

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax

September 15, 2022

Report Number: 2022-34-062

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..

HIGHLIGHTS: Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax

Final Audit Report issued on September 15, 2022

Report Number 2022-34-062

Why TIGTA Did This Audit

On December 22, 2017, the Tax Cuts and Jobs Act was enacted and provided for a one-time deemed repatriation tax on U.S. shareholders of specified foreign corporations set forth under Section 965 of the Internal Revenue Code.

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. This estimate was not based solely on the payment of the Section 965 repatriation tax and contained other revenue generating impacts such as the increase in qualified dividends paid by businesses that would also result in increased tax revenue.

This audit was initiated to evaluate the IRS's efforts to ensure compliance of those taxpayers subject to the Internal Revenue Code Section 965 because it was expected to be a main revenue generating provision of the Tax Cuts and Jobs Act.

Impact on Tax Administration

Before passage of the Tax Cuts and Jobs Act, applicable taxpayers could defer U.S. taxes on certain foreign sourced net income by keeping the assets in a foreign jurisdiction. Section 965 removed this option and required taxpayers to pay this new tax on previously untaxed post-1986 earnings and profits.

What TIGTA Found

According to the IRS, multiple issues, including complex payment deferral procedures, have limited the agency's ability to compile accurate Section 965 data. Those limitations aside, the following figure shows that the amount of Section 965 tax reported has lagged behind initial estimates.

Projected Revenue From Section 965	\$338.8 billion
Amount of Section 965 Liability Reported	\$251 billion
Amount of Section 965 Tax Paid	\$94 billion
Amount of Section 965 Tax Currently Deferred to Be Paid in Installments	\$157 billion

The Large Business and International Division, which is responsible for ensuring that taxpayers comply with the Section 965 tax, initiated three compliance campaigns to address individual and business taxpayer compliance. The two ongoing campaigns have resulted in taxpayers filing amended returns reporting the tax and significant changes to the Section 965 tax calculation. However, TIGTA is concerned that the campaign focused on the compliance of individuals does not plan any follow-up actions with the taxpayers who did not respond to the soft letters.

The Section 965 repatriation tax can be paid in eight installments. Some installment payments were applied to incorrect tax periods, which could result in the taxpayer being identified as not compliant. Numerous payments were miscoded as Section 965 payments, impacting the IRS's ability to determine Section 965 revenue. Also, the IRS does not have the ability to systemically identify taxpayers not compliant with the required installment payments or S Corporation shareholders who failed to annually report their deferred liability on the Form 965-A, *Individual Report of Net 965 Tax Liability*.

What TIGTA Recommended

TIGTA recommended that the IRS: 1) prioritize and follow up with compliance actions on nonresponsive taxpayers issued soft letters; 2) revise notices to add more information on how the Section 965 installment payments should be made; 3) ensure that system changes identify Section 965 payments that were potentially processed incorrectly; 4) develop procedures to systemically identify taxpayers that are not compliant with the Section 965(h) deferral requirements; and 5) develop procedures to identify S Corporation shareholders who made an election under Section 965(i) and who did not annually submit the Form 965-A or did not report the correct amount of the Section 965 deferral on the Form 965-A. The IRS agreed or partially agreed with four of the five recommendations. The IRS



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

September 15, 2022

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

Heather Hill

FROM: Heather M. Hill
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax (Audit # 202130423)

This report presents the results of our review to assess the Internal Revenue Service's efforts to ensure compliance with Internal Revenue Code § 965. This review is part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of *Increasing International Tax Compliance*.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Background

On December 22, 2017, the Tax Cuts and Jobs Act (hereafter referred to as the Act) was enacted.¹ The Act provided 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.).² This tax is imposed on U.S. shareholders (and other U.S. persons who own 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 with certain exceptions.³ 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.

Section 965 applies to the last taxable year of a specified foreign corporation beginning before January 1, 2018, and the amount included in income under Section 965 of the I.R.C. is included in the U.S. shareholders' year in which such a specified foreign corporation's year ends. Some U.S. shareholders had to pay the repatriation tax when filing their Tax Year (TY) 2017 income tax returns.⁴ The tax should have been reported on a U.S. shareholder's TY 2017 return (due April 17, 2018) if both the U.S. shareholder and the specified foreign corporation's last taxable year ended on December 31, 2017. If the specified foreign corporation's tax year ended on or after January 1, 2018, then the Section 965 tax liability would have been 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.

Certain taxpayers could make elections with respect to Section 965, which include:

- An election under Section 965(h) to pay the Section 965 tax liability in installments over eight years. Failure to pay an installment may result in the acceleration of any unpaid portion of the remaining installment liability. Acceleration events include a liquidation, sale, exchange, or other disposition of substantially all the assets of a person (including in a title 11 bankruptcy or similar case), or in the case of an individual, by reason of

¹ See Appendix VII for a glossary of terms. 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 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. A specified foreign corporation is (1) a controlled foreign corporation or (2) a foreign corporation (other than a passive foreign investment company) that has a corporate U.S. shareholder. A controlled foreign corporation is a foreign corporation greater than 50 percent directly, indirectly, or constructively owned, by vote or value, by one or more U.S. shareholders at any time during the taxable year of the corporation.

³ 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.

⁴ I.R.C. § 965(a).

death.⁵ However, in certain instances, an acceleration event will not accelerate payment of the tax if a transfer agreement is timely filed.

- An election by S Corporation shareholders to defer assessment of the Section 965 tax liability with respect to such S Corporation until a triggering event. For instance, the S corporation ceases to be an S Corporation.

The Large Business and International (LB&I) Division is responsible for tax administration activities for domestic and foreign businesses with a U.S. tax reporting requirement and assets equal to or exceeding \$10 million as well as the Global High Wealth and International Individual Compliance programs.⁶ A key focus of the LB&I Division's mission is to identify the highest potential compliance risks among taxpayers and to assign resources to address those potential risks. This includes the enforcement of the Section 965 provision.

The Wage and Investment (W&I) Division was responsible for processing the tax returns filed reporting a Section 965 inclusion and responding to taxpayer inquiries on the filing of those returns.⁷ They are also responsible for processing Section 965 payments and monitoring taxpayer compliance with the election to pay the Section 965 liability in installments and the election by S Corporation shareholders to defer tax.

The Small Business/Self-Employed (SB/SE) Division is also responsible for monitoring taxpayer compliance with the Section 965(h) election to pay the Section 965 liability in installments. In addition, the SB/SE Division was responsible for implementing procedures to monitor the transfer of liability and the future payment of the installment liabilities due from a transferee who enters into a transfer agreement with the Internal Revenue Service (IRS) accepting liability for the remaining installments due from the 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 under Section 965(h)(3) occurs.

Prior audit on implementation of the Section 965 provision

We conducted an audit on the implementation of the Section 965 provision of the Act and issued a report in May 2019.⁸ We reported that while the LB&I Division had taken actions to ensure that taxpayers are aware of their Section 965 filing responsibilities, actions needed to be taken to more fully identify and address those taxpayers that do not comply. During that audit, the LB&I Division acknowledged that it faced significant challenges with the ability to detect and respond to taxpayer noncompliance with Section 965 for TY 2017. The LB&I Division indicated that there was insufficient time available to draft regular IRS forms due to the limited time period between the Act's enactment and effective dates, and that 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 were filed. To illustrate, the LB&I Division noted that for calendar year U.S. shareholders in specified

⁵ I.R.C. § 965(h)(3). United States Code Title 11 – BANKRUPTCY.

⁶ www.irs.gov/businesses/large-business-and-international-lbi-division.

⁷ The Accounts Management function within the W&I Division is responsible for responding to taxpayer inquiries on the filing of returns.

⁸ Treasury Inspector General for Tax Administration (TIGTA), Report No. 2019-34-033, *Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges* (May 2019).

foreign corporations with calendar years, the Section 965 tax payment was generally due by April 17, 2018, less than four months after passage of the Act.⁹

- May not have the data it needs to properly identify and analyze compliance risks on 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.
- 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.

We recommended that the Deputy Commissioner for Services and Enforcement 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 Return of U.S. Persons With Respect to Certain Foreign Corporations*, information.
- Procedures to monitor 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.

IRS management agreed with this recommendation and had been working to develop and document a comprehensive compliance plan that would 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.

Results of Review

Section 965 of the Act imposed a one-time tax on U.S. shareholders (and other U.S. persons who own interests through a domestic pass-through entity that is a U.S. shareholder) through a

⁹ This example was provided by the LB&I Division during this audit.

deemed repatriation of post-1986 accumulated earnings and profits and is imposed on the U.S. shareholder's share of such earnings with certain exceptions. This provision was to be one of the main revenue generating provisions of the Act. IRS executives stated that this was a complicated provision to implement because some U.S. shareholders had to pay the repatriation tax when filing their TY 2017 tax returns shortly after passage of the Act. This prevented the IRS from developing needed tax forms and making necessary processing changes for the repatriation tax reported and paid by those TY 2017 taxpayers. IRS management indicated that the IRS continues to struggle to ensure compliance with Section 965 because: the IRS has experienced certain tax account issues; personnel disruptions due to the Coronavirus Disease 2019 (COVID-19) pandemic; and ongoing IRS resource limitations have complicated their efforts.¹⁰ Our review evaluated the LB&I Division's efforts to ensure compliance of those taxpayers subject to the Section 965 filing requirements as well as the W&I Division's efforts to ensure the compliance of those taxpayers that deferred the Section 965 liability.

Multiple Issues Limited the Ability to Compile Accurate Section 965 Data

The Joint Committee on Taxation projected Section 965 to be one of the most significant revenue raisers of the Act. While the amount of Section 965 tax reported by taxpayers has lagged behind original estimates, according to the IRS, almost \$251 billion in Section 965 tax liability has

Taxpayers have reported almost \$251 billion in Section 965 liability lagging behind original estimates.

been reported by business and individual taxpayers as of March 17, 2022. Just over \$94 billion of that \$251 billion (38 percent) has been paid, and the remainder has been deferred or is being paid in installments. According to the LB&I Division, the fact that only 38 percent of the Section 965 liability has been paid is consistent with the Section 965 liability being backloaded with 60 percent of the installment liability to be paid in the final three years of the eight-year installment period. Figure 1 contains the total amount of Section 965 liability reported by taxpayers, the total amount of Section 965 tax paid, and the Section 965 liability initially deferred by taxpayers and currently outstanding, according to data provided by the IRS.

