



*Implementation of the Tax Cuts and Jobs Act
Deemed Repatriation Tax Presented
Significant Challenges*

May 22, 2019

Reference Number: 2019-34-033

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

IMPLEMENTATION OF THE TAX CUTS AND JOBS ACT DEEMED REPATRIATION TAX PRESENTED SIGNIFICANT CHALLENGES

Highlights

Final Report issued on May 22, 2019

Highlights of Reference Number: 2019-34-033 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

On December 22, 2017, the Tax Cuts and Jobs Act (hereafter referred to as the “Act”) was enacted into law. The Act was the most significant revision of the U.S. tax code in more than 30 years, and according to the IRS, implementing the Act is its highest priority.

Among its many provisions, the Act provides for a tax (subject to special tax rates) on U.S. shareholders of specified foreign corporations (and U.S. persons that own interests through domestic pass-through entities that are U.S. shareholders of specified foreign corporations) through a one-time deemed repatriation of foreign accumulated earnings set forth under Section 965 of the Internal Revenue Code. The provision was immediately effective upon enactment and included several retroactive components for Tax Year 2017. The Joint Committee on Taxation estimate for Fiscal Years 2018 through 2027 was that this provision would generate revenue for the U.S. Government of \$338.8 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated to provide a status of the IRS’s progress in implementing the deemed repatriation tax on the post-1986 accumulated earnings and profits of foreign corporations.

WHAT TIGTA FOUND

The retroactive components of Section 965 presented significant challenges for the IRS in implementing the provision. The IRS made reasonable efforts to provide information to external stakeholders to explain Section 965 requirements and the process for filing a Tax

Year 2017 tax return reporting a Section 965 inclusion amount.

However, in issuing guidance, the IRS initially did not specifically address the circumstances when taxpayers made payments in excess of the Section 965 portion of their Tax Year 2017 income liability immediately due and did not clearly inform taxpayers of the implications of making these excess remittances. This resulted in at least 115 taxpayers making \$2.8 billion in payments on their Section 965 liability that they did not intend to make. The IRS explained that the Internal Revenue Code prevents it from refunding any excess remittances until the entire Section 965 liability is paid, even if the taxpayer elected to pay the liability in installments.

Because of the retroactive aspect of this provision, some taxpayers were required to report Section 965 tax on their Tax Year 2017 returns. The IRS had less time to develop a process to identify tax returns reflecting the repatriation tax as well as procedures to process the returns manually. As a result, some taxpayers experienced delays in the processing of their filed returns, and the process established contained risks, such as the proper identification of returns reporting the tax as well as the proper tracking of Section 965 tax payments. For example, as of November 8, 2018, about \$11.2 billion in taxes have been tracked as being paid pursuant to Section 965, which is far below estimates of repatriation tax liability.

WHAT TIGTA RECOMMENDED

TIGTA recommended that if the IRS is unable to refund excess remittances to taxpayers because the entire income tax liability was not overpaid, it should take steps to inform taxpayers that their excess remittances were applied to the deferred Section 965 portion of their income tax liability and inform them of the status of the liability, including when the next installment payment is due. TIGTA also recommended that the IRS take steps to ensure that Section 965 payments were properly recorded and that the IRS establish a comprehensive compliance plan.

The IRS agreed with our recommendations and initiated corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 22, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Implementation of the Tax Cuts and Jobs Act
Deemed Repatriation Tax Presented Significant Challenges
(Audit # 201830429)

This report presents the results of our review to assess how effectively the Internal Revenue Service implemented the Tax Cuts and Jobs Act's deemed repatriation tax on the post-1986 accumulated earnings and profits of foreign corporations.¹ This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of the Impact of Global Economy on Tax Administration.

Management's complete response to the draft report is included as Appendix VII.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

¹ Pub. L. No. 115-97. Officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."



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Abbreviations

AICPA	American Institute of Certified Public Accountants
FAQ	Frequently Asked Questions
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LB&I	Large Business and International
PMTA	Program Manager Technical Assistance
REIT	Real Estate Investment Trust
SERP	Service-Wide Electronic Research Program
TY	Tax Year
W&I	Wage and Investment



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

Background

On December 22, 2017, the Tax Cuts and Jobs Act (hereafter referred to as the “Act”) was enacted.¹ The Act contains 119 provisions that are administered by the Internal Revenue Service (IRS) and affect both domestic and international taxes. The Act was the most significant revision of the U.S. tax code in more than 30 years, and according to the IRS, implementing the Act is its highest priority. IRS officials indicated that they would implement the new law in a way that serves taxpayers, facilitates tax compliance, and protects sensitive data by initially focusing on the following areas:

The IRS’s Strategic Plan for Fiscal Years 2018 through 2022 states that the IRS’s highest priority is implementing the Tax Cuts and Jobs Act.

- Creating new and revised taxpayer forms, instructions, and publications.
- Providing technical support to taxpayers on issues involving interpretations of the law and of related published guidance.
- Training IRS employees on the new law and helping the public, tax professionals, and other industry partners understand how the law applies to them by issuing timely guidance.
- Reprogramming information technology systems, with special focus on return processing and compliance systems (the backbone of the tax system).²

The Act introduced major changes to international tax administration, including changing to a quasi-territorial system for multinational corporations. This includes the introduction of a deemed repatriation of deferred income, the introduction of a tax on global intangible low-taxed income, and the expansion of the base erosions rules. Most of the Act’s provisions took effect in Tax Year (TY)³ 2018 and beyond.

The Act provides for a one-time deemed repatriation tax on U.S. shareholders of specified foreign corporations (Act Provision 14103) set forth under Section 965 of the Internal Revenue Code (I.R.C.).⁴ This tax is imposed on U.S. shareholders (and other U.S. persons that own

¹ Pub. L. No. 115-97. Officially known as “An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018.”

² IRS, Strategic Plan, Fiscal Years 2018 through 2022.

³ See Appendix VI for a glossary of terms.

⁴ A U.S. shareholder, for this purpose, is a U.S. person who owns directly, indirectly, or constructively 10 percent or more of the total combined voting power of all classes of stock of a foreign corporation entitled to vote. A U.S. person is a U.S. citizen or resident or a domestic entity including a partnership, corporation, or estate trust.



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interests through a domestic pass-through entity that is a U.S. shareholder) through a deemed repatriation of post-1986 accumulated earnings and profits and is imposed on the U.S. shareholder's share of such earnings not previously subject to taxation. The Joint Committee on Taxation estimated that, for Fiscal Years 2018 through 2027, this provision would generate revenue for the U.S. Government of \$338.8 billion.

Earnings attributable to cash and cash equivalents under applicable rules are intended to effectively be taxed at a rate of 15.5 percent, while all other assets are intended to be taxed at a rate of 8 percent. Those taxpayers subject to the Section 965 tax may elect under I.R.C. Section 965(h) to pay the tax liability in installments over an eight-year period.

This provision of the Act has retroactive components requiring some taxpayers to report the repatriation income on the last taxable year of the foreign corporation that began before January 1, 2018.⁵ The tax should have been reported on a U.S. person's TY 2017 return if the specified foreign corporation's last taxable year ended on December 31, 2017. If the foreign corporation's tax year ended on or after January 1, 2018, then the Section 965 tax would be reported on the shareholder's TY 2018 return. For example, if the specified foreign corporation's tax year ended on September 30, 2017, its next taxable year would begin on October 1, 2017, and end on September 30, 2018. The U.S. persons would be reporting the Section 965 tax on their TY 2018 tax return. Some taxpayers could be reporting and paying the Section 965 tax on both their TY 2017 and TY 2018 tax returns.

The IRS established the Tax Reform Implementation Office with centralized responsibility for leading the Service-wide, coordinated implementation of the new tax reform provisions. According to the IRS, the Tax Reform Implementation Office is responsible for ensuring a disciplined, project management approach to the planning and execution of this complex initiative, which touches on virtually every organization within the IRS and requires significant changes to tax administration. The Tax Reform Implementation Office also oversees the related forms, publications, information technology systems, training content, and public guidance that needs to be updated or developed to make the implementation of the tax reform provisions a success.

The Large Business and International (LB&I) Division was designated as the operating division responsible for the implementation of the deemed repatriation tax provision, which includes coordinating with the other IRS divisions and functions that have a role in the implementation of this provision. Other IRS organizations with a significant role in the implementation of this provision include:

- The Office of Chief Counsel is responsible for drafting and publishing guidance such as regulations, notices, and revenue procedures.

⁵ I.R.C. Section 965(a).



