

IRS to Begin Enforcing Section 965 Transition Tax in October

The IRS has announced that it will begin enforcing Section 965's repatriation tax in October 2020. Section 965 and its regulations require United States shareholders to pay a one-time transition tax on untaxed foreign earnings of certain foreign corporations as if these earnings had been repatriated to the United States. Cash holdings are taxed at 15.5% and non-cash or non-liquid assets are taxed at 8%. Taxpayers can make payments over eight years. Prior to the repatriation tax, which was enacted in 2017 as part of the Tax Cuts and Job Act ("TCJA"), companies could defer tax on any earnings made and held abroad, and would be taxed on such income at a rate of 35% only upon repatriation.

During an American Bar Association webinar, Douglas O'Donnell, commissioner of the IRS' Large Business & International ("LB&I") Division, explained there will be two treatment streams:

- The first will target thousands of taxpayers who the agency believes may need to more fully comply with Section 965's repatriation tax. Such taxpayers will receive letters suggesting that they review their returns and consider whether they need to file amended returns. These taxpayers may have misunderstood reporting requirements or did not obtain information relevant to their tax liabilities.
- The second will target taxpayers who the IRS believes failed to comply with their obligations under Section 965. Those taxpayers will be placed into the IRS' audit pipeline.

It is expected that the IRS will focus on a few key substantive issues with taxpayers' calculation of Section 965 inclusions, including:

- Calculation of historic earnings and profits;
- Classification of assets as cash or non-cash; and
- Methodology used to determine taxpayers' foreign tax credits.

LB&I's announcement is consistent with its previously announced enforcement efforts focusing on compliance with Section 965 and the TCJA. Earlier this month, LB&I [announced](#) a compliance campaign targeting individuals' compliance with Section 965 through soft letters and examinations. In November 2019, LB&I announced a compliance campaign examining 2017 and 2018 tax returns for Section 965 compliance, as described more fully in a prior post [here](#). Likewise, in May 2020, LB&I announced a broad tax reform audit campaign, as described in a prior post [here](#).

Please contact the [Ropes & Gray tax controversy team](#) with any questions you may have or if you would like any further information.