

## US IRS updates Section 965 transition tax FAQs to include late-payment penalty and filing relief – action may be needed by 15 June 2018

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### Executive summary

On 4 June 2018, the United States (US) Internal Revenue Service (IRS) updated "[Questions and Answers about Reporting Related to Section 965 on 2017 Returns](#)" (the FAQs, originally released 13 March 2018). In the new FAQs (FAQs 15-17), the IRS announced that it will waive certain late-payment penalties on estimated tax payments resulting from the application of tax year 2017 overpayments to the transition tax (provided all required estimated tax payments are made by 15 June 2018). The FAQs also include relief for certain individuals who failed to timely pay the full first installment of the transition tax or failed to timely elect to pay the transition tax in installments.

### Detailed discussion

#### **FAQ 15: Waiver of late-payment penalties for estimated tax payments**

##### Background

In prior FAQs (FAQs 13 & 14), the IRS announced that, to the extent that a taxpayer's 2017 payments, including estimated tax payments made in 2017 and credit elects from 2016, exceeded the taxpayer's net income tax determined without regard to Internal Revenue Code<sup>1</sup> Section 965 (the

transition tax), the excess would be applied to the taxpayer's net tax liability under Section 965, including those amounts that are subject to payment in installments under a Section 965(h) election. The excess payments cannot be refunded nor can such payments be used to offset a taxpayer's required future estimated tax payment obligations unless they exceed the entire unpaid 2017 income tax liability, including all amounts to be paid in installments under Section 965(h) in subsequent years.

#### **FAQ 15**

In FAQ 15, the IRS announced that it will waive the penalty for the underpayment of estimated taxes in certain circumstances for taxpayers subject to the transition tax that attempted on their 2017 income tax return to apply a 2017 calculated overpayment to their 2018 estimated tax – provided those taxpayers make all required estimated tax payments by 15 June 2018.

This relief applies only to taxpayers whose first required installment for 2018 was due on or before 18 April 2018. Specifically, the IRS states that it has determined that no addition to tax for an underpayment of estimated taxes under Section 6654 or 6655 will apply if a taxpayer makes an estimated tax payment sufficient to satisfy both the underpayment of the first required estimated tax installment for 2018 and the full amount of the second required estimated tax installment for 2018 on or before the due date for the second installment (i.e., 15 June 2018, for calendar-year taxpayers).

Taxpayers meeting the conditions of this relief that receive a notice of an addition to tax for underpayment of estimated tax under Section 6654 or 6655 should contact the IRS office that issued the notice and request abatement of the addition to tax.

#### **FAQ 16: Relief for individuals who failed to timely pay first installment**

In FAQ 16, the IRS grants relief to certain individual taxpayers subject to the transition tax for their 2017 tax year who timely elect to pay the transition tax in installments and failed to pay all or a part of the first installment by the due date for such payment. The IRS will not apply penalties to the missed payment amount, provided the individual pays the full amount of the first installment (and the second installment) by the 2018 return due date (determined without regard to extensions, i.e., generally 15 April 2019,

although later deadlines apply to certain individuals who live and work outside the US). In addition, the failure to timely pay the first installment will not cause the remaining installment payments to become due immediately under the acceleration provision in Section 965(h)(3).

This relief is only available if the individual's total transition tax liability for its 2017 tax year is less than US\$1 million.<sup>2</sup> Interest will still be due on the missed payment amount from the due date of the first installment. Taxpayers meeting the conditions of this relief that receive an associated notice of an addition to tax from the IRS should contact the IRS office that issued the notice and request abatement of the addition to tax.

#### **FAQ 17: Relief for failure to make election to pay transition tax in installments**

Individuals who already filed a 2017 return without electing to pay the transition tax in eight annual installments may still make such an election by filing with the IRS a 2017 [Form 1040X](#). The amended form must be filed by the due date of the individual's 2017 return, taking into account any additional time that would have been granted if the individual had made an extension request (i.e., generally by 15 October 2018). The amended form must also comply with all relevant procedures described in the FAQs.

## **Implications**

Many taxpayers were surprised that the IRS's FAQs provide that estimated tax payments exceeding a taxpayer's annual tax liability, computed without taking into account future years' installment payments under Section 965(h), would be applied against a taxpayer's net outstanding transition tax liability, even when the taxpayer had no current obligation to make any additional payments of such tax because it had elected to pay the transition tax in installments. While FAQ 15 is unclear as to whether it applies only to taxpayers that have already filed their income tax returns or also to taxpayers that included 2018 estimated tax payments in their payments with their 2017 extension requests, taxpayers that inadvertently underpaid their estimated taxes in the first installment period for 2018 based on the assumption they could apply their excess estimated taxes from their 2017 tax year against their 2018 tax liability should make sure to pay any outstanding estimated tax liabilities.

Individual taxpayers also should consider taking advantage of the relief provisions in FAQs 16 and 17 if applicable. However, the relief provided in FAQ 16 (preventing application of penalties and acceleration of the subsequent years' installment payments for taxpayers who underpaid their first year's installment payment) only applies to taxpayers whose transition tax liability is less than \$1 million.

Taxpayers with transition tax liabilities of \$1 million or more are not eligible for this relief and may face acceleration of their subsequent years' installment payments, even if the first year's underpayment was due to unavailability of information at the time the payment was due (for example, if the taxpayer needs to wait to receive a Schedule K-1 from a partnership to determine its transition tax liability).

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## Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. Currency references in this Alert are to US\$.

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