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- The Wage and Investment (W&I) Division is responsible for establishing procedures for processing the tax returns filed reporting a Section 965 inclusion and responding to taxpayer inquiries on the filing of those returns.⁶
- The Information Technology organization is responsible for making needed system modifications.
- The Small Business/Self-Employed Division is responsible for implementing procedures to monitor the transfer of liability and the future payment of the installment liabilities due from a buyer who enters into an agreement with the IRS accepting liability for the remaining installments due from the taxpayer (transferor). According to the IRS, the transfer of liability occurs after a transfer of substantially all the assets of a taxpayer, which would otherwise accelerate the payment of the remaining liability after a triggering event under Section 965(h)(3) occurs.
- The Chief Financial Officer organization is responsible for the financial reporting of the Section 965 tax assessments, specifically the Section 965(h) outstanding tax liabilities as tax receivables for the IRS Financial Statements. This organization is also responsible for ensuring that the IRS internal controls around Section 965 are developed and maintained by the applicable business operations and that financial reporting on the provisions is accurate and available.

Once the LB&I Division was assigned responsibility for implementing this provision, LB&I Division management was required to develop an implementation action plan. The action plan outlines the steps that need to be taken to implement the provision as well as estimated delivery dates associated with the various steps to be taken for implementation.⁷ The steps needed to implement this provision included the issuance of guidance to taxpayers describing the new law and the requirements, issuance of instructions to taxpayers for filing their TY 2017 tax returns reporting a Section 965 inclusion, development of new tax forms and instructions and modification of existing ones, providing training to IRS employees, and updating the Internal Revenue Manual (IRM).

This review was performed with information obtained from the Tax Reform Implementation Office, the LB&I Division, the Office of Chief Counsel, and the W&I Division. We also performed this review at the W&I Division's Submission Processing function at the Kansas City, Missouri, campus. The review was performed during the period May through October 2018. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions

⁶ The Accounts Management function within the W&I Division is responsible for responding to taxpayer inquiries on the filing of returns.

⁷ TIGTA, Ref. No. 2018-44-027, *Tax Cuts and Jobs Act: Assessment of Implementation Planning Efforts* (Apr. 2018).



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based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

While Significant Efforts Were Taken to Inform Taxpayers and Practitioners, a Lack of Guidance Resulted in Some Corporate Taxpayers Making Payments in Excess of Their First Section 965 Installment Payment Obligation

According to the Taxpayer Bill of Rights, taxpayers have the right to be informed.⁸ They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. The provision of the Act designed to repatriate deferred income from foreign corporations presented challenges for taxpayers because of the retroactive components for TY 2017. The IRS indicated that, due to the limited period of time between the enactment of the Act and the effective dates of this provision, TY 2017 forms, instructions, and comprehensive taxpayer guidance could not be developed in time for the 2018 Filing Season's filing and payment deadlines.

To help overcome these challenges, the IRS issued three notices and one revenue procedure before the filing deadline that provided background on Section 965 and described the various rules and procedures for determining the transition tax that would help those taxpayers subject to the Section 965 tax meet their filing responsibilities.⁹ For instance, Notice 2018-07, *Guidance Under Section 965*, issued on December 29, 2017, provided background on the requirements, provided guidance to those subject to the Section 965 tax, and described regulations that the Department of the Treasury and the IRS intend to issue. Subsequent notices and the revenue procedure provided additional guidance on how to report and pay the transition tax, provided additional rules for the calculation of earnings, and modified the circumstances under which the IRS grants approval for changes in annual accounting periods.¹⁰ The IRS also issued Notice 2018-78, *Additional Guidance Under Section 965*, on October 1, 2018, announcing that the due date for the basis election that would otherwise be required before the final regulations are published will be extended to 90 days after the publication of the final regulations. The notice also announced that relief would be provided to taxpayers affected by Hurricane Florence. In the issued notices, the IRS solicited stakeholder comments and concerns for consideration.

⁸ I.R.C. Section 7803(a)(3).

⁹ Notices are public pronouncements which may contain guidance that involves substantive interpretations of the I.R.C. or other provisions of the law. Revenue procedures are official statements of a procedure that affects the rights or duties of taxpayers or other members of the public under the I.R.C., related statutes, tax treaties, and regulations that should be a matter of public knowledge. A revenue procedure provides return filing or other instructions concerning an IRS position.

¹⁰ See Figure 1 for further description of the subsequent notices and the revenue procedure.



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On March 13, 2018, the IRS posted a frequently asked questions (FAQs) document at www.irs.gov providing instructions to taxpayers for reporting their Section 965 tax obligations on their TY 2017 tax returns.¹¹ This document also provided instructions for making a separate payment relating to the Section 965 tax. The IRS revised this document a number of times: on April 13, 2018, to address questions on the overpayment of taxes; on June 4, 2018, to include late payment penalty relief; and on November 6, 2018, to provide information on filing transfer agreements. To correlate with the FAQs document, the IRS published a guide (Publication 5292, *How to Calculate Section 965 Amounts and Elections Available to Taxpayers*) on April 6, 2018, for calculating the Section 965 tax amounts. However, the IRS issued the filing instructions (both the FAQs and Publication 5292) several weeks after the filing season started, which left little time for most taxpayers to comply with their filing obligations given the complexity of Section 965. IRS officials indicated that they could not provide the information earlier because of the time needed to work through the programming issues with the Information Technology organization and the W&I Division so they could properly process the tax returns reporting the Section 965 tax and payments.

For most taxpayers, including individuals and C corporations, the deadline for filing the TY 2017 tax return and submitting payment for any taxes owed was April 17, 2018.¹² For other taxpayers such as partnerships and S corporations, the filing deadline for calendar year taxpayers was March 15, 2018. All taxpayers had the option of requesting an automatic six-month filing extension, but that does not grant the taxpayer an extension of time for payment of any taxes owed.¹³

Furthermore, the IRS did not provide comprehensive guidance on the preparation of all other tax forms that may have been affected by Section 965, such as Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*. The American Institute of Certified Public Accountants (AICPA) submitted a letter to Acting IRS Commissioner David Kautter on August 28, 2018, requesting the need for guidance in the preparation of Form 5471. In the letter, the AICPA representative stated that the guidance issued to date does not provide taxpayers with information on the reporting requirements related to the TY 2017 filing of Form 5471. The AICPA recommended that the IRS provide automatic relief from penalties incurred by taxpayers that had acted reasonably and made a good faith effort to properly report any required information relating to their Section 965 tax liability on their TY 2017 tax returns.

¹¹ IRS, *Questions and Answers about Reporting Related to Section 965 on 2017 Returns*, dated March 13, 2018, and revised on April 13, 2018, and June 4, 2018. The FAQs document is accessible via the IRS website, www.irs.gov. The IRS told us during our audit that taxpayers that filed prior to the issuance of the March 13 guidance did not have guidance on how to report, properly calculate, pay, and make elections required to comply with Section 965.

¹² This is assuming the corporation's tax year ended on December 31, 2017. A corporation's Form 1120, *U.S. Corporation Income Tax Return*, is due four months and 15 days after the end of the corporation's tax year.

¹³ For individual taxpayers, the fourth quarter estimated tax payment was due on January 16, 2018. For C corporations, the fourth quarter estimated tax payment was due on the fifteenth day of the twelfth month of the C corporation's tax year. For instance, if the C corporation's tax year ended on December 31, 2017, then the fourth quarter estimated tax payment would have been due on December 15, 2017.



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This was in reference to the preparation of Form 5471. The IRS indicated that the filing instructions issued in December 2018 for Form 5471 should have addressed many of the concerns of the practitioners and taxpayers.

The IRS also issued guidance on December 12, 2018, related to TY 2018 tax return filing and payment obligations resulting from Section 965. This included reporting and payment obligations resulting from amounts included in income for TY 2017.¹⁴

The IRS issued a Notice of Proposed Rulemaking, *Guidance Regarding the Transition Tax Under Section 965 and Related Provisions*, to the public on August 1, 2018, and has requested public comments on the suggested changes.¹⁵ This document contained proposed regulations implementing Section 965 of the I.R.C. as amended by the Act and also addressed comments and concerns the IRS received from stakeholders in response to the notices. The final regulations were issued on January 15, 2019, effective as of February 5, 2019.

Figure 1 lists the guidance issued on Section 965 by the IRS since the passage of the Act.

Figure 1: Guidance Issued by the IRS

Date Issued	Document Title	Description
12/29/17	Notice 2018-07, <i>Guidance Under Section 965</i>	Provided background on Section 965, described regulations that the Department of the Treasury and the IRS intend to issue, and provided guidance on determining the aggregate foreign cash position, calculating the Section 965 tax (including guidance regarding the determination of accumulated post-1986 deferred foreign income), and making basis adjustments.
1/19/18	Notice 2018-13, <i>Additional Guidance Under Section 965 and Guidance Under Sections 863 and 6038 in Connection with the Repeal of Section 958(b)(4)</i>	Described regulations that the Department of the Treasury and the IRS intend to issue, including rules addressing the calculation of earnings under the Section 965 tax and other rules to clarify certain aspects of the law. The notice provides taxpayers targeted relief from certain unintended regulatory and reporting consequences arising from a change to existing stock attribution rules in the recent tax legislation and an alternative method for calculating earnings and profits.

