

Reporting and Paying the §965 Transition Tax for 2017

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The IRS announced the publication of a set of questions and answers related to the tax imposed under IRC §965 under changes made by the Tax Cuts and Jobs Act in [News Release IR-2018-53](#). The questions and answers are published in the form of a frequently asked question document (FAQ) on the IRS website at:

<https://www.irs.gov/newsroom/questions-and-answers-about-reporting-related-to-section-965-on-2017-tax-returns>

The news release notes that the IRS had previously provided some guidance on IRC §965 issues in Notices 2018-07 and 2018-13 and Revenue Procedure 2018-17. The IRS describes the purpose of these questions and answers in the news release as follows:

As the March 15 and April 17 deadlines approach for various filers, the IRS released information today in a question and answer format. The Frequently Asked Questions address basic information for taxpayers affected by section 965. This includes how to report section 965 income and how to report and pay the associated tax liability. The information on IRS.gov also provides details on several elections under section 965 that taxpayers can make.

As the FAQ notes, this provision of the TCJA imposes a tax due on 2017 returns of affected taxpayers. For example, tax may be due from a calendar year U.S. shareholder holding an interest in a calendar year specified foreign corporation that needs to be reported and paid with the 2017 return.

Summary of IRC §965 Tax

The FAQ gives the following quick summary of the IRC §965 tax:

In general, section 965 of the Code requires United States shareholders, as defined under section 951(b) of the Code, to pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States. Very generally, section 965 of the Code allows taxpayers to reduce the amount of such inclusion based on deficits in earnings and profits with respect to other specified foreign corporations. The effective tax rates applicable to such income inclusions are adjusted by way of a participation deduction set out in section 965(c) of the Code. A reduced foreign tax credit applies to the inclusion under section 965(g)

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of the Code. Taxpayers, pursuant to section 965(h) of the Code, may elect to pay the transition tax in installments over an eight-year period. Generally, a specified foreign corporation means either a controlled foreign corporation, as defined under section 957 of the Code (“CFC”), or a foreign corporation (other than a passive foreign investment company, as defined under section 1297 of the Code, that is not also a CFC) that has a United States shareholder that is a domestic corporation.

How to Report the Tax

One item the IRS concedes is that the agency is still working to implement reporting for this provision. The FAQ requests that individual taxpayers who are electronically filing their 2017 return wait to file the return on or after April 2, 2018. The FAQ indicates the IRS needs “time to make certain system changes to allow the returns to be accepted and processed.”

The FAQ contains an appendix that outlines how taxpayers are to report the tax due on the forms due from the various taxing entities that may need to report the tax.

For example, the appendix provides the following guidance for Form 1040 filers:

<i>Individual Taxpayer</i>				
<i>Follow these reporting instructions along with attaching the IRC 965 Transition Tax Statement</i>				
<i>Form</i>	<i>965(a) Amount [1]</i>	<i>965(c) Deduction [2]</i>	<i>Foreign Tax Credit (FTC) [3]</i>	<i>Reporting of Net Tax Liability Under Section 965 [4] and Amounts to Be Paid in Installments Under Section 965(h) or Deferred Under Section 965(i), If Applicable</i>
1040	Include a net section 965 amount (section 965(a) amount less section 965(c) deduction) on Page 1, Line 21, Other Income. Write SEC 965 on the dotted	See 965(a) amount column.	Report the relevant section 965(a) amount and the relevant section 965(c) deduction on Form 1116. If an IRC 962 election is made, report	Reduce on Page 2, Line 44, Tax the amount of net tax liability deferred under section 965(i), if applicable. Check box ‘c’ on Line 44 and write 965 to the right of the box. Include in total on Page 2, Line 73 the amount to be paid in

<i>Individual Taxpayer</i>				
	line to the left of Line 21.		the relevant section 965(a) amount, the relevant section 965(c) deduction, the deemed paid foreign taxes with respect to the relevant section 965(a) amount, and the disallowed foreign taxes under section 965(g) on Form 1118.	installments for years beyond the 2017 year, if applicable. Check box 'd' on Line 73 and write TAX to the right of the box.

[1] This includes section 965(a) inclusion amounts of a United States shareholder of a deferred foreign income corporation and distributive shares and pro rata shares of section 965(a) inclusion amounts of domestic partnerships, S corporations, and other passthrough entities.

[2] This includes deductions under section 965(c) of a United States shareholder of a deferred foreign income corporation and distributive shares and pro rata shares of deductions under section 965(c) of domestic partnerships, S corporations, and other passthrough entities.

[3] See section 965(g).

[4] See section 965(h)(6) and Q&A3.

Similar tables are provided for other forms that affected taxpayers and entities must file.

