# The continuing US tax impact of the 'one-time' section 965 transition tax

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IRC section 965,[1] as added by the Tax Cuts and Jobs Act of 2017,[2] imposed a one-time tax on some taxpayers — typically for their tax years ended in 2017 or 2018 — regarding their allocable share of the unrepatriated earnings of some foreign corporations in which they held stock. However, the tax imposed by section 965, often referred to as the transition tax or mandatory repatriation tax (hereinafter transition tax) will have relevance for taxpayers for years to come. The primary reason for this is that taxpayers were permitted to (and many affected taxpayers did) elect to pay their transition tax liabilities on installment over eight years, with payments backloaded and no interest charge imposed.

Similarly, taxpayers owning foreign corporate stock through an S corporation were permitted to elect to defer their transition tax inclusions indefinitely. Some future transactions or events can trigger an acceleration of remaining installment payments or an end of the deferral permitted to S corporation shareholders.[3] For example, remaining transition tax liabilities could be accelerated because a taxpayer sells all or substantially all assets or, if the taxpayer is an individual, ceases to be a U.S. citizen or resident. Similarly, indefinite deferral of transition tax liabilities could be ended if an S corporation terminates its S election or a shareholder disposes of his or her S corporation shares.

This article focuses on the potential for subsequent transactions or events to accelerate liability to the transition tax and the ability in some cases to avoid those triggers and prevent acceleration.

## Overview of the transition tax

Section 965 applies to U.S. persons who directly, indirectly, or constructively owned 10 percent or more of the voting power or value (U.S. shareholders) of any specified foreign corporation (SFC) on the last day of the last tax year of such SFC beginning before January 1, 2018.[4] For these purposes, an SFC includes any foreign corporation that is a controlled foreign corporation[5] or any other foreign corporation that has at least one U.S. shareholder that is a corporation (provided that the foreign corporation is not a passive foreign investment company).[6]

Such U.S. shareholders were required to include in income their proportionate shares of the unrepatriated foreign earnings of those SFCs as a taxable subpart F inclusion under section 951.[7] The inclusion was then used to determine the U.S. shareholder's section 965 net tax liability — the difference between such U.S. shareholder's overall tax liability as computed with and without the section 965 inclusion.[8] Amounts required to be included in income under section 965 were effectively subject to federal income tax at reduced rates, arrived at through the application of a special

deduction.[9] Broadly speaking, the deduction resulted in effective tax rates for corporate taxpayers of 15.5 percent on their transition tax inclusions up to their proportionate shares of the cash and cash equivalents held by their SFCs, and 8 percent on the remainder.[10] Because this deduction was computed based on corporate tax rates, the effective rates on inclusions could be either higher or lower for noncorporate taxpayers, depending on their particular circumstances.

The inclusion amounts represented U.S. shareholders' proportionate shares of the unrepatriated foreign earnings of their relevant foreign corporations accrued during periods after 1986 during which such foreign corporations were SFCs. As a result, some U.S. shareholders of SFCs that conducted active businesses and had neither produced substantial subpart F income nor made material distributions had substantial unrepatriated earnings and profits and, consequently, transition tax liabilities. Corporate taxpayers were able to claim reduced indirect foreign tax credits against their transition tax liabilities.[11] Individuals and trusts and estates generally were unable to claim indirect FTCs.[12] Subsequent distributions of the same earnings are generally not subject to federal income tax.[13] Most states chose not to conform to the federal transition tax rules, but 15 states tax all or some portion of a taxpayer's federal section 965 inclusion.[14] Of those states, only Oregon and Utah conform to the federal installment payment rules.[15]

## The installment election and corresponding acceleration events

Any person with net transition tax liability (other than passthrough entities such as partnerships and S corporations) could elect under section 965(h) to pay that liability in eight annual installments, beginning in the year of inclusion, provided the taxpayer's election was not barred by the occurrence of one of several triggering events (discussed below).[16] Under the installment regime, the amount of each of the first five installment payments is 8 percent of the total tax liability; the amounts of the remaining installment payments are, respectively, 15 percent, 20 percent, and 25 percent.[17] Interest does not accrue on the unpaid balance of the transition tax liability.[18] If an installment election has been made and the amount of a taxpayer's total transition tax liability is later adjusted upward, the additional tax liability is generally prorated over the eight installments, with amounts allocated to prior installment payments becoming immediately due and payable.[19]