¹⁴ IRS, *Questions and Answers about Tax Year 2018 Reporting and Payments Arising under Section 965*, dated December 12, 2018. This FAQs document was accessible via the IRS website.

¹⁵ A Notice of Proposed Rulemaking, a form of IRS guidance, is a public pronouncement which may contain guidance that involves substantive interpretations of the I.R.C. or other provisions of the law. Taxpayers generally may not rely on proposed regulations for planning purposes except if there are no applicable final or temporary regulations in force and there is an express statement in the proposed regulations that taxpayers may rely on them currently.



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Date Issued	Document Title	Description
2/13/18	Revenue Procedure 2018-17, <i>Changes in Accounting Periods and Methods of Accounting</i>	Applies to a Section 965 specified foreign corporation (for purposes of Section 965) seeking changes to its taxable year that ends on December 31, 2017.
3/13/18	Questions and Answers About Reporting Related to Section 965 on 2017 Tax Returns	Contained the FAQs relating to the filing and payment requirements under Provision 14103 of the Act on TY 2017 tax returns. This included the requirement that the taxpayer make a separate payment for the Section 965 liability. The IRS revised this document on April 13, 2018, to address questions on the overpayment of taxes; on June 4, 2018, to include late payment penalty relief; and on November 6, 2018, to provide information on filing transfer agreements.
4/2/18	Notice 2018-26, <i>Additional Guidance Under Section 965; Guidance Under Sections 62, 962, and 6081 in Connection with Section 965; and Penalty Relief Under Sections 6654 and 6655 in Connection with Section 965 and Repeal of Section 958(b)(4)</i>	Describes rules and procedures relating to certain special elections under Section 965 and provides guidance on how to report and pay the transition tax. It also provides relief from certain estimated tax requirements and penalties.
4/6/18	Publication 5292 – <i>How to Calculate Section 965 Amounts and Elections Available to Taxpayers</i>	Provides a workbook to help taxpayers calculate the Section 965(a) inclusions, the Section 965(c) deductions, the paid foreign taxes with respect to the Section 965(a) inclusions, and the portion of such deemed paid foreign taxes disallowed under Section 965(g).
8/1/18	Notice of Proposed Regulations for Section 965	Section 965 proposed regulations.
10/1/18	Notice 2018-78, <i>Additional Guidance Under Section 965</i>	Announced that the due date for the basis election that would otherwise be required before the final regulations are published will be extended to 90 days after the publication of the final regulations. Elections made in the interim will be revocable. Also provides a postponement for taxpayers affected by Hurricane Florence to make elections related to Section 965.



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Date Issued	Document Title	Description
12/12/18	Questions and Answers About Tax Year 2018 Reporting and Payments Arising Under Section 965	Contains the FAQs relating to the filing and payment requirements under Section 965 on TY 2018 tax returns. This includes reporting and payment obligations resulting from amounts included in income for TY 2017.
1/15/19	Regulations Regarding the Transition Tax Under Section 965 and Related Provisions	Section 965 final regulations, effective February 5, 2019.

Source: IRS guidance found on www.irs.gov.

In addition, the IRS indicated that it conducted outreach to provide external stakeholders with information about the Section 965 tax. This included:

- Communicating the potential Section 965 filing and payment obligations to stakeholders, including the Tax Executives Institute, the AICPA, the American Bar Association, and various accounting firms.
- LB&I executives participating in a webinar hosted by a major accounting firm and discussing the status in implementing the international provisions of the Act, including Section 965.
- Hosting an international and corporate roundtable on February 6, 2018, on the tax reform provisions, attended by representatives from outside professional service organizations, to solicit comments and concerns regarding the implementation of the Act, including Section 965.

Considering the complexity of the law and the limited period of time between the enactment of the Act and the effective dates of this provision, we believe that the IRS made a reasonable effort to provide information to external stakeholders that explains Section 965 requirements and the process for filing a TY 2017 tax return reporting a Section 965 inclusion amount. One of the consequences of the limited time available for devising a process for taxpayers to report the Section 965 tax on their tax returns and providing filing instructions is that it did not leave much time for taxpayers to understand the procedures and timely comply with their obligations.

The guidance issued by the IRS resulted in some taxpayers making payments in excess of their Section 965 net tax liability that was due on the date of their TY 2017 return

Because of the timing and order of IRS-issued guidance, some taxpayers attempted to comply with the new IRS guidance by remitting a separate payment for the amount of their Section 965



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net tax liability installment that was due in Calendar Year 2018 but paid more than their first Section 965(h)(1) installment immediately due. These taxpayers may have anticipated that these excess remittances would be treated as overpayments for their TY 2017 income tax liability and that they could request refunds of these excess remittances or elect to use them as credits for their TY 2018 taxes. However, the IRS has taken the position that, under the law, there is no overpayment for the TY 2017 income tax liability until the entire TY 2017 income tax liability is overpaid, including the immediately due portion of the TY 2017 income tax liability plus the payment-deferred Section 965 net tax liability. Furthermore, the IRS has announced that it will apply any amount paid in excess of the then-due installment under Section 965 to any unpaid portion of the TY 2017 income tax liability, including deferred installments under Section 965 not yet due, before allowing a refund or credit election.

As part of the Act, the taxpayer may elect under Section 965(h) to pay the Section 965 tax liability in annual installments over an eight-year period. Some taxpayers included their first installment with their first quarter TY 2018 estimated tax payments. However, the first FAQs document, issued on March 13, 2018, instructed taxpayers to make two distinct payments: one specifically for the tax liability related to Section 965 and the other for their tax liability not related to Section 965. This implied that the taxpayer had to make a second payment for the Section 965 tax even if they had already made sufficient payments to cover the amount of their first Section 965 installment. Some taxpayers that had already included their initial Section 965 liability with their estimated tax payments submitted a second Section 965 tax payment to try to comply with the instructions contained in the FAQs document dated March 13, 2018. Those taxpayers assumed that any payment of the Section 965 installments in excess of the first installment could be refunded or could be applied to their TY 2018 estimated taxes. However, in the FAQs document, revised on April 13, 2018, that included a response to a question regarding the application of overpayments, the IRS indicated:

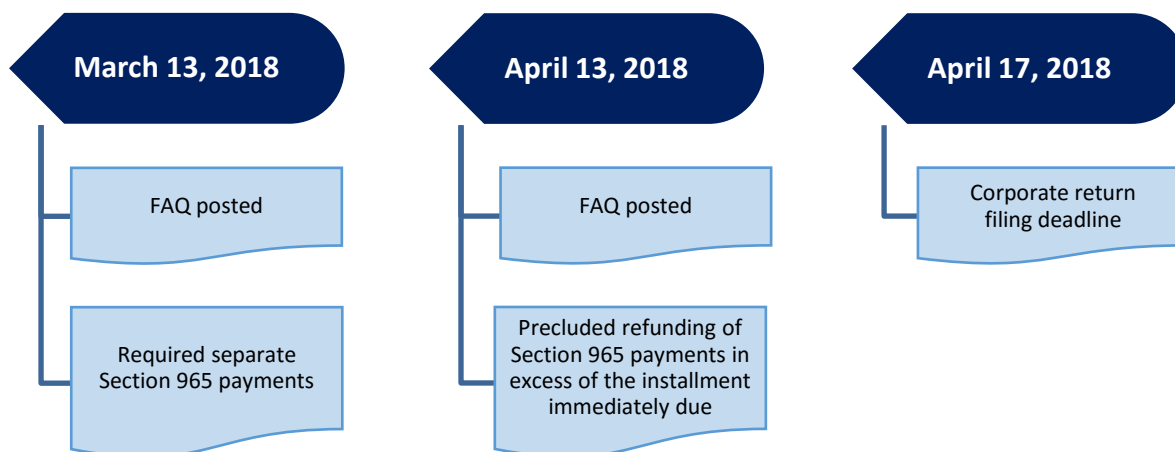
A taxpayer may not receive a refund or credit of any portion of properly applied 2017 tax payments unless and until the amount of payments exceeds the entire unpaid TY 2017 unpaid income tax liability, including all amounts to be paid in installments under Section 965(h) in subsequent years.

Figure 2 shows the timing of the guidance in relation to the filing due dates.



