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January 20, 2011

Hon. Douglas Shulman  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Re: Comments on Guidance on Determining Permission for Late Filing

Dear Commissioner Shulman:

Enclosed are comments on the guidance on determining permission for late filing. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Charles H. Egerton  
Chair, Section of Taxation

Enclosure

cc: Michael F. Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury  
William J. Wilkins, Chief Counsel, Internal Revenue Service  
Jeffrey Van Hove, Acting Tax Legislative Counsel, Department of the Treasury  
Stephen E. Shay, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury  
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**ABA SECTION OF TAXATION  
COMMENTS ON GUIDANCE ON DETERMINING  
PERMISSION FOR LATE FILING  
(SECTION 897 – FOREIGNERS’ REAL ESTATE SALES)**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Jason Bazar of the U.S. Activities of Foreigners and Tax Treaties Committee of the Section of Taxation. Substantive contributions were made by Matthew Sontag, Alan Appel, Mark Stone, and Meghan Bright. The Comments were reviewed by Alan I. Appel, Committee Chair. The Comments were further reviewed by Michael Hirschfeld of the Section’s Committee of Government Submissions and by Joan Arnold, Council Director for the U.S. Activities of Foreigners and Tax Treaties Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who may be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: January 20, 2011

## EXECUTIVE SUMMARY

These Comments address certain issues raised by requests for 9100 relief related to section 897<sup>1</sup> and section 1445 under Revenue Procedure 2008-27<sup>2</sup> (the “Revenue Procedure”) in response to a request for comments by the Internal Revenue Service (the “Service”).<sup>3</sup>

Section 897(a)(1) provides that the gain or loss of a nonresident alien individual or foreign corporation from the disposition of a U.S. real property interest (“USRPI”) shall be taxed as if the taxpayer were engaged in a trade or business in the United States, and as if such gain or loss were effectively connected with such trade or business under section 871(b) or section 882. Section 897(c)(1)(A)(ii) presumes that all non-creditor interests in a domestic corporation are USRPIs unless the foreign person selling the interest establishes that the domestic corporation was not a U.S. real property holding corporation (“USRPHC”) during the five years ending on the date of the disposition. Regulation section 1.897-2 provides requirements that, if met, establish that a corporation is not a USRPHC.

Section 1445(a) generally requires the transferee of a USRPI to withhold ten percent of the amount realized by the foreign person on the disposition of the USRPI. Pursuant to Regulation section 1.1445-2(d)(2), a transferee is not required to withhold if the transferor provides notice that, by reason of the operation of a nonrecognition provision of the Code or the provisions of any United States treaty, the transferor is not required to recognize any gain or loss with respect to the transfer. Regulation section 1.1445-2(c)(3) provides another exception to withholding in the case of the transfer of an interest in a domestic corporation that is not a USRPHC. To take advantage of this exception, the transferee must obtain a statement from the domestic corporation that an interest in the corporation is not a USRPI. The domestic corporation is required to mail notice of the request to the Service; otherwise, the statement of USRPI status may not be relied upon for the avoidance of the withholding.

The Revenue Procedure provides a simplified method to request relief when the filings discussed in the preceding paragraph are not made in a timely manner. These Comments include suggestions for clarification or elaboration of matters covered in the Revenue Procedure:

- We recommend that the Revenue Procedure be revised to state that relief, if granted, is retroactive in effect. As the Revenue Procedure is currently written, even if the Service grants relief, it is not clear whether the taxpayer would be liable for interest, penalties, or both even though the seller was not subject to withholding tax on the disposition of the property. It would be helpful if clarification was provided that

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<sup>1</sup> References to a “section” are to a section of the Internal Revenue code of 1986, as amended (the “Code”), unless otherwise indicated.

<sup>2</sup> 2008-21 I.R.B. 1014.