Taxpayers were required to make the installment election no later than the extended due date for the tax return for the year of the taxpayer's section 965 inclusion. This means that the election must have been made by the due date of the 2017 tax returns of calendar-year taxpayers whose SFCs were reported on a calendar year for U.S. tax purposes. For a taxpayer using a fiscal year or reporting a section 965 tax liability regarding one or more SFCs that were reported on a fiscal year for U.S. tax purposes, the election would have had to have been made by the due date for the taxpayer's tax year ended in 2018 or 2019. Late election relief under section 301.9100-2 or 301.9100-3 of the Treasury regulations is not available regarding the installment election.[20]

If a taxpayer has made an installment election, the taxpayer's remaining installment payments can be accelerated (and become immediately due and payable) upon the occurrence of one of the following events:

- failure to timely make an installment payment;
- a liquidation, sale, exchange, or other disposition of substantially all of the taxpayer's assets (including in a title 11 or similar case or, in the case of an individual, by death);
- in the case of a taxpayer that is not an individual, a cessation of business;
- any event that results in the taxpayer no longer being a U.S. person, including when a resident alien becomes a nonresident alien;
- a taxpayer that was not a member of any consolidated group becoming a member of a consolidated group;
- a consolidated group ceasing to exist, including by reason of the acquisition of a consolidated group or the group discontinuing its filing of consolidated returns; or
- an IRS determination that a transfer agreement (described below) contains a material misrepresentation or omission, or that its requests for additional information have not been satisfied.[21]

Most acceleration events cannot be mitigated. However, under section 965(h), some acceleration events can be cured by entrance into an agreement with an eligible transferee whereby the transferee assumes the transferor's unpaid transition tax liability (a transfer agreement).[22]

Curable acceleration events include a liquidation of the taxpayer that made the installment election; a sale, exchange, or other disposition of substantially all such taxpayer's assets (excluding, in the case of an individual, an acceleration event caused by death); a corporate taxpayer becoming a member of a consolidated group; and a consolidated group ceasing to exist or ceasing to file consolidated returns.[23] For a transferee to be eligible, the transferee must be a single U.S. person that is not a passthrough entity such as a partnership or S corporation, and must satisfy other requirements specific to the type of acceleration event that the transfer agreement is intended to cure. For example, regarding an acceleration event involving a free-standing corporation becoming a member of a consolidated group, the transferee must be the agent of the consolidated group that the taxpayer joins; in the case of a liquidation or transfer of substantially all assets of a corporate taxpayer, the transferee must have acquired substantially all the assets.[24] There is no guidance regarding what constitutes substantially all of a taxpayer's assets for this purpose, leaving taxpayers to draw analogies to other authorities for making this determination.[25]

In general, a transfer agreement must be signed under penalties of perjury by both the transferor and transferee and filed with the IRS within 30 days of the acceleration event, and a duplicate copy must be attached to the returns of both the transferor and transferee for the tax year during which the acceleration event occurred.[26] No relief is available under reg. section 301.9100-2 or 301.9100-3 for an untimely transfer agreement.[27]

As is noted in the preamble to the section 965 final regulations, the IRS cannot provide late election relief regarding an installment election because its due date is prescribed by statute. By contrast, the IRS does have the leeway to provide election relief regarding the filing of transfer agreements (and S corporation transfer agreements and consent agreements, discussed later), but has declined to do so on the basis that it would create administrative difficulties.[28] Given the complexity of these rules in general and the short time frame in which to file a transfer agreement (within 30 days after a triggering event), this seems unduly harsh.