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Figure 2: Timing and Order of Guidance in Relation to Filing Due Dates



Source: TIGTA analysis of the timing and order of IRS Section 965 guidance for TY 2017 calendar year taxpayers.

Taxpayers expressed concerns with the legal basis of the response to the FAQ noted above. For any amount that exceeded the amount currently due, some taxpayers wanted to obtain a refund or apply the amount as a credit to their next year's estimated tax liability. On August 2, 2018, the IRS made public a Program Manager Technical Assistance (PMTA) memorandum addressing overpayments and Section 965.¹⁶ The IRS indicated in the memorandum that, "By its terms, I.R.C. Section 6402(a) does not grant the Service the legal authority to credit or refund any amount except to the extent that an overpayment exists with respect to a liability." It further reasoned that, "Section 965(h) does not permit the United States shareholders to defer recognizing the (installment) amounts as income and therefore defer the tax liability; it only permits a deferral of the payment of that liability if the shareholder elects to do so." It also provided that, "I.R.C. Section 6403 does not permit the Service to refund any excess installment payment to the taxpayer prior to there being an overpayment of the entire liability as provided in I.R.C. Section 6402."

Some corporate taxpayers applied for a quick refund using Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, requesting a refund of their excess estimated income tax payments. In calculating the amount of their excess estimated income tax payments, some taxpayers included only the amount of their first installment of Section 965 net tax liability as part of their income tax liability for the taxable year.¹⁷ However, according to the IRS,

¹⁶ PMTA 2018-016, *Overpayments and I.R.C. Section 965(h)*, dated August 2, 2018. A PMTA memorandum contains the results of a request for non-taxpayer-specific legal advice from the Office of Associate Chief Counsel. A PMTA may not be used or cited as precedent. This specific memorandum was issued to the Commissioner, LB&I Division, from the Associate Chief Counsel (Procedure and Administration).

¹⁷ The function of Form 4466 is to enable corporate taxpayers to receive a refund of excess estimated income tax without having to wait until their tax return is filed. The overpayment must be at least \$500 and at least 10 percent of the expected income tax liability. The form is filed after the end of the corporation's tax year and no later than the unextended due date for filing the corporation's income tax return.



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taxpayers are required to include the full amount of Section 965 net tax liability in their estimate of income tax liability. Accordingly, only those taxpayers that made estimated income tax payments in excess of the full liability would be entitled to a refund. IRS management indicated that, on May 21, 2018, they placed a hold on processing all Form 4466 claims, including those from taxpayers with a Section 965 liability, due to an identity theft scheme involving the filing of Form 4466 and that all claims were suspended while IRM procedures were updated and implemented. The IRS did not provide a notice to explain the status of taxpayers' refund requests. The IRS explained during this audit that legal advice received on reporting Section 965 liabilities on Form 4466 was interpreted as preventing the IRS from issuing refunds on these requests until the Section 965 tax liability is fully paid. According to data provided by the IRS, 115 taxpayers filed a Form 4466 involving Section 965 refund claims totaling \$2.8 billion. Considering the purpose of filing Form 4466, we believe that these taxpayers had made payments on their Section 965 liability that they did not intend to make. Given the large dollar amount, the inability to obtain a refund of overpaid installments could cause a burden to corporate taxpayers that may need those funds to maintain operations. Appendix V contains the complete PMTA.

The implementation of this provision presented challenges to the IRS due to the enactment date of the Act and the retroactive components. In rolling out the guidance, the IRS overlooked the potential for taxpayers to make payments in excess of the Section 965 portion of their TY 2017 income liability immediately due and did not clearly inform taxpayers of the implications of making these excess remittances. This resulted in some taxpayers making payments on their Section 965 liability that they did not intend to make.

Recommendation

Recommendation 1: The Deputy Commissioner for Services and Enforcement should ensure that, if it is unable to refund excess payments to taxpayers because the entire income tax liability was not overpaid, the IRS takes steps to inform taxpayers that their excess payments will be applied to the deferred Section 965 portion of their income tax liability and inform them of the status of the liability, including when the next installment payment is due.

Management's Response: The IRS agreed with this recommendation and, in the 2018 Filing Season, issued manual notices to inform taxpayers of how their payments in excess of liabilities were applied to their Section 965 balance due and how this process was automated for the 2019 Filing Season. In March 2019, the IRS began issuing installment payment reminder notices to reach taxpayers before the mid-April payment due date. The IRS will continue to issue these notices annually until the taxpayer's Section 965 balance is paid or the balance is accelerated and made due immediately.



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The Processing of Tax Year 2017 Tax Returns Reporting the Section 965 Tax Presented Significant Challenges

The IRS indicated that the Tax Forms and Publications function, the Information Technology organization, and the W&I Division's Submission Processing function normally need at least 18 months to develop and program the intake requirements for a tax form. Because of this, the IRS needed to develop procedures for processing the TY 2017 tax returns filed reporting Section 965 tax during the 2018 Filing Season. The IRS identified several risks related to processing returns and payments submitted by taxpayers arising under Section 965, including the ability to:

- Identify all tax returns with Section 965 issues present.
- Successfully complete manual processing of returns through the error resolution process.
- Successfully complete manual processing to allow proper taxpayer account correction and management (including amended return processing).
- Successfully build systems to track amounts from TY 2017 that are owed, paid, deferred under Section 965 during TY 2017 and periods beyond under installment plans, or indefinitely deferred.

During the 2018 Filing Season, the IRS accepted tax returns reporting a Section 965 net tax liability, but the returns were held until programming was in place to properly identify and record the data. After the filing guidance was issued on March 13, 2018, the IRS issued a Service-Wide Electronic Research Program (SERP) Alert¹⁸ on March 19, 2018, notifying Submission Processing personnel of the method to identify tax returns filed reporting Section 965 tax and advising that those returns were to be held in the Error Resolution System until processing changes were finalized.

For all paper tax returns filed, IRS Submission Processing employees had to manually review the tax returns for any indication that the return reported Section 965 tax. There was the risk that some returns would not be identified if the taxpayers did not follow the filing instructions or if the IRS employees were not aware of the procedure. The IRS identified Section 965 tax returns filed electronically by systemically searching the return for the string "965." If the numbers "965" appeared in the taxpayer's address, bank account number, or anywhere on the tax return, it would have been falsely identified as a Section 965 tax return and would not have been processed timely, creating a burden for those taxpayers, especially those expecting a tax refund. If "965" was omitted from the return, it would not have been identified. Once the IRS identified the tax returns, they were held in management suspense until processing procedures were implemented and they could be processed.

¹⁸ SERP Alert 18A0105, dated March 19, 2018.



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Processing of Section 965 payments

The filing guidance issued on March 13, 2018, directed taxpayers to make a separate payment for their Section 965 liability and to note the payments as a Section 965 payment.¹⁹ The IRS issued a SERP alert on the procedures for processing Section 965 payments, instructing Submission Processing employees to designate the payment with a payment code designed to track the amount of Section 965 tax paid.²⁰ If the taxpayer submitted the payment with the tax return, the IRS would have processed the payment to the tax account while the processing of the tax return was suspended. However, this SERP alert was not issued until April 6, 2018, increasing the risk that Section 965 payments were not properly processed because payments may have already been received. If taxpayers did not make the payments according to IRS guidance or Submission Processing personnel did not process the payments correctly, there is a risk that Section 965 revenue will be understated.

During this audit, we selected a judgmental sample of 19 corporations and reviewed their tax account information to determine if they had a TY 2017 Section 965 filing obligation and if any Section 965 payments were processed with the Section 965 designated payment code.²¹ Our analysis found that payments totaling approximately \$1.2 billion made by *1* corporations were not processed with the Section 965 payment code.²² The IRS explained that it processed the payments correctly; however, in these cases, it applied overpayments to the unpaid portion of the Section 965 liability, and those payments were not recorded with the Section 965 payment code.

Even though we were able to review only a small sample of payments during this audit, we determined that the processing of these payments has presented a challenge for the IRS to record the Section 965 payments accurately. The IRS should take steps to ensure that these payments are accurately recorded. This could include reviewing the processing of the payments as the tax returns are processed.

Processing of tax returns reporting the Section 965 tax

In March 2018, the IRS's Chief Financial Officer identified the following significant risks related to the processing of tax returns reporting the Section 965 tax:

- If the TY 2017 returns with Section 965 tax reporting, payment election, and payment designations are not validated using the submission systems due to late legislative

¹⁹ Some corporate taxpayers may have included their Section 965 payment with their fourth quarter estimated tax payment that was due on December 15, 2017.

²⁰ SERP Alert 18A0118, dated April 6, 2018.

²¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We judgmentally selected corporations that may have had a Section 965 obligation.

