Alert: One-Time Repatriation Tax Required Under the Tax Cut and Jobs Act

July 11, 2018

The 2017 Tax Cut and Jobs Act ("Tax Act," "Act" or "TCJA") fundamentally changed the taxation of foreign income earned by U.S. corporations. The Tax Act moved the U.S. from a worldwide taxation scheme, closer to a territorial taxation scheme. As a result of the transition, a mandatory one-time **repatriation tax** is imposed on United States ("U.S.") taxpayers who own an interest in certain foreign corporations.

Most tax practitioners are likely aware that this facet of the Tax Act was effective for 2017 tax returns. However, this alert has been issued because of the concern that some practitioners may not be aware of this change and its impact on 2017 returns because the IRS was late in communicating the issue and the tax treatment.

This new provision of the Tax Act, set forth in section 965 of the Internal Revenue Code ("IRC § 965"), requires U.S. shareholders, as defined under IRC § 951(b), to pay a transition tax on the untaxed foreign earnings of specified foreign corporations as if those earnings had been repatriated to the U.S. This one-time **repatriation tax** is levied on undistributed, non-previously taxed post-1986 through December 31, 2017 earnings and profits ("E&P") of certain U.S.-owned foreign corporations. For example, IRC § 965 may give rise to a 2017 tax liability for a calendar year U.S. shareholder holding an interest in a specified foreign corporation. **As such, taxpayers may have to pay tax resulting from IRC § 965 when filing their 2017 tax returns.**

According to recent IRS guidance, the repatriation tax applies to individual and corporate shareholders of foreign corporations. Domestic pass-through entities must report additional information to their owners in connection with IRC § 965 by attaching a statement to Schedule K-1s detailing specific information for each deferred foreign income corporation that has a § 965(a) inclusion amount. Individuals that have income under IRC § 965 for the 2017 tax year are required to include an IRC 965 Transition Tax Statement with their federal income tax returns.

A complex calculation is required to determine the amount of the levy imposed on all post-1986 E&P, through 2017, as a new Subpart F category. Foreign tax paid and dividend distributions typically reduce the amount of E&P included in the calculation. A participation exemption, which factors in the tax rate, may further reduce E&P subject to tax. For state income tax purposes, corporate taxpayers must determine whether state taxing authority adopts the Tax Act's provisions and then figure out whether the state requires the § 965(a) addition to income, the § 965(c) deduction, or both, be incorporated as adjustments to federal taxable income.

If applicable, the one-time repatriation tax impacts individual and business 2017 income tax returns. However, an election to pay the repatriation tax in installments over an eight-year period is available [(IRC § 965(h)] and may be made on an amended return filed by the extended due date even when no extension was requested [See IRS Q&A about Reporting Related to Section 965 on 2017 Tax Returns ("IRS Q&A"), Q17]. The IRS will treat the situation as if the taxpayer had requested and received the extension. Moreover, Q16 of the IRS Q&A states that "[i]f an individual meets the criteria in this paragraph and pays the total amount of the first installment on or before the due date for the second installment, the IRS will not assess an addition to tax for failure to timely pay the first installment and will not accelerate subsequent installments under section 965(h)(3)."

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Under the installment election, the first five payments are 8% of the repatriation tax amount and escalate in the last three years to 15%, 20%, and 25%, respectively. Generally, payments are due by the taxpayer's tax return due date (without extension). However, the first installment may be made as late as April 15, 2019 (the due date for the second installment) although interest would accrue from April 17, 2018. Also, S corporation shareholders may elect to defer payment until the tax year of a triggering event (e.g., termination of the S corporation status, liquidation, or transfer of the S corporation stock).

Risk Management Guidance

Given the magnitude and complexity of the Tax Act's changes to the U.S. taxation of foreign income, tax practitioners need to be extremely diligent, especially as it relates to assessing IRC § 965 implications for both federal and state income tax purposes. Addressing the repatriation tax issue will require a prompt, thoughtful review of clients to assess applicability. Taxpayers with investment company holdings can hopefully rely on receiving the needed information accompanying investment company K-1s. However, there is significant risk that smaller, **loosely run investment vehicles may not have addressed this issue**. Again, the possibility that the repatriation tax ramifications have been ignored by these advisors should be considered when CPAs review their client lists to identify potentially impacted individual and business taxpayers. Those potentially impacted should be advised to obtain the documentation needed to comply with IRC § 965.

CAMICO strongly recommends that policyholders who have not yet addressed the foreign income taxation changes with their 2017 tax clients consider the following risk management steps. This list is not meant to be all-inclusive.

1. Send a notification letter explaining the new one-time **repatriation tax** to both individual and business clients that could be impacted. The letter should also include a strong "call to action" message encouraging clients to contact the firm immediately if they feel that they may be subject to this one-time **repatriation tax.** For defensive documentation purposes, CAMICO recommends maintaining and retaining a list detailing to whom this letter was sent. **CAMICO provides a sample client notification letter to CAMICO policyholders on the CAMICO Members-Only Site under Knowledge Tree –> Reference Library –> Alert Documents –> 2018 –> Repatriation Tax.**

2. For impacted clients, practitioners should inform both those with federal income tax returns on extension as well as those who have already filed of the significance of filing the installment election with their original/amended income tax returns by October 15, 2018. According to the IRS Q&A, failure to carefully follow the prescribed procedures may trigger unwarranted notices from the Service. Taxpayers who do not include the net tax liability due under IRC § 965 in the total tax amount on their returns may be subject to accuracy-related penalties.

3. Practitioners should document those clients choosing to postpone the first installment beyond the October 15, 2018 due date. As noted above, the first installment may be made as late as April 15, 2019 (the due date for the second installment) although interest would accrue on the first installment.

The following attachments will need to accompany amended returns filed to obtain the eight-year installment treatment:

- Amended versions of forms and schedules listed in the IRS Q&A;
- An election statement; and

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- The IRC § 965 Transition Tax Statement [see IRS Q&A for illustrative example]

Additional Resources

For additional information, you can reference the following resource:

[IRS Q&A about Reporting Related to Section 965 on 2017 Tax Returns]

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