Required IRC Transition Tax Statement

A taxpayer subject to this tax must attach an IRC Transition Tax Statement to the tax return. A sample statement is provided by the IRS in [Appendix Q&A3](#) to this FAQ and as a downloadable PDF. The FAQ provides the following information about this statement:

A person that has income under section 965 of the Code for its 2017 taxable year is required to include with its return an IRC 965 Transition Tax Statement, signed under penalties of perjury and, in the case of an electronically filed return, in Portable Document Format (.pdf) with a filename of "965 Tax". The IRC 965 Transition Tax Statement must include the following information:

- *The person's total amount required to be included in income under section 965(a) of the Code.*
- *The person's aggregate foreign cash position, if applicable.*
- *The person's total deduction under section 965(c) of the Code.*
- *The person's deemed paid foreign taxes with respect to the total amount required to be included in income by reason of section 965(a).*
- *The person's disallowed deemed paid foreign taxes pursuant to section 965(g).*

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- *The total net tax liability under section 965 (as determined under section 965(h)(6), without regard to whether such paragraph is applicable), if applicable, which will be assessed.*
- *The amount of the net tax liability under section 965 to be paid in installments under section 965(h) of the Code, if applicable.*
- *The amount of the net tax liability under section 965, the payment of which has been deferred, under section 965(i) of the Code, if applicable.*
- *A listing of elections under section 965 of the Code or the election provided for in Notice 2018-13 that the taxpayer has made, if applicable.*

Making Elections Under IRC §965

The FAQ at Q&A 5 provides the following information about who can file the various elections under IRC §965:

The elections under section 965 of the Code are limited to taxpayers with a net tax liability under section 965 (in the case of section 965(h) of the Code), taxpayers that are shareholders of S corporations and that have a net tax liability under section 965 (in the case of section 965(i) of the Code), taxpayers that are REITs (in the case of section 965(m) of the Code), or taxpayers with an NOL (in the case of section 965(n) of the Code). Thus, a domestic partnership or an S corporation that is a United States shareholder of a deferred foreign income corporation may not make any of the elections under section 965 of the Code. In advance of April 2, 2018 (see Q&A11), the Treasury Department and the IRS intend to provide further guidance concerning the availability of the elections under section 965 of the Code to direct and indirect partners in domestic partnerships, shareholders in S corporations, and beneficiaries in other passthrough entities that are United States shareholders of deferred foreign income corporations.

The election under Notice 2018-13, Section 3.02 may be made on behalf of a specified foreign corporation pursuant to the rules of §1.964-1(c)(3).

In the case of a consolidated group (as defined in §1.1502-1(h)), in which one or more members are United States shareholders of a specified foreign corporation, the agent for the group (as defined in §1.1502-77) must make the elections on behalf of its members.

Q&A 6 notes that elections are due on or before the due date (including extensions) of the date for filing the return to which the provision first applies (the “relevant year”). As well, if the election is made to pay the tax in installments under IRC §965(h), the first payment must be made by the due date ***not including extensions*** for filing returns for the relevant year.

The Q&A is not clear regarding whether the IRS will consider lack of a timely payment an issue that would eliminate the option to make the election or if the warning is merely to advise taxpayers penalties and interest would apply to a late payment. IRC §965(h)(5) itself does not appear to explicitly require payment for the election to be valid, but it does grant the IRS the authority to prescribe rules for making the election.

The IRS provides the following details on how the election is to be made in Q&A 7

A person makes an election under section 965 of the Code or the election provided for in Notice 2018-13, Section 3.02, by attaching to a 2017 tax return a statement signed under penalties of perjury and, in the case of an electronically filed return, in Portable Document Format (.pdf), for each such election. Each such statement must include the person’s name, taxpayer identification number and any other information relevant to the election, such as the net tax liability under section 965 with respect to which the installment election under section 965(b)(1) of the Code applies, the name and taxpayer identification number of the S corporation with respect to which the deferral election under section 965(i)(1) of the Code is made, the section 965(a) inclusion amount with respect to which the election under section 965(m)(1)(B) of the Code applies, the amount described in section 965(n)(2) of the Code to which the election under section 965(n)(1) of the Code applies, and the name and taxpayer identification number, if any, of the specified foreign corporation with respect to which the election under Notice 2018-13, Section 3.02, is made. Model statements are included in Appendix: Q&A7. Each election statement must have the applicable title and, in the case of an attachment in Portable Document Format (.pdf) included with an electronically filed return, the file name reflected in the following table:

Provision Under Which Election is Made	Title	File Name
<u>Section 965(h)(1)</u>	Election to Pay Net Tax Liability Under Section 965 in Installments under Section 965(h)(1)	965(h)
<u>Section 965(i)(1)</u>	S Corporation Shareholder Election to Defer Payment of Net Tax Liability Under Section 965 Under Section 965(i)(1)	965(I)
<u>Section 965(m)(1)(B)</u>	Statement for Real Estate Investment Trusts Electing Deferred Inclusions Under Section 951(a)(1) By Reason of Section 965 Under Section 965(m)(1)(B)	965(m)
<u>Section 965(n)</u>	Election Not to Apply Net Operating Loss Deduction under section 965(n)	965(n)

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<i>Provision Under Which Election is Made</i>	<i>Title</i>	<i>File Name</i>
Notice 2018-13, Section 3.02	Election Under Section 3.02 of Notice 2018-13 to Use Alternative Method to Compute Post-1986 Earnings and Profits	2018-13

Again, the IRS has provided example forms for the elections in Appendix Q&A7 and links to example PDFs.