²² For the remaining *1* corporations reviewed, we found that, in *1* instances, the processing of the return was not completed and we did not have information that would allow us to make a determination. For the other *1* corporations reviewed, either they: 1) did not have a Section 965 obligation or 2) their tax return reporting the obligation was not yet filed.



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

enactment for Processing Year 2018 and rely on manual validation and transcription into the tax administration systems, then the financial accounting and reporting of the Section 965 tax assessed and Section 965(h) unpaid assessments (current and delinquent) may be prone to human error.

- If the backend processing in business operations and information technology programming requirements to account, report, and monitor Section 965 eight-year payment elections are not developed, then the current and delinquent Section 965 unpaid assessments may not be accurate on taxpayer accounts and financial reporting.

The IRS developed procedures and instituted midyear programming changes for the manual processing of TY 2017 returns reporting Section 965 tax. The new programming included the capability to manually input and post transaction codes to record the total Section 965 tax liability to the taxpayer's tax account, which would systemically generate the amount of deferred tax. For instance, the deferred amount for Individual Master File tax returns will systemically generate when a tax examiner manually processes the tax return information.

As of July 13, 2018, the IRS estimated that the total number of Individual Master File and Business Master File tax returns suspended for potential "965" screening by Submission Processing employees in relation to Section 965 was 3,400 returns. After the manual screening process, we estimate that 353 tax returns were identified as false positives and potentially were not processed timely nor tracked further by the IRS. The IRS advised us that it completed testing on the functionality of the programming changes on July 26, 2018, and started manually processing the returns. The IRS tested 10 Individual Master File and five Business Master File returns and found that the functionality was working as expected. We tested an additional eight Individual Master File returns and found that six were correctly processed. The other two returns had yet to be processed because the taxpayer's entries differed from what was covered in the IRM instructions and required the assistance of the LB&I Division.

As of November 8, 2018, the IRS advised us that 30,858 tax returns reporting \$30.2 billion in Section 965 tax had been manually processed, of which \$22.7 billion was deferred. According to the IRS, a total of \$11.2 billion of Section 965 tax had been paid.²³ However, according to our analysis, that amount could be understated.²⁴ Figure 3 contains the number of returns received thus far along with the Section 965 tax reported, deferred, and paid.

²³ The IRS suggested caution in the use of these preliminary numbers. The IRS expects significant changes to these numbers as tax returns that were filed at the filing extension deadline in October 2018 are being manually processed. It is also conducting an extensive post-filing return analysis to identify and adjust tax accounts for available credits and to identify omissions and errors. The IRS indicated that it would have more complete and reliable information after the extension filing deadline and completion of its post-filing analysis.

²⁴ The amount reflects payments designated by taxpayers for their Section 965 tax liability and includes payments submitted by taxpayers that have not filed the associated tax return yet.



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

Figure 3: Section 965 Tax Reported and Paid as of November 8, 2018

Description	Total
Number of Section 965 Returns Identified and Processed as of November 8, 2018	30,858
Section 965 Liability Reported ²⁵	\$30.2 billion
Section 965 Tax Deferred ²⁶	\$22.7 billion
Section 965 Tax Paid ²⁷	\$11.2 billion

Source: IRS Chief Financial Officer and W&I Division
Section 965 data extracts.

While IRS management has not established related quality review procedures, they are confident that the steps taken and established treatment streams will ensure that the TY 2017 tax returns are properly processed. They indicated that they selected a very small number of their most experienced tax examiners to manually process these returns and made Submission Processing analysts and LB&I Division experts available for processing questions. They also believe that standard treatment streams are in place in case an error is made processing the tax returns, including the Notice Review function's review of notices and refunds and the Error Resolution System addressing unpostable conditions as well as taxpayers contacting the IRS when they believe a tax return was processed incorrectly.

The W&I Division indicated that backend processing is still under discussion and may include other proactive measures to monitor Section 965 tax accounts with deferred tax and credit balances. The IRS's Chief Financial Officer reported on August 31, 2018, that there are still significant challenges remaining with the implementation of the backend processing and monitoring that could jeopardize the success of the Section 965 implementation if the mitigation actions fail.

The IRS is anticipating the 2019 Filing Season to be a smoother process because the available captured data from the tax returns will systemically generate the information needed to record the Section 965 tax liability and maintain the eight-year payment election. It also requested programming to generate an installment notice to taxpayers in advance of the installment due date. The payment stub provided with the notice will be used to identify installment payments to

²⁵ The total amount of Section 965 tax liability reported on the filed tax returns.

²⁶ This amount is the deferred Section 965(h) tax amount reported on the filed tax returns.

²⁷ The sum of payments processed with the Section 965 payment code. If the Section 965 payment was not processed with the designated payment code, it would not be included in this amount.



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be processed with the designated payment code. The IRS also requested programming to systemically reverse the deferred tax amount once an installment payment is received.

Recommendation

Recommendation 2: The Commissioner, W&I Division, should take steps to ensure that Section 965 payments are recorded with the correct designated payment code. For instance, develop a report that lists the amount recorded as the Section 965 net tax liability and the amount recorded as owed and compares the difference between the two amounts to the amount recorded as paid.

Management's Response: The IRS agreed with this recommendation and stated that a report that compares the net Section 965 tax liability with the deferral amount will not recognize scenarios in which accounts may be underpaid, or transferrable credits from other tax account modules are used to offset the liability. To meet the intent of the recommendation, the IRS will develop a methodology to accurately recognize Section 965 liabilities, total Section 965 credits, and total remaining Section 965 taxes deferred. Programming resources will be required to implement the reporting methodology. The IRS anticipates that the reports will be available by January 2020. However, budgetary limitations and competing priorities for information technology resources prevent it from specifying an implementation date.

Delayed Delivery Deadlines for Tax Forms and Instructions Did Not Affect Readiness for the 2019 Filing Season

The implementation of this provision required the development of new forms and supporting schedules and the modification of others so that taxpayers can comply with their Section 965 obligations starting with their TY 2018 tax returns. This provision also required the development of related instructions that will assist taxpayers in meeting the filing requirements.

The Tax Forms and Publication function and the LB&I Division reviewed the new legislation and identified the tax forms and instructions that needed to be developed and updated. The IRS has developed a package of new forms with supporting schedules along with the corresponding instructions related solely to Section 965 reporting requirements. For example, the following are three of the new tax forms the IRS is creating to assist taxpayers in complying with Section 965 filing requirements:²⁸

- Form 965, *Inclusion of Deferred Foreign Income Upon Transition to Participation Exemption System*, will be used by taxpayers to calculate the Section 965(a) inclusion, calculate the 965(c) deduction, and report the elections made.

²⁸ These new form titles are subject to change until they are finalized.



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- Form 965-A, *Individual Report of Net 965 Tax Liability*, will be used by individual taxpayers to report the net Section 965 tax liability and election to pay in installments, record the amount of net Section 965 tax liability paid, compute the net Section 965 tax liability related to Section 965 amounts from an S corporation, and report the net Section 965 tax deferred related to Section 965 amounts allocated from the S corporation.
- Form 965-B, *Corporate and Real Estate Investment Trust (REIT) Report of Net 965 Tax Liability and Electing REIT Report of 965 Amounts*, will be used by corporate taxpayers and REITs electing to report a taxpayer's net 965 liability for each tax year in which a taxpayer must account for section 965 amounts.

The related schedules for the above Forms 965 encompass information pertinent to the reporting of various amounts such as the Section 965(a) inclusion amount, deferred foreign income corporation's earnings and profits, U.S. shareholder's aggregate foreign earnings and profits deficit, and U.S. shareholder's aggregate foreign cash position. The IRS is also in the process of developing Form 965-C, *Transfer Agreement Under 965(h)(3)*, and Form 965-D, *Transfer Agreement Under 965(i)(2)*.

The IRS's original goal was to have the new and revised forms and instructions related to the reporting of Section 965 information finalized and published by December 10, 2018. The final Forms 965, 965-A, and 965-B and related schedules were released on or before December 20, 2018, and posted at www.irs.gov (and therefore available to the public) a day or two after. The IRS did not make the final instructions related to those forms available to the public until January 2019. Forms 965-C and 965-D were in draft status as of March 2019.

The IRS also developed several new lines within Form 1040, *U.S. Individual Income Tax Return*, that will include the reporting of Section 965 amounts calculated using the Forms 965 previously noted. According to W&I Division personnel, the information from the Form 1040 schedules should relieve the processing challenges that they faced processing the TY 2017 returns. Similar changes were made to the Form 1120 series²⁹ of tax returns for corporations that require the reporting of Section 965 amounts. There were also modifications made to other existing forms, such as Form 5471, that will require the taxpayer to report information related to Section 965. Furthermore, the IRS also developed three new schedules for calculating amounts to be reported on Forms 1116, *Foreign Tax Credit*, and 1118, *Foreign Tax Credit – Corporations*, to determine disallowed foreign taxes.

