The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service (I.R.S.)
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Overpayments and §965(h)

Dear Commissioner Rettig:

The undersigned organizations respectfully request that Treasury revise relevant guidance to allow taxpayers with deferred §965 tax liabilities to choose how their tax overpayments are applied. We believe any other policy would be inconsistent with Congressional intent and with the letter of the Tax Cuts and Jobs Act (Public Law 115–97).

Congress enacted §965 as part of a package of reforms to transition U.S. taxation of foreign income from a modified worldwide tax system to a quasi-territorial system. This transition was achieved primarily through the application of a Dividends Received Deduction (DRD) to the dividends paid by Controlled Foreign Corporations (CFCs) to the parent C corporation. Congress designed the deferred foreign income tax under §965 to collect any outstanding tax obligations of U.S. owned CFCs prior to taxpayers qualifying for the territorial tax system and the new DRD.

In order to ensure taxpayers had the time and wherewithal to pay the deferred foreign income tax, Congress gave the shareholders of domestic C corporations the option to choose an eight-year installment payment plan. Section 965(h)(1) allows taxpayers to spread their deferred foreign income tax over eight years. Section 965(h)(3) provides specific events that would accelerate payments under this section. According to the legislative history, “[t]he tax resulting from the provision would be payable over time, to allow taxpayers time to compute their liability and repatriate funds to pay it.”

Since S corporations did not benefit from the new territorial tax system – dividends paid by a CFC to a parent S corporation do not qualify for the new DRD – S corporation shareholders were allowed an election to indefinitely defer payment of their §965 tax liability until a “triggering event” occurs pursuant to §965(i)(1). Following a triggering event, S corporation shareholders are allowed to further defer payment of their §965 over the next eight years.

On March 13, 2018, the IRS provided taxpayers with guidance consistent with Congressional intent as described above. The IRS told taxpayers that payments related to the §965 liability would be tracked separately and that taxpayers should submit two separate payments, one payment reflecting the tax owed without regard to §965 and a separate payment reflecting the amount owed under §965.
Q10. How should a taxpayer pay the tax resulting from section 965 of the Code for a 2017 tax return?

A10. A taxpayer should make two separate payments as follows: one payment reflecting tax owed without regard to section 965 of the Code, and a second, separate payment reflecting tax owed resulting from section 965 of the Code and not otherwise satisfied by another payment or credit as described in Q&A13 and Q&A14 (the 965 Payment).

On April 13, however, the IRS amended the previous guidance and abandoned the bifurcated approach of FAQ 10. The new guidance made clear that IRS would apply estimated tax payments of net tax liabilities to a taxpayer’s net income tax liability first, and then to their tax liability under §965.

Q13. How will the IRS apply 2017 estimated tax payments (including credit elects from 2016) to a taxpayer’s net tax liability under section 965?

A13. The IRS will apply 2017 estimated tax payments first to a taxpayer’s 2017 net income tax liability described under section 965(h)(6)(A)(ii) (its net income tax determined without regard to section 965), and then to its tax liability under section 965, including those amounts that are subject to payment in installments pursuant to an election under section 965(h).

Q14. If a taxpayer’s 2017 payments, including estimated tax payments, exceed its 2017 net income tax liability described under section 965(h)(6)(A)(ii) (its net income tax determined without regard to section 965) and the first annual installment (due in 2018) pursuant to an election under section 965(h), may the taxpayer receive a refund of such excess amounts or credit such excess amounts to its 2018 estimated income tax?

A14. No. A taxpayer may not receive a refund or credit of any portion of properly applied 2017 tax payments unless and until the amount of payments exceeds the entire unpaid 2017 income tax liability, including all amounts to be paid in installments under section 965(h) in subsequent years. If a taxpayer’s 2017 tax payments exceed the 2017 net income tax liability described under section 965(h)(6)(A)(ii) (net income tax determined without regard to section 965) and the first annual installment (due in 2018) pursuant to an election under section 965(h), the excess will be applied to the next successive annual installment (due in 2019) (and to the extent such excess exceeds the amount of such next successive annual installment due, then to the next such successive annual installment (due in 2020), etc.) pursuant to an election under section 965(h).

Taxpayers often overpay their tax liabilities, either through excessive estimated tax payments or through amendments to earlier returns. The policy articulated in FAQ 13 and 14 would require that these overpayments be applied to any outstanding §965 liabilities, even if the taxpayer had elected to defer those liabilities under §965(h) and (i). That result is simply not consistent with the clear reading of §965(h) and (i) nor with the policy goals Congress articulated when it adopted the deferral election.
The IRS has argued that their hands are tied and the statute requires this policy. A Chief Counsel Memorandum dated August 2 argued that the §965 guidance was based on their interpretation of §6402 and §6403. Section 6403 provides:

*In the case of a tax payable in installments, if the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 6402.*

Contrary to the August 2nd memorandum, §6403 does not compel the policy articulated in the April IRS guidance. Section 6403 clearly applies only to overpayment of a specific installment of a tax payable in installments. It is silent as to the treatment of overpayment of tax liabilities not subject to payment in installments.

Meanwhile, taxes due at some future date under the provisions of §965(h) or (i) are not outstanding as of the date of a current overpayment, and therefore §6402 does not cover them. Even if they were, §6402(a) provides that the Secretary “may” apply overpayments on one tax to another existing liability. The failure in §6402(a) to mandate application to such a tax provides the Secretary with ample latitude to comply with the clear intent of Congress to defer the payment of the future §965 installments.

Taxpayers who overpaid their 2017 taxes did not overpay as an installment of the §965 tax. They overpaid their 2017 net income tax liability, which, by definition, excludes the §965 liability for the year. These payments were made consistent with the March IRS guidance, which required taxpayers to make separate payments of the first installment of their §965 tax liability.

Congress explicitly gave taxpayers the election to defer – for eight years for C corporation shareholders and indefinitely for S corporation shareholders – their tax liabilities under §965. The guidance issued by the IRS and the subsequent memorandum from the Chief Counsel’s Office seek to overturn this policy without any statutory authority.

U.S. taxpayers routinely overpay their estimated taxes because there are substantial tax penalties for underpayment. The policy IRS articulated regarding §965 liabilities would establish a new penalty for taxpayers who overpay their taxes. It is contrary to Congressional intent and it is contrary to a plain reading of the law. We respectfully request that the IRS revise its guidance and restore to allowing taxpayers the full deferral of their §965 tax liabilities, as Congress intended.

Signed,

Air-Conditioning, Heating, and Refrigeration Institute
Alliance for Competitive Taxation
American Council of Life Insurers
American Forest and Paper Association
American Institute of Architects
Auto Care Association
Business Roundtable
Consumer Technology Association
Family Business Coalition
Financial Executives International
Heating, Air-conditioning & Refrigeration Distributors International
Information Technology Industry Council
Manufacturers Alliance/MAPI
Motion Picture Association of America
Motor & Equipment Manufacturers Association
National Association of Broadcasters
National Association of Electrical Distributors
National Association of Wholesaler-Distributors
National Foreign Trade Council
Policy and Taxation Group
S Corporation Association
Semiconductor Industry Association
Silicon Valley Leadership Group
Silicon Valley Tax Directors Group
Small Business & Entrepreneurship Council
The National Association of Manufacturers
U.S. Chamber of Commerce
United States Council for International Business
Wisconsin Grocers Association
Wisconsin Small Businesses United

CC: Steven T. Mnuchin, Secretary of the Treasury, U.S Department of the Treasury

    David J. Kautter, Assistant Secretary, Office of Tax Policy, U.S. Department of the Treasury