¹⁰ According to the LB&I Division, the eight-year installment payment rules of I.R.C. § 965(h) made Section 965 very difficult to implement and to monitor compliance because in almost all instances, IRS information technology and compliance systems are designed for taxes that are due in a specific year and not spread over a multiyear period. The implementation of these payment deferral procedures for Section 965(h) are not common tax return processing or examination processing issues that existed prior to the Act. They created significant complexity for both the IRS and taxpayers. A unique feature of the Section 965(h) election is the long period for which a taxpayer's Section 965 liability and payment history must be monitored and tracked. This can be compounded because there are circumstances in which Section 965 liabilities can be transferred to a transferee upon the occurrence of certain acceleration events (potentially multiple times), which again requires detailed monitoring and tracking systems that the IRS has not had to address previously. The Master File was not initially capable of easily tracking payments where there was a Section 965 income inclusion on the Master File in the income inclusion year (*e.g.*, TY 2017), but payments on that liability would be received over the inclusion year and the seven subsequent years (or in the case of a Section 965(i) election where the payment of the liability can be deferred indefinitely). The LB&I Division cited the payment schedule in Section 965(h)(1) as support for this assertion.

Figure 1: Amount of Section 965 Liability Reported, Paid, and Deferred by Business and Individual Taxpayers (as of March 17, 2022)

Description	Taxpayers	Amount
Number of Taxpayers and Amount of Section 965 Liability Reported ¹¹	72,156	\$250,884,372,332
Amount of Section 965 Tax Paid ¹²	Not Available	\$94,283,534,175
Number of Taxpayers and Amount of Section 965 Liability Initially Payment Deferred – Section 965(h) ¹³	11,360	\$239,359,008,218
Number of Taxpayers and the Outstanding Amount Remaining of Section 965 Liability Payment Deferred – Section 965(h)	8,270	\$156,600,838,157
Number of S Corporation Shareholders and Amount of Section 965 Tax Liability Initially Deferred – Section 965(i) ¹⁴	1,331	\$1,422,478,045
[REDACTED]	[REDACTED] ¹⁵	[REDACTED]

Source: Chief Financial Officer (CFO) and W&I Division.

We have some concerns about the IRS information contained in Figure 1. For instance, [REDACTED]

[REDACTED] The IRS CFO stated that because the Section 965 designated payment code (DPC) could not be relied on to determine Section 965 revenue, it had to develop a

¹¹ This does not include the S Corporation shareholders who have elected to defer the Section 965 liability using I.R.C. § 965(i).

¹² According to the IRS, the current methodology and calculation used for the tax paid (or revenue) is the Section 965 liability (see the first row of this table) reduced by, if any, Section 965(h) remaining payments deferred (see the fourth row of this table). The calculation does not exclude revenue amounts where: the taxpayer’s account has an overall delinquent balance due that is both the Section 965 liability and non-Section 965 liability; the Section 965(h) deferral was accelerated and is now showing as a delinquent balance due; and the tax liability is less than the Section 965 liability. The calculation is also not limited to designated payment code 64 payments, because other credits and payments could be attributed to the reduction of the Section 965 liability.

¹³ This is the number of taxpayers and the amount of payments that they originally elected to defer.

¹⁴ According to the IRS, where a Section 965(i) is triggered, the taxpayer can further make a Section 965(h) election to pay the liability in installments. Therefore, there could be some overlap between these amounts and the amounts noted in the row above. Specifically, the 8,270 taxpayers with an outstanding amount of Section 965(h) liability payment of which is deferred.

¹⁵ [REDACTED]

This requires complex analysis, and the IRS is also in the process of developing business requirements to allow it to track this data more effectively.

workaround calculation to estimate the revenue.¹⁶ Specifically, the Section 965 revenue is calculated as the difference between total Section 965 tax liability reported and the Section 965(h) payment amount remaining.¹⁷ LB&I Division management also noted that they have identified instances in which the taxpayer reported the Section 965 tax liability on the filed tax return, but it was not recorded on the taxpayer's Master File account. This would not have been included in the Section 965 liability reported amount noted in Figure 1.¹⁸

Nevertheless, the data provided by the IRS are the best available information to assess compliance with the Section 965 tax. Accordingly, the difference between the Joint Committee on Taxation's \$338.8 billion revenue estimate and the approximately \$251 billion reported by taxpayers would not necessarily indicate significant taxpayer noncompliance. In addition to the impacts of the processing issues noted in the prior paragraph, LB&I Division executives stated that the Joint Committee on Taxation's estimate does not only represent the expected amount of revenue related to Section 965. Specifically, the Joint Committee on Taxation's estimate also reflects any indirect tax effects associated with taxpayer behavior in response to Section 965 tax changes.

The Large Business and International Division Initiated Three Campaigns Related to Section 965

The IRS has devoted significant resources to ensure that taxpayers comply with Section 965, which includes the LB&I Division initiating three campaigns. The following campaigns were designed to focus on Section 965 compliance among business and individual taxpayers. Our audit focused on evaluating the two campaigns that are still ongoing.

- **Section 965 Taxpayer Awareness Campaign** – Announced on July 2, 2018, and conducted primarily by the LB&I Division's Cross-Border Activities (CBA) Practice Area, this campaign focused on communicating to potentially impacted taxpayers about the new tax filing and tax payment obligations arising under the recently revised Section 965.¹⁹ This campaign has been retired.
- **I.R.C. 965** – Announced on November 4, 2019, and conducted primarily by the LB&I Division's CBA Practice Area, this campaign focuses on the compliance of business taxpayers including corporations, partnerships, and S Corporations (hereafter referred to as the Business Campaign). This campaign is ongoing.

¹⁶ The CFO 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 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.

¹⁷ According to the CFO, the revenue amount is inclusive of unpaid non-deferred tax (including Section 965(h) accelerations) and Section 965 tax by designated Section 965 payments, other payment types, or other tax credits identified when the Section 965(h) payment deferral transaction is offset.

¹⁸ According to the CFO, to compensate for the processing issues, they make financial adjustments to the Section 965 tax liability and the Section 965(h) deferral amounts prior to reporting. Any reporting to outside stakeholders, such as the U.S. Congress, would include a footnote on the financial adjustment.

¹⁹ The CBA Practice Area is responsible for providing tax administration, services, and enforcement associated with most international issues impacting business taxpayers.

- **I.R.C. Section 965 for Individuals** – Announced on July 6, 2020, and conducted by the LB&I Division’s Withholding Exchange and International Individual Compliance (WEIC) Practice Area, this campaign focuses on the compliance of individual taxpayers (hereafter referred to as the Individual Campaign).²⁰ This campaign is ongoing.

Campaigns are an approach the LB&I Division uses to address specific compliance issues. As part of a campaign, the LB&I Division plans for and establishes specific objectives intended to improve compliance across the population of taxpayers for whom it is responsible. According to the LB&I Division, campaigns involve a thorough analysis of data to support the identification and evaluation of a compliance issue; a deliberate consideration of potential treatment streams; decisions about the resources to be deployed; identification of training, mentoring, networking, and tools needed as well as a robust feedback mechanism to ensure that all elements of a campaign are continuously improved.

Campaigns apply treatment streams (*i.e.*, a compliance action or combination of actions) to achieve intended compliance outcomes. The idea is to respond with a variety of treatments to maintain high compliance across the LB&I Division filing population. Campaign treatment streams can include audits and the issuance of soft letters as well as other taxpayer interactions, such as reaching out to taxpayers and tax professionals, issuing guidance, and participating in industry events for outreach.²¹

The IRS envisions that the successful implementation of campaigns will provide improved return selection, identify issues representing a risk of noncompliance, make the greatest use of limited resources, increase taxpayer compliance, and enhance the IRS’s tax administration efforts.

The Individual Campaign has likely increased taxpayer compliance, but additional actions are needed

The goals of the Individual Campaign are twofold: increase compliance of individual taxpayers who did not voluntarily report their Section 965 obligations on their tax returns and review the Section 965 tax computations by individual taxpayers who did report the tax on their tax returns. The planned treatment streams were the issuance of up to 4,500 “soft letters” to encourage the filing of amended tax returns by noncompliant taxpayers who did not report the Section 965 tax and conducting up to 300 examinations to identify noncompliance by those taxpayers who did report the Section 965 tax. The LB&I Division was approved to allocate 40 full-time equivalent employees requiring 15,756 staff hours to conduct the examinations and one full-time equivalent requiring 1,125 staff hours for the issuance of the soft letters. The LB&I Division intends to maintain this campaign until there is an observed increase in the compliance of taxpayers with Section 965 liabilities by its use of the soft letters and examinations. The

²⁰ The WEIC Practice Area has responsibility for the following taxpayers: U.S. citizens living or working abroad or in a U.S. Territory, U.S. citizens or resident aliens who hold income producing assets in a foreign country or claim the foreign earned income exclusion or foreign tax credit, and permanent residents and non-resident aliens who have a U.S. filing requirement.

²¹ A soft letter is directed at a particular filing position taken by a taxpayer and seeks information or suggests a course of action, although it is not necessarily followed up by an IRS compliance action, such as an examination.

campaign team will continue to monitor compliance with Section 965 and review feedback from examiners.

The campaign was initiated because of concerns that a significant population of individual taxpayers did not report the Section 965 tax and a segment of individual filers who did report the Section 965 tax did so incorrectly because of the complexity involved in calculating the tax. Preliminary analysis by the LB&I Division identified nearly 37,000 individual income tax returns filed for TY 2017 with a Section 965 indicator on the return. This analysis also showed that nearly 1,800 Form 1040 filers filed a Form 5471 with [REDACTED].²²

The LB&I Division campaign staff identified high-income taxpayers who may not have reported the Section 965 tax by [REDACTED] specifically the Section 965 processing codes indicating the taxpayer reported the Section 965 tax liability.²³ From this analysis, the campaign identified approximately 4,500 individual taxpayers with earnings and profits of [REDACTED] who did not report the Section 965 tax on an income tax return. The campaign staff also identified approximately 1,000 individual taxpayers with earnings and profits [REDACTED] who reported the Section 965 tax on their TY 2017 tax return. Figure 2 contains the population segments identified for this campaign along with the potential treatment streams.

[REDACTED]

[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

Source: LB&I Division WEIC I.R.C. § 965 for Individual Campaign PowerPoint presentation.

²² LB&I Division management indicated in a prior audit 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. During this audit, IRS personnel indicated that the Act treats certain foreign corporations (known as specified foreign corporations) as having immediately repatriated the post-1986 deferred foreign income (generally accumulated earnings and profits with certain exclusions). The prior audit was TIGTA, Report No. 2019-34-033, *Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges* p. 20 (May 2019).

²³ I.R.C. § 6038(a) requires a U.S. citizen or resident alien to furnish information with respect to certain foreign business entities. This information includes any foreign partnership/corporation entity data, stock ownership data, and financial statements. Penalties for not timely filing the Form 5471 are severe - \$10,000 for each Form 5471 that is filed after the due date of the associated income tax return, including any extensions. The Form 5471 is used to comply with the law and regulations.