²⁹ Various corporate income tax returns, such as Form 1120, *U.S. Corporation Income Tax Return*, and Form 1120S, *U.S. Income Tax Return for an S Corporation*.



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

The Internal Revenue Service Faces Significant Challenges Ensuring Compliance With the Section 965 Repatriation Tax

Section 965 is expected to be one of the most significant revenue raisers of the Act, with projected revenue of \$338.8 billion in Fiscal Years 2018 through 2027. While the LB&I Division has taken actions to ensure that taxpayers are aware of their Section 965 filing responsibilities, we believe that actions need to be taken to more fully identify and address those taxpayers that do not comply. To that end, the LB&I Division needs to develop and document a comprehensive Service-wide compliance strategy.

One of the goals of the IRS's Strategic Plan for Fiscal Years 2018 through 2022 is to protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code. A supporting objective is to identify and plan for compliance risks proactively, which includes creating comprehensive strategies to prevent and address noncompliance in high-risk areas. An example cited is the LB&I Division's compliance campaigns that, according to the LB&I Division, involve a more thorough analysis of data to support the identification and evaluation of a compliance issue; a more deliberate consideration of potential treatment streams; decisions about the resources to be deployed; identification of training, mentoring, networking, and tools needed; and a robust feedback mechanism to ensure that all elements of a campaign are continuously improved.

The LB&I Division has stated that it continues to move toward issue-based examinations and a compliance campaign process in which the organization decides which compliance issues that present risk require a response in the form of one or multiple treatment streams to achieve compliance objectives. The LB&I Division indicated that this approach makes use of IRS knowledge and deploys the resources to address those issues. The LB&I Division announced a Section 965 Transition Tax campaign on July 2, 2018.

During this audit, the LB&I Division acknowledged that, in addition to the customer service and operational risks, it faces significant challenges with the ability to detect and respond to taxpayer noncompliance with Section 965 for TY 2017. The LB&I Division indicated that, because there was insufficient time available to draft regular IRS forms due to the limited time period between the enactment and effective dates, the IRS:

- Did not have the appropriate time to develop a comprehensive compliance strategy (including information reporting) prior to the period when TY 2017 tax returns are filed.
- May not have the data it needs to properly identify and analyze compliance risks on the TY 2017 returns.
- May not be able to correlate data and payments it receives related to TY 2017 Section 965 payments (*e.g.*, elections to defer tax) in future years.



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- May not have the appropriate resources and training for its employees on Section 965 for them to properly identify and assess Section 965 liabilities, especially for Compliance Assurance Program taxpayers.
- May not have the appropriate networks in place to share knowledge, capture feedback, and provide assistance to employees on this provision.

Use of Form 5471 data to identify taxpayers subject to Section 965

The LB&I Division has the ability to identify a large number of filers that should have reported Section 965 inclusion on their tax returns. LB&I Division management indicated that, upon passage of the Act, they analyzed Form 5471 data filed during prior years to identify taxpayers that may be subject to the Section 965 tax. They indicated that, if a taxpayer filed a Form 5471 with their tax return, it might indicate that they were a shareholder in a certain foreign corporation during that tax year and could have a Section 965 obligation. The Act treats certain foreign corporations (known as specified foreign corporations) as having immediately repatriated all previously deferred and untaxed earnings and profits.

The LB&I Division analyzed the post-1986 accumulated earnings and profits information reported on the Form 5471 as well as the retained earnings data that allowed it to identify approximately 52,000 tax returns for which taxpayers may be subject to Section 965. The LB&I Division emphasized to us that this information would help identify some but not all taxpayers subject to Section 965. Figure 4 contains our estimate of the information provided of the potential filing populations by segment.

Figure 4: Potential Filing Population

Filing Segment	Potential Number of Filers That May Have Section 965 Inclusion
1040³⁰	27,000 ³¹
1120	14,000
1120S³²	3,000
1065	7,600
Total	51,600

Source: Our estimate of the LB&I Division's analysis of Form 5471 data.

³⁰ The LB&I Division indicated that these results are based on its analysis of electronically filed tax returns only.

³¹ The LB&I Division indicated that these results could be inflated if two spouses filed Forms 5471 separately.

³² Entities such as domestic partnerships and S corporations are not liable for tax under Section 965 but must report required Section 965 information on Form 1120S and Form 1065, *U.S. Return of Partnership Income*. The partners (but only if they themselves qualify as U.S. shareholders) and S corporation shareholders (regardless of the amount of ownership interest) would then make the elections.



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The LB&I Division considered using this information to send letters to taxpayers during the 2018 Filing Season to notify them of their potential obligations. However, it did not, partly because this would not include all potential taxpayers subject to Section 965 and would include some taxpayers not subject to Section 965. Instead, the IRS decided to adopt a broader communications strategy that reached out to potential taxpayers through various industry associations and taxpayer representatives. Nonetheless, we believe these data provide the IRS with an opportunity to identify many taxpayers that may be subject to Section 965 filing requirements and could provide part of the basis of a strategy to ensure compliance.

Monitoring of taxpayers that default on elections to defer tax

According to the Act, the taxpayer may elect to pay a Section 965 tax liability in installments over an eight-year period. If the taxpayer defaults on the payment of an installment and is assessed an addition to tax for failure to timely pay an installment, then the unpaid portion of all remaining installments becomes due. Processing changes made by the IRS will enable it to monitor taxpayer compliance with the deferral election. W&I Division personnel indicated that they will be able to identify those taxpayers with deferral elections and may send annual letters reminding them of the payment requirement. However, the IRS has yet to implement procedures to identify those taxpayers that default on the payment requirement, but W&I Division personnel indicated that they are working with other IRS divisions to establish these procedures.

According to the IRS, the Small Business/Self-Employed Division³³ is in the process of detailing the actions needed to monitor whether an installment payment was made timely and, if not, whether the taxpayer had reasonable cause for not making the installment payment timely. The IRS indicated that if the taxpayer does not have reasonable cause, it will assess a failure to pay penalty and accelerate the liability.

In addition, the law provides that shareholders of S corporations can make a different election to defer the payment of tax. They can defer the payment of tax until a triggering event, such as the corporation ceasing to be an S corporation. With the new programming changes, the IRS needs to determine the feasibility of monitoring the shareholders to ensure that they are still able to defer this tax.

Prior to the Act, the United States applied a 35 percent tax rate to the global earnings of U.S. multinational companies but allowed them to defer paying taxes on offshore income until they repatriated it. As a result, these companies have amassed substantial amounts of undistributed earnings in controlled foreign corporations. The Joint Committee on Taxation estimate for Fiscal Years 2018 through 2027 was that the Section 965 Repatriation Tax would generate revenue for the U.S. Government of \$338.8 billion. A total of \$78.6 billion was projected for Fiscal Year 2018 alone. As of November 8, 2018, about 31,000 tax returns

³³ According to the IRS, the Small Business/Self-Employed Division is responsible for monitoring whether an installment payment was timely made and determining the actions to take when it is not.



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reporting Section 965 tax have been identified and processed by the IRS and about \$11.2 billion has been paid. It is essential that the IRS develop a Service-wide compliance strategy to ensure compliance with Section 965 of the Act. Without a documented, comprehensive strategy, the IRS cannot ensure that current and future efforts are effective in fully addressing noncompliance with Section 965 filing requirements.

Recommendation

Recommendation 3: The Deputy Commissioner for Services and Enforcement should develop and document a comprehensive compliance plan that, at a minimum, includes:

- A strategy to identify taxpayers that did not properly comply with Section 965.
- An assessment of the benefit of issuing notices to those taxpayers that may be subject to Section 965 filing requirements according to Form 5471 information.
- Procedures to monitor those taxpayers that elected to defer tax.
- Validation of Section 965 data reported by the taxpayer.
- Steps to ensure that taxpayers did not violate anti-abuse rules. For instance, if a U.S. shareholder becomes an “expatriated entity” at any point during the 10-year period following the enactment of the law, the reduced rates are recaptured and the shareholder is subject to a retroactive 35 percent rate.

