



December 17, 2018

Mr. William M. Paul
Acting Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Audit Protection for Controlled Foreign Corporations under Section 8.02(5) of Revenue Procedure 2015-13

Dear Mr. Paul:

The American Institute of CPAs (AICPA) submitted a letter¹ dated August 30, 2018 to the Department of the Treasury (“Treasury Department”) and Internal Revenue Service (“Service”) regarding audit protection for controlled foreign corporations under Section 8.02(5) of Rev. Proc. 2015-13. We appreciate the Service’s response, sent October 4, 2018, that provides clarification on the proper application of section 8.02(5) of Rev. Proc. 2015-13. As noted in the Service’s response, the concerns regarding the likely effect on taxpayers electing to make methods changes in the three years following the section 965² inclusion year remain and are a great concern to us. Accordingly, we stress the importance of resolving this issue in a timely manner.

To prevent unintended consequences, the exception under Section 8.02(5) should disregard the section 965 transition tax. Specifically, we recommend that taxpayers exclude the amount of deemed foreign taxes paid in the inclusion year under section 965 (generally 2017) from the 150 percent calculation. Otherwise, the audit protection rules provided for an accounting method change under Rev. Proc. 2015-13 provide limited value for these taxpayers.

The Service has issued procedural guidance for years that encourages taxpayers to voluntarily correct impermissible methods of accounting and, in appropriate circumstances, mitigate exposure to penalties and interest.³ In particular, the procedures provide incentives including a prospective year of change, a spread of an unfavorable section 481(a) adjustment, and audit protection for prior

¹ AICPA letter, “[Audit Protection for Controlled Foreign Corporation under Section 8.02\(5\) of Revenue Procedure 2015-13](#),” August 30, 2018.

² All references to “section” or “§” are to the Internal Revenue Code of 1986, as amended, and all references to “Treas. Reg. §” and “regulations” are to U.S. Treasury regulations promulgated thereunder.

³ Rev. Proc. 2015-13, 2015-5 I.R.B. 419 (Jan. 1, 2015), Rev. Proc. 97-27, 1997-1 C.B. 680 (May 8, 1997), Rev. Proc. 92-20, 1992-1 C.B. 685 (Mar. 2, 1992), Rev. Proc. 84-74, 1984-2 C.B. 736, Rev. Proc. 80-51, 1980-2 C.B. 818, Rev. Proc. 70-27, 1970-2 C.B. 509, Rev. Proc. 64-16, 1964-1 C.B. 677.

years.⁴ This approach continues today in the general procedures to obtain consent to change a method of accounting per Rev. Proc. 2015-13.

Section 8.02(5) of Rev. Proc. 2015-13 provides an exception to the general audit protection rules. The 150 percent special rule denies audit protection to a controlled foreign corporation for prior tax years when the amount of foreign taxes deemed paid, in the year prior to the method change (“tested year”), exceeds 150 percent of the average amount of foreign taxes deemed paid in the three years prior to the tested year.⁵ According to the Service, this 150 percent rule was intended to prevent taxpayers from inappropriately utilizing accounting method changes to increase the taxpayer’s foreign tax credits. However, the significant increase in foreign taxes deemed paid related to the section 965 transition tax is involuntary and effectively denies audit protection for any method change filed in the following three years after the inclusion of the transition tax. For example, a taxpayer that was subject to the transition tax in 2017 may not receive audit protection with respect to 2017 for a method change filed in its 2018, 2019, or 2020 tax years.

Additionally, as previously mentioned,⁶ foreign corporations already have onerous barriers to securing audit protection. Foreign corporations are not eligible to use the 120-day window when a Service exam ends. In addition, they may only use the three-month window if they are under exam for 24 months and the specific method change is not an issue under consideration.⁷ Due to the audit currency initiative, this window is not available in many circumstances.

To prevent the unintended denial of audit protection under section 8.01 of Rev. Proc. 2015-13, we recommend excluding the amount of deemed foreign taxes paid in the inclusion year of the transition tax under section 965 from the calculation of the 150 percent special rule of section 8.02(5) of Rev. Proc. 2015-13. Furthermore, we urge you for a timely resolution to this issue to alleviate any potential burdens to taxpayers.

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The AICPA is the world’s largest member association representing the CPA profession, with more than 431,000 members in 137 countries and territories, and a history of serving the public 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. If you would like to discuss these issues, please feel free to contact Jennifer Kennedy, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (415) 498-5952, or Jennifer.Kennedy@pwc.com; Melanie Lauridsen, Senior

⁴ *Id.*

⁵ *Id.* at section 8.02(5).

⁶ AICPA letter, “[Comments on Modification to Rev. Proc. 97-27 and 2011-14](#),” July 9, 2013.

⁷ Rev. Proc. 2015-13, section 8.02(1)(a)(iii) and 8.02(1)(b)(iii).

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Manager – AICPA Tax Policy & Advocacy, at (202) 434-9235, or Melanie.Lauridsen@aicpa-cima.com; or me at (408) 924-3508 or Annette.Nellen@sjsu.edu.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Nellen". The signature is fluid and cursive, written in a professional style.

