



September 26, 2019

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Ms. Holly Porter
Associate Chief Counsel
Passthrough & Special Industries
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Tax Reform Administrative Relief for Section 965 Elections and Transfer Agreements

Dear Messrs. Kautter and Desmond, and Ms. Porter:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) to address the need for guidance related to new Internal Revenue Code provisions enacted under Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (the “TCJA”).

Specifically, the AICPA submits comments requesting relief with respect to late or incomplete elections under section 965(i)¹ and late or incomplete transfer agreements under section 965(i)(2). We recommend that Treasury and the IRS:

1. Provide a process to obtain relief for late filed or incomplete elections under sections 965(i) and 965(h) upon the triggering event of a section 965(i) election;
2. Allow reasonable cause or section 9100 relief for late filed or incomplete transfer agreements under section 965(i)(2); and
3. Provide a process to obtain relief for late or incomplete elections under section 965(h).

The AICPA is the world’s largest member association representing the CPA profession, with more than 429,000 members in the United States and worldwide, and a history of serving the public

¹ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Robert Keller, Chair, AICPA S Corporation Taxation Technical Resource Panel, at (504) 584-1030 or rkeller@kpmg.com; Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Wang@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,

A handwritten signature in blue ink that reads "Christopher W. Hesse". The signature is fluid and cursive, with a large initial "C" and a stylized "H".

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation

AMERICAN INSTITUTE OF CPAs

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Overview

The Tax Cuts and Jobs Act amended section 965 to provide for a one-time subpart F inclusion for United States (“U.S.”) shareholders of certain specified foreign corporations, including ownership of such foreign corporations through passthrough entities. In general, a specified foreign corporation means either a controlled foreign corporation (“CFC”), as defined under section 957, or a foreign corporation (other than a passive foreign investment company, as defined under section 1297, that is not also a CFC) with respect to which one or more domestic corporations is a United States shareholder. Section 965 allows U.S. shareholders to reduce the amount of the income inclusion based on deficits in earnings and profits with respect to other specified foreign corporations. The effective tax rates applicable to income inclusions are adjusted by way of a participation deduction set out in section 965(c). A reduced foreign tax credit applies to the inclusion under section 965(g). The new tax applies to the last taxable year of specified foreign corporations beginning before January 1, 2018, and the tax is includible in the U.S. shareholder’s taxable year in which the specified foreign corporation’s year ends.

On August 9, 2018, Treasury and the IRS published proposed regulations under sections 962, 965, and 986 in the Federal Register.¹ The proposed regulations were issued following guidance announcing and describing regulations intended for issuance under section 965.² On February 5, 2019, Treasury and the IRS published final regulations under sections 962, 965, and 986.³ On June 27, 2019, the IRS published a document: “General Section 965 Questions and Answers (Including Transfer and Consent Agreements).”⁴

I. Election Under Section 965(i)

Generally, the section 965 tax liability is payable as of the due date of the inclusion year return (without extensions). Section 965(i)(1) provides that in the case of any S corporation that is a U.S. shareholder of a deferred foreign income corporation, each shareholder of such S corporation may elect to defer payment of such shareholder’s net tax liability under this section with respect to such S corporation until the shareholder’s taxable year which includes the “triggering event” with respect to such liability. The regulations provide that “each shareholder with a section 965(i) net tax liability with respect to an S corporation may make the section 965(i) election with respect to such S corporation,” provided that, in regards to the shareholder, none of the triggering events described in Treas. Reg. § 1.965-7(c)(3)(ii) have occurred before the election is made.⁵

¹ 83 Fed. Reg. 39,514.

² See Notice 2018-07, 2018-4 I.R.B. 317; Notice 2018-13, 2018-6 I.R.B. 341; and Notice 2018-26, 2018-16 I.R.B. 480.

³ 84 Fed. Reg. 1,838.

⁴ See “[General Section 965 Questions and Answers \(Including Transfer and Consent Agreements\)](#).”

⁵ Treas. Reg. § 1.965-7(c)(2)(i).

Treasury Reg. § 1.965-7(c)(3)(i) specifies the following:

“If a shareholder makes a section 965(i) election with respect to an S corporation, the shareholder defers payment of its section 965(i) net tax liability with respect to the S corporation until the shareholder’s taxable year that includes the occurrence of a triggering event described in [Treas. Reg. § 1.965-7(c)(3)(ii)] with respect to the section 965(i) net tax liability with respect to the S corporation. If a triggering event described in [Treas. Reg. § 1.965-7(c)(3)(ii)] with respect to an S corporation occurs, except as provided in [Treas. Reg. § 1.965-7(c)(3)(iv)]⁶ of this section, the shareholder’s section 965(i) net tax liability with respect to the S corporation will be assessed as an addition to tax for the shareholder’s taxable year that includes the triggering event.”