Management’s Response: The IRS agreed with this recommendation and has been working to develop and document a comprehensive compliance plan that will consider each of the elements of this recommendation and other aspects of compliance with this provision. With respect to assessing the benefit of issuing notices to Form 5471 filers, the IRS stated that it previously considered this in a pre-filing environment and will continue to evaluate whether such a strategy would be appropriate in a post-filing environment. The IRS has developed procedures to monitor the various elections available to taxpayers under Section 965 and will continue to evaluate potential enhancements to these procedures. The validation of the Section 965 data is an ongoing and important component of IRS compliance strategy, as is ensuring compliance with the anti-abuse rules.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess how effectively the IRS implemented the Tax Cuts and Jobs Act deemed repatriation tax on the post-1986 accumulated earnings and profits of foreign corporations.¹ To accomplish our objective, we:

- I. Determined whether the IRS took the necessary actions and properly implemented the Tax Cuts and Jobs Act deemed repatriation tax on the post-1986 accumulated earnings and profits of foreign corporations.
 - A. Identified the actions taken by the IRS to implement the provision. We identified the:
 1. Guidance provided to taxpayers and practitioners.
 2. Development of new and revised forms, schedules, instructions, or publications.
 3. Computer programming requirements.
 4. Employee training.
 5. IRM updates and revisions.
 - B. Interviewed IRS personnel regarding the actions taken by the IRS to implement this provision. We spoke with personnel from the:
 1. Tax Reform Implementation Office.
 2. LB&I Division.
 3. W&I Division.
 4. Office of Chief Counsel.
 5. Information Technology organization.
 6. Chief Financial Officer organization.
 - C. Identified and evaluated the procedures developed by the IRS for processing returns filed by taxpayers reporting a Section 965 liability for TY² 2017.
 1. Interviewed and corresponded with W&I Division Submission Processing personnel at the Kansas City campus and identified the procedures for processing

¹ Pub. L. No. 115-97. Officially known as “An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018.”

² See Appendix VI for a glossary of terms.



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

TY 2017 tax returns that reported Section 965 tax. This included the procedures for tracking and ensuring compliance with Section 965(h) installment payments and the processing of payments in excess of the Section 965 net tax liability.

2. Obtained copies of eight tax returns filed at the Kansas City Campus by taxpayers reporting a Section 965 liability and assessed whether the IRS processed them correctly.
3. Selected a judgmental sample of 19 corporations, reviewed their tax account information on the Integrated Data Retrieval System, and determined if any Section 965 payments were recorded with the correct payment code.³ We reviewed information from the Fiscal Year 2017 Form 1120, *U.S. Corporation Income Tax Return*, for 11 of the 19 corporations to supplement our analysis.
4. Obtained from the W&I Division a listing of 115 taxpayers that filed a Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, involving Section 965 refund claims totaling \$2.8 billion.⁴
5. Obtained statistical information from the Chief Financial Officer and the W&I Division on the number of TY 2017 tax returns reporting a Section 965 liability that were processed.
6. Interviewed and corresponded with LB&I personnel regarding the development of procedures and their responsibility in monitoring the processing of TY 2017 tax returns.
7. Interviewed and corresponded with Taxpayer Advocate Service personnel regarding issues raised by taxpayers reporting a Section 965 liability.

II. Determined whether the IRS established a compliance plan to ensure that taxpayers complied with Section 965 filing requirements.

- A. Interviewed LB&I personnel and determined if a compliance plan was established and whether any systemic filters had been developed or were being developed to identify noncompliance.
- B. Obtained and analyzed the results from LB&I's analysis of Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, information filed with the Forms 1040, *U.S. Individual Income Tax Return*; Forms 1065, *U.S.*

³ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We judgmentally selected corporations that may have had a Section 965 obligation.

⁴ The function of Form 4466 is to enable corporate taxpayers to receive a refund of excess estimated income tax without having to wait until their tax return is filed. The overpayment must be at least \$500 and at least 10 percent of the expected income tax liability. The form is filed after the end of the corporation's tax year, and no later than the unextended due date for filing the corporation's income tax return.



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Return of Partnership Income; Forms 1120; Forms 1120S, *U.S. Income Tax Return for an S Corporation*, and Forms 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts*, from TYs 2014 through 2017 conducted after passage of the Act to identify those taxpayers that might be subject to Section 965 filing requirements.

- III. Reviewed the IRS's responses and reactions to comments and concerns noted by internal and external stakeholders during an April 23, 2018, LB&I International Practice Network to comments submitted to the Office of Chief Counsel and the LB&I Division in response to issued guidance, and to concerns identified by monitoring news outlets and forums.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the IRS procedures for implementing the tax law, processing tax returns reporting Section 965 tax, and ensuring compliance with Section 965 filing requirements. We accomplished this by interviewing and corresponding with IRS personnel and reviewing key system documentation related to the tracking of tax provisions included in the Tax Cuts and Jobs Act.



*Implementation of the Tax Cuts and Jobs Act Deemed
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Appendix II

Major Contributors to This Report

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*Implementation of the Tax Cuts and Jobs Act Deemed
Repatriation Tax Presented Significant Challenges*

Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Large Business and International Division
Commissioner, Wage and Investment Division
Chief Counsel
Chief Financial Officer
Chief Information Officer
Director, Office of Audit Coordination



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 115 taxpayers filed a Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, involving Section 965 refund claims totaling \$2.8 billion (see page 5).¹

Methodology Used to Measure the Reported Benefit:

Some corporate taxpayers applied for a quick refund with a Form 4466, requesting a refund of their excess estimated income tax payments. In calculating the amount of their excess estimated income tax payments, some taxpayers included only the amount of their first installment of Section 965 net tax liability as part of their income tax liability for the taxable year. However, according to the IRS, taxpayers are required to include the full amount of Section 965 net tax liability in their estimate of income tax liability. Accordingly, only those taxpayers that made estimated income tax payments in excess of the full tax liability would be entitled to a refund. IRS management indicated they placed a hold on processing all Form 4466 claims, including those from taxpayers with a Section 965 liability, on May 21, 2018, due to an identity theft scheme involving the filing of Forms 4466 and that all claims were suspended while IRM procedures were updated and implemented. The IRS did not provide a notice to explain the status of taxpayers' refund requests. The IRS explained that legal advice received on reporting Section 965 liabilities on Form 4466 was interpreted as preventing the IRS from issuing refunds on those requests until the Section 965 tax liability is fully paid. According to data provided by the IRS, 115 taxpayers filed a Form 4466 involving Section 965 refund claims totaling \$2,838,004,061. This could cause a burden to corporate taxpayers that may need those funds to maintain operations.

¹ The function of Form 4466 is to enable corporate taxpayers to receive a refund of excess estimated income tax without having to wait until their tax return is filed. The overpayment must be at least \$500 and at least 10 percent of the expected income tax liability. The form is filed after the end of the corporation's tax year, and no later than the unextended due date for filing the corporation's income tax return.



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

Type and Value of Outcome Measure:

- Reliability of Information – Potential; \$1.2 billion for *1* taxpayers for which the Section 965 tax paid during TY 2017 was not properly recorded on the tax account (see page 13).

Methodology Used to Measure the Reported Benefit:

Guidance was not issued until April 6, 2018, increasing the risk that Section 965 payments were not properly processed because payments may have already been received. If taxpayers did not make the payments according to IRS guidance or Submission Processing personnel did not process the payments correctly, there is a risk that Section 965 revenue will be understated.

During this audit, we selected a judgmental sample² of 19 corporations and reviewed their tax account information to determine if they had a TY 2017 Section 965 filing obligation and if any Section 965 payments were processed with the Section 965 designated payment code.³ Our analysis found that payments totaling \$1,185,337,299 made by *1* corporations were not processed with the Section 965 payment code.

² A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population. We judgmentally selected corporations that may have had a Section 965 obligation.

³ See Appendix VI for a glossary of terms.



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Appendix V

Program Manager Technical Assistance 2018-016

**Office of Chief Counsel
Internal Revenue Service
memorandum**
CC:PA:04:TWCurtzman

date: August 2, 2018

to: Commissioner, Large Business and International (LB&I) Division

from: Associate Chief Counsel Kathryn A. Zuba
(Procedure and Administration)

subject: Overpayments and I.R.C. § 965(h)

Background

In March, April, and June of 2018, the Service published and updated on IRS.gov a list of questions and answers (Q&As) relating to I.R.C. § 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." Taxpayers have expressed concerns with the legal basis for this answer, and some would like 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 Service's offset refund bypass procedures apply. See IRM 21.4.6.5.11.1.

Analysis

The Service's legal authority to make a credit or refund, and the limited circumstances in which the Service may exercise that authority, is found in section 6402. Section 6402(a) authorizes the Service to apply overpayments as credits against tax liabilities and refund any balance. Additionally, section 6402(b) grants the Service the authority to allow certain taxpayers to elect to credit an overpayment from one tax year to the succeeding year's estimated income tax. By its terms, section 6402(a) does not grant the Service the legal authority to credit or refund any amount except to the extent that an overpayment exists with respect to a liability. *Minihan v. Commissioner*, 138 T.C. 1 (2012). Likewise, section 6402(b) does not authorize the Service to apply any amount as a credit to the succeeding year's



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estimated income tax except to the extent that such amount constitutes an overpayment. I.R.C. § 6402(a) and (b).

