



August 28, 2018

The Honorable David J. Kautter
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Douglas O'Donnell
Commissioner
Large Business & International Division
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Guidance on Reporting the Transition Tax under Section 965

Dear Messrs. Kautter and O'Donnell:

The American Institute of CPAs (AICPA) appreciates the guidance provided by Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) related to the reporting requirements for section 965¹ as amended by [Pub. L. No. 115-97](#), commonly referred to as the Tax Cuts and Jobs Act (TCJA). The guidance issued to date includes several notices,² [Rev. Proc. 2018-17](#), [Publication 5292](#), [Frequently Asked Questions](#) (FAQs) with sample reporting statements and proposed regulations.³

The guidance has provided assistance to taxpayers and practitioners as they prepare and file their 2017 tax returns. However, significant uncertainty remains on how to properly disclose certain information related to the calculation of their section 965 transition tax liability on the necessary tax forms. The extended deadlines for filing 2017 tax returns are rapidly approaching and guidance is urgently needed on the factors which the IRS will consider in determining whether a taxpayer has substantially complied with their tax reporting obligations in relation to their section 965 transition tax liability.

RECOMMENDATION

The AICPA urges the IRS to provide automatic relief from penalties incurred by a taxpayer who has acted reasonably and made a good faith effort to properly report their section 965 tax liability on their 2017 tax returns.

¹ Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to Treasury Regulations promulgated thereunder.

² [Notice 2018-07](#), [Notice 2018-13](#), [Notice 2018-26](#).

³ [Guidance Regarding the Transition Tax Under Section 965 and Related Provisions](#).

ANALYSIS

Uncertainty on Reporting Section 965 Transition Tax on Form 5471

Section 965 requires a series of calculations in order to properly determine the transition tax and reporting on the related installment payment schedule. The guidance released to date does not provide taxpayers with information on the reporting requirements related to the 2017 filing of Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*. However, section 6038 imposes a \$10,000 penalty for failure to furnish the required information on a Form 5471 submitted with a timely filed tax return.

There are several new “buckets” of previously taxed income (PTI) created by the TCJA and section 965. The notices and proposed regulations issued by the IRS and Treasury related to section 965 indicate that the PTI arising from section 965 is within the section 959 “(c)(2)” bucket of PTI. The existing Form 5471 does not provide a way for taxpayers to differentiate between the different categories of (c)(2) PTI (i.e., whether arising from “regular” subpart F inclusions; section 965(a) inclusions that are treated as partially tax-exempt for purposes of section 986(c); and section 965(b)(4)(A) “offset PTI” arising from the allocation of an E&P deficit to the foreign corporation).

In addition, guidance is specifically needed on how to properly report earnings and profits related to section 965 on Schedule J of Form 5471, including the deemed increase to E&P provided in section 965(b)(4)(B) for the allocation of a foreign corporation’s E&P deficits. The IRS should confirm that the Subpart F income arising from section 965(a) is reported on Schedule I of the Form 5471.

Uncertainty on Reporting Section 965 Transition Tax on Form 1120

The guidance released to date does not provide clear instruction on how to report certain information and the supporting calculations on a taxpayer’s primary tax form, particularly with respect to the Form 1120, *U.S. Corporation Income Tax Return*.

For example, according to IRS FAQ #2 posted on March 13, 2018, the section 965(a) amount, the section 965(c) deduction, the deemed paid foreign taxes with respect to the section 965(a) amount, and the foreign taxes disallowed under section 965(g) are not reported on Form 1118, *Foreign Tax Credit – Corporations*. The deemed paid foreign taxes with respect to the section 965(a) amount and the foreign taxes disallowed under section 965(g) are reported on a separate statement, the *IRC 965 Transition Tax Statement*. Since the relevant section 965(a) amount is not reported on Form 1118, taxpayers must manually apportion expenses without the benefit of a schedule or worksheet to determine any foreign tax credit limitation. Taxpayers also need guidance on how to reflect any credits carried forward that are used to offset their section 965 transition tax liability.

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The disconnect between a Form 1120 presentation that excludes the section 965 amounts and the taxpayer's taxable income, which includes the section 965 amounts, also complicates the filing of forms and schedules which are used as a starting point for the corporation's taxable income. Examples include the Form 8903, *Domestic Production Activities Deduction*, used for the section 199 domestic production activities deduction and the Form 4626, *Alternative Minimum Tax – Corporations*, used for corporate alternative minimum taxable income calculations.

Also, the IRS FAQ's provide for different treatment of pass-through and individual returns, which include the section 965 amounts, and the corporate Form 1120, which the IRS instructs should exclude the section 965 amounts. Specifically, guidance is needed on how a corporate partner in a domestic partnership that receives an allocation of section 965 amounts on its Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.*, from the partnership should exclude the passed-through amounts from their calculation of the section 965 inclusion on Form 1120. Presumably this result is intended, as the IRS's guidance in Section 3.05(b) of Notice 2018-26 indicates that a corporation in this context has a single section 965 tax liability and that, for example, section 965 elections made by the corporation are only made with respect to the entire combined section 965 amounts.

An additional issue requiring clarification is how a taxpayer should reflect an election under section 965(n) to not apply a current or carryover net operating loss to the section 965 transition tax liability.

CONCLUSION

In the absence of updated forms or instructions for the 2017 tax year or binding guidance, taxpayers are unaware what information is required or how to properly report such information on Form 5471 to meet the "substantially complete" definition and thus avoid penalties under sections 6038, 6038A and 6046. The AICPA recommends that the IRS provide automatic relief from these penalties for any taxpayer who has acted reasonably and made a good faith effort to provide any required information.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please contact Philip Pasmanik, Chair, AICPA International Taxation Technical Resource Panel, at (212) 686-7160, ext. 156 or Philip.Pasmanik@hertzherson.com; Jonathan Horn, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204 or Jonathan.Horn@aicpa-cima.com; or me at (408) 924-3508 or Annette.Nellen@sjsu.edu.

Respectfully submitted,



Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

cc: Mr. William M. Paul, Acting Chief Counsel, Internal Revenue Service
Ms. Marjorie A. Rollinson, Associate Chief Counsel (International), Internal Revenue Service
Ms. Kathryn Zuba, Associate Chief Counsel (Procedure & Administration), Internal Revenue Service