



October 20, 2020

The Honorable Charles Grassley
Chairman
U.S. Senate Committee on Finance
Washington, DC

The Honorable Richard Neal
Chairman
U.S. House Committee on Ways and Means
Washington, DC

The Honorable Ron Wyden
Ranking Member
U.S. Senate Committee on Finance
Washington, DC

The Honorable Kevin Brady
Ranking Member
U.S. House Committee on Ways and Means
Washington, DC

RE: Overpayments, Section 965(h) Transition Tax Installments, and Net Operating Loss Carryback Relief under the CARES Act

Dear Chairmen Grassley and Neal, and Ranking Members Wyden and Brady:

The American Institute of CPAs (AICPA) thanks you for your efforts to provide relief to individuals and businesses affected by the Coronavirus disease 2019 (COVID-19) Pandemic.

This letter is intended to highlight an urgent and unresolved issue regarding the availability for the refund of taxpayers' regular tax overpayments in years subject to the section 965¹ "transition tax." We have previously expressed concern about the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS or "Service") positions on this matter.² This issue now warrants urgent action in light of the recent enactment of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act or "the Act").³

Specifically, the AICPA urges Congress to enact legislation to permit taxpayers with outstanding section 965(h) installments to obtain a refund for overpayments of tax, notwithstanding any future installment amounts of section 965 transition tax liability. We ask for a legislative reversal of the conclusion reached by Treasury and the IRS in the section 965 question and answer ([Q&A 13 and 14](#) for the 2017 filing years. These FAQs were posted to the IRS website on April 13, 2019, later explained in an IRS Chief Counsel Memorandum ([PMTA 2018-16](#) or "PMTA"), and most recently re-affirmed in [Q&A 4](#) of a new set of IRS FAQs issued in response to the CARES Act, posted to the IRS website on April 23, 2020. Allowing taxpayers to obtain a refund for losses incurred during this tumultuous economic

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.

² See AICPA Comment letter, "[Tax Reform Administrative Relief for Section 965 Elections and Transfer Agreements](#)," submitted September 26, 2019.

³ Pub. L. 116-136 (2020).

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period, regardless of whether they have outstanding section 965(h) installments, is necessary for fair and sound administration of the tax system

BACKGROUND

Prior to the enactment of the legislation commonly referred to as the Tax Cuts and Jobs Act of 2017 (“TCJA”),⁴ the United States had a worldwide system of international taxation with a deferral component. Income earned directly by a U.S. taxpayer from a foreign business was taxed on a current basis while income earned indirectly through a foreign corporation was not generally taxed until distributed to the taxpayer.⁵ The TCJA transformed the United States international system of corporation taxation into a quasi-territorial one. Under new section 245A of the Internal Revenue Code (IRC or “Code”), a 10% corporate shareholder of a foreign corporation is ordinarily entitled to a 100% deduction for the portion of foreign-source earnings distributed to the shareholder as a dividend.

To prevent earnings of foreign corporations from escaping U.S. taxation on transitioning from a worldwide system of taxation to a quasi-territorial system of international taxation, the TCJA added section 965 to the Code, which imposed a one-time transition tax on certain U.S. shareholders’ share of the untaxed earnings of certain foreign corporations.

Section 965 deems income taxable without repatriated cash or property for purposes of determining transition tax liability on past accumulated earnings of a foreign corporation. The deemed income subject to the section 965 transition tax does not arise from any transfer, disposition, or other realization-type event that would provide liquidity for the U.S. shareholder to pay its tax liability under section 965.

Although the applicability of the section 965 transition tax does not turn on a taxpayer’s ability to repatriate the earnings or to otherwise pay the tax, section 965(h) allows taxpayers with a section 965 transition tax liability to elect to pay that liability in installments over eight years.⁶

On March 13, 2018, the IRS issued section 965 guidance in the form of questions and answers posted to the IRS website. Q&A 10 directed taxpayers with a transition tax liability to make two separate tax payments, “one payment reflecting tax owed without regard to section 965 of

⁴ An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution of the Budget for Fiscal Year 2018, Pub. L. No. 115-97, 131 STAT. 2054, 1295 (2017).

⁵ Certain anti-deferral rules applied to require that U.S. shareholders of controlled foreign corporations include certain types of earnings of such controlled foreign corporations concurrently. *See* I.R.C. §§ 951 *et seq.* (Subpart F income and earnings invested in U.S. property); I.R.C. §§ 1291 *et seq.* (passive foreign investment companies). These exceptions to the former general rule of deferral applied primarily to passive or mobile categories of income.

⁶ If a section 965(h) election is made, the installment amounts are “8 percent of the net tax liability in the case of each of the first 5 of such installments, 15 percent of the net tax liability in the case of the 6th such installment, 20 percent of the net tax liability in the case of the 7th such installment, and 25 percent of the net tax liability in the case of the 8th such installment.” I.R.C. § 965(h)(1). Section 965(h)(3) provides certain situations in which the requirement to pay the section 965 transition tax may be accelerated.

