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Rev. Proc. 2018-17: Effects of prohibited tax year changes for “specified foreign corporations”

Rev. Proc. 2018-17 provides guidance concerning section 965—added to the Code by the new tax law (Pub. L. No. 115-97)—and modifies the circumstances under which the IRS will grant approval of certain requests by “specified foreign corporations” for changes in annual accounting periods filed under Rev. Proc. 2006-45 and Rev. Proc. 2002-39.

Rev. Proc. 2018-17 [PDF 24 KB] was issued, according to the IRS, to prevent the avoidance of the application of section 965 by changes in the tax years of certain “specified foreign corporations”—which are any controlled foreign corporation (CFC) and any foreign corporation with respect to which one or more domestic corporations is a “United States shareholder” (see section 965(e)).

As the following discussion indicates, however, the new limitations announced by Rev. Proc. 2018-17 apply to all tax year changes involving “specified foreign corporations” within the scope, and are not limited to the section 965 implications of the change.

Preliminary analysis of Rev. Proc. 2018-17

“Specified foreign corporations” to which Rev. Proc. 2018-17 applies

Rev. Proc. 2018-17 adds a new section to the accounting period change procedures for automatic approval (Rev. Proc. 2006-45) and for non-automatic approval (Rev. Proc. 2002-39). This new section, therefore, prohibits a “specified foreign corporation” from making any accounting period change, regardless of whether the change would otherwise qualify for automatic or non-automatic consent, if it meets the following three conditions:

- The specified foreign corporation's tax year (determined without regard to the requested change) ends on December 31;
- If the requested change were permitted, the first effective year of the corporation (this is generally the "short period") would begin on January 1, 2017, and would end on a date before December 31, 2017; and
- The specified foreign corporation has one or more United States shareholders that must include an amount in gross income under section 951(a)(1) by reason of section 965 with respect to the specified foreign corporation or any other specified foreign corporation (with such amount determined without regard to the requested change).

This new section prohibits a specified foreign corporation currently on a calendar tax year from changing from its year that would end on December 31, 2017, to a year ending before then (i.e., November 30, 2017). It only applies to changes from a December 31, 2017 year. Therefore, prior changes from a calendar year made before 2017, changes to pre-existing fiscal years ending in 2017, or future changes to post-2017 tax years, all are not prohibited by this new section.

Because the new section is applicable if **any** of the specified foreign corporation's United States shareholders have an overall net positive section 965 inclusion, the specified foreign corporation must look at all of its United States shareholders—not just any majority owner—and determine whether any of the United States shareholders have an overall net positive section 965 inclusion. If so, the specified foreign corporation is prohibited from changing its tax year. Similarly, the United States shareholder must look at whether it has an overall net positive section 965 inclusion from **any** of its specified foreign corporation; if so, none of the specified foreign corporations can change their tax year.

KPMG observation

Importantly, attribution under section 958(b) will make most domestic members of corporate groups into United States shareholders of all of the group's specified foreign corporations. Accordingly, all such group members must be tested for a section 965(a) inclusion, taking into account the 965(b)(5) affiliated group loss sharing rules or the Notice 2018-7 consolidated group "one taxpayer" rule.

The new section applies regardless of whether the specified foreign corporation has a required U.S. tax year under section 898 or is able to use any U.S. tax year it chooses.

KPMG observation

The restriction added by Rev. Proc. 2018-17 potentially affects not only the application of section 965(a), but other provisions as well, such as new section 951A (the “global intangible low-taxed income” (GILTI) tax).

Taxpayers to which Rev. Proc. 2018-17 does not apply

Rev. Proc. 2018-17 by its terms only affects the ability of a specified foreign corporation to change its year for a short period that begins on January 1, 2017, and ends before December 31, 2017, but does not prohibit a U.S. C corporation, even if it has specified foreign corporations, from making an automatic accounting period change if it otherwise qualifies. The new section added by Rev. Proc. 2018-17 adds an additional restriction (number (15)) to the list of scope restrictions in section 4.02 of [Rev. Proc. 2006-45](#) [PDF 56 KB]. New section 4.02(15) only applies to a specified foreign corporation.

Under section 4.02(2) of Rev. Proc. 2006-45, a corporation that is a shareholder in a CFC is generally prohibited from changing its tax year under the automatic change procedures, with certain exceptions. One of the exceptions permits the corporation to change if the CFC would be required to change its tax year to the new tax year of the corporation under the required tax year or one-month deferral year provisions of section 898. This exception permits a corporation that is a majority United States shareholder in a CFC to change its tax year, provided that the CFC makes a concurrent conforming change in its tax year under Rev. Proc. 2006-45 (see section 4.02(2)(a) of Rev. Proc. 2006-45). The new specified foreign corporation restriction in section 4.02(15) of Rev. Proc. 2006-45 does not preclude a majority United States shareholder and its CFC from meeting the concurrent conforming change condition to be able to make the change for the majority United States shareholder and the CFC under Rev. Proc. 2006-45.

The reason for this is found in section 6.09 of Rev. Proc. 2006-45. When a CFC is required to make a concurrent conforming change in its tax year in order for the majority United States shareholder to qualify for automatic approval, section 6.09 explicitly waives the full list of restrictions in section 4.02 of Rev. Proc. 2006-45, which now includes waiving new section 4.02(15). The CFC is deemed to be within the scope of Rev. Proc. 2006-45—notwithstanding any other limitation under section 4.02. Rev. Proc. 2018-17 does not alter the waiver in section 6.09 of Rev. Proc. 2006-45.

Next steps for specified foreign corporation that has taken action to change from a December 31, 2017 tax year

If a specified foreign corporation tried to implement a year-end change through filing a Form 1128 or through a Form 1120-F, the change is not valid. Section 6 of Rev. Proc. 2018-17 states that it applies to any request to change an annual accounting period that ends on December 31, 2017, regardless of when such request was filed.

KPMG observation

It is not surprising that this provision is retroactive, based on section 965(o), which gave the Treasury authority to prescribe such regulations or other guidance to prevent the avoidance of the purposes of the transition to a participation exemption system of taxation, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.

A specified foreign corporation that filed a Form 1128 and/or a Form 1120-F for a tax year ending other than December 31, 2017, will need to file a Form 1120-F for its pre-change December 31, 2017 tax year.

A specified foreign corporation or United States shareholder that recognized a change for a specified foreign corporation to a year other than December 31, 2017, in its financial statements may need to consider how to report this disregarded accounting period on its financial statements.

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