<sup>3</sup> Proposed Collection; Comment Request for Rev. Proc. 2007-99 (RP-127367-07), 9100 Relief Under Sections 897 and 1445, 75 Fed. Reg. 69,741 (2010) (requesting comments concerning 9100 relief under sections 897 and 1445 and Revenue Procedure 2007-99). Revenue Procedure 2008-27 provides a simplified method to request relief for certain late filings under sections 897 and 1445 and thus is the Revenue Procedure addressed in these comments.

indicates that upon grant of relief, the taxpayer is treated as having timely complied with the regulations, with no interest or penalties due with respect to the failure to withhold.

- We recommend that the Service revise the Revenue Procedure to provide a more predictable timeframe for the taxpayer to determine if relief has been granted. Currently, the Service must first notify the taxpayer in writing that the taxpayer's request for relief has been received and assigned for review, and second notify the taxpayer within 120 days following such receipt of notice if the Service determines that the failure to comply was not due to reasonable cause, or if additional time is needed to make a determination. However, in our experience, after filing a request for relief, taxpayers have not always received notice from the Service that the request has been received and assigned for review. As such, taxpayers have been unsure whether and when the relief requested has been granted. It would be helpful for the Service to revise the Revenue Procedure to prevent this outcome. One possible solution would be for relief to be deemed granted unless the Service notifies the taxpayer within 120 days of receipt of the request, taking into account the application of the deemed delivery rules provided under section 7502, that reasonable cause has not been demonstrated or that the Service requires additional time to make the determination.
- We recommend reasonable cause guidance be issued in the case of controlled entity restructurings and transactions involving mergers and acquisitions ("M&A transactions"). In controlled subsidiary contexts (*e.g.*, restructurings, internal reorganizations) we recommend that reasonable cause be established by a statement (i) describing the relationship among the parties, (ii) stating that the facts in possession of the parent supported a conclusion by the parent that the parties involved were not USRPHCs, and (iii) stating that the failure to file was not deliberate or motivated by a desire to avoid U.S. tax. In the M&A transaction context, we recommend that reasonable cause be established by a statement that (i) a signed representation of non-USRPHC status was acquired during the course of the transaction and (ii) the failure to file was not deliberate or motivated by a desire to avoid U.S. tax.

## COMMENTS

### I. Overview of Section 897 and Section 1445

Section 897(a)(1) provides that the gain or loss of a nonresident alien or foreign corporation from the disposition of a USRPI will be taxed as if the taxpayer were engaged in a trade or business in the United States, and as if such gain or loss were effectively connected with such trade or business under section 871(b) or section 882. A USRPI includes an interest in real property located in the United States or the Virgin Islands and any interest (other than an interest solely as a creditor) in a domestic corporation unless the taxpayer establishes that the corporation was at no time a USRPHC during the five years immediately preceding the disposition.<sup>4</sup>

Regulation section 1.897-2 provides requirements to establish that a corporation is not a USRPHC. Unless these requirements are satisfied, it is presumed that a domestic corporation is a USRPHC.

Section 1445(a) generally requires the transferee of a USRPI to withhold ten percent of the amount realized by the foreign person on the disposition of the USRPI. As discussed below, section 1445(b) and the regulations thereunder provide several exceptions to this general requirement and section 1445(e) provides special rules for certain dispositions and distributions.

Pursuant to Regulation section 1.1445-2(d)(2), a transferee is not required to withhold if the transferor provides notice that, by reason of the operation of a nonrecognition provision of the Code or the provisions of any United States treaty, the transferor is not required to recognize any gain or loss with respect to the transfer. Under Regulation section 1.1445-2(d)(2)(i)(A), the transferor may provide a notice to the transferee that the transferor is not required to recognize any gain or loss. The notice must include the information described in Regulation section 1.1445-2(d)(2)(iii). The transferee must provide a copy of the notice to the Service within 20 days of the transfer.<sup>5</sup> Similarly, in transfers described in section 1445(e), such as distributions by corporations to their shareholders, an entity or fiduciary otherwise required to withhold is not required to withhold if, by reason of the operation of a nonrecognition provision of the Code or the provisions of any United States treaty, no gain or loss is required to be recognized by the foreign person with respect to which withholding would otherwise be required.<sup>6</sup> Withholding is not required if, within 20 days of the transfer, the entity or fiduciary delivers a notice to the Service that includes the information described in Regulation section 1.1445-5(b)(2)(ii).<sup>7</sup>

Another exception to withholding involves the transfer of an interest in a domestic corporation that was not a USRPHC within the five years immediately preceding the transaction. Because section 897(a)(1) does not apply to the gain (or loss) from a foreign person's disposition

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<sup>4</sup> I.R.C. § 897(c)(1)(A)(ii).