WEIC personnel stated that the primary treatment stream designed for those individual taxpayers who could have a Section 965 obligation but have not reported the liability to the IRS was the issuance of soft letters. They indicated that the original intent of the soft letters was to educate the taxpayers and did not require a response.²⁴ The taxpayers are asked to self-correct by filing an amended tax return to report the Section 965 tax if they determine they have an obligation. The soft letters were sent to almost 2,500 individual taxpayers on September 18, 2020. Figure 3 shows the numbers of letters sent to individual taxpayers located in the United States and letters sent to taxpayers currently not residing in the United States.

Figure 3: Soft Letters Sent to Individual Taxpayers

Location of Taxpayers Sent Soft Letters	Total
Located in the United States	1,779
Located Outside the United States	707
Total	2,486

Source: LB&I Division's WEIC.

The soft letter treatment stream likely resulted in 546 (22 percent) of the 2,486 taxpayers sent the soft letter amending their tax returns to report \$88,706,375 of Section 965 tax. In response to the soft letters, the IRS also received 89 telephone calls into the IRS Hotline telephone number shown on the letter and 84 pieces of correspondence delivered to the IRS address noted on the letter.

Because of other compliance priorities and resource availability, WEIC personnel stated they do not plan [REDACTED]. They prioritize work based on prior audit results, strategic importance, relative compliance risks, and resource availability. They believe that taxpayers who did not report the Section 965 tax but reported earnings and profits between [REDACTED] on the Form 5471 represent a lower compliance risk.

We are concerned that without any follow-up actions the campaign team will be unable to adequately determine if there is a significant amount of noncompliance. For instance, they could follow up by conducting examinations on a sample of taxpayers who did not file amended returns reporting the Section 965 tax. Without a sufficient evaluation of compliance, the IRS will not know if resources should be devoted to conducting examinations on these taxpayers in the future.

²⁴ See Appendix III for an example of the soft letter that was issued to individual taxpayers.

The campaign also recently selected 316 tax returns for examination of those individual taxpayers with:

- Potential unreported Section 965 tax but with earnings and profits [REDACTED] reported on the Form 5471.
- Reported Section 965 tax and had [REDACTED] reported on the Form 5471.

The examinations are being conducted to determine if the Section 965 computations were accurately determined by the taxpayers who reported the tax and if there was a Section 965 reporting requirement for those who did not.

The Business Campaign has identified errors in the Section 965 liability calculations

The Business Campaign is part of LB&I Division's overall Tax Cuts and Jobs Act international compliance strategy. Among the goals of the Business Campaign are to ensure taxpayer compliance with the Section 965 filing obligations for those reporting the largest Section 965 inclusions; measure taxpayer compliance among the Form 1120, *U.S. Corporation Income Tax Return*, filing population; and use the results to determine future actions. The campaign was initiated because the LB&I Division had observed noncompliance in the tracking and reporting of accumulated earnings and profits on the Form 5471, a key component of calculating the Section 965 inclusion. The LB&I Division also anticipated the possibility of noncompliance on the issue of whether the appropriate Section 965(c) deduction was applied in accordance with the aggregate foreign cash position. Because of the complexity of the Section 965 provision of the Act, it anticipated a high amount of inadvertent noncompliance.²⁵

The Business Campaign has identified noncompliance in those taxpayers that reported the largest amount of Section 965 tax.

The primary treatment stream of this campaign is the use of issue-based examinations primarily of Forms 1120 filed for TY 2017. The campaign was initially authorized to examine 200 TY 2017 returns requiring 50 full-time equivalents using 96,000 staff hours. The campaign team (composed primarily of LB&I Division personnel from CBA and Geographical and Financial Product Practice Areas) stated that they would supplement the examinations with the issuance of soft letters to remind taxpayers that could have a Section 965 obligation that has not been reported to the IRS.

The campaign team had difficulty identifying taxpayers that reported the Section 965 tax on their Form 1120 filed for TY 2017 because the IRS did not have time to develop tax forms needed for taxpayers to properly report the Section 965 tax obligations. Instead, for TY 2017, the IRS developed a Transition Tax Statement for the taxpayer to report the Section 965 liability.²⁶ This document had limitations that required manual processing which limited the

²⁵ LB&I Division, I.R.C. § 965 Approved Campaign Document, <https://irssource.web.irs.gov/LBI>.

²⁶ The Transition Tax Statement was a document developed by the IRS that would allow the taxpayer to report the Section 965 liability for TY 2017. This was in Portable Document Format that was attached to the tax return filed with the IRS. See Appendix IV for an example. The Section 965 tax liability was also reflected on the taxpayer's standard income tax form, such as the Form 1040 for individuals and the Form 1120 series for businesses, but was not broken out separately as a Section 965 tax liability.

viability of conducting systemic analysis on the information reported by taxpayers on the Transition Tax Statement. Instead, the team had to rely on analyzing the various transaction codes that the W&I Division Submission Processing unit placed on taxpayer accounts as the Transition Tax Statements were processed. This led the campaign team to conclude that examinations were required as the primary treatment stream.

The campaign team stated that when they started analyzing TY 2017 data, they found that the vast amount of Section 965 tax was reported by Form 1120 filers and concentrated in a small number of those filers. Therefore, they focused most of their resources on examining those business taxpayers that reported the highest amount of Section 965 tax liability on their TY 2017 tax returns.

The total population from which the tax returns were selected for examination was approximately 55,000 Forms 1120 filed for TY 2017. The campaign team initially selected 190 total returns for examination from the following three population segments: top 104 filers that reported the Section 965 tax, which represented 90 percent of the overall Section 965 tax reported on the Forms 1120; statistical sample of 43 filers from a population of 4,746 that reported the Section 965 tax and reported earnings and profits on the Form 5471; and a random sample of 43 selected from a population of approximately 50,000 Forms 1120.²⁷ The LB&I Division expanded the scope of the campaign by obtaining approval to conduct examinations of 50 Partnership and 25 S Corporation tax returns that reported Section 965 inclusions. We agree with the campaign team's focus on the filers that reported the largest amount of Section 965 tax when selecting the returns for examination. Figure 4 contains a breakdown of the three population segments, Partnership, and S Corporation tax returns selected for examination along with their status as of April 2022.

²⁷ These returns were selected using a confidence level of 95 percent and a precision percentage of ± 15 percent from a population of approximately 50,000 Forms 1120. This is the total population of approximately 55,000 minus the Segments 1 and 2 populations and other filers of the Forms 1120 already under examination.

**Figure 4: Business Campaign Examination
Population Segment Statistics as of April 2022**

Description	Total Selected	In Progress	Completed
Segment One: Form 1120 Filers That Reported Largest Section 965 Tax ²⁸	104	97	7
Segment Two: Statistical Sample of Filers That Also Reported Earnings and Profit on Form 5471	43	9	34
Segment Three: Random Sample of Form 1120 Filers	43	4	39
Partnerships	30	23	7
S Corporations	15	15	0
Totals	235	148	87

Source: *Business Campaign PowerPoint presentation to LB&I Division executives on October 16, 2019, and information provided by the campaign team.*

The examinations resulted in the identification of noncompliance and substantial adjustments to the returns filed by the Form 1120 filers that reported the largest amount of Section 965 tax. The IRS issued 632 Notices of Proposed Adjustments (NOPA) to these taxpayers, and nearly \$6.4 billion in adjustments have been made to the tax returns.²⁹ In IRS examinations, multiple NOPAs may be issued if multiple issues requiring tax adjustments are identified. The campaign team noted that among the areas of noncompliance, they have found that business taxpayers did not always accurately track their Accumulated Earnings and Profits on the Form 5471 from year to year, and they have had to work with those taxpayers to determine the amounts. There are also issues in the treatment of cash equivalents and foreign tax credits, and they are finding math errors in the various Section 965 computations. Figure 5 contains the number of NOPAs issued to taxpayers and the amount of adjustments made as a result of the examinations conducted for each of the segments.

²⁸ The LB&I Division used the term "Population" for each of these sample groups. We used the term segments to avoid confusion with the total population of Form 1120 filers.

²⁹ For LB&I Division examinations, all adjustments are proposed on Form 5701, *Notice of Proposed Adjustment*, which is generally accompanied by Form 886-A, *Explanations of Items*. Form 5701 provides a summary of the proposed adjustment. Form 886-A provides a detailed explanation of the adjustment. When issuing a NOPA, the tax determination for that issue is based on applying the law to the relevant facts developed during the examination. NOPAs will be issued as soon as a tax determination has been made but no later than the milestone date set in the issue timeline.

Figure 5: Business Campaign Examination Results as of April 2022

Description	Total NOPAs Issued	Total Adjustment Amount
Segment One: Form 1120 Filers That Reported Largest Section 965 Tax ³⁰	632	\$6,393,034,300
Segment Two: Statistical Sample of Filers That Also Reported Earnings and Profit on Form 5471	17	\$3,833,698
Segment Three: Random Sample of Form 1120 Filers	8	\$1,658,068
Partnerships	10	\$15,645,248
S Corporations	-	-
Totals	667	\$6,414,171,314

Source: Information provided by the Business Campaign team.

The campaign team expected that accounting firms will learn from these examinations the importance of maintaining accurate earnings and profits. They believe this will increase compliance in the long run. Based on these initial examination results, the campaign team has been approved to issue 100 soft letters to those taxpayers that may have underreported or not reported the Section 965 tax. They mailed the initial 50 soft letters in January 2022 and will make a determination to issue the other 50 based on the results from the initial 50. We believe that due to the smaller scope of taxpayers mailed the soft letter, compared to the Individual Campaign, it should be easier for the Business Campaign to track the results and follow up with taxpayers that do not respond.

Recommendation 1: The Commissioner, LB&I Division, should prioritize and follow up on the list of nonresponsive taxpayers issued soft letters to determine whether any follow up procedures are appropriate, taking into consideration WEIC examination priorities.

Management’s Response:

[Redacted Management’s Response]

Office of Audit Comment:

[Redacted Office of Audit Comment]

³⁰ The LB&I Division used the term “Population” for each of these sample groups. We used the term segments to avoid confusion with the total population of Form 1120 filers.

Section 965 Payments Were Not Correctly Applied to Taxpayer Accounts

The IRS receives taxpayer payments for multiple reasons and through various methods. For example, some payments are voluntary, such as payments submitted with a timely filed tax return. Other payments are submitted in response to collection actions. The IRS established two-digit DPCs to identify events (*e.g.*, lien, levy, seizure) that were primarily responsible for the subsequent payments being made. The DPCs are used at the time the subsequent payment is processed. Data from this type of input are congressionally mandated and should be accumulated on a national basis to determine the revenue effectiveness of specific collection activities.

