(3)(i) further provides that

> [i]f no return for the taxable year immediately preceding the current taxable year has been filed, the required return for the current taxable year (other than the first taxable year of the foreign corporation for which a return is required to be filed) must have been filed no later than the <u>earlier</u> of the date which is 18 months after the due date, as set forth in section 6072, for filing the return for the current taxable year or the date the Internal Revenue Service mails a notice to the foreign corporation advising the corporation that the current year return has not been filed and that no deductions...or credits...may be claimed by the taxpayer. [Emphasis added.]

Thus, in order for a foreign corporation to be allowed the benefit of deductions and credits, the corporation must file its return within 18 months of the due date set forth in section 6072 (discussed above), if a return was filed for the preceding tax year, or no later than the earlier of 18 months after the due date set forth in section 6072 or the date the Internal Revenue Service mails a notice to the foreign corporation advising it that no return has been filed, if no return for the taxable year preceding the current year has been filed. The disallowance of a foreign corporation's otherwise allowable deductions and credits for failure to file a timely return was intended to encourage the timely filing of full and complete returns by foreign corporations.

<u>Issue 3</u>

Waiver of Filing Deadlines

When the final regulations were issued, along with the new filing deadlines, they also contained a provision allowing the District Director or the Assistant Commissioner (International) to waive the filing deadlines set forth in Treas. Reg. §1.882-4(a)(3)(i). Treas. Reg. §1.882-4(a)(3)(ii) permits such a waiver only

> in rare and unusual circumstances if good cause for such waiver, based on the facts and circumstances, is established by the foreign corporation.

Prior to the issuance of these final regulations, the Service never needed to provide a waiver from the filing requirements set forth under section 882(c)(2) as there was no express statutory timely filing requirement. Notwithstanding the lack of precedent in defining the circumstances under which it would be appropriate to grant a waiver of the filing deadlines, however, the legislative history and case law support the conclusion that such a waiver should not be freely granted. As the court in Blenheim noted

> Congress' intention that the condition in section 233...be strictly applied is apparent from both the use of the limitation 'only' and from the fact that [a] 'reasonable cause' exception...was not included in section 233.

125 F.2d at 909.

Good Cause

In order to avoid the consequences of section 882(c)(2), a foreign corporation must, at least initially, demonstrate that it is entitled to a waiver of the filing deadline under Treas. Reg. §1.882-4(a)(3)(ii) by showing that "good cause" exists, based on all the facts and circumstances, for failure to timely file a tax return. While there is no legal precedent that sets forth the level of action required by a taxpayer in order to establish "good cause" under Treas. Reg. §1.882-4(a)(3)(ii), certain penalty provisions of the Internal Revenue Code do include "reasonable cause" exceptions. It is our view that the precedent that has been developed with respect to these penalty provisions is relevant to the determination of whether a taxpayer satisfies the "good cause" requirement under Treas. Reg. 1.882-4(a)(3)(ii). It should be noted, however, that the "good cause" threshold involves a higher standard of proof than that required to establish "reasonable cause."

Section 6651(a)(1) provides that a penalty will be assessed against a taxpayer who either fails to timely file a required return or fails to timely pay a tax due unless it is shown that such failure is due to "reasonable cause" and not willful neglect. Reasonable cause has been held to exist when a taxpayer "exercise[s] ordinary business care and prudence and [is] nevertheless unable to file the return within the prescribed time." United States v. Boyle, 469 U.S. 241, 243 (1985) citing Treas. Reg. §301.6651-1(c)(1). In order to escape the statutory penalty for failure to file a tax return, the taxpayer has the burden of affirmatively showing that such failure was due to reasonable cause, not willful neglect, and "if the taxpayer offers no excuse, the penalty will be sustained by the court." Norton v. United States, 551 F.2d 821, 827 (Ct. Cl. 1977). See also Boyle at 245.

In Boyle, the executor of an estate engaged an attorney experienced in probate to handle the estate's tax matters. However, because the attorney failed to note the due date of the estate tax return on his calendar, the federal estate tax return was filed three months late. The facts indicated that while the executor inquired of the attorney on a number of occasions as to whether the return was being prepared, and was assured that it was, the executor never asked for the due date of the return. While the Commissioner conceded that the failure to file the estate tax return did not result from willful neglect, the IRS argued that reliance on an attorney under the circumstances was not reasonable cause for failure to file on time. The Court upheld imposition of the penalty holding as follows:

> To say that it was 'reasonable' for the executor to assume that the attorney would comply with the statute may resolve the matter as between them, but not with respect to the executor's obligations under the statute. Congress has charged the executor with an unambiguous, precisely defined duty to file the return within nine months.... That the attorney, as executor's agent, was expected to attend to the matter does not relieve the principal of his duty to comply with the statute.