<sup>5</sup> Reg. § 1.1445-2(d)(2)(i)(B).

<sup>6</sup> Reg. § 1.1445-5(b)(2)(i)(A).

<sup>7</sup> Reg. § 1.1445-5(b)(2)(i)(B).

of stock in a domestic corporation that is not, and has not been within the five years immediately preceding the transaction, a USRPHC, section 1445 does not require the transferee to withhold upon a foreign person's disposition of stock in such domestic corporation. To establish that an interest in a domestic corporation was not a USRPI as of the date of the disposition, the foreign person must obtain a statement from the domestic corporation that the domestic corporation was not a USRPHC within the relevant period (a "USRPI statement"). The foreign transferor must obtain this statement from the domestic corporation no later than the date, including any extensions, on which a tax return would otherwise be due with respect to the foreign transferor's disposition.<sup>8</sup> The domestic corporation must mail a notice of the statement to the Service within 30 days after this statement is provided to the foreign transferor, unless the domestic corporation meets the requirements of Regulation section 1.897-2(h)(4)(i).<sup>9</sup> Pursuant to Regulation section 1.1445-2(c)(3), if the Service has been so notified and a copy of the domestic corporation's statement is provided to the transferee, the transferee is excused from withholding. Similarly, in transactions involving the transfer of an interest in a domestic corporation that is not a USRPHC under section 1445(e), when the transferor or fiduciary obtains a statement that the domestic corporation is not a USRPHC and timely notice of such statement is provided to the Service pursuant to Regulation section 1.897-2(h), Regulation section 1.1445-5(b)(4)(iii) provides that no withholding is required.

## II. Overview of Revenue Procedure 2008-27

The Revenue Procedure provides a simplified method to request relief for certain late filings under Regulation sections 1.897-2(g)(1)(ii)(A), 1.1445-2(c)(3)(i), 1.1445-2(d)(2), 1.1445-5(b)(2), and 1.1445-5(b)(4). A taxpayer is eligible for relief for a late filing under these sections if a statement or notice described in one or more of those sections was not provided to the relevant person or the Service by the specified deadline and the taxpayer has reasonable cause for the failure to make a timely filing. Once the taxpayer becomes aware of the failure to file the statements or notices required by those sections, the taxpayer must file the completed statement or notice with the appropriate person or the Service, as applicable. The taxpayer must attach an explanation describing why the taxpayer's failure to timely file the statement or notice was due to reasonable cause. Upon receipt of a completed application requesting relief, the Service will notify the taxpayer in writing within 120 days if the Service determines that the failure to comply was not due to reasonable cause, or if additional information will be needed to make a determination. For this purpose, the 120 day period begins on the date the taxpayer is notified in writing that the request has been received and assigned for review.

## III. Retroactive Relief

The Revenue Procedure does not clearly state that relief, if granted, is retroactive in effect. As the Revenue Procedure is currently written, even if the Service grants relief, it is not clear whether the taxpayer would be liable for interest and penalties even though the taxpayer

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<sup>8</sup> Reg. § 1.897-2(g)(1)(ii)(A). As a practical matter, the statement must be obtained prior to closing to ensure that the transferee is not subject to withholding. See the discussion immediately following on Regulation section 1.1445-2(c)(3).

<sup>9</sup> Reg. § 1.897-2(h)(2), -2(h)(4)(i).

never held an interest in U.S. real property. To illustrate, in PLR 9519056,<sup>10</sup> the Service took the position that

[p]ursuant to section 1.1445-1(e)(3)(ii), a transferee that fails to withhold or to obtain a withholding certificate is relieved of its liability for the tax imposed under section 1445 if the transferor satisfies its substantive tax liability (namely, by filing an income tax return and paying any amount due). However, the transferee remains liable for interest on the entire amount required to have been withheld, which runs until the date the transferor's tax liability is satisfied. This rule applies even if the substantive liability on the transferor is zero.