We previously reported that payments made were not always processed with the Section 965 payment code. Our analysis found that payments totaling approximately \$1.2 billion made by four corporations were not processed with the Section 965 payment code. 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.³¹ Even though we were able to review only a small sample of payments during this audit, we determined that the accurate recording of Section 965 payments has presented a challenge for the IRS.

The IRS established a DPC specifically for Section 965 payments, DPC 64. According to the Internal Revenue Manual (IRM), all Section 965 payments must be processed with DPC 64.³² All Section 965 payments must be applied to the tax module for which the Section 965 inclusion was made. For example, if the Section 965(h) election to pay installments over the course of eight years was made on the TY 2017 tax return, then the installment payments made towards the Section 965 liability should be applied to the TY 2017 module. Most inclusion years will be TYs 2017 or 2018 while very few would be TY 2019.³³ Except in rare circumstances, the Section 965 payments should not be posted to TY 2019 or later tax modules.

Our analysis of Master File data identified over 15,000 tax payments coded as DPC 64 totaling over \$1.3 billion made by businesses and individuals that were posted to TYs 2019, 2020, or 2021 tax modules.³⁴ To determine if the posting of these payments to later modules were correct, we selected a judgmental sample of the payments with the highest dollar amounts and those associated with a refund on the tax module.³⁵ Our sample included 101 payments totaling over \$1.2 billion made by businesses and 96 payments totaling over \$28 million made by individuals. The sample of payments selected totaled almost 96 percent of the total payments. Figure 6 details the number of payments identified that were posted to TYs 2019, 2020, or 2021 tax modules and the judgmental samples selected for testing.

³¹ TIGTA, Report No. 2019-34-033, *Implementation of the Tax Cuts and Jobs Act Deemed Repatriation Tax Presented Significant Challenges* (May 2019).

³² IRM 3.17.278.12.11(3) (Dec. 2, 2021).

³³ IRM 3.17.277.2.4.19.7(c) (Dec. 8, 2020).

³⁴ We only included payments of \$100 or more.

³⁵ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Figure 6: Analysis of Section 965 Payments Applied to TYs 2019 Through 2021 Taxpayer Tax Modules

Description	Individuals	Businesses	Totals
Total Number of Payments	13,459	2,025	15,484
Total Amount of Payments	\$71,042,372	\$1,232,324,832	\$1,303,367,204
Judgmental Sample of Payments Tested	96	101	197
Total Amount of Judgmental Sample of Payments Tested and Percentage of Total Amount	\$28,487,971 (40.10%)	\$1,220,919,192 (99.07%)	\$1,249,407,163 (95.86%)

Source: Individual and Business Master File data identified from the Treasury Inspector General for Tax Administration's (TIGTA) Data Center Warehouse (DCW).

We conducted an analysis of taxpayer information on the Integrated Data Retrieval System (IDRS) to determine if the payments posted to the tax modules were correct. We found 90 payments totaling \$37.4 million for which there was not a corresponding Section 965 liability on the taxpayer's tax account and 37 payments totaling \$58 million that were applied to the incorrect tax module, which resulted in the issuance of \$1.2 million in erroneous refunds. In most of the cases, when the payment was misapplied, it was not posted to the taxpayer's Section 965 inclusion year, which generally would have been TYs 2017 or 2018.³⁶ We believe the payments reviewed are in most instances the annual installment payments made toward the outstanding Section 965 liability. When payments are applied to the incorrect tax period, a taxpayer's account would show the taxpayer as noncompliant and could result in the Section 965 liability being accelerated. Figure 7 provides details of our analysis.

³⁶ According to IRM 3.17.277.2.4.19 (Dec. 8, 2020), most inclusion years will be 2017 and/or 2018 while a very small few could be in 2019.

Figure 7: Results of Analysis of Taxpayer Tax Modules

Description	Individuals		Businesses		Totals	
	No.	Amount	No.	Amount	No.	Amount
Number and Amount of Payments Misapplied to Incorrect Tax Period	23	\$2,739,139	14	\$55,352,211	37	\$58,091,350
Number and Amount of Erroneous Refunds Resulting From Payments Misapplied to Incorrect Tax Periods	9	\$433,815	3	\$742,481	12	\$1,176,296
Number and Amount of Payments Incorrectly Coded as DPC 64	51	\$16,972,906	39	\$20,390,436	90	\$37,363,342

Source: TIGTA analysis of taxpayer information on the IDRS.

IRS management indicated that they are aware of the Section 965 payment issues and from their analysis believe the incorrectly coded and misapplied payments are largely the result of taxpayer errors made when submitting the payment. To address these issues, the IRS developed several mitigation procedures to ensure that these payments are correctly processed going forward. W&I Division Submission Processing personnel stated that they have identified the following causes for the payments being incorrectly coded as DPC 64 or misapplied to the incorrect tax module:

- **Taxpayer entered the incorrect tax year when submitting the payment via the Electronic Federal Tax Payment System (EFTPS).** The EFTPS requires the taxpayer to enter the four-digit tax year to which the IRS should apply the payment, and the taxpayer may have entered the incorrect year. This could result in the payment being applied to the incorrect tax period.
- **Taxpayer incorrectly indicated the payment was a Section 965 payment either when submitting a payment using the EFTPS or mailing a paper check.** The IRS indicated in most instances its research on these cases could not identify a Section 965 inclusion on the taxpayer’s tax account. Our analysis of the 90 sample cases when there was not a liability on the account confirmed this conclusion.
- **The debit/credit card payment platforms did not allow for retroactive Section 965 payments.** When taxpayers made a Section 965 payment using the debit/credit card platform, they did not have the option to apply the payment to TYs 2017 or 2018. This could have resulted in the payment being applied to the incorrect tax period.

In response to the payment issues identified, the W&I Division developed the following mitigation strategies to ensure that future Section 965 payments are correctly processed and applied to the correct tax period.

- Manually review all Section 965 payments prior to posting to the taxpayer’s account.

- Issue instructions to W&I Division Payment Perfection analysts to address any training deficiencies.³⁷
- Work with vendors to update the debit/credit plan payment platform to allow for the allocation of Section 965 payments to the TYs 2017 and 2018 tax modules. Until this is perfected, the taxpayers will receive the message that “The IRS debit/credit card program cannot accept Section 965 payments for tax years 2017 and 2018. Please contact the IRS for other payment options.”
- Establish a team of IRS personnel (called the “Tiger Team”) to manually review the accounts of all taxpayers that deferred the Section 965 liability to identify misapplied or miscoded Section 965 payments and make the necessary corrections.³⁸
- Develop business requirements to allow the IRS to systemically monitor Section 965 payments and taxpayers with outstanding Section 965 liabilities. This is being done by a team of IRS personnel (called the “Section 965 CORE Team”) from several IRS operating divisions who are taking a more macro approach on how the payment issues are impacting the ability to ensure compliance.³⁹

We agree with the mitigation strategies developed by the IRS to ensure that Section 965 payments are properly processed. However, we believe the IRS can take additional steps to ensure that Section 965 payments are correctly applied to taxpayer accounts. Starting in Processing Year 2019, the IRS began sending notices to taxpayers reminding them that a Section 965 installment payment was due in six to eight weeks.⁴⁰ Our review of this notice found that the notices do not clearly instruct the taxpayers on how to make the payments especially when making payments electronically. For instance, when making the payment using the EFTPS, the notice does not indicate the correct drop-down box to use. The notice also does not indicate that the taxpayer currently cannot use the debit/credit card payment platform to make these payments. The IRS should consider revising both the CP56 and CP256 notices. The IRS should also ensure that any business requirements developed by the “Section 965 Core Team” identify all Section 965 payments applied to TY 2019 or later modules. This would help identify payments that were incorrectly applied and prevent the issuance of any erroneous refunds.

The inability to process these payments correctly has resulted in the IRS being unable to rely on the DPC 64 to determine Section 965 revenue. The IRS’s CFO stated that it cannot rely on DPC 64 to determine revenue and has had to develop a workaround computation for an estimate. In addition, when Section 965 payments are not applied to the correct tax module, it impacts the IRS’s ability to effectively or efficiently monitor those taxpayers that elected to pay

³⁷ The W&I Division Payment Perfection function performs analysis and research on taxpayer remittances and returns/documents that require additional preparation prior to depositing money.

³⁸ The Tiger Team is comprised of personnel from the W&I Division Accounts Management and Submission Processing functions and the SB/SE Division.

³⁹ The CORE Team is comprised of personnel from the W&I Division Accounts Management, CFO, LB&I Division, and SB/SE Division.

⁴⁰ IRS notice CP56 is sent to individuals and notice CP256 is sent to businesses. See Appendix V for an example of notice CP56.

the Section 965 liability in eight annual installments. The IRS has had to manually review each Section 965 deferral to determine if the taxpayer is compliant.

The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should:

Recommendation 2: Revise the CP56 and CP256 notices to add more information on how the Section 965 installment payments should be made. For instance, when making a payment using the EFTPS, the notice should specify how the payments should be made. The notice should also indicate that the taxpayer currently cannot use the debit/credit card payment platform to make Section 965 installment payments.

Management's Response: The IRS agreed with this recommendation and will update CP56 and CP256 notices to advise taxpayers how to properly make Section 965(h) repatriation tax installment payments.

Recommendation 3: Ensure that any business requirements developed by the "Section 965 Core Team" systemically identify all Section 965 payments that are applied to TY 2019 or later tax modules so they can be evaluated to determine if they were correctly processed.

Management's Response: The IRS partially agreed with this recommendation and has already drafted unified work requests to identify all Section 965 repatriation tax designated payments going forward. The IRS is evaluating whether current manual efforts of determining application of payments are sufficient. Also, the IRS will consider the benefit of providing an additional systemic review against limited resources.

Several Obstacles Impacted the Ability to Effectively Monitor Taxpayers That Made Deferral Elections With Respect to the Section 965 Liability

The Act allowed certain taxpayers to make the following two deferral elections with respect to the Section 965 tax:

- An election to pay the Section 965 tax liability over eight years in installments. If there is an addition to tax for failure to timely pay an installment, a liquidation or sale of substantially all the assets of the taxpayer, a cessation of business by the taxpayer, or any similar circumstance, then the unpaid portion of the remaining installments shall be due on the date of such event or in the case of a Title 11 bankruptcy or similar case, the day before the petition is filed.⁴¹
- An election by S Corporation shareholders to defer the Section 965 tax liability indefinitely with respect to such S Corporation until a triggering event. For instance, the S Corporation ceases to be an S Corporation.⁴²

According to IRS personnel, upon passage of the Act, they have encountered several obstacles impacting their ability to effectively monitor compliance of taxpayers that made the deferral elections. These included the following:

⁴¹ I.R.C. § 965(h)(3).

⁴² I.R.C. § 965(i).

