

## Transition Tax Campaign Expected To Fuel Further Disputes

By **Dylan Moroses**

*Law360 (December 10, 2021, 6:03 PM EST)* -- Taxpayers under audit by the Internal Revenue Service in its repatriation tax compliance campaign face a host of valuation questions that attorneys told Law360 could lead to new legal disputes.

As cases move from the audit stage to assessment and appeals, several questions related to accurately calculating the one-time transition tax created by the 2017 Tax Cuts and Jobs Act are becoming more clear with new data available to the IRS. Issues around accurately reporting foreign-sourced income subject to the transition tax and following its rules, some which have already been challenged in court, are causing consternation for tax lawyers and their clients.

Peter Glicklich of Davies Ward Phillips & Vineberg LLP told Law360 the compliance campaign feels like it "was designed in some kind of Rube Goldberg fashion to be complicated."

Questions surrounding the cash value of income repatriated under the transition tax, contained in Internal Revenue Code Section 965, and concerns about calculating earnings and profits have been front and center in the agency's compliance campaign, said Kat Saunders Gregor of Ropes & Gray LLP.

Under the TCJA, Section 965 imposed a one-time transition tax on offshore profits accumulated since 1986 — earnings deemed to have been repatriated to the U.S. at a rate of 15.5% for cash or other liquid assets and 8% for reinvested income. As one of its compliance efforts following the tax overhaul's implementation, the IRS established a campaign to help administer Section 965 and examine taxpayers that may have issues with their calculations.

Gregor said taxpayers who may have had to make "judgment calls" in calculating their Section 965 liability have come under scrutiny. The IRS is analyzing any tax planning or timing shifts in transactions that may have occurred around the measurement date for the transition tax, she added.

"The IRS is bringing in specialists who can look at specific aspects of the calculations," Gregor said, noting that the specialists have often been involved early in the process.

Glicklich suggested the IRS would look to mount challenges against taxpayers who may have "acted to accelerate the amount that would be subject to deferral" during the period leading up to and shortly after Section 965 was enacted. "There's a lot at stake, [and] no downside to challenging it," Glicklich said.

Part of what makes accounting tricky for the Section 965 levy is the sheer amount of time it covers, said David J. Fischer of Crowell & Moring LLP. The repatriation provision, which was part of the TCJA's shift to a quasi-territorial system, required companies to bring home billions of dollars in foreign earnings they had deferred since 1986.

Smaller businesses and individual taxpayers may have an especially hard time with the calculation because they haven't kept records of their earnings and profits for that long, Fischer said. In those cases, he asked, "How do you actually prove what you've done since 1986?"

The information document requests that the IRS is sending to taxpayers in the Section 965 campaign "tend to be very, very broad," seeking information on whether taxpayers calculated the repatriation tax properly, Fischer said. For larger corporations under constant audit by the IRS, it may be "a little easier" to agree that a calculation under Section 965 was made correctly because both sides generally have comprehensive records, he said.

Despite the possibly easier calculation, Fischer said controversies may emerge for larger corporate taxpayers with "gigantic foreign tax credit pools." One such case to address issues with Section 965 and its rules is already in court, raised by FedEx last year.

This week, John Hinding, director of the IRS' cross-border activities practice area, said the agency is wrapping up its audits of C corporations that were under examination in the Section 965 campaign and moving toward exams of large partnerships and S corporations.

With data now available to the IRS from 2018 — the first year under changes made by the TCJA — he said the agency is looking to see "whether there were gaps" in its original compliance program plan.

Hinding said some "account issues" have arisen surrounding elections to pay the repatriation tax over eight annual installments under IRC Section 965(h). Those issues, which have been more prevalent among individual taxpayers, relate to IRS systems, he said. Some "closing procedure issues" also have come up at the end of the examination process, the official said.

With corporate audits wrapping up in the Section 965 campaign, Hinding acknowledged that the number of cases related to the transition tax is increasing in the IRS appeals pipeline.

The IRS is aware of some pending litigation surrounding the Section 965 tax and its associated regulations, but isn't formally considering suspending its ongoing examinations while waiting for results of those cases, Hinding said.

In the FedEx case, the company sued the federal government in November 2020 for an \$89 million refund, nearly three years after Congress enacted the TCJA. It contended the U.S. Department of the Treasury exceeded its authority by denying foreign tax credits on offshore income targeted by the overhaul's transition tax.

FedEx is seeking to invalidate final regulations Treasury issued in January 2019 under Section 965.

Several open questions remain as cases in the Section 965 campaign move from the audit process, Gregor said, including how the agency's Independent Office of Appeals might approach common issues taxpayers have raised.

The IRS may decide to combine cases at the appeals stage, Gregor said. "I'm hopeful that one of the trends we'll see is that the IRS is taking a proactive approach to all these cases at the appeals level."

Fischer and Gregor said taxpayers should try to keep comprehensive records to support their Section 965 calculations. Fischer emphasized that for smaller taxpayers, cooperating with the IRS in the Section 965 campaign is crucial because of the difficulties in trying to accurately capture all the income to be repatriated since 1986.

"They have less to prove, but it's harder to prove," Fischer said.

The IRS didn't respond to requests for comment for this story.

--Additional reporting by Natalie Olivo. Editing by Aaron Pelc and Roy LeBlanc.

*Editor's note: Gregor is a member of the Law360 Tax Authority International Editorial Advisory Board.*