Overpayments are payments that exceed the amount properly due. *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947). An overpayment is not created just because a taxpayer remits more than a part of a liability immediately due when a taxpayer makes an election to pay an otherwise properly due liability in installments. *Estate of Bell v. Commissioner*, 928 F.2d 901, 903-04 (9th Cir. 1991) (a taxpayer is not entitled to a refund of amounts of an estate tax liability for which the taxpayer elected to defer payment under section 6166, despite the taxpayer having remitted an amount in excess of those tax liability installments then due). The amount of income tax properly due for the 2017 tax period is the entire income tax liability for that period, even though a taxpayer may have the ability to elect to pay that liability in installments. See *Lewis v. Reynolds*, 284 U.S. 281, 283 (1932) (for a tax year's liability, "[a]n overpayment must appear before refund is authorized"); *Estate of Bell*, 928 F.2d at 903-04.

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. Section 965(h)(1) provides that a "United States shareholder of a deferred foreign income corporation. . . may elect to pay the net tax liability under this section in 8 installments. . . ." Section 965(h) does not permit the United States shareholders to defer recognizing these amounts as income and therefore defer the tax liability; it only permits a deferral of the *payment* of that liability if the shareholder elects to do so. Accordingly, 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 Service cannot issue a credit or refund under section 6402(a) with respect to the 2017 tax period.

Taxpayers who made elections under section 965(h) to pay in installments, and who made estimated tax payments with respect to their 2017 income tax liability prior to Congress enacting the amendments to section 965, may have 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. A taxpayer's section 965(h) election to defer payment of the net tax liability under section 965(h)(6) makes that liability a tax payable in installments. Cf. *Estate of Bell*, 928 F.2d at 903 ("[s]ection 6166 deferred payments [of an estate tax liability] are clearly taxes payable in installments"). "In the case of a tax payable in installments," section 6403 provides that any amount paid in excess of the correct amount of the installment "shall be credited against the unpaid installments, if any." Section 6403 does not set out the order in which the excess payments are to be applied to the remaining installments due. The Service 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



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to the next such successive annual installment until the excess amount has been fully applied. Section 6403 does not permit the Service to refund any excess installment payment to the taxpayer prior to there being an overpayment of the entire liability as provided in section 6402. 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 Service's offset refund bypass procedures will not apply.



*Implementation of the Tax Cuts and Jobs Act Deemed
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Appendix VI

Glossary of Terms

Term	Definition
Accounts Management Function	This is the organization within the W&I Division responsible for taxpayer service by answering taxpayers' tax law/account inquiries, providing information on the status of their tax returns/refunds, and resolving the majority of issues and questions to settle their tax accounts.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Filing Season	The period from January through mid-April when most individual income tax returns are filed.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Internal Revenue Code	Federal tax law begins with the I.R.C., enacted by Congress in Title 26 of the U.S. Code. It is the main body of domestic statutory tax law of the United States organized topically, including laws covering income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.
Internal Revenue Manual	Provides procedural guidance for IRS operations.
Master File	The IRS database that maintains transactions or records of tax accounts.
Processing Year	The calendar year in which the tax return or related document is processed by the IRS.



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Term	Definition
Program Manager Technical Assistance	A PMTA memorandum contains the results of a request for non-taxpayer specific legal advice from the Office of Associate Chief Counsel. A PMTA may not be used or cited as precedent. This specific memorandum was issued to the Commissioner, LB&I Division, from the Associate Chief Counsel (Procedure and Administration).
Service-Wide Electronic Research Program Alert	A SERP portal designed to provide employees from all IRS functions intranet access to the IRM and other reference materials and to retrieve frequently referenced documents required to perform their jobs. The use of alerts is reserved for quick, need-to-know information that does not change the content of the IRM.
Submission Processing Function	The data processing arm of the IRS that processes paper and electronic submissions, corrects errors, and forwards data to the Computing Centers for analysis and posting to taxpayer accounts.
Tax Year	The 12-month period for which tax is calculated.



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Appendix VII


Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

April 24, 2019

**MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT**

FROM: Douglas W. O'Donnell, 
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report # 2018-30-429, Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

Thank you for the opportunity to respond to your report entitled "*Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges (TIGTA Audit 2018-30-429)*." Like the implementation of most new and significant legislation, the implementation of the deemed repatriation provision of the Tax Cuts and Jobs Act was a broad and substantial undertaking for IRS and necessitated an expedited implementation timeframe due to the provision's effective date. We appreciate TIGTA's acknowledgement of IRS's significant efforts to educate stakeholders of the new filing requirements.

The immediate implementation tasks entailed making significant changes to our information technology systems and processing; developing formal and informal guidance; updating and creating tax forms, instructions, and educational materials; preparing training for our employees; and ensuring stakeholder outreach. Looking ahead, we are working to provide training to IRS employees who will be conducting the post-filing compliance activities, and to develop a variety of treatment streams, including taxpayer education. We will monitor compliance and make modifications as appropriate, and our continued implementation will proceed in a manner that is informed by our taxpayers' experience, responsive to stakeholder feedback, and maintains the appropriate balance between compliance burden and risk.

We agree with the outcome measures based on the data included in the report.

We appreciate your recommendations. Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact John Hinding, Director, Cross Border Activities Practice Area, at (202) 317-8686.

Attachment



Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges

Attachment I

RECOMMENDATION 1:

The Deputy Commissioner for Services and Enforcement should ensure that:

If the IRS is unable to refund excess payments to taxpayers because the entire income tax liability was not overpaid, it should take steps to inform taxpayers that their excess payments will be applied to the deferred Section 965 portion of their income tax liability and inform them of the status of the liability, including when the next installment payment is due.

CORRECTIVE ACTIONS:

We agree. In filing season 2018 we issued manual notices to inform taxpayers of how their payments in excess of liabilities were applied to their Section 965 balance due, and this process was automated for the 2019 filing season. In March 2019 we began issuing installment payment reminder notices, to reach taxpayers before the mid-April payment due date, and we will continue those notices annually until their Section 965 balance is paid or the balance is accelerated and made due immediately.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTIONS MONITORING PLAN:

N/A

RECOMMENDATION 2:

The Commissioner, Wage and Investment Division, should:

Take steps to ensure that Section 965 payments are recorded with the correct designated payment code. For instance, develop a report that lists the amount recorded as the Section 965 net tax liability and the amount recorded as owed and compares the difference between the two amounts to the amount recorded as paid.

CORRECTIVE ACTIONS:

We agree, although the recommendation does not recognize the complexity associated with reconciling Section 965 payments as numerous variations of circumstances will exist among the Section 965 population. A report that compares the net Section 965 tax liability with the deferral amount will not recognize scenarios where accounts may be underpaid or transferrable credits from other tax account modules are used to offset the



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liability. To meet the intent of the recommendation, we will develop a methodology to accurately recognize Section 965 liabilities, total Section 965 credits, and remaining Section 965 taxes deferred. Programming resources will be required to implement the reporting methodology. We anticipate reports will be available by January 2020; however, budgetary limitations and competing priorities for Information Technology resources prevent us from specifying an implementation date.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTIONS MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3:

The Deputy Commissioner for Services and Enforcement should:

Develop and document a comprehensive compliance plan that should, at a minimum, include:

- A strategy to identify taxpayers that did not properly comply with Section 965.
- An assessment of the benefit of issuing notices to those taxpayers that may be subject to Section 965 filing requirements according to Form 5471 information.
- Procedures to monitor those taxpayers that made elections to defer tax.
- Validation of the Section 965 data reported by the taxpayer.
- Steps to ensure taxpayers did not violate anti-abuse rules. For instance, if a U.S. shareholder becomes an "expatriated entity" at any point during the 10-year period following the enactment of the law, the reduced rates are recaptured and the shareholder is subject to a retroactive 35 percent rate.

CORRECTIVE ACTIONS:

We agree with this recommendation. We have been working to develop and document a comprehensive compliance plan, which will consider each of the elements of this recommendation and other aspects of compliance with this provision. With respect to assessing the benefit of issuing notices to Form 5471 filers, we previously considered this in a pre-filing environment, and will continue to evaluate whether such a strategy would be appropriate in a post-filing environment. We have developed procedures to monitor the various elections available to taxpayers under 965 and will continue to



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evaluate potential enhancements to these procedures. Validation of the 965 data is an ongoing and important component of our compliance strategy, as is ensuring compliance with the anti-abuse rules.

IMPLEMENTATION DATE:

October 15, 2019

RESPONSIBLE OFFICIAL:

Director, Cross Border Activities Practice Area, LB&I

CORRECTIVE ACTIONS MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.