- The Act was enacted in December 2017 and the first installment of the Section 965 tax for calendar year U.S. shareholders of specified foreign corporations with calendar year ends generally had to be paid by April 17, 2018 (less than four months after the Act's enactment). It was impossible for the IRS to develop and implement a proper tax form for the reporting of the Section 965 tax in this four-month window. The eight-year installment rule of Section 965(h) makes I.R.C. § 965 very difficult to implement and to monitor compliance because in almost all instances, IRS information technology and compliance systems are designed for taxes that are due in a specific year, not spread over a multiyear period. The implementation of these deferral payment procedures for Section 965(h) are not common tax return processing or examination processing issues that existed prior to the Act. They created significant complexity for both the IRS and taxpayers.
- The IRS does not have the infrastructure to hold current debt (meaning the total amount of Section 965 deferral tax liability, some of which may be delinquent if the taxpayer has failed to pay some of the current debt pursuant to the eight-year repayment provisions). The Section 965 deferral liability to pay in installments is considered current debt as opposed to the traditional delinquent debt. This has created complications because a taxpayer can have both types of debt on their account, and the IRS cannot assess interest and penalties on current debt unless some or all of the current debt has become delinquent.
- The COVID-19 pandemic impacted every aspect of processing of tax returns, which included the processing of Section 965 payments and the monitoring of taxpayers that deferred the Section 965 tax. The implementation of the COVID-19 legislation took priority and this impacted the resources available to resolve Section 965 issues. For instance, some of the personnel assigned to resolve Section 965 processing issues were reassigned.
- The Government shutdown from December 22, 2018, through January 25, 2019, which lasted 35 calendar days.

Our analysis of Master File data identified over 11,000 business and individual taxpayers that elected to defer payments of over \$122 billion to be paid in eight installments (Section 965(h)). We also identified over 900 S Corporation individual taxpayers who deferred over \$650 million.⁴³ We selected judgmental samples of taxpayers that made the largest Section 965 deferral elections to determine if they were in compliance with the deferral requirements.⁴⁴ Specifically, we selected a sample of 140 taxpayers that deferred over \$91 billion to be paid in eight installments and 100 S Corporation individual taxpayers who deferred payment of over \$500 million. Figure 8 details the number of taxpayers we identified that made deferral elections with respect to Section 965(h) and Section 965(i) along with the amounts deferred and the judgmental samples selected for testing.

⁴³ We are not confident that we identified the population of S Corporation taxpayers that deferred the Section 965 liability. The W&I Division stated that it is still in the process of identifying the tax returns of S Corporation taxpayers that deferred the tax to input the correct processing codes on the inclusion year (Transaction Code 971 with Action Code 165). We identified these 926 taxpayers if they had a Transaction Code 971 with Activity Code 165 on any tax module.

⁴⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Figure 8: Population of Taxpayers Identified That Deferred Section 965 Liability

Description	Individuals		Businesses		Totals	
	No.	Amount	No.	Amount	No.	Amount
Number of Taxpayers and Amount of Payments Deferred to Be Paid in Installments – Section 965(h)	8,875	\$3,744,793,921	2,270	\$119,048,096,099	11,145	\$122,792,890,020
Judgmental Sample Selected for Analysis	99	\$1,949,455,899	41	\$89,560,149,866	140	\$91,509,605,765
Number of S Corporation Taxpayers and Amount Deferred – Section 965(i)	926	\$654,769,697	N/A	N/A	926	\$654,769,697
Judgmental Sample Selected for Analysis	100	\$531,545,410	N/A	N/A	100	\$531,545,410

Source: Individual and Business Master Data identified from TIGTA DCW.

Processing challenges impacted the ability to effectively monitor taxpayer compliance with the election to pay the Section 965 liability in installments

Taxpayers that make an I.R.C. § 965(h) election to pay the Section 965 liability in eight annual installments pay the following amounts:

- 8 percent in years one through five.
- 15 percent in year six.
- 20 percent in year seven.
- 25 percent in year eight.

The IRS developed reminder notices (CP56 to individuals and CP256 to businesses) and payment vouchers to remind taxpayers about their next installment payment. The reminder notice is sent six to eight weeks before the unextended tax return due date. This notice should show the total amount of unpaid Section 965(h) liability and the amount of the liability to be paid by the installment due date. However, because of the payments issue noted in the prior section, these notices could contain inaccurate data if the payments were applied to the incorrect tax period.

Annual installments are due on the unextended due date of the tax return.⁴⁵ Failure to pay a required installment could result in the assessment of an addition to tax, which could accelerate the unpaid portion of the remaining installments and cause it to become immediately due.⁴⁶ Taxpayers identified as noncompliant with the required installments should be sent a Letter 6154, *965(h) Soft Notice*, giving the taxpayer 30 days to respond with payment, plus interest, and statement of reasonable cause as to why installment payments were not made

⁴⁵ I.R.C. § 965(h)(2).

⁴⁶ I.R.C. § 965(h)(3).

timely.⁴⁷ If the taxpayer does not provide reasonable cause, the remaining Section 965 liability will be accelerated and will become due immediately.⁴⁸

Our analysis of the judgmental samples of 140 (99 individual and 41 business) taxpayers that elected to pay the Section 965 liability in installments showed that they were not always compliant with the payment requirements.⁴⁹ Our analysis showed that 15 (10.7 percent) of the 140 taxpayers had just over \$11.7 billion in unpaid Section 965 liability and may not have been compliant with the installment payments.⁵⁰ The IRS sent Letter 6154 to six of the 15 taxpayers with unpaid liability of almost \$44 million indicating they were not in compliance. The IRS eventually accelerated the unpaid Section 965 liability of just over \$31 million for four of the six taxpayers.

In the other nine cases in which taxpayers had unpaid liability of almost \$11.7 billion, we did not find evidence that the IRS had sent Letter 6154 to the taxpayers indicating they were not compliant. The SB/SE Division agreed with our determinations for these nine cases and indicated that it has been unable to process these cases yet.⁵¹ Figure 9 contains details of our analysis of the judgmental sample of 140 taxpayers that elected to pay the Section 965 liability in installments.

⁴⁷ SB/SE Division Collection Policy is responsible for initiating collection and sending the Letter 6154.

⁴⁸ IRM 21.6.4.4.21.12 (June 13, 2019).

⁴⁹ Our research consisted mainly of reviewing data on the IDRS. Information was retrieved using IDRS Command Codes BMFOL and IMFOL with definer M that was developed to track taxpayer compliance with Section 965(h) installments. The accuracy of the information retrieved with the command code is based on the accurate input of the installment processing codes and payment codes. We supplemented our review of this information by assessing the entirety of the taxpayer's account using IDRS Command Codes BMFOL, IMFOL, and TXMOD to identify any misapplied payments.

⁵⁰ Our analysis showed that 41 of the 140 taxpayers had misapplied Section 965 payments on the tax account at some point. It appeared that the IRS identified and correctly applied most of these payments. If these payments were properly coded, we considered them in making our determinations regarding compliance.

⁵¹ According to the SB/SE Division, the collection team that processes the possible acceleration cases consists of only seven tax examiners who are tasked with processing Section 965(h) transfer agreements, Section 965(i) transfer agreements as well as acceleration of unpaid Section 965(h) installments. The work for this team was transferred from the Memphis Campus to the Brookhaven Campus in October 2021. The current team addressing these matters is fairly new to Section 965 processing and a backlog of work is the result.

Figure 9: Compliance Analysis of Business and Individual Taxpayers That Elected to Pay the Section 965 Liability in Installments

Description	Individual Taxpayers		Business Taxpayers		Totals	
	No.	Amount	No.	Amount	No.	Amount
Judgmental Sample and Amount Deferred	99	\$1,949,455,899	41	\$89,560,149,866	140	\$91,509,605,765
Taxpayers Not in Compliance With Installment Requirements and Remaining Unpaid Balance	12	\$127,945,790	3	\$11,614,424,707	15	\$11,742,370,497
Letter 6154 Sent to Taxpayer with Unpaid Balance	6	\$43,842,117	--	--	6	\$43,842,117
Unpaid Section 965 Liability Accelerated	4	\$31,358,166	--	--	4	\$31,358,166

Source: TIGTA review of taxpayer information on the IDRS.

Eight of the 15 taxpayers that may not be compliant were not sent at least one reminder notice (CP56 to individuals and CP256 to businesses) during Calendar Years 2019 through 2021, including five of the six that were sent the Letter 6154 from the IRS. This could have been a contributing factor in the noncompliance of the taxpayers and may have been caused by the various processing issues encountered by the IRS. Taxpayers that did not receive a reminder notice may have concluded a payment was not due in the year(s) they did not receive the notice. When determining if a taxpayer is compliant, the IRS should consider if they were sent reminder notices and whether this contributed to the taxpayer’s noncompliance.

In addition, our analysis of the 140 taxpayers that elected to pay the Section 965 liability in installments identified an additional four taxpayers (in addition to the six noted in Figure 9) that were sent the Letter 6154 but were in compliance with the installment payments. We believe this occurred because in three cases, the Section 965 payments were originally misapplied and they were located when the SB/SE Division corresponded with the taxpayers. [REDACTED]

[REDACTED] We are confident that if the IRS resolves the various Section 965 payment issues (noted previously), this will resolve the identification of any false positives regarding noncompliance.

W&I Division Submission Processing personnel stated that the monitoring of those taxpayers that elected to pay their Section 965 liability in installments has been a manual process each year. The W&I Division has established a group of 12 personnel that reviews data extracts to identify taxpayers that deferred the tax as well as Section 965 payments. They review the tax accounts of taxpayers that deferred the tax to determine if they were compliant with the required payments and if any payments were misapplied to another tax year or were miscoded. If they determine that an installment was not made, they will refer the case to the SB/SE Division for possible acceleration.

Employees using the current manual procedures employed by the W&I Division are not timely identifying all taxpayers that are noncompliant with the installment requirements. This could be

a result of the limited resources available to conduct this research. W&I Division personnel are in the process of drafting business requirements to make this a more streamlined automated process. For instance, when an installment payment is not paid, the taxpayer will be identified as noncompliant and for a possible acceleration event. However, this identification would be dependent on the correct processing of Section 965 payments. The IRS needs to ensure that processes are developed to ensure that taxpayers that elected to pay the Section 965 liability in installments are compliant. Without the ability to promptly identify these taxpayers, there is the risk that the Section 965 liability will go unpaid.