Under Treas. Reg. § 1.965-7(c)(3)(ii), the following events are considered triggering events for purposes of Treas. Reg. § 1.965-7(c)(3)(i) with respect to a shareholder’s section 965(i) net tax liability with respect to an S corporation:

- (i) The corporation ceases to be an S corporation (determined as of the first day of the first taxable year that the corporation is not an S corporation);
- (ii) A liquidation, sale, exchange, or other disposition of substantially all of the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, or the S corporation ceasing to exist;
- (iii) The transfer of any share of stock of the S corporation by the shareholder (including by reason of death or otherwise) that results in a change of ownership for federal income tax purposes; or
- (iv) A determination by the Commissioner described in the second sentence of Treas. Reg. § 1.965-7(c)(3)(iv)(C)(2).⁷

If any shareholder of an S corporation makes a section 965(i) election, the S corporation is jointly and severally liable for the payment of the shareholder’s section 965(i) net tax liability with respect to the S corporation, as well as any penalties, additions to tax, or other additional amounts attributable to such net tax liability.⁸

Section 965(i)(8) requires a section 965(i) election no later than the due date (taking into account extensions, if any) for the shareholder’s return for each taxable year that includes the last day of the taxable year of the S corporation in which the S corporation has a section 965(a) inclusion to which the shareholder’s section 965(i) net tax liability is attributable. Neither section 965(i) nor

⁶ Treas. Reg. § 1.965-7(c)(3)(iv), discussed below, provides an exception to the general rule for transfers of S corporation stock by the shareholder.

⁷ The second sentence of Treas. Reg. § 1.965-7(c)(3)(iv)(C)(2) provides that, on the date that the Commissioner determines that the transfer agreement includes a material misrepresentation or material omission, the Commissioner may determine that a triggering event has occurred with respect to the eligible section 965(i) transferee as of the date of the determination, such that the unpaid section 965(i) net tax liability of the eligible section 965(i) transferor that was assumed by the eligible section 965(i) transferee becomes due on the date of the determination.

⁸ Section 965(i)(5) and Treas. Reg. § 1.965-7(c)(4).

its legislative history addresses whether late section 965(i) election relief is available. Treasury Reg. § 1.965-7(c)(2)(ii) specifically denies relief to make a late election under Treas. Reg. § 301.9100-2 or § 301.9100-3. The preamble to these regulations provides that the IRS does not have the discretion to provide section 9100 relief with respect to an election whose due date is prescribed by statute. Treasury and the IRS determined that providing additional relief would create administrative difficulties and is, therefore, inappropriate.⁹

In addition to an election under section 965(i), section 965(h) provides that taxpayers may elect to pay the transition tax in installments over an eight-year period. Section 965(i)(4) provides that a shareholder that has made a section 965(i) election with respect to an S corporation, upon the occurrence of a triggering event with respect to such S corporation, may make a section 965(h) election relating to the portion of the shareholder's section 965(i) net tax liability. Specifically, this election is with respect to an S corporation that is assessed as an addition to tax for the shareholder's taxable year that includes the triggering event pursuant to Treas. Reg. § 1.965-7(c)(3)(i) as if such portion were a section 965(h) net tax liability.¹⁰ Section 965(i)(4)(B) prescribes the due date for a shareholder who has made a section 965(i) election to make a section 965(h) election upon the occurrence of a triggering event. This section 965(h) election must occur no later than the due date (taking into account extensions, if any) for the shareholder's return for the taxable year in which the triggering event occurs. Section 965(i)(4) does not address whether late election relief is available for a section 965(h) election. However, Treas. Reg. § 1.965-7(c)(3)(v)(B) denies late election relief under Treas. Reg. § 301.9100-2 or § 301.9100-3 to make a late election.

II. Transfer Agreements

Section 965(i)(2)(C) provides that a transfer of S corporation stock is not treated as a triggering event if the transferee enters into a transfer agreement with the transferor. Treasury Reg. § 1.965-7(c)(3)(i) will not apply (such that a shareholder's section 965(i) net tax liability with respect to an S corporation is not assessed as an addition to tax for the shareholder's taxable year that includes the triggering event) if certain requirements are satisfied.¹¹ First, the triggering event is the transfer of any share of stock of the S corporation by the shareholder (including by reason of death or otherwise) that results in a change of ownership for federal income tax purposes.¹² Second, the shareholder with respect to which a triggering event occurs, and an eligible section 965(i) transferee,¹³ must enter into an agreement with the Commissioner that satisfies certain requirements (this agreement is referred to as a "transfer agreement").¹⁴

⁹ T.D. 9846, 84 Fed. Reg. 1,838 at 1,868 (Feb. 5, 2019).