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

Encl.

cc: The Honorable David J. Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Krishna P. Vallabhaneni, Deputy Tax Legislative Counsel, Department of the Treasury
Christopher Call, Attorney-Advisor, Office of Tax Policy, Department of the Treasury
William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
Marjorie Rollinson, Associate Chief Counsel (International), Internal Revenue Service
Scott K. Dinwiddie, Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service
Jeffery G. Mitchell, Chief, Branch 2, Office of the Associate Chief Counsel (International), Internal Revenue Service

DEPUTY
CHIEF COUNSELDEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OCT 03 2018

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee
1455 Pennsylvania Ave. NW
Washington, DC 20004-1081

Dear Ms. Nellen:

I am responding to your August 30, 2018 letter on behalf of The American Institute of CPAs ("AICPA"), in which you expressed concern that the Tax Cuts and Jobs Act ("TCJA"), Pub. L. No. 115-97, will trigger the limitation on audit protection in section 8.02(5) of Revenue Procedure 2015-13, 2015-5 I.R.B. 419 ("section 8.02(5) rule"). The TCJA enacted a new provision, § 965, that requires certain United States shareholders of foreign corporations to include in income an amount determined by reference to the post-1986 earnings and profits of the corporation. Section 965 applies to the last taxable year of the foreign corporation beginning before January 1, 2018 (hereinafter the § 965 inclusion year).

Section 8.01 of Rev. Proc. 2015-13 provides that, with certain exceptions, a taxpayer will receive audit protection when it timely files a Form 3115 to change an accounting method. Section 8.02(5) denies audit protection for changes made on behalf of certain foreign corporations where the following exception applies:

(5) CFC or 10/50 corporation. In the case of a change in method of accounting made on behalf of a CFC or 10/50 corporation, the IRS may change the method of accounting for the same item that is the subject of a Form 3115 filed under this revenue procedure for taxable years prior to the requested year of change in which any of the CFC or 10/50 corporation's domestic corporate shareholders computed an amount of foreign taxes deemed paid under §§ 902 and 960 with respect to the CFC or 10/50 corporation that exceeds 150 percent of the average amount of foreign taxes deemed paid under §§ 902 and 960 by the domestic corporate shareholder with respect to the CFC or 10/50 corporation in the shareholder's three prior taxable years.

Your letter specifically expresses a concern that the income inclusion under § 965 will result in the denial of audit protection for all accounting method changes made on behalf of CFCs in the § 965 inclusion year. As a result of a § 951(a) inclusion, the US shareholder is also entitled to deemed paid foreign tax credits under §§ 902 and 960. In many instances, the deemed foreign taxes paid for the § 965 inclusion year will exceed the average of the deemed paid taxes for the three prior taxable years due to the income inclusion required by § 965.

As an initial matter, we note that your letter reflects a misunderstanding of how the section 8.02(5) rule applies. The section 8.02(5) rule denies audit protection when an accounting method change is made on behalf of a CFC for a taxable year that is after a taxable year in which one or more of its U.S. shareholders has an unusually large amount of deemed paid taxes (150 percent of the average amount for the preceding three taxable years) with respect to the CFC (a "150 percent year"). For example, the section 8.02(5) rule would deny audit protection for an accounting method change made on behalf of a CFC in the 2018 taxable year if one or more of its U.S. shareholders had an amount of deemed paid taxes with respect to the CFC in the 2017 taxable year that exceeded 150 percent of the average amount of deemed paid taxes in the 2014, 2015, and 2016 taxable years. The rule does not consider the deemed paid taxes in the year of change. Accordingly, a change in accounting method made for the CFC's § 965 inclusion year will not be impacted by the section 8.02(5) rule as a result of a § 965 inclusion in that year and corresponding deemed paid taxes of the U.S. shareholder.

The primary purpose of the section 8.02(5) rule is to encourage prompt voluntary compliance with proper accounting methods by CFCs. The rule does this by preventing a controlling U.S. shareholder from causing a CFC to pay a dividend out of, or cause an income inclusion under § 951(a) with respect to, earnings and profits that were computed using an improper accounting method that inappropriately inflated the amount of deemed paid taxes associated with the dividend or inclusion and subsequently insulating the benefits of the inappropriate foreign tax credits through the audit protection that ordinarily accompanies an accounting method change. The section 8.02(5) rule was drafted so that the 150 percent year need not be the taxable year immediately preceding the year of change to prevent U.S. shareholders from simply paying dividends with hyped taxes and then waiting two or more years instead of just one to secure audit protection. Although the revenue procedure is not perfectly clear on this point, as a practical matter, the limitation on audit protection ceases to apply when the statute of limitations runs on the 150 percent year.

We recognize, however, that the section 8.02(5) rule will often apply in the taxable year after the § 965 inclusion year and sometimes in the following two taxable years. We are currently considering whether the limitation on audit protection should be modified in light of new §§ 245A and 951A.

I hope this letter answers some of the questions in your letter. Please feel free to contact Jeffery G. Mitchell on (202) 317-5004 if you need additional assistance.

Sincerely,



Scott K. Dinwiddie
Associate Chief Counsel
(Income Tax & Accounting)