A transfer agreement must include, among other components, a detailed description of the acceleration event; a statement that the transfer agreement constitutes an agreement by the transferee to assume the transferor's unpaid transition tax installment payments; a representation that the transferee is able to make the remaining installment payments; an acknowledgment that the transferor remains jointly and severally liable for any unpaid installment payments (if it continues to exist after the acceleration event); and a statement that the transferee (and the transferor, if it continues to exist) agrees to comply with all the conditions and requirements of the transition tax installment payment rules. A transfer agreement must also include a statement as to whether the transferee's leverage ratio (which is computed in a manner that approximates a typical debt-to-equity ratio) exceeds 3 to 1.[29]

Once a transfer agreement has been filed, the IRS may determine that additional information is necessary, which must be provided on request.[30] The regulations indicate that additional information requests could, for example, relate to the transferee's ability to pay the remaining transition tax liability that it has assumed.[31] The IRS may reject a transfer agreement, effective as of the date of the acceleration event, if it is found to contain any material misrepresentation or omission, or if a transferee fails to provide additional information on request.[32] Alternatively, the IRS may deem an acceleration event to have occurred on the date it determines that there has been a material misrepresentation or omission, or a failure to comply with a request for supplemental information.[33] This gives the IRS the apparent flexibility to select whether the party primarily liable for the accelerated transition tax will be the transferor or the transferee.

If a transfer agreement is in force, the transferee is responsible for making future installment payments of the assumed transition tax, and undertaking the corresponding reporting.[34] The transferor remains jointly and severally liable for any unpaid transition tax installment payments that were assumed, and any subsequent increases to the transition tax liability, penalties, additions to tax, or other amounts attributable thereto.[35]

### The deferral election for S corporation shareholders and corresponding acceleration events

Any taxpayer that incurred transition tax liability regarding SFC stock owned indirectly through an S corporation was permitted to make an election to defer indefinitely payment of such transition tax under rules that are broadly similar to the installment election rules.[36] An S corporation shareholder would have been required to make the deferral election no later than the due date (including extensions) for the shareholder's return for the tax year that included the last day of the tax year of the S corporation in which the S corporation had the transition tax inclusion.[37] Thus, the S corporation shareholder's deferral election generally would have been made on such shareholder's 2017 or 2018 federal income tax return. Late election relief regarding the deferral election is not available under reg. section 301.9100-2 or 301.9100-3.[38]

If any S corporation shareholder has made a deferral election, the statute of limitations on assessment of the deferred transition tax liability does not begin to run until the deferral is terminated by a later triggering event and is extended from three years to six years, and the relevant S corporation is considered to be jointly and severally liable for the payment of the shareholder's transition tax liability regarding the S corporation.[39] An S corporation shareholder that has made a deferral election must report the deferred transition tax amount annually on its federal income tax returns, and will be assessed an amount equal to 5 percent of the deferred transition tax amount for any tax year in which the reporting requirement is not satisfied.[40]

If a taxpayer has made a deferral election, that deferral can be terminated upon the occurrence of triggering events. In that scenario, the taxpayer's share of the corresponding transition tax liability generally would be assessed as an addition to tax for the shareholder's tax year that includes the triggering event.[41] Subject to exceptions described below, the following events will result in the termination of an S corporation shareholder's deferral election:

- the relevant S corporation ceasing to be an S corporation;
- a liquidation, sale, exchange, or other disposition of substantially all of the assets of the S corporation (including in a title 11 bankruptcy or similar case), cessation of business by the S corporation, or the S corporation ceasing to exist;
- a transfer of any share of stock of the S corporation by the shareholder (including by death) that results in a change of ownership for federal income tax purposes;[42] or
- a determination by the IRS that a transfer agreement contains a material misrepresentation or omission, or that requests for additional information have not been satisfied.[43]

In the event that a deferral election under section 965(i) would otherwise be terminated because of a transfer of S corporation shares, termination may be avoided by assumption of the transition tax liability by an eligible transferee under an agreement with terms like the general transfer agreements described

above (an S corporation transfer agreement).[44] In this context, an eligible transferee is a single U.S. person that becomes a shareholder of the S corporation.[45] As with a transfer agreement entered into to avoid acceleration of installment agreements, an S corporation transfer agreement must be signed under penalties of perjury by both the transferor and transferee and generally must be filed with the IRS within 30 days of the acceleration event, and a duplicate copy must be attached to the returns of both the transferor and transferee for the tax year during which the acceleration event occurred.[46] No relief is available under reg. sections 301.9100-2 or 301.9100-3 for a late-filed S corporation transfer agreement.[47]

