11 November 2019

Global Tax Alert

US IRS announces campaign to audit Section 965 transition tax compliance

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

The United States (US) Internal Revenue Service (IRS) Large Business and International (LB&I) Division has opened a new campaign to examine companies' compliance with the Internal Revenue Code[1] Section 965 transition tax, the IRS announced on its website 4 November 2019.

Background

Section 965, added by the *Tax Cuts and Jobs Act* (TCJA), imposed a transition tax on untaxed foreign earnings of foreign subsidiaries of US companies by deeming those earnings to be repatriated. Foreign earnings held in the form of cash and cash equivalents are taxed at 15.5%, and the remaining earnings are taxed at 8%. (For details, see EY Global Tax Alert, *US Tax Cuts and Jobs Act significantly affects US private companies with outbound investments*, dated 5 February 2018.)

In 2018, the IRS released FAQs with guidance on reporting, filing, and payment requirements under Section 965.[2]

Final Section 965 regulations were released in January.[3] The rules were retroactive and applied to a foreign corporation's last tax year that began before 1 January 2018, and to a US shareholder's tax year in which or with which the foreign corporation's year ends.

Building a better working world

LB&I campaign

The goal of the new LB&I campaign is to promote compliance with Section 965. The IRS will conduct examinations of the reported Section 965 liability on selected tax returns, in most cases looking at the returns for both 2017 and 2018. In addition, those staffing the campaign will provide technical assistance to teams examining Section 965 issues, "with a focus on identifying and addressing taxpayer populations with potential material compliance risk." LB&I will also risk-assess returns selected as part of the campaign for other material issues, especially those "related to TCJA planning."

Implications

LB&I's announcement of a Section 965 campaign aligns with the IRS's heightened focus on TCJA compliance. LB&I has publicly stated that it intends to examine tax planning around the TCJA, including the components underlying the calculation of a taxpayer's Section 965 liability. IRS representatives have indicated that the IRS will be looking closely at taxpayers' earnings and profits calculations, the classification of assets as cash versus non-cash, and how taxpayers determined their foreign tax credits, among other issues. Exam personnel will also look at how Section 965 intersects with other TCJA provisions, such as BEAT, GILTI and FDII. This is particularly significant given the extended six-year statute of limitations on assessments that applies to Section 965 liabilities.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. See EY Global Tax Alert, *US IRS issues guidance on Section 965 transition tax in form of frequently asked questions*, dated 21 March 2018.
3. See EY Global Tax Alert, *US Final Section 965 regulations largely follow proposed regulations, but include significant changes*, dated 28 January 2019.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP (United States), Tax Policy and Controversy, Washington DC

- John DiIorio john.diiorio@ey.com
- Heather Maloy heather.maloy@ey.com
- Melissa Wiley melissa.wiley@ey.com

Ernst & Young LLP (United States), International Tax and Transaction Services, Washington DC

- Martin Milner martin.milner@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 005111-19Gbl

1508-1600216 NY
ED None

ey.com