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ALERT ▪ Tax Controversy

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Repatriation Tax Compliance: IRS to Begin Examining 2017 & 2018 Returns

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On November 4, 2019, the IRS announced that the LB&I division will begin examining 2017 and 2018 tax returns for compliance with the so-called repatriation tax under Internal Revenue Code Section 965. The examinations will target US-based multinational companies.

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.

The announcement provides little guidance on the focus or scope of the examinations, noting only that the goal of the campaign is "to promote compliance with IRC 965" and that the focus is "identifying and addressing taxpayer populations with potential material compliance risk." A selected return could also be examined "for other material issues, especially issues related to TCJA planning."

The examination on Section 965 issues may include:

- Computational issues, such as the calculation of earnings and profits of foreign corporations and foreign tax credits claimed by taxpayers.
- Anti-abuse rules promulgated under Treasury Regulation §1.965-4, which operate to disregard certain transactions when applying the transition tax.

The IRS' inquiry into "other material issues…related to TCJA planning" could include taxpayers' compliance with global intangible low-taxed income ("GILTI") regulations and temporary regulations relating to Section 245A's dividends received deduction.

The announcement comes weeks after the Treasury Inspector General for Tax Administration released a report on LB&I's approach to using issue-based campaigns to select audits. The report determined that LB&I should focus on issues with the highest risk of non-compliance. This announcement by LB&I appears directly responsive to that concern by focusing first on identifying taxpayers with potential material compliance risk.

Please contact the Ropes & Gray tax controversy team with any questions you may have or for further information.