An S corporation transfer agreement must include a detailed description of the triggering event; a statement that the transferee agrees to assume the transferor's unpaid transition tax liability; a representation that the transferee is able to satisfy the transition tax liability being assumed; an acknowledgment that the transferor, or any successor, will remain jointly and severally liable for the full amount of the transition tax liability assumed; and a statement that the transferee agrees to comply with all of the requirements of the section 965(i) transition tax and related rules, including annual reporting requirements.[48] Like a general transfer agreement, an S corporation transfer agreement must include a statement as to whether the transferee's leverage ratio (computed in a manner that approximates a typical debt-to-equity ratio) exceeds 3 to 1.[49]

Once an S corporation transfer agreement has been filed, if the IRS determines that additional information is necessary, it must be provided on request.[50] The IRS may reject an S corporation transfer agreement, effective as of the date of the acceleration event, if it is found to contain any material misrepresentation or omission, or if a transferee fails to provide additional information on request, or may deem an acceleration event to have occurred on the date of its determination that there has been a material misrepresentation or omission, or a failure to comply with a request for supplemental information.[51]

Again, this provides the IRS with the apparent flexibility to select whether the party primarily liable for the accelerated transition tax will be the transferor or the transferee. If an S corporation transfer agreement is in force, the transferee is responsible for making future payments of the assumed transition tax and the corresponding reporting.[52] As noted above, the transferor remains jointly and severally liable for any unpaid transition tax installment payments that were assumed, and any penalties, additions to tax, or other amounts attributable thereto.[53]

If an S corporation shareholder's deferral election is terminated, it may be possible for the shareholder to make an installment election regarding the transition tax liability that would otherwise become due and payable for the tax year of the termination.[54] The election must be made no later than the due date (taking into account extensions) for the shareholder's federal income tax return for the tax year in which the triggering event occurs; the regulations expressly indicate that late election relief is not available.[55] If the triggering event is (i) a liquidation, sale, exchange, or other disposition of substantially

all of the assets of the relevant S corporation; (ii) a cessation of business by the S corporation; or (iii) the S corporation otherwise ceasing to exist, a shareholder that wants to make an installment election must enter into an agreement with the IRS containing representations and warranties similar to those included in the transfer agreements discussed above (a consent agreement).[56]

### Situations in which triggering event considerations arise

As one might surmise based on the number of triggering events built into the regulations, there is an array of situations in which these rules can come into play. These include sale of a business, internal restructurings, transfer of S corporation shares into a trust, and the death of an individual who has made an installment election or a deferral election. A brief discussion of some transition tax-related issues that can arise in these situations follows.

### Sale of a business

The transition tax implications of the sale of a business vary, depending on type of entity through which the business is conducted and the form of the transaction. One commonality is that the nature of transfer agreements and S corporation transfer agreements creates risk on both sides. Either the buyer or the seller could unilaterally cause an acceleration or termination of deferral by violating transfer agreement terms (for example, because of a failure to furnish information requested by the IRS). This risk is relevant to both seller and buyer because the seller remains jointly and severally liable for unpaid transition tax. A buyer bears the risk of a redetermination of the entire amount of transition tax assumed. It is, therefore, generally advisable for a buyer or seller that enters into a transfer agreement or S corporation transfer agreement to obtain an appropriate level of contractual protection against these risks, to the extent possible. Following are some additional considerations specific to different types of target companies.

### Target business is a partnership

When the business is carried on through an entity classified as a partnership for tax purposes, transition tax acceleration could come into play if the partnership assets include stock of an SFC regarding which one or more partners has made a section 965(h) installment election. However, if a partner were to sell its interest in such a partnership, the sale should only constitute a triggering event if the partnership interest constitutes substantially all of the assets of the selling partner. As noted, it is unclear where the substantiality threshold lies for purposes of these rules. A sale of the partnership assets would not seem to literally constitute a triggering event, because the partnership did not, itself, make an installment election. However, it should be considered whether there is any theory under which a sale of substantially all of the partnership's assets could be viewed as tantamount to a transfer of a partnership interest — for example, by applying aggregate principles to the partnership.[57] Moreover, if a partnership were to distribute all of its assets and ultimately liquidate, the liquidating distribution may, itself, constitute a triggering event.[58]