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the Code, and a second, separate payment reflecting tax owed resulting from section 965 of the Code . . .”⁷

On April 13, 2018, days before the payments were due, the IRS posted additional Q&As to its website, including Q&A 13 and 14. The response to Q&A 13 states, “The IRS will apply 2017 estimated tax payments first to a taxpayer’s 2017 net income tax liability . . . determined without regard to section 965 . . . and then to its tax liability under section 965, including those amounts that are subject to payment in installments pursuant to an election under section 965(h).”⁸ The response to Q&A 14 provides, “A taxpayer may not receive a refund or credit of any portion of properly applied 2017 tax payments unless and until the amount of payments exceeds the entire unpaid 2017 income tax liability, including all amounts owed in installments under section 965(h) in subsequent years.” Unlike Q&A 10, which implies separate tracking of the tax owed because of section 965 and the tax owed without regard to section 965, Q&A 13 and 14 indicate a unified tracking of payments.

On August 2, 2018, the IRS explained its position taken in Q&A 14 in a Chief Counsel Memorandum (PMTA 2018-16) for taxpayers who had expressed “concerns with the legal basis for this answer.” In the PMTA, the IRS concludes that it lacks the authority under sections 6402(a) and 6403 to refund overpayments of income tax to a taxpayer with outstanding section 965(h) installments because, to the extent of the amount of the yet unpaid section 965(h) installments, an “overpayment” is not allowed.

Section 6402(a) grants the IRS authority to “credit the amount of [an] overpayment . . . against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and . . . refund any balance to such person.” This provision permits the IRS to apply an overpayment to offset an outstanding tax liability, but it does not require it.⁹

Section 6403 provides, “In the case of a tax payable in installments, if the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any.” An overpayment is a payment of tax in excess of the amount of tax “properly due” under the law.¹⁰

The PMTA reasons that the mechanics of section 965(a) increase the taxable income of certain U.S. shareholders of a foreign corporation in the tax period during which the foreign

⁷ See Q&A 10, “[How should a taxpayer pay the tax resulting from section 965 of the Code for a 2017 tax return?](#)” originally posted on March 13, 2018.

⁸ See Q&A 13, “Q13. [How will the IRS apply 2017 estimated tax payments \(including credit elects from 2016\) to a taxpayer’s net tax liability under section 965?](#)” posted on April 13, 2018.

⁹ See *U.S. v. Ryan*, 64 F.3d 1516 (11th Cir., 1995) (finding that the IRS had not voluntarily restricted its statutory discretion to allocate overpayments to tax liabilities); *Northern States Power Co. v. U.S.*, 73 F.3d 764 (8th Cir., 1996) (“the IRS has discretion whether to credit an overpayment to that liability or not.”), cert. denied, 519 U.S. 862 (1996).

¹⁰ *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947) (“The word ‘overpayment’ . . . is to be read in its usual sense, as meaning any payment in excess of that which is properly due, whether traceable to an error in mathematics or in judgment or in interpretation of facts or law, and whether the error is committed by the taxpayer or the revenue agents.”)

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corporation's inclusion year ends. Consequently, the PMTA explains that since section 965(h) "does not permit the United States shareholders to defer recognizing these amounts as income and therefore defer the tax liability," no overpayment under section 6402(a) exists "unless and until the entire liability is fully paid, including any amount of that liability that is subject to an election to pay that income tax liability in installments under section 965(h).

To support its interpretation, the PMTA cites *Estate of Bell v. Comm'r.*¹¹ In that case, two estates elected to pay their estate taxes in installments pursuant to section 6166. After making initial installment payments, the executrix for the estates filed claims for refund on the grounds that the principal asset of the estates, stock of Bell, Inc., had been overvalued upon the original calculation of the estates' adjusted gross value. The IRS declined to refund the payment to the extent of the outstanding installments taking the position that section 6403 required the IRS to credit the overpayment to any unpaid installments. The U.S. Court of Appeals for the Ninth Circuit, affirming the decision of the Tax Court, determined that the estate tax, in this case, was "a tax payable in installments" subject to section 6403 and held in favor of the IRS.

On September 17, 2018, the AICPA submitted a comment letter¹² to Steven Mnuchin, Secretary of the Treasury, and David Kautter, Assistant Secretary for Tax Policy, urging reversal of the Treasury and the IRS conclusion of Q&A 13 and 14.¹³ In that letter, we maintained that section 965(h) installment payments for future years are not "properly due" and, as a result, should not be considered in determining whether there is an overpayment that might be refunded. In addition, our comments reasoned that section 6403 applies only when a taxpayer has "paid as an installment of the tax more than the amount determined to be the correct amount of the installment." Consequently, section 6403 would not apply when an overpayment related to a taxpayer's tax liability exclusive of section 965(h) installments.

