IRS provides ‘toll tax’ reporting guidance

March 16, 2018

In brief
The IRS issued IR-2018-53 on March 13, 2018 addressing certain questions and answers (Q&A) regarding reporting requirements and election procedures relating to the newly enacted mandatory deemed repatriation of deferred foreign earnings (the ‘toll tax’). The Q&A addresses specific questions about who must report amounts related to the toll tax, the form of the reporting, and when certain related elections must be filed, following the introduction of the new territorial tax regime under the 2017 tax reform reconciliation act, also known as the ‘Tax Cuts and Jobs Act’ (the Act). Of immediate concern, calendar-year taxpayers electing to pay their toll tax liability in annual installments under Section 965(h) must make such payment by the unextended due date of their inclusion year tax return, due on April 17, 2018. The IRS will provide additional guidance and other information on IRS.gov in the weeks ahead.

For prior coverage on the Act, the first installment of administrative guidance on the toll tax, Notice 2018-07, and the second installment of administrative guidance, Notice 2018-13, see our prior PwC Insights, Republican tax bill will significantly impact US international tax rules, IRS Notice addresses the ‘Toll Tax’ under amended Section 965, and Second IRS Notice issued regarding the ‘Toll Tax’ under amended Section 965, respectively.

In detail
Background
As addressed in a previous PwC Insight, the Act imposes a one-time toll tax on the undistributed, nonpreviously taxed post-1986 foreign E&P of certain US-owned corporations as part of the transition to a new territorial tax regime. The rules relating to the toll tax are set forth in the Act’s amendments to Section 965, which imposes the tax at a 15.5% rate on cash or cash equivalents and at a 8% rate on illiquid assets. Section 965 generally applies to a specified foreign corporation (SFC), which is defined as any controlled foreign corporation (CFC) or any foreign corporation with one or more domestic corporations as part of the transition to a new territorial tax regime. The rules relating to the toll tax are set forth in the Act’s amendments to Section 965, which imposes the tax at a 15.5% rate on cash or cash equivalents and at a 8% rate on illiquid assets. Section 965 generally applies to a specified foreign corporation (SFC), which is defined as any controlled foreign corporation (CFC) or any foreign corporation with one or more domestic corporations that is treated as a US shareholder (i.e., a domestic corporation treated as owning 10% or more of the foreign corporation’s voting stock pursuant to the attribution rules of Section 958(a) and (b)).

Section 965(h) provides US shareholders with an election to pay the net tax liability imposed by Section 965 over a period of up to 8 years in installments of 8% for the first 5 years, 15% in year 6, 20% in year 7, and 25% in year 8. The first installment payment is due on the unextended due date of the tax return containing the Section 965 toll tax inclusion. For calendar year taxpayers with calendar year SFCs, the first payment is due April 17, 2018.

For taxpayers that do not elect under Section 965(h) to pay the net tax liability imposed by Section 965 in
installments, the entire toll charge amount is included in their tax liability for each inclusion year. In that case it would be due on the unextended due date of the tax return reporting each Section 965 inclusion.

Section 965(i) allows shareholders of an S corporation that is a US shareholder to defer the payment of any tax relating to the toll tax until a future year that includes a triggering event: the S corporation ceases to be an S corporation, the S corporation liquidates or sells substantially all of its assets, or the shareholder transfers any share of stock in the S corporation (including by reason of death).

Section 965(m) provides an election for real estate investment trusts (REITs) that are US shareholders to spread the toll tax income inclusion over a period of up to 8 years, in the same manner as the tax liability in Section 965(h).

Section 965(n) allows US shareholders with net operating losses (NOLs) to elect not to consider their toll tax inclusion when determining the amount of an NOL to be utilized in the inclusion year.

On January 19, 2018, the IRS and Treasury issued Notice 2018-13 providing administrative guidance relating to the toll tax due upon the mandatory deemed repatriation of certain deferred foreign earnings. As addressed in a previous PwC Insight, Notice 2018-13, Sec. 3.02, permits certain taxpayers to elect to compute earnings and profits as of the November 2, 2017 and December 31, 2017 measurement dates under an alternative method.