If the rationale of this PLR were applied to other taxpayers, a purchaser who, without receiving the required statement from the foreign seller, decides not to withhold from the foreign seller's amount realized on the basis that the interest transferred is not a USRPI would be liable for failure to withhold if the interest is, in fact, a USRPI. It is also possible given the rationale of PLR 9519056, that if the purchaser does not withhold the section 1445(a) tax, even if the purchaser ultimately shows that the domestic corporation was not a USRPHC during the relevant period, and therefore an interest in that domestic corporation was not a USRPI and that no tax under section 897 was ultimately owed, the purchaser would remain liable for interest on the entire amount required to have been withheld. Such interest would accrue from the date on which the purchaser should have withheld until the date that the purchaser ultimately proves that the stock of the domestic corporation it purchased was not a USRPI.

Conversely, CCA 200521031<sup>11</sup> concluded that in the section 1441 withholding context, section 6601, which imposes interest on underpayment of withholding tax, has no application if it is determined that no tax was ever due. Although CCA 200521031 was issued under section 1441 and the Service might not apply the same rationale to withholding tax under section 1445, the Service may, of course, nevertheless determine that no interest should be assessed under section 1445. Therefore, it is also possible that a purchaser would not be liable for interest under section 6601 on the amount that it failed to withhold under 1445 if the purchaser ultimately provides the Service with documentation establishing that no tax was imposed on the purchase (because the domestic corporation was not a USRPHC at any point during the relevant period).

To avoid any uncertainty, we recommend that guidance be provided that clarifies that upon grant of relief, the taxpayer is treated as having timely complied with the Regulations, and thus no interest or penalties are due with respect to the transaction.

#### IV. Administrative Delays in Receiving Notice from the Service

Under section 4.03 of the Revenue Procedure, the Service must notify the taxpayer in writing that the taxpayer's request for relief has been received and assigned for review. The Service must then notify the taxpayer within 120 days following the date of such notice if the Service determines that the failure to comply was not due to reasonable cause, or if additional

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<sup>10</sup> Feb. 16, 1995.

<sup>11</sup> May 27, 2005.

time is needed to make a determination. Taxpayers have indicated that in many cases they did not receive notice from the Service that a request for relief had been received and assigned for review. As such, the 120 day period for determining whether relief is granted does not commence, and taxpayers are unsure whether and when their obligations under the regulations are satisfied and relief granted. We believe it would assist taxpayers if the Service were to revise the Revenue Procedure to both reduce the administrative burden on the Service of issuing the notice to begin the 120 day review period, as well as provide a more predictable timeframe for the taxpayer to determine if relief is granted. We recommend that the 120 day period commence on the date of receipt by the Service of the taxpayer's request for relief, taking into account the application of the deemed delivery rules provided under section 7502.

## V. Reasonable Cause

### A. *Establishing Reasonable Cause in Transactions Within a Controlled Group*

The requirements for a USRPI status statement do not contain an exception for transactions within a controlled group in which the USRPI status of an interest in a controlled corporation is conclusively known to all parties in the transaction based upon facts in their possession in advance of the transaction. In such situations, in our experience, a compliance requirement with respect to the USRPI status of an interest in the corporation is often overlooked, but the grounds necessary to establish "reasonable cause" in the absence of further guidance are unclear, which greatly increases both the length and complexity of the explanations submitted. In this specific context, we believe the potential risk of substantive noncompliance with U.S. tax law is low, the additional content submitted by taxpayers increases the review burden to the Service, and the lack of guidance as to the information required reduces taxpayer certainty.