In the event that a partner's sale of a partnership interest did constitute an acceleration event, it should be possible, in theory, for the selling partner to avoid acceleration of the remaining transition tax liability by entering into a transfer agreement with the buyer if the buyer is an eligible transferee. Presumably, the buyer would require a purchase price adjustment for the assumption of the seller's transition tax liability, and perhaps a premium for undertaking future reporting obligations and bearing related audit risk. At a minimum, a buyer presumably would require representations and warranties from the seller regarding the accuracy of the transition tax amount computed. The complexity for the buyer is also compounded if there are multiple sellers because the buyer may then receive requests to enter into multiple transfer agreements. Conceivably, some buyers would flatly decline to make this accommodation. Entrance into a transfer agreement also presents a continuing risk from the seller's perspective, because the seller continues to be jointly and severally liable for the transition tax assumed and, if the buyer defaults, could be called on pay any remaining amounts.

### Target business is an S corporation

When the business is conducted through an S corporation, one or more of the S corporation's shareholders may have made a section 965 deferral election regarding SFC stock owned by the S corporation. If the sale is structured as an asset acquisition, or if a section 338(h)(10) election is made, any deferral election that has been made by a shareholder of the S corporation is terminated and cannot be cured by entrance into an S corporation transfer agreement.[59] In that scenario, an S corporation shareholder generally would have the option of electing to pay such shareholder's share of the transition tax liability on installment under section 965(h) if the shareholder timely enters into a consent agreement with the IRS.[60]

If, on the other hand, the sale of the business takes the form of a stock sale, an S corporation shareholder with a deferral election in place could avoid a termination of the deferral election if such shareholder enters into an S corporation transfer agreement with the buyer. A buyer could be expected to require a purchase price adjustment to consider the future tax liability, compliance obligations, and audit risk. Additionally, if the buyer is not a valid S corporation shareholder, the S election would terminate on the closing date.[61] In that case, it does not appear that any further deferral would be possible, and the selling shareholder would be limited to considering an installment election. Even if the seller and buyer do not enter into an S corporation transfer agreement, a buyer would want to know whether any other shareholder of the S corporation has made a deferral election under section 965(i), because the S corporation itself is jointly and severally liable for the ultimate payment of deferred transition tax payments.

### Target business is a C corporation

When the target is a C corporation, an installment election regarding an SFC owned by the C corporation would have been made by the C corporation itself, rather than its shareholders. An

acquisition of substantially all the C corporation's assets (or a stock sale in conjunction with a section 338(h)(10) election) generally would accelerate unpaid transition tax of the C corporation.

A sale of the C corporation stock would also accelerate its unpaid transition tax, if the corporation is not a member of a consolidated group and becomes a member of a consolidated group after the acquisition, or if the acquisition results in the seller consolidated group ceasing to exist. In an asset sale (or deemed asset sale), the accelerated transition tax generally would be borne by the target C corporation and its shareholders; however, successor liability risk needs to be taken into consideration.[62] In the case of a stock sale, whether the accelerated transition tax would be borne by the seller or buyer depends on the contractual agreement of the parties (for example, whether the transition tax is to be treated as a pre-closing tax). In either case, acceleration of the remaining transition tax installments could be avoided by the filing of a transfer agreement between the C corporation transferor and the buyer, if the buyer is an eligible transferee. As with the partnership and S corporation sale fact patterns, a seller would need to determine whether (i) the contemplated transaction actually triggers a transition tax acceleration event, (ii) the buyer is actually willing to enter into a transfer agreement, and (iii) if so, whether the associated costs outweigh the benefit of avoiding the acceleration of the remaining transfer tax liabilities.

### Internal or related-party restructurings

It is also possible to trigger the acceleration of unpaid transition tax installments because of purely internal transactions, even where those transactions qualify for nonrecognition treatment. For example, if an individual transfers her SFC stock regarding which she has made a section 965(h) installment election to a new holding company, an acceleration of the remaining installments would result, absent the timely filing of a transfer agreement. A similar issue arises if a member of a U.S. affiliated group that does not file consolidated federal income tax returns is the direct SFC shareholder, and has made an installment election under section 965(h), is merged into an affiliate with the affiliate surviving, or is liquidated into its direct parent. This transaction would accelerate the remaining installment payments, unless a transfer agreement is timely filed.[63]

The occurrence of acceleration events in these types of related-party transactions presents somewhat of a trap for the unwary; acceleration of transition tax liabilities may not be top of mind in such fact patterns because, from the taxpayer's perspective, there has been no disposition of the beneficial ownership of assets.