**Q&A reporting guidance**

Publication of the Q&A provides responses to various ongoing questions received by the IRS related to the reporting requirements under Section 965. Generally, the Q&A addresses the type of taxpayer required to report a Section 965 tax liability, the method for reporting the toll tax liability, and the process for filing elections related to Section 965 and Notice 2018-13. These are discussed in detail below.

**Who is required to report Section 965 amounts**

The Q&A indicates that the reporting requirements broadly apply to a person who includes amounts in income as a result of Section 965. Specifically, the Q&A states that toll tax filing requirements are imposed on (i) a US shareholder of a deferred foreign income corporation (DFIC) (i.e., generally any SFC that has positive post-1986 E&P as of either November 2 or December 31, 2017), (ii) a direct or indirect partner in a domestic partnership that is a US shareholder of a DFIC, (iii) a shareholder of an S corporation that is a US shareholder of a DFIC, or (iv) a beneficiary of a passthrough entity that is a US shareholder of a DFIC.

Furthermore, the Q&A clarifies that, subject to certain exceptions, Form 5471 should be filed for all SFCs for which a person is a US shareholder, regardless of whether the SFC is a CFC.

**Observation:** Basic filing requirements are imposed on both US shareholders and any taxpayers that own interests in US shareholders that are passthrough entities. The Q&A appendix includes the specific information that must be included on each relevant form filed with the IRS. The Q&A provides that individual taxpayers who electronically file their Form 1040 and have not already filed their 2017 tax return should file on or after April 2, 2018. However, individual taxpayers who file a paper Form 1040 can file their return at any time.

**Reporting Section 965 amounts**

The Q&A introduces a new reporting form, the IRC 965 Transition Tax Statement. This form is required for reporting Section 965 amounts to the IRS. The Q&A further states that any Section 965 amount must be reported based on the specific type of taxpayer with the reporting obligation. For example, the appendix to the Q&A requires a domestic corporate taxpayer with a Section 965 inclusion to report the toll tax liability on Line 1 of the IRC 965 Transition Tax Statement, while deductions under Section 965(c) are reported on Line 3. Interestingly, the IRS does not require a domestic corporation to report its Section 965(a) amount on Form 1120. Furthermore, the Q&A indicates domestic corporate taxpayers do not report on Form 1118 any Section 965(a) amounts, any relevant deductions under Section 965(c), any deemed paid foreign taxes that reduce the tax on a Section 965(a) inclusion, or any foreign taxes that are disallowed under Section 965(g). Instead, domestic corporate taxpayers report these amounts on Lines 4a and 4b of the IRC 965 Transition Tax Statement. The Q&A further indicates that the net Section 965 liability and installments to be paid under Section 965(h) are reported on Schedule J of Form 1120. For additional reporting information related to non-domestic corporate taxpayers, see the Appendix to the Q&A.

The Q&A also includes certain information that must be reported on a taxpayer’s IRC 965 Transition Tax Statement. Such information includes, but is not limited to, the total amount required to be included under Section 965(a), a taxpayer’s aggregate foreign cash position amount, and a listing of elections made by the taxpayers under either Section 965 or Notice 2018-13. Additional requirements may
apply if a taxpayer decides to electronically file its IRC 965 Transition Tax Statement.

Observation: Despite the fact that foreign tax credits deemed paid as a result of the toll tax are reported on the IRC 965 Transition Tax Statement, and not on Form 1118, there is no indication that the IRS has attempted to curtail the use of those credits against regular income tax. Nothing in Section 965 or in any other part of the Act limits the use of foreign tax credits deemed paid in connection with the toll tax.

The form of reporting described in the Q&A is quite specific, including the fact that, in the case of an electronically filed return, any Section 965 Transaction Tax Statement must be filed in portable document format (pdf) entitled ‘965 Tax.’ In addition to the IRC 965 Transition Tax Statement, US shareholders must also file Forms 5471 for each CFC included in their toll tax calculation.

Elections under Section 965

Under Section 965 and Notice 2018-13, Section 3.02, a taxpayer may make a number of elections related to the payments of its net toll tax liability or the determination of the post-1986 E&P of an SFC. Prior to the Q&A’s release, it was unclear who could make such elections, and when and how such elections could be made.

