

## IRS issues Q&As on Section 965 transfer and consent agreements

The IRS recently issued questions and answers (Q&As) regarding the transition tax imposed by Internal Revenue Code Section 965. Under finalized regs issued early in 2019, Sec. 965 generally requires U.S. shareholders to pay a “transition tax” on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States.

Under the old rules, U.S. taxpayers were generally taxed on all income whether earned in the U.S. or abroad, but foreign income earned by a foreign subsidiary of a U.S. corporation wasn’t subject to U.S. tax on that income until it was “repatriated” to the United States via dividend. The transition tax effectively bridges the old rules with the new by taxing certain previously untaxed foreign income.

The Q&As provide guidance on several important points related to Sec. 965 and the transition tax.

### Transfer agreements

Under Sec. 965(h)(3) and Sec. 965(i)(2), transfer agreements should be filed with the IRS’s Memphis Compliance Service Collection Operations at Memphis CSCO, 5333 Getwell Road MS 81, Memphis, TN 38118.

Such agreements are considered timely only if filed within 30 days of the date that an acceleration event or triggering event occurs. However, if a triggering event is the death of the eligible Sec. 965(i) transferor, the transfer agreement must be filed by the unextended due date for the eligible Sec. 965(i) transferor’s final income tax return.

### Consent agreements

Consent agreements must also be filed with the IRS’s Memphis Compliance Service Collection Operations at the address above. Each S corporation shareholder must file a consent agreement and obtain IRS consent. The S corporation cannot obtain consent on behalf of its shareholders.

Even after a shareholder has filed a consent agreement, the shareholder still needs to make a Sec. 965(h) election on its tax return to pay its Sec. 965(i) net tax liability in eight annual installments. The shareholder must attach to the tax return a statement signed (under penalties of perjury) electing Sec. 965(h).

In the case of an electronically filed return, the election statement should be attached in Portable Document Format (.pdf). The shareholder’s Form 965-A or 965-B, as applicable, should also be updated to reflect the triggering event and Sec. 965(h) election.

### S corporation scenario

In its Q&As, the IRS presents a scenario in which an S corporation shareholder previously made a Sec. 965(i)(1) election with respect to its Sec. 965(i) net tax liability, and a triggering event occurred in a later year.

The shareholder made a Code Sec. 965(h) election on its tax return for the year of the triggering event. Its payments, including estimated tax payments, for the year of the triggering event exceeded its net income tax liability (that is, its net income tax determined without regard to Sec. 965) and its first annual installment.

Can the shareholder receive a refund of the excess amounts or credit the excess amounts to its next year's estimated income tax? The IRS says no. The shareholder doesn't receive a refund or credit of any portion of properly applied tax payments unless and until the amount of its payments exceeds its entire unpaid income tax liability — including all amounts to be paid in installments under Sec. 965(h) in subsequent years. If its tax payments exceed the sum of its net tax liability determined without regard to Sec. 965 and its first annual installment, the excess will be applied to its next annual installment and so on until the full amount of its Sec. 965(i) net tax liability is satisfied or until the full amount of the tax payment is applied.

The IRS points out that, under regulations, the S corporation and a transferor of the underlying S corporation shares (if any) remain jointly and severally liable for the payment of the transferee's Sec. 965(i) net tax liability after the transferee made a Sec. 965(h) election to pay the liability in eight annual installments. In addition, the S corporation is jointly and severally liable for any penalties, additional tax or other amounts attributable to the net tax liability.

If the transferee received the S corporation shares pursuant to a transfer agreement under Sec. 965(i)(2)(C), the transferor is also jointly and severally liable for any penalties, additional tax or other additional amounts attributable to the net tax liability. A Sec. 965(h) election to pay the transferee's net tax liability in eight annual installments doesn't alter the joint and several liability of the S corporation or the transferor (if any) with respect to the underlying S corporation shares.

### **Important changes**

The finalized Sec. 965 transition regs have changed the taxation landscape for U.S. taxpayers with foreign income. Work closely with your CPA to determine how your situation has been affected. •