¹⁰ Treas. Reg. § 1.965-7(c)(3)(v)(A). If the triggering event is a liquidation, sale, exchange, or other disposition of substantially all of the assets of the S corporation (including in a title 11 or similar case), a cessation of business by the S corporation, or the S corporation ceasing to exist, then the 965(h) election may only be made with the consent of the Commissioner.

¹¹ Treas. Reg. § 1.965-7(c)(3)(iv)(A).

¹² Treas. Reg. § 1.965-7(c)(3)(iv)(A)(1).

¹³ Under Treas. Reg. § 1.965-7(c)(iv)(B), the term eligible section 965(i) transferee refers to a single U.S. person that becomes a shareholder of the S corporation (including a person listed in Treas. Reg. § 1.1362-6(b)(2) with respect to a trust or estate, but not a domestic passthrough entity itself).

¹⁴ Treas. Reg. § 1.965-7(c)(3)(iv)(A)(2).

A transfer agreement must have the title: “Transfer Agreement Under Section 965(i)(2).” Additionally, the transfer agreement must include specific representations and information. The representations and information required include:

- (i) A statement that the document constitutes an agreement by the eligible section 965(i) transferee to assume the liability of the eligible section 965(i) transferor for the unpaid portion of the section 965(i) net tax liability or, in the case of a partial transfer, for the unpaid portion of the section 965(i) net tax liability attributable to the transferred stock;
- (ii) A detailed description of the triggering event that led to the transfer agreement, including the name and taxpayer identification number of the S corporation with respect to which the section 965(i) election was effective;
- (iii) A representation that the eligible section 965(i) transferee is able to pay the section 965(i) net tax liability being assumed; and
- (iv) An acknowledgement that the eligible section 965(i) transferor and any successor to the eligible section 965(i) transferor will remain jointly and severally liable for the section 965(i) net tax liability being assumed by the eligible section 965(i) transferee.¹⁵

Importantly, section 965(i) does not provide a due date for the filing of a transfer agreement. However, the regulations provide a due date. Specifically, Treas. Reg. § 1.965-7(c)(3)(iv)(B)(2)(i) states that, subject to certain exceptions, a transfer agreement is considered timely filed only if the transfer agreement is filed within 30 days of the date that the triggering event occurs. Further, Treas. Reg. § 1.965-7(c)(3)(iv)(B)(2) denies relief for a late transfer agreement under Treas. Reg. § 301.9100-2 or § 301.9100-3. The transfer agreement must be filed in accordance with the rules provided in publications, forms, instructions, or other guidance. In addition, a duplicate copy of the transfer agreement must be attached to the returns of both the transferee and the transferor for the taxable year during which the triggering event occurs filed by the due date (taking into account extensions, if any) for such returns.

The requirement to “enter into an agreement with the Commissioner” is straightforward. Except as otherwise provided in publications, forms, instructions, or other guidance, if an eligible section 965(i) transferor and an eligible section 965(i) transferee file a transfer agreement (in accordance with the requirements described in the regulations), the parties are considered to have entered into an agreement with the Commissioner for purposes of section 965(i)(2) and Treas. Reg. § 1.965-7(c)(3)(iv).

If the Commissioner determines that an agreement contains a material misrepresentation or material omission, or if the eligible section 965(i) transferee does not provide the additional information requested within a reasonable timeframe, then the Commissioner may reject the transfer agreement (effective as of the date of the related triggering event).¹⁶

¹⁵ Treas. Reg. § 1.965-7(c)(3)(iv)(B)(4).

¹⁶ Treas. Reg. § 1.965-7(c)(3)(iv)(C)(2).

Recommendations

Treasury and the IRS should:

1. Provide a process to obtain relief for late filed or incomplete elections under sections 965(i) and 965(h) upon the triggering event of a section 965(i) election;
2. Allow reasonable cause or section 9100 relief for late filed or incomplete transfer agreements under section 965(i)(2); and
3. Provide a process to obtain relief for late or incomplete elections under section 965(h).

Analysis

I. Election Under Section 965(i)

The overview above provides the background on how the regulations under section 965 state that relief is not available under Treas. Reg. § 301.9100-2 or § 301.9100-3 with respect to an election under section 965(i) and a section 965(h) election upon the termination of a section 965(i) election. This inability to obtain relief is an unduly harsh result given the broad reach of section 965 to S corporation shareholders with different levels of sophistication. Given the significant changes stemming from tax reform, it is likely that many taxpayers and their advisors, through reasonable cause, failed to properly file an election under section 965(i). Treasury and the IRS take the position that section 9100 relief is disallowed, and taxpayers do not have alternative means for obtaining relief for a late or incomplete election under section 965(i). Therefore, inequitable consequences could result that were not intended by Congress.

