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IRS Chief Counsel memo: Overpayments and section 965(h)

An IRS Chief Counsel memorandum (dated August 2, 2018) was issued to address certain taxpayer questions about overpayments and section 965(h).

The questions addressed in the memorandum concern instances when taxpayers made elections under section 965(h) to pay the transfer tax in installments, and also had made estimated tax payments with respect to their 2017 income tax liability (before enactment of section 965 in the new tax law in late December 2017) of amounts greater than the portion of their 2017 income tax liability not subject to payment in installments and their first installment payment of their section 965(h) net tax liability.

The [IRS Chief Counsel memo](#) [PDF 131 KB] explains that the IRS:

- Will apply any excess amount to the next successive annual installment due in 2019, and to the extent such excess exceeds the amount of that installment due, then to the next such successive annual installment until the excess amount has been fully applied
- Will not refund any excess installment payment to the taxpayer prior to there being an overpayment of the entire liability
- Will not apply its offset refund bypass procedures

As explained in more detail below, while the memorandum addresses the situation when a taxpayer has filed its 2017 return and made the section 965(h) election to pay the section 965 tax in installments, the analysis in the Chief Counsel memo does not address the situation of taxpayers that have not yet filed their 2017 returns—e.g., those that filed a request for extension of the due date of their 2017 returns.

Background

Section 965—added to the Code by the new tax law (Pub. L. No. 115-97), enacted December 22, 2017—imposes a transition tax, one that requires a mandatory deemed repatriation of previously untaxed earnings of foreign subsidiaries.

Earlier this year, IRS published a list of “questions and answers” (Q&As) relating to section 965 and pertaining to the 2017 tax year.

Question 14 of the Q&As addresses whether taxpayers making an election under section 965(h) could receive refunds of any 2017 payments or estimated tax payments that exceeded the sum of their 2017 net income tax liability described under section 965(h)(6)(A)(ii)—which is the taxpayer’s net income tax liability determined without regard to section 965, plus the taxpayer’s first annual installment pursuant to an election under section 965(h) due in 2018.

Answer 14 states that taxpayers are not eligible for a refund of this amount 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.

Answer 14 further provides that any excess amount paid would instead be applied to the “next successive annual installment (due in 2019), and to the extent such excess exceeds the amount of that installment due, then to the next such successive annual installment (due in 2020), etc.”

Read more about Q&A 14 in [TaxNewsFlash](#)

IRS Chief Counsel memo

According to the IRS Chief Chief memo, taxpayers have expressed concerns with the legal basis for the answer provided in Q&A 14.

Some taxpayers have expressed a desire to obtain a refund of, or apply as a credit to their next year’s estimated tax liability, any amount that exceeds the amount currently due. Questions have also been raised about whether the IRS’s “offset refund bypass” procedures apply.

The IRS Chief Counsel memo examines the IRS’s legal authority to make a credit or refund, and the limited circumstances in which the IRS may exercise that authority. Specifically, it is noted that section 6402(b) does not authorize the IRS to apply any amount as a credit to the succeeding year’s estimated income tax except to the extent that such amount constitutes an overpayment.

The memo continues to explain that section 965 increases the subpart F income of deferred foreign income corporations, and through the operation of section 951, a pro rata share of that income is included in income by the corporations’ United States shareholders in the tax period during which the corporations’ inclusion year ends. This in turn increases a United States shareholder’s income tax liability. While section

965(h)(1) allows a United States shareholder of a deferred foreign income corporation to elect to pay the transfer tax liability in eight installments, it does not permit the United States shareholders to defer recognizing these amounts as income and therefore defer the tax liability. Section 965(h) only permits a deferral of the payment of that liability if the shareholder elects to do so.

Thus, the IRS memo continues to explain that an overpayment under section 6402(a) does not exist with respect to a 2017 income tax liability:

...unless and until the entire liability is fully paid, including any amount of that liability that is subject to an election to pay that income tax liability in installments under section 965(h). Absent an overpayment of the entire tax liability for the 2017 tax period, the [IRS] cannot issue a credit or refund under section 6402(a) with respect to the 2017 tax period.

The memo notes that there may be taxpayers that made elections under section 965(h) to pay in installments, and that made estimated tax payments with respect to their 2017 income tax liability before enactment of the new tax law. Also, it is noted that these taxpayers that remitted more than the sum of the portion of their 2017 income tax liability not subject to payment in installments and their first installment payment of their section 965(h) net tax liability may make an election under section 965(h) to defer payment of the net tax liability under section 965(h)(6) and to pay the tax in installments.

In such instances, the IRS will apply any excess amount to the next successive annual installment due in 2019, and to the extent such excess exceeds the amount of that installment due, then to the next such successive annual installment until the excess amount has been fully applied.

The IRS will not refund any excess installment payment to the taxpayer prior to there being an overpayment of the entire liability. The memo concludes that because there is no overpayment under section 6402 until the entire 2017 tax liability is paid—including all of the installments of the deferred payment—the IRS's offset refund bypass procedures will not apply.

KPMG observation

It is noteworthy that the IRS Chief Counsel memorandum discusses taxpayers that have **made** (note the use of the past tense) an election under section 965(h) to pay the transfer tax in installments, and the memorandum appears to treat the 2017 tax liability relating to the section 965 tax as if it had already been assessed, which typically occurs following the filing of a return. Section 6201(a)(1).

Although Question 14 indicates that the IRS will not refund or credit amounts in excess of tax that would be due with respect to the current year's installment payment following an election under section 965(h), many taxpayers—including those taxpayers that requested extensions of the due date of their 2017 returns—have not

yet filed their 2017 return which allows assessment of the tax. Nor have they made the section 965(h) election as specifically directed by the statute, initial IRS guidance, and the recently proposed section 965 regulations, and required to be made by attaching a statement to the return.

Accordingly, the analysis in the memorandum does not address the common situation of taxpayers that have not yet filed their 2017 returns, and as a result have not yet self-assessed a section 965 liability nor elected section 965(h) treatment for such a liability. A tax liability is not established until the IRS assesses the tax (i.e., makes the required formal bookkeeping entry under section 6203). In other words, the memorandum does not discuss the authority of the IRS to withhold overpaid estimated taxes paid before an actual tax liability being established—it presumes an actual liability that does not yet exist.

So, despite the Chief Counsel memorandum, it remains unclear what authority the IRS relies upon for the practice described in Question 14 of applying amounts against section 965 tax liabilities that have not yet been assessed.

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