### Transfer of S corporation shares into trust

It is not uncommon for an individual S corporation shareholder to make a transfer of her S corporation shares to a trust as part of such individual's personal tax and estate planning. As discussed above, when an S corporation shareholder has made a deferral election under section 965(i), a complete or partial termination of the deferral occurs if such shareholder makes a transfer of all or a portion of her S

corporation stock that results in a change of ownership for federal income tax purposes. Presumably a transfer to a trust or portion a trust that is classified as a grantor trust for federal income tax purposes does not result in a termination event, given that a transfer of S corporation shares is only considered a triggering event to the extent that it results in a change of ownership for tax purposes.

However, a transfer to a qualified subchapter S trust (QSST) or electing small business trust (ESBT) (to the extent not treated as a grantor trust) would result in a termination of the transferor's deferral election because the transfer could result in a change of ownership for tax purposes. That result can be avoided by the filing of an S corporation transfer agreement between the transferring shareholder and the transferee trust. The short (generally 30-day) period for timely filing an S corporation transfer agreement and the absence of late election relief requires close attention from taxpayers and their advisers.

## Death of a taxpayer

As noted above, a transfer because of the death of a taxpayer also results in the termination of an installment election under section 965(h) or a deferral election under section 965(i). A termination of an installment election because of the electing taxpayer's death cannot be avoided by entrance into a transfer agreement. The IRS made this clear in the preamble to the final regulations, citing perceived administrative difficulties.[64]

The preamble to the final regulations notes, in particular, that the operative statutory provision does not permit multiple transferees (that is, because an eligible transferee must acquire substantially all of the transferor's assets), and a transfer at death, in many cases, results in transfers to multiple beneficiaries.[65] Accordingly, in such a case, any remaining transition tax liability is accelerated; this could be problematic if there is insufficient liquidity to pay the tax at that time. If this becomes a material concern, the purchase of life insurance to cover the accelerated transition tax amount could be considered as a possible solution. In that case, it generally would be advisable to hold the policy through an irrevocable life insurance trust to keep the value of the policy out of the shareholder's estate.

By contrast, when a transfer results from the death of an S corporation shareholder, the resulting termination of a section 965(i) deferral election can be avoided by filing an S corporation transfer agreement. In that case, subject to the exception noted below, the S corporation transfer agreement is generally required to be filed by the unextended due date for the decedent's final income tax return, rather than simply within the 30-day period after the shareholder's death. When the S corporation stock passes through the decedent's estate (rather than being transferred into trust), a special rule applies.

If the identity of the beneficiaries is determined as of the due date for the decedent's final income tax return, then the transfer may be treated as a transfer directly between the decedent and the beneficiaries. By contrast, if the identity of the beneficiaries has not been determined at that time, then

there are deemed to be two separate transfers — an initial transfer between the decedent and his estate at the time of death and second transfer when the shares are actually transferred to the beneficiaries.[66] In that case, separate S corporation transfer agreements must be filed for each transfer.[67] The S corporation transfer agreement associated with the initial transfer must be filed by the unextended due date for the decedent's final income tax return and the S corporation transfer agreement associated with the second transfer must be filed within 30 days thereafter. A plan that involves a transfer of the S corporation shares to a QSST or ESBT at death is likely to make sense, to keep the S corporation shares out of the shareholder's estate (with an ESBT likely being preferable to a QSST because it entails a transfer to a single transferee).[68]

The situations discussed represent a few of the more common scenarios in which triggering events could occur, but there is a multitude of other situations where these rules can come into play. Given the complexity of the rules, the short time periods permitted for critical elections, and situational ambiguities, transition tax acceleration events should be included in the diligence checklists of taxpayers and their advisers for an array of transactions, both third-party and internal, for the next several years.

*For more information on this topic and to answer any questions you may have, please contact your regular Withers attorney or the authors of this piece.*

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## Footnotes

1 Unless otherwise indicated, section in this document refers to the Internal Revenue Code of 1986, as amended, or the U.S. Treasury regulations promulgated thereunder.