Section 172 of the Code permits a deduction for NOLs. Prior to 2017, businesses could carry back net operating losses (NOLs) and claim refunds for taxes paid in the prior two years. The American Recovery and Reinvestment Act of 2009¹⁴ included a temporary extension of the loss carryback period to five years for certain businesses. In 2017, the TCJA revised section 172 to no longer permit the carryback of NOLs to prior years.

On March 27, 2020, President Donald Trump signed the CARES Act into law. Section 2203 of the CARES Act includes an extension of the carryback period to five years for NOLs incurred in 2018, 2019, or 2020. The extended loss carryback period provides relief to businesses whose revenues are inhibited during these difficult times.

¹¹ 928 F.2d 901 (1991).

¹² See AICPA comment letter, "[Application of 2017 Estimated Tax Payments to Section 965\(h\) Installment Obligations](#)," submitted September 17, 2018.

¹³ The National Taxpayer Advocate expressed similar concerns in [NTA Blog: IRS Administration of the Section 965 Transition Tax Contravenes Congressional Intent and Imposes Unintended Burden on Taxpayers](#), dated August 16, 2018. Similar analyses were submitted in correspondence by [the Chamber of Commerce of the United States of America](#) on August 21, 2018 and by Kirkland & Ellis LLP on behalf of Huntsman on August 14, 2018.

¹⁴ Pub. L. 111-5, 123 STAT. 115 (2009).

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The CARES Act extension permits businesses that had positive taxable income in previous years, but who experience losses in 2018, 2019, and 2020, to carry back such NOLs to deduct against their taxable income during the now extended five-year period and to receive a refund for those years. The CARES Act does not permit taxpayer to use the carryback NOLs to offset section 965 income.¹⁵

Currently, for taxpayers who had a section 965 transition tax liability and elected to pay that liability in installments over eight years, Treasury and the IRS's interpretations in Q&A 14 may prevent them from obtaining the benefit of a refund. This decision by Treasury and the IRS may prevent many businesses whose revenues have been reduced by COVID-19 from obtaining relief that Congress intended to provide through the CARES Act. Depending on a business's liquidity reserves, inability to obtain relief may result in businesses having to further reduce spending, which could reduce employment, wages, and the quality of life of U.S. workers.

An early version of the CARES legislation, S. 3548, introduced by Majority Leader McConnell on March 19, 2020 for himself and Senate co-sponsors, included a provision that would have overturned the Treasury and the IRS rule that disallowed refunds to a taxpayer with unpaid section 965(h) installments. Specifically, section 2208 of the bill added a new portion, section 965(h)(7), which provided *inter alia* that "no installment of such [section 965 transition] tax liability shall in the case of a request for credit or refund, be taken into account as a liability for purposes of determining whether an overpayment exists for purposes of section 6402 before the date on which such installment is due . . . and the first sentence of section 6403 shall not apply with respect to any such installment." This provision, however, was not included in the subsequent bill, H.R. 748, ultimately signed into law.

Treasury and the IRS have declined to revisit the guidance in Q&A 14 to allow taxpayers to obtain a refund of overpayments of tax exclusive of the section 965(h) installments. Indeed, the IRS reaffirmed this position in Q&A 4 of its most recently issued FAQs that specifically address the interaction of the CARES Act NOL provisions with prior taxpayer years subject to section 965.

RECOMMENDATION

The AICPA respectfully requests that Congress enact legislation to permit taxpayers with outstanding section 965(h) installments to obtain a refund for overpayments of tax, notwithstanding any future installment amounts of section 965 transition tax liability. Specifically, we urge Congress to enact legislation similar to that provided for in section 2208

¹⁵ Specifically, the Act provides, "If a net operating loss of a taxpayer is carried pursuant to clause (i)(I) to any taxable year in which an amount is includible in gross income by reason of section 965(a), the taxpayer shall be treated as having made the election under section 965(n) with respect to each such taxable year." *Id.* In the alternative, Section 2303 of the Act permits a taxpayer to, "elect under such paragraph to exclude all such taxable years from such carryback period." *Id.* Thus, taxpayers either skip over the section 965 inclusion year with the NOL carryback or are prevented via the section 965(n) election from using the NOL to offset the net section 965(a) inclusion income.