S Corporation shareholders did not always report the Section 965 deferral annually

S Corporation shareholders that make an I.R.C. § 965(i) deferral election are required to annually report the amount of deferred S Corporation-related 965 tax liability.⁵² This is reported on Form 965-A, Part IV, *Annual Report of Deferred Net 965 Tax Liability Related to 965 Amounts Allocated From S Corporations*.⁵³ This annual reporting is required every year until the liability is fully paid. The reporting of this information is important because the IRS does not have the ability to systemically monitor for the occurrence of a triggering event. If this deferral is not reported on the Form 965-A, the IRS is statutorily required to assess a 5 percent penalty when the taxpayer fails to report the deferral on the Form 965-A.⁵⁴

For the 100 cases in our judgmental sample, we reviewed tax return information found on the Employee User Portal and the IDRS to determine if the shareholders reported the unpaid deferral on TYs 2019 and 2020 tax returns. S Corporation shareholders who deferred the Section 965 liability did not always report the liability annually on the Form 965-A, and when it was not reported, the IRS failed to assess the required 5 percent penalty. Specifically, 19 of the 100 S Corporation shareholders did not always report on the Form 965-A the \$64,979,646 they elected to defer.⁵⁵ The IRS did not assess \$6,265,523 in penalties when the deferral amount was not reported on the Form 965-A. The IRS generally agreed with our conclusions but responded that 13 of the 19 cases required further research. Figure 10 contains the results of our analysis.

⁵² I.R.C. § 965(i)(7)(A).

⁵³ The Form 965-A is filed with the taxpayer's income tax return for the reporting year by the due date of the income tax return (taking into account extensions, if any).

⁵⁴ I.R.C. § 965(i)(7)(C).

⁵⁵ We identified instances in which the taxpayer reported the deferral in one year but not the other.

Figure 10: Compliance Analysis of S Corporation Taxpayers Who Deferred Section 965 Liability

Description	Number of S Corporation Taxpayers Who Deferred Section 965 Liability	Amount of Section 965 Liability Deferred
Population	926	\$654,769,697
Judgmental Sample	100	\$531,545,410
Shareholders Who Did Not Always Report the Section 965 Liability on the Form 965-A	19	\$64,979,646
5 Percent Penalties Not Assessed on the Applicable Tax Years	35 (number of tax years)	\$6,265,523

Source: TIGTA review of taxpayer information on the Employee User Portal and the IDRS.

In three of the 100 sample cases, the IRS indicated that the S Corporation shareholder transferred approximately \$11.2 million in deferred liability to other taxpayers. However, we found that transfers were not properly accounted for on the S Corporation shareholder’s account. In addition, we identified five S Corporation shareholders for which the amount of Section 965 liability deferred, reported by the taxpayers on TYs 2019 or 2020 Forms 965-A, decreased by approximately \$8.3 million from the initial amount deferred. The IRS could not account for the decreases in three of the cases [REDACTED] and indicated that further research to resolve the differences is being conducted. The amount reported on the subsequent years’ Forms 965-A should match the amount initially deferred by S Corporation shareholders unless part of it was paid, transferred, or became due. The IRS needs to account for any changes in the deferral amounts from year to year to ensure that taxpayers remain in compliance and that any potential revenue is not lost.

W&I Division personnel stated that for each year the S Corporation shareholder reports the deferral on the Form 965-A, the IRS needs to input the processing codes (Transaction Code 971 with Action Code 165) indicating the deferral was properly reported. Ideally, when these codes are properly input, this information could be used to systemically identify those taxpayers who did not properly report the deferral on the Forms 965-A year to year. However, we found in 82 of the 100 cases that the processing codes were not input when it appeared the taxpayer properly reported the deferral on the Form 965-A during TYs 2019 and 2020. W&I Division personnel indicated they are lagging in their efforts to ensure that these codes are manually input each year.

The IRS needs to develop procedures to allow it to identify S Corporation shareholders who did not annually report the correct amount of Section 965 deferral on the Form 965-A to ensure that the penalties are properly assessed. This includes accounting for differences in the amounts deferred by S Corporation shareholders and ensuring that the processing codes are input when the S Corporation shareholder properly reports the deferral. It is important these steps are taken because it would help the IRS to systemically identify occurrences of a triggering event.

The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should:

Recommendation 4: Develop procedures to systemically identify taxpayers that made the Section 965(h) deferral election and are not compliant with the required payments.

Management's Response: The IRS agreed with this recommendation and in its response acknowledged that taxpayers who elected to defer Section 965 repatriation tax liability under Section 965(h) and who are not compliant with required payments should be identified. The IRS stated that due to the complexity of the balances, the IRS will continue current systemic and manual processes to identify taxpayers who made Section 965(h) elections and who are not compliant with payments.

Recommendation 5: Develop procedures to identify S Corporation shareholders who made an election under Section 965(i) and who did not annually submit the Form 965-A or did not report the correct amount of the Section 965 deferral on the Form 965-A. The procedures should ensure that the correct processing codes are applied when the deferral is reported on the Form 965-A.

Management's Response: The IRS partially agreed with this recommendation while acknowledging that S Corporation taxpayers that did not annually report or failed to report the correct amount of net Section 965 repatriation tax deferral on the Form 965-A should be identified. In its response, the IRS stated that the steps to accomplish this include developing procedures to ensure that the correct processing codes are applied when the deferral is reported on the Form 965-A. Additionally, the Section 965 Core Team has submitted a unified work request to identify potential Section 965(i) Repatriation Tax annual filing noncompliance.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the IRS's efforts to ensure compliance with I.R.C. Section 965. To accomplish our objective, we:

- Determined if the Section 965 provision of the Tax Cuts and Jobs Act produced the amount of tax revenue expected by the Joint Committee on Taxation by obtaining from the IRS the amount of Section 965 liability reported and the current amount of Section 965 liability deferred. We interviewed LB&I Division executives and determined possible reasons why Section 965 did not generate the revenue as expected.
- Evaluated the two active LB&I Division Section 965 compliance campaigns by interviewing applicable LB&I Division executives and personnel and reviewing the campaign submission documents and the results from the treatment streams used.
- Interviewed applicable IRS personnel and determined the procedures for monitoring compliance with the Section 965 elections to pay the liability in installments over an eight-year period and to defer the payment of the tax until a triggering event for shareholders of S Corporations.
- Interviewed applicable IRS personnel and determined the procedures for processing Section 965 payments when submitted by taxpayers.
- Determined if Section 965 payments were properly accounted for and protected from inadvertent refund, misapplication, or misappropriation by analyzing Master File data from the TIGTA DCW. We identified 15,484 payments totaling \$1,303,367,204 with DPC 64 made by business and individual taxpayers that were applied to TYs 2019, 2020, or 2021 tax modules. We selected a judgmental sample¹ of those payments with the highest dollar amount and those associated with a refund on the tax module and reviewed taxpayer information on the IDRS to determine if the posting of those payments to those later modules were correct. A total of 96 payments were made by individuals totaling \$28,487,971 and 101 payments were made by businesses totaling \$1,220,919,192.² Judgmental samples were selected to focus on the larger dollar payments and those payments associated with refunds.
- Evaluated the compliance of those taxpayers that elected to pay the Section 965 liability over an eight-year period. We analyzed Master File data from the TIGTA DCW and identified 11,145 taxpayers that used the election to defer \$122,792,890,020 in Section 965 liability to pay in installments. We selected judgmental samples of 99 individual taxpayers who elected to defer payment of \$1,949,455,899 and 41 business taxpayers that elected to defer payment of \$89,560,149,866. We reviewed Master File data on the IDRS to determine if the taxpayers were compliant with their installment

¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

² We only included payments of \$100 or more.

payments. Judgmental samples were selected to focus on those taxpayers that deferred the largest amount of Section 965 liability.

- Evaluated the compliance of shareholders of S Corporations who elected to defer the Section 965 liability. We analyzed Master File data from the TIGTA DCW and identified 926 taxpayers who used the S Corporation election to defer \$654,769,697 in Section 965 liability. We selected a judgmental sample of 100 taxpayers who elected to defer \$531,545,410 and reviewed Form 965-A, Part IV, on the Employee User Portal and Master File data on the IDRS to determine if the taxpayers reported the deferral for TYs 2019 and 2020. For those taxpayers who did not report the deferral, we analyzed Master File data on the IDRS to determine if the 5 percent penalties were applied.³ Judgmental samples were selected to focus on those taxpayers that deferred the largest amount of Section 965 liability.

Performance of This Review

This review was performed with information obtained from and discussions with personnel in the LB&I Division, W&I Division, the SB/SE Division, and staff from the CFO during the period of June 2021 through May 2022. We were limited during this audit to conducting conference calls and requesting information via electronic mail because the COVID-19 pandemic curtailed our plans to make visitations to audit sites. We believe we were still able to conduct 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 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.

Major contributors to the report were Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Christina Dreyer, Director; Tim Greiner, Director; Eugenia Smoak, Audit Manager; Meaghan Tocco, Acting Audit Manager; and Jeff K. Jones, Lead Auditor.

Validity and Reliability of Data From Computer-Based Systems

During this review, we relied on information obtained from the TIGTA DCW. We compared the amount of Section 965 liability on the DCW to the amount of liability recorded on the taxpayer's account on the IDRS for 10 cases and determined that the data were sufficiently reliable for purposes of this audit.

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: controls related to the

³ The Form 965-A is filed with the taxpayer's income tax return for the reporting year by the due date of the income tax return (taking into account extensions, if any). IRM 20.1.9.16.1.

processing of Section 965 payments and controls related to the monitoring of those taxpayers that deferred the Section 965 tax. We evaluated these controls by interviewing and corresponding with key personnel and analyzing Master File data.

Appendix II

Outcome Measures

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

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 90 payments totaling \$37.4 million that were incorrectly coded as a Section 965 payment (see Recommendation 3).

Methodology Used to Measure the Reported Benefit:

Our analysis of Master File data identified over 15,000 tax payments totaling over \$1.3 billion made by businesses and individuals that were posted to TYs 2019, 2020, or 2021 tax modules.¹ To determine if the posting of these payments to later modules were correct, we selected a judgmental sample of the payments with the highest dollar amount and those associated with a refund on the tax module.² Our sample included 101 payments totaling over \$1.2 billion made by businesses and 96 payments totaling over \$28 million made by individuals. The sample of payments selected totaled almost 96 percent of the total payments.

We conducted an analysis of taxpayer information on the IDRS to determine if the payments posted to the tax modules were correct. We found 90 payments totaling \$37,363,342 for which there was not a corresponding Section 965 liability on the taxpayer's tax account. These were incorrectly coded as Section 965 payments.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 37 payments totaling \$58 million that were misapplied to the incorrect tax module (see Recommendations 2 and 3).

Methodology Used to Measure the Reported Benefit:

Our analysis of Master File data identified over 15,000 tax payments totaling over \$1.3 billion made by business and individuals that were posted to TYs 2019, 2020, or 2021 tax modules.³ To determine if the posting of these payments to later modules were correct, we selected a judgmental sample of the payments with the highest dollar amount and those associated with a refund on the tax module.⁴ Our sample included 101 payments totaling over \$1.2 billion made by businesses and 96 payments totaling over \$28 million by individuals. The sample of payments selected totaled almost 96 percent of the total payments.