2 P.L. 115-97 (155th Cong., 2d Sess.), section 14103(a).

3 Of course, the transition tax could have future relevance for other reasons. For example, it might be determined that a taxpayer's liability to the transition tax was miscalculated or overlooked. Transition tax inclusions also have lasting impacts on the previously taxed and nonpreviously taxed earnings and profits of foreign corporations and, thus, the tax consequences of future distributions.

4 See IRC sections 965(a), 951(a)(1).

5 A foreign corporation is a CFC for a tax year if it is more than 50 percent owned — directly, indirectly, or constructively — by U.S. shareholders on any day during the tax year.

6 IRC section 965(e).

7 Subject to a reduction under section 965(b) to account for a U.S. shareholder's ownership of some foreign corporations with earnings and profits deficits.

8 Reg. section 1.965-7(g)(10).

9 IRC section 965©.

10 See IRC section 965©(3).

11 IRC section 965(g).

12 A noncorporate taxpayer could have made an election under section 962 to claim a reduced FTC, but this election did not make economic sense for some taxpayers. When a noncorporate taxpayer makes a section 962 election, the taxpayer's inclusion under subpart F (or under the global intangible low-taxed income rules of section 951A for tax years beginning on or after January 1, 2018) is taxed at corporate rates and an indirect FTC is permitted under section 960 to reduce the inclusion. However, a subsequent distribution of the income previously included under subpart F or GILTI over the tax paid on the initial inclusion is subject to a second level of tax. As a result, depending on the timing of the distribution and the rate of tax applicable to it, a section 962 election may result in a higher overall tax liability for the electing taxpayer.

13 Some states, such as California, do not follow the federal subpart F regime and generally would impose tax on distributions out of what constitutes nontaxable previously taxed income for U.S. federal income tax purposes.

14 See Jared Walczak and Erica York, "GILTI and Other Conformity Issues Still Loom for States in 2020," Tax Foundation Fiscal Fact No. 682 (Dec. 2019).

15 Id.

16 IRC section 965(h); reg. section 1.965-7(b).

17 Reg. section 1.965-7(b)(1).

18 See reg. section 1.965-7(b)(1)(ii)(C).

19 Reg. section 1.965-7(b)(1)(ii). If the adjustment is because of the taxpayer's negligence, intentional disregard of the rules and regulations, or fraud, then the full liability to the transition tax can be accelerated to its original due date without the deferral benefits of the elective installment regime.

20 Reg. section 1.965-7(b)(2)(ii).

21 Reg. section 1.965-7(b)(3)(iii)(C)(2).

22 Reg. section 1.965-7(b)(3).

23 Reg. section 1.965-7(b)(3)(iii)(A)(1).

24 Reg. section 1.965-7(b)(3)(iii)(B)(1). For the rules governing the determination of the agent of a consolidated group, see reg. section 1.1502-77.

25 The preamble to the final regulations under section 965 provides that "clarification of the meaning of 'substantially all' was requested for purposes of the acceleration event and triggering event rules. The phrase 'substantially all' is used in various Code provisions and in regulations, and often is determined based on all of the facts and circumstances. Consistent with this general approach, the Treasury Department and the IRS decline to provide a bright-line definition of 'substantially all' in the final regulations." T.D. 9846, 2019-09 IRB 583, 609. For example, in Rev. Proc. 77-37, 1977-2 C.B. 568, the IRS indicated that, for purposes of determining whether the requirements for a tax-free reorganization under section 368(a) have been satisfied, the requirement that substantially all assets have been acquired is generally satisfied if there is a transfer of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the FMV of the gross assets of a transferor corporation.

26 Reg. section 1.965-7(b)(3)(iii)(B)(2).

27 Reg. section 1.965-7(b)(3)(iii)(B)(3).

28 See T.D. 9846 at 617.

29 Reg. section 1.965-7(b)(3)(iii)(B)(3), (6). The regulations define a transferee leverage ratio as the ratio that the total indebtedness of the transferee bears to the sum of its money and adjusted basis of all other assets reduced (but not below zero) by such total indebtedness. The amount considered regarding any indebtedness with original issue discount is its issue price plus the portion of the original issue discount previously accrued.