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of the original version of the CARES Act legislation introduced in the Senate on March 19, 2020, which provides as follows:

(a) **IN GENERAL.**—Section 965(h) of the Internal Revenue Code of 1986 is amended by adding at the end the following new paragraph:

“(7) **INSTALLMENTS NOT TO PREVENT CREDIT OR REFUND OF OVERPAYMENTS OR INCREASE ESTIMATED TAXES.**—If an election is made under paragraph (1) to pay the net tax liability under this section in installments—

“(A) no installment of such net tax liability shall—

“(i) in the case of a request for credit or refund, be taken into account as a liability for purposes of determining whether an overpayment exists for purposes of section 6402 before the date on which such installment is due, or

“(ii) for purposes of sections 6425, 6654, and 6655, be treated as a tax imposed by section 1, section 11, or subchapter L of chapter 1, and

“(B) the first sentence of section 6403 shall not apply with respect to any such installment.”

(b) **LIMITATION ON PAYMENT OF INTEREST.**—In the case of the portion of any overpayment which exists by reason of the application of section 965(h)(7) of the Internal Revenue Code of 1986 (as added by this section)—

(1) if credit or refund of such portion is made on or before the date which is 45 days after the date of the enactment of this Act, no interest shall be allowed or paid under section 6611 of such Code with respect to such portion; and

(2) if credit or refund of such portion is made after the date which is 45 days after the date of the enactment of this Act, no interest shall be allowed or paid under section 6611 of such Code with respect to such portion for any period before the date of the enactment of this Act.

(c) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall take effect as if included in section 14103 of Public Law 115–97.

ANALYSIS

The AICPA remains concerned about the negative effect of the decision of Treasury and the IRS for certain taxpayers regarding the application of overpayments of tax unrelated to the

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section 965 transition tax or the installment payments under section 965(h). This concern has been amplified by the recent crisis caused by the COVID-19.

One of the results of the COVID-19 crisis has been that many businesses are experiencing significant reductions in revenues and cash flow. Without cash reserves, the reduction in revenues may force many businesses to either look for additional funding in a difficult market or to reduce their expenses, including through layoffs or reduction of wages. Indeed, we have already seen dramatic layoffs and increases in unemployment claims since the Coronavirus affected the U.S..¹⁶

Many U.S. businesses have foreign subsidiaries and may have incurred a section 965 transition tax liability following the enactment of the TCJA. These businesses, which may now experience constrained revenues, may have elected to pay the section 965 transition tax liability in eight annual instalments under section 965(h). Some of the central purposes of the CARES Act are to provide relief for businesses and their employees and to help stabilize the U.S. economy.¹⁷

We understand that the intent and purpose of the CARES Act provision granting relief through a temporary carryback period for NOL deductions extends to U.S. businesses and employers with payment in installments of the transition tax liability under section 965(h). However, we believe such businesses and employers may face severe constraints in obtaining the benefits of that extended NOL carryback period because of Q&A 14. Due to the Treasury and IRS interpretation, many U.S. businesses who generated positive taxable income prior to the COVID-19 pandemic but are now experiencing losses and revenue constraints could not obtain a refund by carrying back the losses to prior year periods as long as they have future section 965 transition tax installments that remain unpaid.

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The AICPA is the world's largest member association representing the CPA profession, with more than 431,000 members in the United States and worldwide, 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.

¹⁶ According to the Bureau of Labor Statistics (BLS) [Employment Situation Summary for September 2020](#), "In September, the unemployment rate declined by 0.5 percentage point to 7.9 percent, and the number of unemployed persons fell by 1.0 million to 12.6 million." The unemployment rate was 3.5 percent in February and jumped quickly to nearly 15 percent in April as U.S. employers laid off more than 20 million people due to the coronavirus pandemic.

¹⁷ See [Senate Majority Leader Mitch McConnell's remarks on the Senate Floor regarding the CARES Act](#) (March 19, 2020); [U.S. Senate Committee on Finance Press Release on Tax Policies for Phase 3 Coronavirus Response](#) (March 19, 2020) (providing that the provision reversing the Q&A 14 guidance of Treasury and the IRS "corrects an error in the Tax Cuts and Jobs Act, allows companies to recover the overpayment of taxes paid on the toll charge to help with liquidity during the current crisis."); [Chairman of the U.S. House Ways and Means Committee Richard Neal's Floor Remarks on the Coronavirus Response Legislation](#) (March 27, 2020).

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact David Sites, Chair, AICPA International Tax Technical Resource Panel, at (202) 861-4104 or David.Sites@us.gt.com; Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Wang@aicpa-cima.com; Lauren Pfingstag, AICPA Director – Congressional and Political Affairs, at (202) 434-9208 or Lauren.Pfingstag@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 long horizontal stroke at the end.

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

cc: The Honorable Nancy Pelosi, Speaker, U.S. House of Representatives
The Honorable Mitch McConnell, Majority Leader, U.S. Senate
The Honorable Kevin McCarthy, Minority Leader, U.S. House of Representatives
The Honorable Charles Schumer, Minority Leader, U.S. Senate
The Honorable David J. Kautter, Asst. Sec. for Tax Policy, Dept. of the Treasury
The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Thomas Barthold, Chief of Staff, Joint Committee on Taxation