¹ We only included payments of \$100 or more.

² A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

³ We only included payments of \$100 or more.

⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

We conducted an analysis of taxpayer information on the IDRS to determine if the payments posted to the tax modules were correct. We found 37 payments totaling \$58,091,350 that were misapplied to the incorrect tax module, which resulted in the issuance of \$1,176,296 in erroneous refunds.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; 35 penalties totaling \$6,265,523 were not assessed for 19 S Corporation shareholders who failed to report the Section 965 tax on the Form 965-A (see Recommendation 5).

Methodology Used to Measure the Reported Benefit:

We selected a judgmental sample of 100 S Corporation shareholders who deferred \$531,545,410 in Section 965 tax. We reviewed tax return information found on the Employee User Portal and the IDRS to determine if the shareholders reported the unpaid deferral on TYs 2019 and 2020 tax returns. We did not find evidence that S Corporation shareholders who deferred the Section 965 liability always reported the liability annually on the Form 965-A, and when it was not reported, the IRS failed to assess the required 5 percent penalty. We found that 19 of the 100 S Corporation shareholders did not always report on the Form 965-A the \$64,979,646 they elected to defer.⁵ The IRS did not assess \$6,265,523 in penalties when the deferral amount was not reported on the Form 965-A.

⁵ We identified instances in which the taxpayer reported the deferral in one year but not the other.

Appendix III

Letter 6311



Department of the Treasury
Internal Revenue Service
[Operating Division / Program Name]

[Mail Stop 4308 AUSC]
[3651 S. IH 35]
[Austin TX 78741]

Date:

04/11/2022

Taxpayer ID number:

Tax form:

Form 1040

Tax year:

Hotline telephone number:

267-466-0020

[Recipient name]

[Address line 1]

[Address line 2]

[Address line 3]

Dear [Taxpayer]:

We're writing to tell you of potential U.S. federal income tax and reporting requirements due to the recent Tax Cuts and Jobs Act amendment of Internal Revenue Code (IRC) Section 965.

Based on your filing of Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, you may be required to take some or all of the following actions:

- include additional amounts in income on your U.S. federal income tax return,
- pay additional tax if applicable, and
- comply with additional information reporting obligations.

What you need to do

Please review your information and ensure you meet your U.S. federal income tax and reporting obligations.

If you have unmet requirements under recently amended IRC Section 965 related to your ownership in one or more foreign corporations, take the actions necessary to meet those requirements.

After reviewing the information referenced below, you should file an amended return if you did not:

- accurately report your income on your U.S. federal income tax return,
- pay the correct amount of tax, or
- follow the information reporting requirements under IRC Section 965 and applicable regulations.

When filing an amended return, write "Letter 6311" at the top of the first page of the return. Mail your amended return to the Internal Revenue Service Center as noted in the Instructions for Form 1040-X.

Failure to timely file a complete and accurate return and to pay tax due could result in penalty and interest charges. For more information, visit www.irs.gov/filing.

What you need to know about IRC Section 965

In general, IRC Section 965 requires certain U.S. persons to pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the U.S. Generally, a specified foreign corporation means either a controlled foreign corporation, as defined in IRC Section 957, or a foreign corporation that has a U.S. shareholder (as defined in IRC Section 951(b)) that is a domestic corporation.

Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax

IRC Section 965 applies to the last taxable year of a specified foreign corporation beginning before January 1, 2018, and the transition tax is generally due with the taxpayer's return for the taxable year in which or with which its specified foreign corporation's taxable year ends.

Most individual taxpayers impacted by the new provisions of IRC Section 965 must report the additional amounts in income on their 2017 income tax returns and must generally pay the transition tax with those returns. In some cases, for example, where the foreign corporation has a fiscal tax year, the U.S. income tax and reporting requirements related to IRC Section 965 may apply to 2018 or a later tax year. If the taxpayer has a IRC Section 965 obligation with respect to both a specified foreign corporation with a calendar tax year and a specified foreign corporation with a fiscal tax year, the taxpayer may have to report amounts under IRC Section 965 with its returns for two tax years (generally, 2017 and 2018).

Additionally, individual taxpayers or entities taxed like individuals required to include amounts in income under IRC Section 965 may have to file some or all the following with their returns:

- IRC 965 Transition Tax Statement (with their 2017 tax return)
- Form 965, Inclusion of Deferred Foreign Income Upon Transition to Participation Exemption System
- Form 965-A, Individual Report of Net 965 Tax Liability

IRC Section 965(k) allows the IRS six years, from the date the taxpayer files the return (for the year in which the taxpayer has an income inclusion due to IRC Section 965), to assess the IRC Section 965 net tax liability.

Where you can find more information

For answers to questions related to IRC Section 965 (not covered in the statute or the regulations), visit:

- Questions and Answers about Reporting Related to Section 965 on 2017 Tax Returns, available at www.irs.gov/section965qa
- Questions and Answers about Tax Year 2018 Reporting and Payments Arising under Section 965, available at www.irs.gov/section965qa2018
- General Section 965 Questions and Answers (Including Transfer and Consent Agreements), available at www.irs.gov/generalsection965qa

Find tax forms or publications by visiting www.irs.gov/forms-pubs or calling 800-TAX-FORM (800-829-3676).

You don't need to respond to this letter. However, we may send future correspondence about potential enforcement activity.

If you have questions, you can call our voice message hotline number shown at the top of this letter and leave a message. Please note this isn't a toll-free number. We'll respond to all messages within three business days.

Thank you for your cooperation.

Sincerely,

[Name]

[Title]

Letter 6311 (8-2020)
Catalog Number 74507Q

Appendix IV

Internal Revenue Code Section 965 Transition Tax Statement

IRC 965 Transition Tax Statement (Portable Document Format with a filename of '965 Tax')

Taxpayer Name: _____ SSN/FEIN: _____

<u>Item</u>	<u>Amount</u>
-------------	---------------

Total amount required to be included in income by reason of section 965(a). Line 1 \$ _____

Aggregate foreign cash position, if applicable. Line 2 \$ _____

Total deduction under section 965(c). Line 3 \$ _____

Total deemed paid foreign taxes associated with the total amount required to be included in income by reason of section 965(a). Line 4a \$ _____

Total deemed paid foreign taxes disallowed pursuant to IRC 965(g)(1). Line 4b \$ _____

Total net tax liability under section 965 (as determined under section 965(h)(6), without regard to whether such paragraph is applicable), if applicable, which will be assessed. Line 5 \$ _____

Amount of the net tax liability under section 965 to be paid in installments under section 965(h), if applicable. Line 6 \$ _____

Amount of the net tax liability under section 965, the payment of which has been deferred, under section 965(i), if applicable. Line 7 \$ _____

Listing of applicable elections under section 965 or the election provided for in Notice 2018-13 that the taxpayer has made, if applicable.

<u>Provision Under Which Election is Made</u>	<u>Title</u>	<u>Attached (Y or N)</u>
Section 965(h)(1)	Election to Pay Net Tax Liability Under Section 965 in Installments under Section 965(h)(1).	
Section 965(i)(1)	S Corporation Shareholder Election to Defer Payment of Net Tax Liability Under Section 965 Under Section 965(i)(1)	
Section 965(m)(1)(B)	Statement for Real Estate Investment Trusts Electing Deferred Inclusions Under Section 951(a)(1) By Reason of Section 965 Under Section 965(m)(1)(B)	
Section 965(n)	Election Not to Apply Net Operating Loss Deduction under section 965(n)	
Notice 2018-13, Section 3.02	Election Under Section 3.02 of Notice 2018-13 to Use Alternative Method to Compute Post-1986 Earnings and Profits	

Under penalties of perjury, I declare that I have examined this statement, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

CP56 Notice



Department of the Treasury
Internal Revenue Service
PO Box 249
Cincinnati, OH 45999-0039

JAMES SPARROW
22 BOULDER ST
HANSON, CT 00000-7253

Notice	CP56
Tax year	2017
Notice date	January 30, 2019
Social Security number	Nnn-nn-nnnn
To contact us	855-xxx-xxxx ext. xxx

Page 1 of 3

Your annual Internal Revenue Code (IRC) Section 965 installment payment is due.

Installment amount due: \$610.00

Your annual IRC Section 965 installment payment of \$610.00 is due by April 15, 2019.

Payment information	
Total unpaid IRC Section 965 amount	\$6,000.00
Underpayment of previous installment	\$100.00
Interest on underpayment	\$10.00
Installment amount due	\$500.00
Total amount due by April 15, 2019	610.00

What you need to do immediately

Pay immediately

- Make your payment of \$610.00 by April 15, 2019. Failure to pay by the due date may result in a penalty, and the full amount of your net tax liability under Internal Revenue Code Section 965 may become immediately due.
- Pay online or mail a check or money order with the attached payment stub. **You can pay online now at www.irs.gov/payments.**

Continued on back



James Hinds
22 Boulder Street
Hanson, CT 00000-7253

Notice CP56
Notice date January 30, 2019
Social Security number nnn-nn-nnnn

Payment

Make your check or money order payable to the United States Treasury. Write your Social Security number (nnn-nn-nnnn), the tax year (2017), and the form number (1040) on your payment and any correspondence.

Payment due by
April 15, 2019

\$610.00

INTERNAL REVENUE SERVICE
P.O. BOX 37004
HARTFORD, CT 06176-7004

0000 0000000 00000000000 00000000 0000

Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax

Notice	CP56
Tax year	2017
Notice date	January 30, 2019
Social Security number	Nnn-nn-nnnn

Page 2 of 3

Payment options

Pay now electronically

We offer free payment options to securely pay your tax bill directly from your checking or savings account. When you pay online or with your mobile device, you can:

- Receive instant confirmation of your payment
- Schedule payments in advance
- Modify or cancel a payment before the due date

You can also pay by debit or credit card for a small fee. To see all of our payment options, visit www.irs.gov/payments.

Account balance and payment history

If you already paid your balance in full within the past 21 days, please disregard this notice.

If you think we made a mistake, call 855-xxx-xxxx extension xxx to review your account.

Interest Charges

We are required by law to charge interest when you do not pay your liability on time. Generally, we calculate interest from the due date of your return (regardless of extensions) until you pay the amount you owe in full, including accrued interest and any penalty charges. Interest on some penalties accrues from the date we notify you of the penalty until it is paid in full. Interest on other penalties, such as failure to file a tax return, starts from the due date or extended due date of the return. Interest rates are variable and may change quarterly. (Internal Revenue Code section 6601)

Description	Amount
Total interest	\$10.00

The table below shows the rates used to calculate the interest on your unpaid amount due. For a detailed calculation of your interest, call 855-xxx-xxxx ext. xxx.