469 U.S. at 245.

As a general proposition, a taxpayer's reliance, in good faith, upon the considered advice of a tax expert whom he has given full information as to all the pertinent facts, constitutes reasonable cause excusing the taxpayer's failure to file a return when due, even if it is ultimately determined that such advice is an erroneous interpretation of the law. Girard Invest. Co. v. Commissioner, 122 F.2d 843 (4th Cir. 1941), cert denied 314 U.S. 699 (1942). Although Boyle was not a case in which

the taxpayer relied on erroneous advice of counsel concerning a question of law, the court nevertheless noted that

> [w]hen an accountant or an attorney advises a taxpayer on a matter of tax law...it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a second opinion, or to try to monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking the advice of a presumed expert in the first place. Ordinary business care and prudence do not demand such actions.

469 U.S. at 251.

The Boyle court concluded that, while failure to make a *timely* filing of a tax return is not excused by the taxpayer's reliance on an agent, reliance on professional advice in interpreting a question of law may constitute "reasonable cause." Id. However, such reliance, standing alone, is not an absolute defense against the imposition of penalties. In Ellwest Stereo Theaters of Memphis, Inc. et al. v. Commissioner, T.C. Memo 1995-610, the Court held that the taxpayer must demonstrate that

> (1) its tax advisor or return preparer had sufficient expertise to justify reliance,...(2) the taxpayer provided necessary and accurate information, and (3) the taxpayer actually relied in good faith on the tax adviser's... judgment." [Citations omitted.]

In addition, a nexus must also be established between the professional advice received and the action taken by the taxpayer (i.e., failure to file the required return). Eastern Investment Corp. v. United States, 49 F.3d 651, 656 (10th Cir. 1995). In Eastern, the dispute involved the classification of the taxpayer's salespersons as independent contractors rather than employees. Upon audit, the Service determined that the salespersons were actually employees and imposed penalties against the taxpayer for failing to file employment tax returns. The taxpayer argued that it relied on its attorneys "to draft new independent contractor agreements, and ensure that its sales representatives were legally treated as independent contractors." The taxpayer introduced letters from various attorneys. The Court however, found that the documents did not support the taxpayer's claim. The Court noted that

> [t]here is absolutely nothing to suggest that [taxpayer] sought a professional opinion as to the appropriate and accurate status of its sales representatives, nor is there evidence that any of the various attorneys explored the relationship between [the taxpayer] and its sales representatives and then advised [the taxpayer] that the representatives were independent contractors. Because counsel never rendered an opinion or any advice on this issue, there was nothing upon which [the taxpayer] could have reasonably relied.

Furthermore, ignorance of the tax law, or even an inability to understand the English language, has been held to be insufficient to establish reasonable cause for failure to file a tax return. See, e.g., Belaieff v. Commissioner, T.C. Memo. 1956-273. Penalties have also been imposed for failure to file where a taxpayer has an honest belief that his income is not taxable in the United States. See e.g., Nilson v. Commissioner, T.C. Memo. 1985-535; Linesman v. Commissioner, 82 T.C. 514 91984). In Linseman, a Canadian citizen and resident played on a professional hockey team that was a member of a league that included both U.S. and Canadian teams. The taxpayer allocated a sign-on bonus solely to Canadian sources and did not report any of the bonus as income an a U.S. tax return. The Tax Court upheld an allocation to U.S. sources of a portion of the bonus and also the imposition of a failure to file penalty. The court observed that,

> [t]he mere fact that petitioner thought that, because of the method of allocation he adopted, he owed no tax is not sufficient to excuse his failure to timely file a return.

In contrast, under certain circumstances, physical disabilities have been held sufficient grounds to excuse an individual's failure to timely file a return and to avoid the imposition of a penalty. See, e.g., United States v. Issac, 91-2 U.S.T.C. 89, 059 (E.D. Ky. 1991), aff'd by the 6th Cir. in an unpublished opinion (July 10, 1992), in which the taxpayer established that he was paralyzed in all four limbs, was unable to function, and was under treatment at the Mayo Clinic during the years in question. Similarly, the court in In the Matter of Joseph A. Sims, 1992-1 U.S.T.C. 83, 141 (B.C. E.D. La. 1991), held that there was reasonable cause for not filing income tax returns where information needed by the taxpayer to complete his returns was held by business ventures and partnerships that refused taxpayer access to the records. The court noted that the taxpayer "had no control over these entities' financial reporting procedures and could not generate these records himself."

It is clear that the courts have found “reasonable cause” for a failure to file in only a limited number of situations. The threshold for a waiver under Treas. Reg. §1.882-4(a)(3)(ii) differs from the exemption from penalty under section 6651(a)(1) in that the waiver is not mandated by the Code and requires a showing of “good cause” rather than reasonable cause. Thus, a foreign corporation seeking a waiver from the operation of section 882(c)(2) and the regulations thereunder should be required to make an extraordinary showing of “reasonable cause” for failure to file a return within the period prescribed by Treas. Reg. §1.882-4(a)(3)(i).