As we noted in our comment letter dated October 31, 2018,¹⁷ if a U.S. shareholder of an S corporation had reasonable cause for a failure to timely file an extension for their calendar year 2017 U.S. income tax return and wanted to make the election under section 965(i) on a late-filed return, the failure to file the extension invalidates the section 965(i) election. Similarly, many shareholders filed their returns before the issuance of the final section 965 regulations and did not make an election under section 965(i). Due to the number of substantive changes between the proposed and final section 965 regulations, Treasury and the IRS should grant relief for shareholders to make an election under section 965(i) if those shareholders now have an increased tax liability under section 965.

While we acknowledge that Treasury and the IRS's discretion to grant section 9100 relief for statutory elections is limited in scope, section 965(o) authorizes the Secretary to prescribe such regulations or other guidance as necessary or appropriate to carry out the provisions of section 965. Moreover, section 965(i) provides that the election "shall be made in such manner as the Secretary shall provide."¹⁸ Taken together, these provisions permit Treasury and the IRS to provide relief to taxpayers who failed to file a complete and timely election under section 965(i). Despite the due date for an election being prescribed by a statute, the IRS has provided relief to

¹⁷ AICPA Comment Letter, "[Proposed Guidance Regarding the Transition Tax Under Section 965 and Related Provisions \(REG-104226-18\)](#)," submitted October 31, 2018.

¹⁸ Section 965(i)(8)(B).

make a late election under section 9100 on prior occasions. Similar relief is needed with respect to an election under section 965(i).

As noted above, an S corporation shareholder may, upon the occurrence of a triggering event, make a section 965(h) election to pay the resulting tax over eight years. The regulations provide that relief is not available under Treas. Reg. § 301.9100-2 or § 301.9100-3 to make a late election. For reasons similar to those noted above, we request that Treasury and the IRS also provide a process to obtain relief for late or incomplete elections under section 965(h).

II. Transfer Agreements

Treasury and the IRS issued regulations under section 965 providing that relief is not available under Treas. Reg. § 301.9100-2 or § 301.9100-3 to file a late transfer agreement. Unlike an election under section 965(i), however, the due date for filing the transfer agreement is not prescribed by statute. Treasury and the IRS have the authority to provide relief to taxpayers who have filed a late or incomplete transfer agreement.

It is important to provide taxpayers with a method to obtain relief where the failure to timely file a complete transfer agreement was due to reasonable cause. For example, if any shareholder of an S corporation elects to defer payment by making an election under section 965(i), the S corporation is jointly and severally liable for the payment and any penalty, addition to tax, or additional amount attributable thereto. If an S corporation shareholder who made a valid election under section 965(i) transfers her shares but fails to timely file a transfer agreement due to reasonable cause, then the S corporation may have liability for payment of the shareholder's section 965 liability that was deferred to the extent the shareholder cannot pay. This result is inequitable and a method should exist for a taxpayer to obtain relief for a transfer agreement that is not timely filed due to reasonable cause.

In a recent news article, the director for IRS Small Business/Self-Employed Division, John Tuzynski, noted that with respect to transfer agreements, the IRS does not issue an approval letter. However, if the agreement is rejected, both the transferor and the transferee that are parties to the agreement will receive a rejection letter.¹⁹ Mr. Tuzynski further stated that the IRS is currently working on an administrative process with regard to those transfer agreements that are rejected and what the transferor is allowed to do in that case. We appreciate the effort by the IRS to provide a method for taxpayers to correct transfer agreements that are rejected by the IRS. However, we recommend that the IRS notify taxpayers when a transfer agreement has been accepted. By providing taxpayers with an approval letter, the IRS will help facilitate business transactions that are otherwise hindered if a transfer agreement cannot demonstrate to have met all the requirements outlined in guidance. The absence of a rejection letter from the IRS does not provide a sufficient level of confidence or documentation to validate a transfer agreement.

¹⁹ Parillo, *IRS Examiners Using Risk-Based Approach on Cryptocurrency*, 163 Tax Notes Federal 1901 (June 17, 2019).

Conclusion

We respectfully request that Treasury and the IRS provide a process to obtain relief for late filed or incomplete elections under section 965(i). We also request that Treasury and the IRS allow reasonable cause or section 9100 relief for late filed or incomplete transfer agreements under section 965(i)(2) and provide a process to obtain relief for late or incomplete elections under section 965(h).