



# TaxNewsFlash

## United States

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### IRS updates FAQs, “transition tax” on foreign earnings under Code section 965

The IRS has updated a list of “frequently asked questions” (FAQs) about return filing and tax payment obligations relating to the “transition tax” under new Code section 965.

The newly added FAQs were indicated by the notation “Updated: 04/13/2018” or “Added: 04/13/2018” on the IRS website. The originally posted FAQs were indicated by the notation “Posted: 03/13/2018.” The IRS then on April 17, 2018, reposted the FAQs.

Read the updated FAQs at: [Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns](#) on the IRS website.

The updated FAQs amend and expand the rules related to payment of the transition tax liability under section 965, including allowing the transition tax to be paid out of an overpayment of estimated income taxes. Taxpayers subject to section 965 mandatory repatriation will now have any excess of estimated tax payments over their regular net income tax liability (determined without regard to section 965) applied to their tax liability under section 965.

FAQ 13 provides:

**Q13.** How will the IRS apply 2017 estimated tax payments (including credit elects from 2016) to a taxpayer’s net tax liability under section 965?

**A13.** The IRS will apply 2017 estimated tax payments first to a taxpayer’s 2017 net income tax liability described under section 965(h)(6)(A)(ii) (its net income tax determined without regard to section 965), and then to its tax liability under section 965, including those amounts that are subject to payment in installments pursuant to an election under section 965(h).

*Added: 04/13/2018*

In addition, the FAQs now provide that any estimated tax overpayment remaining after application of estimated taxes paid to a taxpayer's regular net income tax (determined without regard to section 965) and to the taxpayer's first annual installment (due in 2018) pursuant to an election under section 965(h) will not be refunded or credited to the taxpayer and instead will be applied to future annual installments until no overpayment remains.

FAQ 14 provides:

**Q14.** If a taxpayer's 2017 payments, including estimated tax payments, exceed its 2017 net income tax liability described under section 965(h)(6)(A)(ii) (its net income tax determined without regard to section 965) and the first annual installment (due in 2018) pursuant to an election under section 965(h), may the taxpayer receive a refund of such excess amounts or credit such excess amounts to its 2018 estimated income tax?

**A14.** No. A taxpayer may not receive a refund or credit of any portion of properly applied 2017 tax payments unless and until the amount of payments exceeds the entire unpaid 2017 income tax liability, including all amounts to be paid in installments under section 965(h) in subsequent years. If a taxpayer's 2017 tax payments exceed the 2017 net income tax liability described under section 965(h)(6)(A)(ii) (net income tax determined without regard to section 965) and the first annual installment (due in 2018) pursuant to an election under section 965(h), the excess will be applied to the next successive annual installment (due in 2019) (and to the extent such excess exceeds the amount of such next successive annual installment due, then to the next such successive annual installment (due in 2020), etc.) pursuant to an election under section 965(h).

*Added: 04/13/2018*

Amendments were also made to some of the other FAQs.

- FAQ 10 was amended to reflect and refer to and to take into account new FAQs 13 and 14.
- FAQ 3, regarding section 965 reporting requirements,
- FAQ 5, regarding who can make a section 965 election,
- FAQ 8, regarding Form 5471 filing requirements, and
- FAQ 9, regarding passthrough entity reporting to partners and shareholders, were all edited.

## **Background**

The new tax law (Pub. L. No. 115-97, enacted December 22, 2017) added section 965 to the Code. Section 965 generally requires "United States shareholders" 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.

The IRS in March 2018 originally released the FAQs to be used by taxpayers in filing 2017 tax returns that report amounts under section 965 and paying the tax required by section 965. Read [TaxNewsFlash](#)

Earlier IRS guidance under section 965 included Notice 2018-7, Notice 2018-13, Notice 2018-26, Rev. Proc. 2018-17, and Publication 5292.

### **KPMG observation**

The new procedures provided by FAQs 13 and 14 are surprising, primarily due to the fact that they come so close to the traditional tax payment deadline (April 17<sup>th</sup> this year). Until issuance of these amended FAQs late on April 13<sup>th</sup>, most taxpayers had assumed that if their 2017 estimated tax payments and credits totaled more than their regular tax liability plus the first section 965 installment, any excess payments would be refunded or available to be used as a credit elect towards 2018 estimated taxes. That assumption is now inoperative, based on this most recent guidance from IRS.

Taxpayers who planned to elect the installment option provided by section 965(h) and accounted for their first annual section 965 liability installment in their estimated taxes paid for 2017 prior to the IRS's issuance of the original FAQs issued on March 13, 2018, found themselves in a dilemma when the original FAQs were issued, requiring two separate and distinct payments of tax—one for regular tax liability and one for section 965 liability. In other words, the original FAQs implied that taxpayers were (1) precluded from applying estimated tax payments to the section 965 liability, and (2) required to make a new, separate payment with respect to their section 965 liability.

In order to comply with the instruction provided in the original FAQs, some taxpayers, taking a reasonable and conservative approach, then made a second, separate payment to the IRS representing their section 965 liability assuming that the resulting overpayment of estimated taxes could be refunded to them or credited to tax year 2018 estimated taxes. FAQ 14 now effectively operates to deny these taxpayers the ability to obtain a refund or make a credit elect, and instead the estimated tax overpayment for tax year 2017 will be applied by the IRS to taxpayers' future annual section 965 installments until no 2017 overpayment remains. This is a particularly harsh result for taxpayers, such as individual taxpayers, who may have limited options available to remediate.

In addition, FAQ 14 will also surprise and negatively affect taxpayers who recently made an extension payment with their applications for extension of time to file to also cover their Q1 estimated tax payment. Pursuant to FAQ 14 as it is currently written, the only way a credit elect comes out of 2017 estimated taxes paid to 2018 estimated tax for "section 965(h) taxpayers" is if the credit is larger than the deferred section 965(h) liability. **As a result, these taxpayers must consider whether making a new, separate payment for 2018 Q1 estimated taxes using a 2018 voucher is**

**necessary. If 2018 Q1 estimated taxes have not yet been paid, section 965(h) taxpayers would make separate 2018 Q1 estimated tax payments using a 2018 voucher.**

Further, IRS guidance provides that the second and later section 965 installments are not due until the due dates for their respective returns and do not have to be taken into account for estimated tax purposes. As a result, FAQ 14 has effectively accelerated one and possibly more of these later installment payments.

Due to FAQ 14, taxpayers who fully accounted for their first annual section 965 liability installment in their estimated taxes paid for 2017 **and have not yet made this second payment** would not make a second payment and instead would allow the IRS to follow the procedures outlined in new FAQs 13 and 14.

Corporate taxpayers who fully accounted for their first annual section 965 liability installment in their estimated taxes paid for 2017 **and have made this second payment** would, if applicable and available, seek a “quick refund” of their overpayment of estimated taxes by filing Form 4466, *Corporate Application for Quick Refund of Overpayment of Estimated Tax*. **Because section 6425 requires that a Form 4466 be filed by the original unextended due date of a corporation’s return and before the day on which the corporation files its return, affected corporate taxpayers who intend to file their returns by the original unextended due date, in this case Tuesday, April 17, 2018, would not file their return until April 17, 2018, and file their Form 4466 on Monday, April 16, 2018. Affected corporate taxpayers who intend to file their returns by their extended due date after April 17, 2018, could file their Form 4466 no later than Tuesday, April 17, 2018.**

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