

# IRS issues Q&As on Section 965 transition tax issues for 2018 returns

January 25, 2019

## In brief

The IRS on December 12, 2018 released a set of Questions and Answers (Q&As) that provide guidance on Section 965 reporting and payment requirements for 2018 tax returns, including obligations resulting from amounts included in income for the 2017 tax year.

## In detail

### Background

Section 965, enacted as part of the 2017 tax reform legislation, imposes a one-time transition tax (toll charge) on the undistributed, non-previously taxed post-1986 foreign earnings and profits (E&P) of certain US-owned foreign corporations, as part of the transition to a new territorial tax regime. Section 965(h) provides that taxpayers generally may elect to pay the toll charge in installments over eight years.

The IRS in March 2018 issued an initial set of Q&As related to tax year 2017 return filing and payment obligations arising under Section 965. Those Q&As were updated in April and June 2018.

### Overview

#### Question 1

The Answer to **Question 1** explains that the entire amount of a 2017 toll charge is assessed as a liability for that year, even though a taxpayer that made a valid Section 965(h) election can pay the liability over eight annual installments.

The IRS will issue an installment notice and payment voucher for the second installment approximately six to eight weeks before its due date (April 15, 2019, for calendar-year taxpayers). The second installment payment should be made separately from any payment due for 2018 income tax because the installment is not part of the 2018 income tax liability. Unlike the first installment of a 2017 toll charge, the second installment can be made using the Electronic Federal Tax Payment System (EFTPS), as well as a number

of other payment methods described in the Answer to Question 1.

Consistent with the Answer to Question 14 in the initial set of Q&As, the IRS will not consider 2017 to be overpaid until the full amount of the taxpayer's 2017 income tax liability, including the entire toll charge liability, is satisfied.

#### Question 2

Similarly, the Answer to **Question 2** explains that the entire amount of a 2018 toll charge is assessed as a liability for that year. A taxpayer that makes a valid Section 965(h) election can pay that liability over eight annual installments, the first of which generally is due on the unextended due date of the 2018 income tax return (April 15, 2019, for calendar-year taxpayers).

A taxpayer should make two separate payments with respect to its 2018 income tax liability: one payment for the amount of income tax owed without regard to Section 965, and a second, separate payment for the entire toll charge or the first installment, as applicable, if the liability is not otherwise satisfied by excess 2018 estimated tax payments. For 2018, toll charge payments can be made using a variety of methods, including EFTPS.

### Question 3

The most noteworthy guidance provided in the new set of Q&As is found in the Answer to **Question 3**, which addresses the situation where (1) a taxpayer made a Section 965(h) election for the 2017 tax year, fully paid the first annual installment, and has an unsatisfied but properly deferred payment obligation for the remaining portion of the 2017 toll charge, and (2) the taxpayer's 2018 income tax payments (including estimated tax payments) exceed the 2018 tax year income tax liability.

Provided the taxpayer has timely paid the second installment of its 2017 toll charge, the IRS will not offset the 2018 overpayment against any future installments whose payment is properly deferred and not yet due. The IRS instead will refund the taxpayer's 2018 overpayment, or apply it as a credit to 2019 estimated tax (if requested by the taxpayer).

### Question 4

The Answer to **Question 4** states that, in the case of a taxpayer that has

a 2018 toll charge liability, the IRS will not consider 2018 to be overpaid until the full amount of the taxpayer's 2018 income tax liability, including the entire toll charge liability, is satisfied. Accordingly, it is the IRS's position that it cannot allow, refund, or apply as a credit to any other tax period, any 2018 tax payments until both the regular 2018 income tax liability and the entire toll charge liability are satisfied. Instead, the IRS will apply excess amounts to future toll charge installments. This treatment is consistent with the guidance provided for 2017 toll charge liabilities, set forth in the Answers to new Question 1 and Question 14 in the initial set of Q&As.

### Question 5

The Answer to **Question 5** explains that a taxpayer's 2018 estimated tax payments (including a 2017 overpayment applied to 2018 estimated tax) are first applied to its 2018 regular tax liability, and then any excess is applied against the 2018 toll charge.

### Question 6

The Answer to **Question 6** explains which forms should be completed and attached to the 2018 income tax return of a taxpayer that reported income under Section 965 on either its 2017 or 2018 tax return (or both).

### The takeaway

The most recent Q&As provide updates and clarifications to the procedures both for making the second 2017 Section 965(h) installment payment due in 2019 and also for making toll charge payments

for the tax year 2018 (either in eight installments or in a lump sum). Taxpayers should carefully review the Q&As when calculating their 2018 and 2019 estimated tax payments.

As noted above, the most significant guidance provided by the new set of Q&As is that the IRS will not offset a 2018 overpayment against any future installments of a 2017 toll charge whose payment is properly deferred and not yet due. The IRS instead will refund the taxpayer's 2018 overpayment or, at the taxpayer's election, apply it as a credit to 2019 estimated tax.

That taxpayer favorable guidance can be reconciled with the IRS's position that it lacks authority to issue a refund or credit under Section 6402 for a tax year that includes a Section 965 liability until the entire toll charge has been satisfied. Although the authority to issue a refund or credit for a particular tax year is conditional on the existence of an overpayment for that year, the decision to offset an overpayment from one tax year against a balance due for a different year (or type of tax) is discretionary rather than mandatory (see *Northern States Power Co. v. United States*, 73 F.3d 764 (8th Cir. 1996)). Here, such an offset would be inconsistent with Congressional intent regarding a taxpayer's ability to elect to pay its Section 965 liability over eight instalments.

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