30 Reg. section 1.965-7(b)(3)(iii)(C)(1).

31 Id.

32 Reg. section 1.965-7(b)(3)(iii)(C)(2).

33 Id.

34 Reg. section 1.965-7(b)(3)(iii)(D)(1).

35 Reg. section 1.965-7(b)(3)(iii)(D)(2).

36 Section 965(i); reg. section 1.965-7©(1).

37 Reg. section 1.965-7©(2)(ii).

38 Id.

39 Reg. section 1.965-7©(4), (5); IRC section 965(k).

40 Reg. section 1.965-7©(6).

41 Reg. section 1.965-7©(3)(i).

42 However, if an S corporation shareholder transfers less than all of its shares, the transfer will be a triggering event only regarding the portion of a shareholder's transition tax liability regarding the S corporation that is properly allocable to the transferred shares. Reg. section 1.965-7©(3)(iii).

43 Reg. section 1.965-7©(3)(ii).

44 Reg. section 1.965-7©(3)(iv)(A).

45 Reg. section 1.965-7©(3)(iv)(B)(1).

46 Reg. section 1.965-7©(3)(iv)(B)(2). If the triggering event occurs because of the transferor's death, an S corporation transfer agreement is considered timely filed if filed by the unextended due date of the transferor's final income tax return. (For transfers by death that occurred before March 7, 2019, S corporation transfer agreements were considered timely filed if filed by the later of the unextended due date of the transferor's final income tax return or March 7, 2019.)

47 Id.

48 Reg. section 1.965-7©(3)(iv)(B)(4).

49 Id. and reg. section 1.965-7©(3)(iv)(B)(6). The transferee's leverage ratio for these purposes is determined in the same manner as the transferee's leverage ratio is determined in relation to a general transfer agreement; see discussion supra note 29.

50 Reg. section 1.965-7©(3)(iv)(C)(1).

51 Reg. section 1.965-7©(3)(iv)(C)(2).

52 Reg. section 1.965-7©(3)(iv)(D)(1).

53 Reg. section 1.965-7©(3)(iv)(D)(2).

54 Reg. section 1.965-7(b)(3)(v)(A).

55 Reg. section 1.965-7(b)(3)(v)(B).

56 See reg. section 1.965-7©(3)(v)(D).

57 For purposes of applying code provisions included in subchapter K, a partnership may be treated as an aggregate of its partners or as an entity distinct from its partners, depending on the purpose and scope of the provisions. See Rev. Rul. 89-85, 1989-2 C.B. 218, 219; and Casel v. Commissioner,

79 T.C. 424 (1982). In fact, the Conference Committee report accompanying the enactment of subchapter K states, "Both the House provisions and the Senate amendment provide for use of the 'entity' approach in the treatment of the transactions between a partner and a partnership which are described above. No inference is intended, however, that a partnership is to be considered as a separate entity for the purpose of applying other provisions of the internal revenue laws if the concept of the partnership as a collection of individuals is more appropriate for such provisions." H.R. Conf. Rep. No 2543, 83d Cong., 2d Sess. 59 (1954).

58 See IRC section 731(a) (in particular, the flush language provides that any gain or loss recognized on distribution governed by section 731(a) "shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner").

59 If a section 338(h)(10) election is made in connection with a stock purchase, the transaction is treated as an asset purchase for purposes of subtitle A of the code. See reg. section 1.338-2(c)(6).

60 Reg. section 1.965-7(c)(3)(v).

61 IRC section 1362(d)(2)(B); reg. section 1.1362-2(b)(2).

62 It has been held that that the federal government may rely on state law successor liability doctrine to hold a successor corporation liable for the tax debts of its predecessor. See Atlas Tool Co. Inc. v. Commissioner, 70 T.C. 86 (1978), aff'd 614 F.2d 860 (3d Cir. 1980); see also CCA 200840001. Most states have laws that impose successor liability when a transaction amounts to a de facto merger or when the successor is a mere continuation of the seller corporation. When a person acquires substantially all the assets of a corporation, the transaction can constitute a de facto merger or a mere continuation of the selling corporation.

63 If an affiliated group is filing consolidated returns, the group is treated as a single corporation under section 1.965-8(e) of the regulations for purposes of section 965(h), so an intragroup transfer should not cause an acceleration event.

64 See T.D. 9846 at 609.

65 Id.

66 Reg. section 1.965-7(c)(3)(iv)(B)(5).

67 Id.

68 Id.