Rare and Unusual Circumstances

A foreign corporation is not entitled to a waiver of the filing deadlines imposed under Treas. Reg. §1.882-4(a)(3)(i) as a matter of right even if “good cause” is established for the failure to timely file. In order to qualify for a waiver under Treas. Reg. §1.882-4(a)(3)(ii), a foreign corporation must not only establish “good cause” for failing to timely file its returns, the District Director or Assistant Commissioner (International) also has the discretion to determine whether the circumstances surrounding such failure are “rare and unusual” and, therefore, justify a waiver. Thus, the phrase “rare and unusual circumstances” limits the circumstances under which the District Director or Assistant Commissioner (International) may exercise his discretion and grant a waiver. The language suggests that the facts and circumstances presented by the taxpayer must involve an infrequent or uncommon occurrence that resulted in the taxpayers failure to timely file its tax returns.

Moreover, the regulation should not be broadly interpreted so as to defeat the legislative intent of disallowing deductions unless a return is filed in a timely manner. If waivers are freely granted, the effect would be to nullify the Treasury’s purpose for setting forth filing deadlines in the regulations which was to carry out the legislative intent of section 882(c)(2); that is, to encourage the timely filing of tax returns by foreign corporations. Thus a waiver should be granted only under circumstances that would be consistent with Congressional intent underlying sections 882(c)(2), 6012, and 6114 as discussed above.

Examples

The following examples set forth factual situations and an analysis under Treas. Reg. §1.882-4(a)(3)(ii) to determine if a waiver is merited.

Example 1. Reliance on Advice of Tax Counsel

Foreign corporation argues that a waiver should be granted under section 1.882-4(a)(3)(ii) on the grounds that it was advised by counsel that it was not engaged in a U.S. trade or business, had no United States tax liability and no requirement to file a return. In order to establish good cause under rare and usual circumstances a foreign corporation will be required to submit evidence of the following: (1) that its counsel was competent to make such legal determination; (2) that the taxpayer provided counsel with true and accurate information regarding all of its activities relating to the United States on which to base each such legal determinations (3) a sworn statement from its attorney that such advice had been given and the basis on which the attorney reached his erroneous conclusions; (4) that the taxpayer, in fact, relied on the advice; and (5) that said reliance was the cause of the failure to timely file the return.

Thus, if a foreign corporation establishes that it provided complete and accurate information to competent tax counsel, that erroneous advice was received on the basis of that complete information, and tax counsel provides a sworn statement that such advice had been given and the basis on which counsel reached his erroneous conclusions, the District Director or Assistant Commissioner (International) should find that such circumstances were rare and unusual and that good cause for the taxpayer's failure to timely file, due to its reliance on said advice, has been established.

Example 2.

Same as Example 1, except that counsel advised the foreign corporation only with respect to whether the foreign corporation had a U.S. tax liability, and there was no evidence that counsel ever evaluated, in its own right, the question of whether the foreign corporation was engaged in a trade or business in the United States or the question of whether the foreign corporation had a filing requirement.

In such a situation, the corporation has not satisfied the requirements set forth in Example 1 and, thus, has not established good cause for a waiver under rare and unusual circumstances.

Example 3. Filing of a Protective Return under Section 6114

Foreign corporation filed Form 8833 pursuant to section 6114, but did not attach it to a Form 1120-F. Foreign corporation argues that the filing of Form 8833 should

qualify as a protective return under Treas. Reg. § 1.882-4, and if not, that a waiver of the filing deadline is appropriate.

In order to meet the requirements of a protective return under Treas. Reg. §1.882-4, a Form 1120-F must be filed. Thus, the mere filing of Form 8833 without attaching Form 1120-F will not qualify as a protective return under Treas. Reg. §1.882-4.

A waiver of filing deadlines is also not appropriate under the circumstances set forth. Pursuant to the Treasury Regulations, a waiver will be granted only in rare and unusual circumstances, if good cause for the foreign corporation's failure to file is established. A foreign corporation cannot establish good cause for failure to file a return if it fails to attach a Form 1120-F to an accurately and timely filed Form 8833. Treas. Reg. §301.6114-1 and the instructions to Form 8833 clearly indicate that said form must be filed as an attachment to Form 1120-F, even if the foreign corporation would not otherwise be required to file a return. Thus, it is not possible for a foreign corporation to establish good cause for failure to file Form 1120-F under such circumstances.

A project has been opened on our 2000 Business Plan to review the regulations under Treas. Reg. §1.882-4, including the waiver provision.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We realize that the standards for granting a waiver described above are extremely difficult for taxpayers to meet, and that there is significant pressure on District Directors around the country to grant waivers on grounds that would not necessarily meet the standards described above. Nonetheless, we feel obligated at this time to continue to interpret the regulations in accordance with their intent and plain meaning.

If you have any further questions, please call (202) 622-3880.

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