August 30, 2018

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William M. Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Re: Audit Protection for Controlled Foreign Corporations under Section 8.02(5) of Revenue Procedure 2015-13

Dear Messrs. Kautter and Paul:

The American Institute of CPAs (AICPA) submits this comment letter to address a significant concern with the accounting method change procedures outlined in Rev. Proc. 2015-13 created by the enactment of Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA). Specifically, we request that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) issue immediate guidance providing additional clarification on the 150 percent special rule referenced in Rev. Proc. 2015-13.

The AICPA recommends that Treasury and the IRS provide guidance that the amount of deemed foreign taxes paid in the inclusion year under section 965 (generally 2017) are excluded from the calculations used to exclude a taxpayer from audit protection for an accounting method change under the special rule of section 8.02(5) of Rev. Proc. 2015-13.

We previously submitted comments on Rev. Proc. 2015-13 in November 2016 and August 2017. In our August 2017 letter, we requested clarification of the special rule under section 8.02(5) of Rev. Proc. 2015-13. The special rule references 150 percent of the average amount of foreign taxes deemed paid, under Internal Revenue Code (IRC or “Code”) sections 902 and 960, in the three taxable years immediately prior to the taxable year of change.

In general, under section 8.01 of Rev. Proc. 2015-13, a taxpayer that voluntarily changes its accounting method with the consent of the IRS Commissioner receives audit protection for that method. Section 8.02(5) of Rev. Proc. 2015-13 provides an exception to the general audit protection rule. It states that:

1 All references to “section” or “§” are to the Internal Revenue Code of 1986, as amended, and all references to “Treas. Reg. §” and “regulations” are to U.S. Treasury regulations promulgated thereunder.
In the case of a change in method of accounting made on behalf of a CFC or 10/50 corporation, the IRS may change the method of accounting for the same item that is the subject of a Form 3115 filed under this revenue procedure for taxable years prior to the requested year of change in which any of the CFC or 10/50 corporation’s domestic corporate shareholders computed an amount of foreign taxes deemed paid under §§ 902 and 960 with respect to the CFC or 10/50 corporation that exceeds 150 percent of the average amount of foreign taxes deemed paid under §§ 902 and 960 by the domestic corporate shareholder with respect to the CFC or 10/50 corporation in the shareholder’s three prior taxable years.\(^4\)

The intent of section 8.02(5) of Rev. Proc. 2015-13 is to prevent taxpayers from utilizing accounting method changes in a manner that inappropriately increases the taxpayer’s foreign tax credits. However, applying section 8.02(5) of Rev. Proc. 2015-13 to method changes in the inclusion year under section 965 (generally 2017) may result in unintended consequences due to the enactment of the TCJA.

Section 965 imposes a one-time transition tax on unrepatriated earnings and profits of specified foreign corporations that also are deferred foreign income corporations. Application of section 965 results in an increased subpart F inclusion under section 951(a) for a United States (US) shareholder of one or more deferred foreign income corporations. As a result of this section 951(a) inclusion, the US shareholder is also entitled to deemed paid foreign tax credits under sections 902 and 960. In many instances, the deemed foreign taxes paid for tax year 2017 is significantly higher due to the income inclusion resulting from section 965. Therefore, it is likely that the deemed taxes paid in 2017 will exceed 150 percent of the deemed taxes paid in the prior three taxable years without regard to any accounting method changes.

Treating the reference to the amount computed (that may not exceed 150 percent of the three-year average) as applying to the amount of foreign taxes deemed paid in the year of change, taxpayers must compare the foreign taxes deemed paid, under section 902 or section 960, in the year of change to the prior three-year average. If the accounting method change results in an increase in the amount of foreign taxes deemed paid in the year of change over the amount that is computed without the method change (and this increase exceeds 150 percent of the three-year average) the taxpayer is denied audit protection for all past years.

We urge the IRS to address this unintended consequence. It is reasonable to disregard any deemed paid foreign tax credits, resulting from the application of section 965, in applying section 8.02(5) of Rev. Proc. 2015-13 to accounting method changes made in tax year 2017 (or, as applicable, 2018). Absent this relief, taxpayers are denied the audit protection generally available under section 8.01 of Rev. Proc. 2015-13.

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\(^4\) Section 8.02(5) of Rev. Proc. 2015-13.
This result is not consistent with the intent of the original rule, which is to deny audit protection when the accounting method change inappropriately increases foreign tax credits. Further, the IRS could not have foreseen the 2017 amendment to section 965 when this rule was included in Rev. Proc. 2015-13. We request that the IRS and Treasury issue immediate guidance amending Rev. Proc. 2015-13 to ensure audit protection is granted consistent with the underlying policy.

The AICPA is the world’s largest member association representing the accounting profession with more than 431,000 members in 137 countries and territories, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Jennifer Kennedy, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (415) 498-5952, or jennifer.kennedy@pwc.com; Ogochukwu Anokwute, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9231, or ogo.anokwute@aicpa-cima.com; or me at (408) 924-3508, or annette.nellen@sjsu.edu.

Sincerely,

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

cc: The Honorable David J. Kautter, Acting Commissioner, Internal Revenue Service
Mr. Christopher Call, Attorney-Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ms. Ellen Martin, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Mr. Scott Dinwiddie, Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service
Mr. John Moriarty, Deputy Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service