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LB&I memo providing updated guidance on the statute of limitations with respect to section 965 examinations

The IRS Large Business and International (LB&I) division released an updated memorandum—LB&I-04-0922-0019 [PDF 179 KB] (September 21, 2022)—for all employees assigned to section 965 examinations to provide updated guidance with respect to the extended statute of limitations for section 965 issues. This guidance updates and supersedes prior guidance provided by LB&I in an interim memorandum, LB&I-04-1120-0200.

Section 965 requires U.S. shareholders to pay a one-time transition tax on the untaxed foreign earnings of specified foreign corporations, as if those earnings had been repatriated to the United States. In general, specified foreign corporations are defined as controlled foreign corporations (CFCs) or a foreign corporation (other than a passive foreign investment company, that is also not a CFC) that has a U.S. shareholder that is a domestic corporation. Section 965 liability is generally applicable to 2017 and/or 2018 tax years, and in some instances the 2019 tax year when involving certain pass-through entities (the "inclusion year"). A taxpayer may elect to pay the transition tax liability in installments over an extended eight-year period.

The transition tax is included in the LB&I's active compliance campaigns, as the "IRC 965 Campaign" and the "IRC Section 965 Individuals Campaign." The goal of these two campaigns is to promote compliance with section 965 by increasing examinations as well as by providing technical assistance to teams examining section 965, with a focus on identifying and addressing taxpayer populations with potential material compliance risk.

Memorandum LB&I-04-0922-0019

Section 965 statute of limitations

The LB&I memorandum provides updated guidance for exam teams on how to apply the extended six-year statute of limitations as provided in section 965(k) with respect to section 965 issues within a return. The memorandum clarifies that the six-year extended statute is only applicable to the section 965 component of the return. According to the memorandum, issues that may warrant an adjustment, unrelated to section 965, are subject to the regular three-year statute of limitations as provided by section 6501(a), or extended statute of limitations applicable to substantial omissions provided by section 6501(e) (another, separate and distinct, six-year statute of limitations which applies to the entire return). *However, a Subpart F oversight in a section 965 calculation can separately trigger application of the assessment period of limitations provided by section 6501(e)(1)(C), keeping the assessment statute open for the entire return for six years.*

Further, the LB&I memorandum clarifies at what point the statute of limitations begins to run in cases involving nuances implicated in section 965. For instance, pursuant to the memorandum, where taxpayers elect to pay the tax liability in installments over an eight-year period, under section 965(h), the six-year statute of limitation begins to run when the return was filed for the inclusion year, i.e., the year the liability was incurred, and not the payment years. However, if a separate section 965 liability arises during a payment year, a new six-year statute of limitations would run with respect to that year. In the case of an S corporation shareholder making an election under section 965(i) to defer liability until a triggering event, the memorandum provides the statute of limitations runs based on the inclusion year, not the triggering event year.

The memorandum provides general recommendations for examiners when approaching a statute of limitations deadline, whether it be a three-year or extended six-year statute of limitations. As explained by the memorandum, the decision to let a statute of limitations expire, rather than solicit an extension from the taxpayer, must be thoroughly documented, discussed, and approved in writing, and be based on the government's best interest. The memorandum does clarify an examination may proceed on a section 965 issue that has its six-year statute of limitations open, but the three-year statute of limitations for the wider return has expired.

Investor level statute control (ILSC) pass-through entities

An ILSC pass-through entity is any S corporation, or partnership that does not fall under the provisions of the "Tax Equity and Fiscal Responsibility Act of 1982" (TEFRA) or elects out of the "Bipartisan Budget Act of 2015" (BBA) provisions. The memorandum provides in such cases that the statute of limitations is generally not controlled at the entity level and that exam teams are responsible for statute of limitations control with respect to all related "investor" returns.

TEFRA partnerships

The memorandum directs employees to refer to Interim Guidance Memorandum LB&I-04-0821-0010 for detailed steps to follow for all TEFRA Partnership cases in the section 965 Campaign or section 965 Individuals Campaign, and in limited circumstances where it is specifically indicated, for cases where a TEFRA Partnership or investor incorrectly calculated 965 net tax liability, or failed to report 965 inclusion, deduction or tax.

BBA returns

The memorandum directs employees to refer to Interim Guidance Memorandum LB&I-04-0821-0009 for detailed steps to follow for all BBA Partnership cases in the 965 Campaign or 965 Individuals Campaign, and any other cases when the BBA partnership incorrectly report or failed to report a 965 inclusion and/or deduction.

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