The Q&A clarifies who is permitted to make Section 965 elections. The Q&A provides that elections can be made by the following: (i) taxpayers with a net toll tax liability, (ii) taxpayers that are shareholders of S corporations and that have a toll tax liability, (iii) taxpayers that are REITs subject to Section 965(m), or (iv) taxpayers with NOLs making an election under Section 965(n). As indicated by the Q&A, domestic partnerships and S corporations that are US shareholders of a DFIC may not make any Section 965 elections on behalf of their direct and indirect partners, shareholders, or beneficiaries.

Observation: Partnerships that are US shareholders may not make elections under Section 965(h) on behalf of their direct and/or indirect partners. Where a direct or indirect partner has a toll tax liability in connection with SFCs owned through a domestic partnership, the partner must elect to defer payments or else the full toll tax liability is due by the unextended due date for the return for the inclusion year.

The Q&A further provides that an election made under Notice 2018-13, Sec. 3.02 may only be made by certain controlling domestic corporations of a foreign corporation that meet the requirements under Treas. Reg. sec. 1.964-1(c)(3). For purposes of US consolidated groups, only the agent (i.e., parent of the US consolidated group as defined under Treas. Reg. sec. 1.1502-77) of the US group is permitted to file elections on behalf of such group.

Taxpayers may make a Section 965 or Notice 2018-13 election under the IRC 965 Transition Tax Statement. The FAQ clarifies that such elections must be filed by the due date (including extensions) of a taxpayer’s annual tax return. For 2017, elections under Section 965 and Notice 2018-13 are made by attaching the IRC 965 Transition Tax Statement to the taxpayer’s 2017 tax return. In addition, taxpayers are required to attach a signed statement including the taxpayer’s name, taxpayer identification number, and a number of other requirements related to the taxpayer’s specific facts and circumstances. The Appendix of the Q&A provides various model statements depending on the specific election. Taxpayers should review Question 7 of the Q&A to determine the specific electronic filing requirements for such elections.

Timing of elections and payments

The elections under Section 965 may be made by the extended due date for filing the relevant tax return. Notwithstanding the extended due date for making these elections, taxpayers electing to pay their toll tax liability in installments under Section 965(h) must make the first installment payment by the unextended due date of their return for the inclusion year. For most individuals and domestic corporations who keep a calendar year for US tax purposes, this is April 17, 2018.

The Q&A provides that a taxpayer should make two separate payments with respect to its 2017 taxable year: one payment reflecting the tax owed without regard to Section 965, and a second, separate payment reflecting the tax owed resulting from the Section 965 toll tax. The Section 965 payment must be made either by wire transfer or by check or money order, and if a wire payment is made, the taxpayer should use the 5-digit tax type code of ‘09650.’

Miscellaneous Q&A

Other miscellaneous Q&A addresses the following related Section 965 reporting issues:

- filing requirements related to filing Form 5471 for SFCs with exception to US shareholders who are constructively considered as owning stock of a foreign entity as a result of downward attribution
- reporting requirements for certain passthrough entities with either partners, shareholders, or beneficiaries with a Section 965 liability
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- electronic payment requirements for paying a taxpayer’s toll tax liability
- timing requirements regarding an individual filing its electronically Form 1040, and
- filing requirements for a taxpayer who already filed its annual tax return without reporting its Section 965 liability.

The takeaway

The Q&A is the latest guidance issued by the IRS related to reporting, paying, and filing elections related to the toll tax.

Taxpayers should immediately review the Q&A prior to submitting the IRC 965 Transition Tax Statement to the IRS in order to make timely toll tax liability payments and comply with the filing requirements for making available elections under Section 965. Importantly, taxpayers should take note of the general requirement to file a Form 5471 with respect to each specified foreign corporation with respect to which the taxpayer is a US shareholder. Taxpayers that have already filed their 2017 tax returns should consider filing an amended return consistent with the guidance provided in IR 2018-53 to avoid potential processing difficulties and erroneous notices being issued by the IRS.

See also:
IR-2018-53
Rev. Proc. 2018-17, IRB 2018-09
Notice 2018-13
Second IRS Notice issued regarding the ‘toll tax’ under amended Section 965
Notice 2018-07
IRS Notice addresses the ‘toll tax’ under amended Section 965
Republican tax bill will significantly impact US international tax rules

Let’s talk

For a deeper discussion of how this might affect your business, please contact:

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