Period	Interest rate
October 1, 2016 – December 31, 2016	3%
Beginning January 1, 2017	3%

Back of payment stub

Additional Actions Are Needed to Ensure Taxpayer Compliance With the Section 965 Repatriation Tax

Notice	CP56
Tax year	2017
Notice date	January 30, 2019
Social Security number	nnn-nn-nnnnn

Page 3 of 3

If we don't hear from you

If we don't receive your payment of \$ 610.00 by April 15, 2019, it may result in a failure to pay penalty, and the full amount of your net tax liability under IRC Section 965 may become immediately due.

Additional information

- Visit www.irs.gov/cp56
- For tax forms, instructions, and publications, visit www.irs.gov/forms-pubs or call 800-TAX-FORM (800-829-3676).
- You can contact us by mail at the address at the top of the first page of this notice. Be sure to include you Social Security number, the tax year, and the form number you are writing about.
- Keep this notice for your records.

If you need assistance, please don't hesitate to contact us.

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

August 29, 2022

MEMORANDUM FOR HEATHER M. HILL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Nikole C. Flax **Nikole C. Flax** Digitally signed by Nikole C. Flax
Date: 2022.08.29 20:45:10 -04'00'
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report # 2021-30-423, "Additional Actions are
Needed to Ensure Taxpayer Compliance with the Section 965
Repatriation Tax"

Thank you for the opportunity to respond to the above referenced report. The Tax Cuts and Jobs Act (TCJA) was the most sweeping international tax reform in a generation. The Section 965 Repatriation Tax, which was part of that reform, created unique challenges for both the IRS and taxpayers. Enacted in late December of 2017, it was effective for the 2017 tax year for certain taxpayers with a December 31 year end. For this group of taxpayers, the Repatriation Tax was due by April 18, 2018 (less than four months after the TCJA was enacted). Further complicating compliance and administrability, taxpayers could elect to defer payment of the tax over 8 annual installments, or in the case of an S Corporation shareholder could defer liability for the tax potentially indefinitely. This "springing" liability feature as well as the 8-year spread feature is different from the existing operation of our master-file taxpayer accounts. In addition to the unique features, complexity and immediate effective date of the Repatriation Tax provision, resources constraints were also an issue as the IRS was working to implement this and hundreds of other provisions under the TCJA.

Notwithstanding these challenges, the IRS developed, and continues to refine and enhance, a multi-pronged and comprehensive strategy for addressing implementation and compliance with the Section 965 Repatriation Tax, resulting in billions of proposed adjustments to taxpayers' positions and improved taxpayer compliance. We made, and continue to make, significant changes to our information technology systems and processing. To enhance taxpayer experience, we developed formal and informal guidance; updated and created tax forms, instructions, and educational materials; delivered training for our workforce; and engaged in stakeholder outreach.

The IRS devoted significant resources to ensure taxpayers comply with the Section 965 Repatriation Tax. The LB&I Division is executing two Section 965 Repatriation Tax campaigns focusing on business and individual compliance. The successful

implementation of campaigns provides improved return selection and identification of issues representing a risk of noncompliance, while making the greatest use of limited resources, increasing taxpayer compliance and enhancing the IRS's tax administration efforts.

The Individual Campaign addresses compliance with the Section 965 Repatriation Tax filing obligations as it pertains to individual taxpayers. The goals of the Campaign are to increase compliance of individual taxpayers who did not voluntarily report their Section 965 inclusions on their tax returns and to determine whether the Section 965 Repatriation Tax computations reported by individual taxpayers are accurate. Detailed focused filters were developed to identify the workload and determine the best treatment stream to address any compliance concerns. The two primary treatment streams consist of mailing out soft letters and conducting examinations. The soft letter treatment stream resulted in almost 2,500 soft letters being mailed out to individual taxpayers located in the U.S. and abroad. The soft letter was educational in nature and did not require a response. The soft letters likely resulted in 546 amended returns being filed that reported \$88,706,375 of Section 965 Repatriation Tax. The examination component of the campaign was designed to select tax returns for examination where the filters identified individual taxpayers with potential unreported Section 965 Repatriation Tax and/or those who may have incorrectly reported Section 965 Repatriation Tax. The examinations are ongoing.

The Business Campaign focuses on ensuring compliance for those reporting the largest Section 965 inclusions. Measured compliance among C Corporations, S Corporations and Partnerships informs future actions. The examinations identify noncompliance and have generated substantial adjustments. To date, hundreds of Notices of Proposed Adjustments were issued to these taxpayers and over \$6 billion in adjustments made to the tax returns. We ensure broad knowledge sharing of the lessons learned from our compliance work in the campaigns with other compliance workstreams so that all agents have the tools and knowledge in identifying and working these issues.

The IRS devotes significant resources to addressing Section 965 Repatriation Tax account issues. Section 965 Repatriation Tax payments are manually reviewed before posting to taxpayer accounts. A team of IRS personnel was established to manually review the accounts of all taxpayers that deferred the Section 965 Repatriation Tax liability. They focus on identifying misapplied or miscoded Section 965 Repatriation Tax payments and making necessary corrections. The IRS developed business requirements that, within the confines of resource constraints, enables the systematic monitoring Section 965 Repatriation Tax payments and those taxpayers with outstanding Section 965 Repatriation Tax liabilities.

Looking ahead, we are, and will continue to, work on additional steps to aid compliance. For example, we will further clarify Notices CP56 and CP256 to advise taxpayers how to properly make Section 965(h) Repatriation Tax installment payments. Our compliance efforts and our continued implementation will proceed in a manner that is informed by our taxpayers' experience and will be responsive to stakeholder feedback.

Attached is our response to your recommendations. If you have any questions, please contact me, or members of your staff may contact John Hinding, Director, Cross Border Activities Practice Area by email (John.E.Hinding@irs.gov) or phone (202-317-8686).

Attachment

Attachment

RECOMMENDATION 1: The Commissioner, LB&I Division should prioritize and follow up on the list of nonresponsive taxpayers issued soft letters to determine whether any follow-up procedures are appropriate, taking into consideration WEIC examination priorities.

CORRECTIVE ACTION: [REDACTED]

RESPONSIBLE OFFICIAL: Director, LB&I Withholding, Exchange & International Individual Compliance Practice Area

IMPLEMENTATION DATE: Implemented

CORRECTIVE ACTION MONITORING PLAN: N/A

RECOMMENDATION 2: The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should revise the CP56 and CP256 notices to add more information on how the Section 965 installment payments should be made. For instance, when making a payment using the EFTPS, the notice should specify how the payments should be made. The notice should also indicate that the taxpayer currently cannot use the debit/credit card payment platform to make Section 965 installment payments.

CORRECTIVE ACTION: The IRS will update CP56 and CP256 notices to advise taxpayers how to properly make Section 965(h) Repatriation Tax installment payments.

RESPONSIBLE OFFICIALS: Director, LB&I Cross Borders Activities Practice Area

IMPLEMENTATION DATE: October 15, 2023

CORRECTIVE ACTION MONITORING PLAN: We will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3: The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should ensure that any business requirements developed by the "Section 965 Core Team" systemically identify all Section 965 payments that are

applied to 2019 or later tax modules so they can be evaluated to determine if they were correctly processed.

CORRECTIVE ACTION: The IRS will implement this recommendation in part. The IRS has drafted unified work requests to identify all Section 965 Repatriation Tax designated payments going forward. The IRS is evaluating whether current manual efforts of determining application of payments are sufficient. Also, the IRS will consider the benefit of providing an additional systemic review against limited resources.

RESPONSIBLE OFFICIALS: Director, LB&I Cross Borders Activities Practice Area

IMPLEMENTATION DATE: October 15, 2023

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4: The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should develop procedures to systemically identify taxpayers that made the Section 965(h) deferral election and are not compliant with the required payments.

CORRECTIVE ACTION: The IRS acknowledges that taxpayers who elected to defer Section 965 Repatriation Tax liability under Section 965(h) and who are not compliant with required payments should be identified. Due to the complexity of the balances, the IRS will continue current systemic and manual processes to identify taxpayers who made Section 965(h) elections and who are not compliant with payments.

RESPONSIBLE OFFICIALS: Director, LB&I Cross Borders Activities Practice Area

IMPLEMENTATION DATE: Implemented

CORRECTIVE ACTION MONITORING PLAN: N/A

RECOMMENDATION 5: The Commissioner, LB&I Division, in coordination with the Commissioner, W&I Division, should develop procedures to identify S Corporation shareholders who made an election under Section 965(i) and who did not annually submit the Form 965-A or did not report the correct amount of the Section 965 deferral on the Form 965-A. The procedures should ensure that the correct processing codes are applied when the deferral is reported on the Form 965-A.

CORRECTIVE ACTION: The IRS will implement this implementation in part. S Corporation taxpayers that did not annually report or failed to report the correct amount of net Section 965 Repatriation Tax deferral on the Form 965-A should be identified.

Steps to accomplish this include developing procedures to ensure the correct processing codes are applied when the deferral is reported on the Form 965-A. Additionally, the Section 965 Core Team has submitted a unified work request to identify potential Section 965(i) Repatriation Tax annual filing non-compliance.

RESPONSIBLE OFFICIALS: Director, LB&I Cross Borders Activities Practice Area

IMPLEMENTATION DATE: October 15, 2023

CORRECTIVE ACTION MONITORING PLAN: We will monitor this corrective action as part of our internal management system of controls.

Appendix VII

Glossary of Terms

Term	Definition
Accounts Management Function	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.
Data Center Warehouse	A TIGTA repository of IRS data.
Employee User Portal	Internal IRS portal that allows IRS employee users to access IRS data systems, such as tax administration processing systems, financial information systems, and other data and applications, including mission-critical applications. TIGTA auditors can also request access to this information.
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.
Full-Time Equivalent	A measure of labor hours in which one full-time equivalent is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.
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.
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 Cuts and Jobs Act	Public Law 115-97, passed in December 2017, was a congressional revenue act that made significant changes to the tax code that affects individuals, businesses, and tax-exempt organizations.
Tax Year	The 12-month period for which tax is calculated.

Appendix VIII

Abbreviations

CBA	Cross-Border Activities
CFO	Chief Financial Officer
COVID-19	Coronavirus Disease 2019
DCW	Data Center Warehouse
DPC	Designated Payment Code
EFTPS	Electronic Federal Tax Payment System
IDRS	Integrated Data Retrieval System
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LB&I	Large Business and International
NOPA	Notice of Proposed Adjustment
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
W&I	Wage and Investment
WEIIC	Withholding Exchange and International Individual Compliance



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