We recommend that the revised Revenue Procedure include a simplified procedure to establish reasonable cause in transactions involving members of a controlled group, so as to enhance taxpayer certainty and lower the review burden on the Service. We suggest that the revised Revenue Procedure state that reasonable cause in transactions occurring completely within a controlled group may be established by setting forth the circumstances of the transaction and stating, under penalties of perjury, that the failure to comply with the USRPI statement requirements was neither intentional nor for the purpose of avoiding U.S. federal income tax. We believe the information provided through such a mechanism would be sufficient to allow the Service to determine that the transactional circumstances were such that a USRPI statement would have conveyed no additional information to the parties to the transaction, and thus failure to provide such a statement did not affect any party's ability to meet their U.S. federal income tax obligations. We also believe the statement as to inadvertency and purpose should provide sufficient comfort with respect to the reasons for the compliance failure. We believe that such a simplified procedure for establishing "reasonable cause" would significantly reduce the length and complexity of reasonable cause statements received, thus simplifying Service's review and lessening taxpayer burden and uncertainty.

B. *Establishing Reasonable Cause in Transactions Involving Unrelated Parties*

The requirements for a USRPI statement also do not include an exception for situations in which the transferee has received, at or prior to closing, a written representation from the transferor or the domestic corporation that an interest in the domestic corporation is not a USRPI, or that domestic corporation has not been a USRPHC during the relevant period specified under section 897(c)(1)(A)(ii). Rather, the exception only applies if the statement comes from the domestic corporation and is timely filed with the Service. Most stock purchase agreements contain a form of representation and warranty to that effect<sup>12</sup> and, as a result, we believe there is a low risk of substantive noncompliance with the section 897 liability and section 1445 withholding obligations because USRPHC status likely does not exist. In these situations, the USRPI status of an interest in the corporation has been warranted to by the transferor or domestic corporation, potentially subjecting the transferor to significant contractual liabilities should the representation prove to be incorrect. Given those potential contractual liabilities, we believe the Service should generally be confident that the representation is provided only after the transferor has conducted due diligence to assure that the representation is accurate. However, given the complexity and timeline of the transactions involved in an acquisition, the technical requirements of a USRPI statement and notice to the Service are often overlooked or incorrectly assumed complied with as a result of obtaining the representation.

As with controlled groups, we recommend that, in situations involving an acquisition in which the USRPI status of an interest in the target is established through a representation from the transferor or target domestic corporation to the transferee, additional guidance provide that “reasonable cause” in this situation may be established by setting out the facts of the transaction, the actual representation given by the transferor or target company,<sup>13</sup> and a statement made under

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<sup>12</sup> In our experience, the following is a typical representation :

§4. Representations and Warranties Concerning Target and Its Subsidiaries. Sellers represent and warrant to Buyer that the statements contained in this §4 are correct and complete as of the date of this Agreement and will be correct and complete as of the Closing Date

....

(k) Tax Matters.

....

(v) Neither Target nor any of its Subsidiaries has been a United States real property holding corporation within the meaning of Code §897(c)(2) during the applicable period specified in Code §897(c)(1)(A)(ii).

Ginsburg & Levin, *Mergers Acquisitions, and Buyouts*, Vol. 5 (August 2010). In certain stock purchase agreements the target domestic corporation is, either alone or in addition to the sellers, included as a party to the agreement. This situation often arises in the case of a publicly traded target corporation or when the sellers are not actively involved in the affairs of the business. In such cases the target domestic corporation generally provides representations and warranties concerning the section 897 status of the entity that are the same as those shown for the sellers.

<sup>13</sup> We suggest that a taxpayer be held to the same standard with respect to such representation as taxpayers are generally held to with respect to other documentary evidence that taxpayers generally may rely on in determining whether withholding tax is applicable. *See, e.g.*, Reg. §§ 1.1441-1(e)(4)(viii), 1.1445-2(b)(4).

penalties of perjury that the failure to conform to the technical requirements of a USRPI statement, including signature under penalties or perjury, and to notify the Service as required, were neither intentional nor with the purpose of avoiding U.S. federal income tax. In these circumstances, we believe the information provided should be sufficient to allow the Service to determine whether the substantive requirements of U.S. tax law were met. We also believe that such a simplified procedure would reduce the length and complexity of reasonable cause statements, again simplifying Service's review and lessening taxpayer burden and uncertainty.