Requirement for Additional Form 5471 Filings for non-CFCs

Q&8 provides that Form 5471 must be filed for each specified foreign corporation even if that corporation is not a controlled foreign corporation (CFC). The Q&A provides the following information regarding such filings:

In order to collect information relevant to the calculation of a United States shareholder's section 965(a) inclusion amount, a person that was a United States Shareholder of a specified foreign corporation during its 2017 taxable year, including on the last day of such year, and owned stock of the specified foreign corporation on the last day of the specified foreign corporation's year that ended during the person's year must file a Form 5471 with respect to the specified foreign corporation completed with the identifying information on page 1 of Form 5471 above Schedule A, as well as Schedule J. The exceptions to filing in the instructions to Form 5471 otherwise will continue to apply. Notice 2018-13, Section 5.02 also provides an exception to filing Form 5471 for certain United States shareholders considered to own stock by "downward attribution" from a foreign person. The IRS intends to modify the instructions to the Form 5471 as necessary.

Information to Be Provided by Passthrough Entities

Q&A9 provides the information that will need to be provided by passthrough entities:

A domestic partnership, S corporation, or other passthrough entity should attach a statement to its Schedule K-1s, if applicable, that includes the following information for each deferred foreign income corporation for which such passthrough entity has a section 965(a) inclusion amount:

- *The partner's, shareholder's, or beneficiary's share of the partnership's, S corporation's, or other passthrough entity's section 965(a) inclusion amount, if applicable.*
- *The partner's, shareholder's, or beneficiary's share of the partnership's, S corporation's, or other passthrough entity's deduction under section 965(c), if applicable.*
- *Information necessary for a domestic corporate partner, or an individual making an election under section 962, to compute its deemed paid foreign tax credits with respect to its share of*

the partnership's, S corporation's, or passthrough entity's section 965(a) inclusion amount, if applicable.

How the Tax is to Be Paid

The tax due under §965 will not simply be paid with the affected tax return. Rather Q&A10 provides the following instructions for paying the tax:

*A taxpayer should make two separate payments as follows: one payment reflecting tax owed without regard to section 965 of the Code, and a second, separate payment reflecting tax owed resulting from section 965 of the Code (the 965 Payment). **Both payments must be paid by the due date of the applicable return (without extensions).***

The 965 Payment must be made either by wire transfer or by check or money order. This may be the first year's installment of tax owed in connection with a 2017 tax return by a taxpayer making the election under section 965(b) of the Code, or the full net tax liability under section 965 of the Code for a taxpayer who does not make such election and does not make an election under section 965(i) of the Code. For the 965 Payment, there is no penalty for taxpayers electing to use wire transfers as an alternative to otherwise mandated EFTPS payments. Accordingly, taxpayers that would normally be required to pay through EFTPS should submit the 965 Payment via wire transfer or they may be subject to penalties. On a wire payment of tax owed under section 965 of the Code, the taxpayer would use a 5-digit tax type code of 09650 (for more information, see <https://www.irs.gov/payments/same-day-wire-federal-tax-payments>). On a check or money order payment of tax owed resulting from section 965 of the Code, include an appropriate payment voucher (such as Form 1040-V or 1041-V) and along with all other required information write on the front of your payment "2017 965 Tax."

For the payment owed without regard to section 965, normal payment procedures apply (for more information, see <https://www.irs.gov/payments>). This payment may be made at the same or different time from the 965 Payment, but must be made by the due date of the return or penalties and interest may apply.

Tax Return Filing Delay and Amending Already Filed Returns

As was noted earlier, Q&A11 requests that electronically filed Forms 1040 containing 965 issues not be filed until April 2, 2018. Of course, that assumes that the adviser's tax software is able to process such returns as of that date, which likely depends on when the IRS gets the information out on the format for such electronic filings.

Q&A12 gives the following advice to taxpayers that may have already filed a return and now discover they have Section 965 issues:

The person should consider filing an amended return based on the information provided in these FAQs and Appendices. Failure to submit a return in this manner may result in processing difficulties and erroneous notices being issued. Failure to accurately reflect the net tax liability under section 965 of the Code in total tax could result in interest and penalties.

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In order to amend a return, a person would file the applicable form for amending the return pursuant to regular instructions and would attach:

- *amended versions of forms and schedules necessary to follow the instructions in these FAQs,*
- *any election statements, and*
- *the IRC 965 Transition Tax Statement included in Appendix: Q&A3.*