

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

Number: **202235009**

Release Date: 9/2/2022

CC:INTL:B02:KJCate

POSTU-113397-22

UILC: 9414.07-00

date: August 9, 2022  
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subject: Application of section 965(h)(4) to deficiency related to regulation challenge

This Chief Counsel Advice responds to your request for assistance. This advice should not be used or cited as precedent.

**ISSUE**

How does section 965(h)(4) apply to the portion of the tax liability that a domestic corporation did not report because it is challenging a regulation that, if not challenged, would increase the amount of the section 965(h) net tax liability as defined in Treas. Reg. section 1.965-7(g)(4)?

**CONCLUSIONS**

The portion of the tax liability that a domestic corporation did not report is a deficiency due to negligence or intentional disregard of Treas. Reg. section 1.78-1 ("Final Regulations"). Thus, the domestic corporation is not entitled to prorate the deficiency under section 965(h)(4), and the deficiency is due on notice and demand. Regardless of whether the domestic corporation filed a Form 8275-R, Regulation Disclosure Statement, or other disclosure of its position, the same conclusion would apply because section 965(h)(4) and Treas. Reg. section 1.965-7(b)(1)(ii)(C) do not provide an exception in cases of disclosure of a disregarded rule. Further, the same conclusion would apply if the domestic corporation's deficiency was due to its negligence or intentional disregard of any other rule or regulation that would

increase the section 965(h) net tax liability. Also, the timing of the filing of the return is not relevant to the conclusion.

## FACTS

A domestic corporation filed Form 1120, U.S. Corporation Income Tax Return, for its tax year ending in 2018 which included a statement electing to pay the section 965(h) net tax liability in eight installments under section 965(h)(1). The domestic corporation's return position did not reflect application of the Final Regulations. The Service determined a deficiency in the domestic corporation's tax resulting from the domestic corporation's position contrary to the Final Regulations.

## LAW

On December 22, 2017, PL 115-97 or the Tax Cuts and Jobs Act of 2017 ("TCJA") amended numerous sections of the Internal Revenue Code, including the following sections that are relevant to the subject of this memorandum.

The TCJA amended section 965 to require, in the case of the last taxable year of a deferred foreign income corporation ("DFIC") which begins before January 1, 2018, the subpart F income of such foreign corporation (as otherwise determined for such taxable year under section 952) to be increased by the greater of the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or December 31, 2017. The TCJA (and the associated regulations) provide additional rules regarding the computation of the inclusion to the U.S. shareholder (aggregate section 965(a) inclusion amount), the allowable deduction with respect to such inclusion (section 965(c) deduction), the allowed deemed paid foreign tax credits,<sup>1</sup> and the required amount of the section 78 gross-up amount.<sup>2</sup>

Under section 965(h)(1), a taxpayer could elect to pay its section 965(h) net tax liability in 8 installments.<sup>3</sup>

In relevant part, the term "section 965(h) net tax liability" means, with respect to a person that has made a section 965(h) election, the total net tax liability under section 965. Treas. Reg. section 1.965-7(g)(4). In relevant part, the term "total net tax liability under section 965" means, with respect to a person, the excess (if any) of - (A) The person's net income tax for the tax year in which the person includes a section 965(a) inclusion in income, over (B) The person's net income tax for the tax year determined (1) without regard to section 965, and (2) without regard to any income, deduction, or credit properly attributable to a dividend received by the person from, or an inclusion under sections 951(a)(1)(B) and 956 with respect

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<sup>1</sup> See section 965(g)(1), (2).

<sup>2</sup> See section 965(g)(4).

<sup>3</sup> See also Treas. Reg. section 1.965-7(b)(1)(i).

to, a DFIC and paid during, or included with respect to, the DFIC's inclusion year. Treas. Reg. section 1.965-7(g)(10)(i).

Section 965(h)(4) provides that if an election is made under section 965(h)(1) to pay the net tax liability under section 965 in installments and a deficiency has been assessed with respect to such net tax liability, the deficiency is prorated to the installments payable under section 965(h)(1). See also Treas. Reg. section 1.965-7(b)(1)(ii)(A)(1). Section 965(h)(4) states that the election to pay the net tax liability under section 965 in installments does not apply if the deficiency is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax. As provided in Treas. Reg. section 1.965-7(b)(1)(ii)(C), if a deficiency or additional liability is due to negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax, the proration rule will not apply, and the deficiency or additional liability, as well as any applicable interest and penalties, must be paid on notice and demand by the IRS, or in the case of an additional liability, reported on a return increasing the amount of the section 965(h) net tax liability after payment of the first installment or on an amended return, with the filing of the return.

### ANALYSIS

On December 7, 2018, the Department of Treasury and the IRS published proposed Treas. Reg. section 1.78-1. Those regulations were finalized with no changes on June 21, 2019 and were applicable to the domestic corporation's tax year ending in 2018. The domestic corporation's return position did not reflect application of the Final Regulations. The resulting deficiency determined by the IRS (if assessed) is a deficiency due to negligence or intentional disregard of Final Regulations. Thus, under section 965(h)(4), the domestic corporation is not entitled to prorate the deficiency, and the deficiency is due on notice and demand under section 965(h)(4) and Treas. Reg. section 1.965-7(b)(1)(ii)(C).

Regardless of whether the domestic corporation filed a Form 8275-R or other disclosure of its position, the same conclusion would apply because section 965(h)(4) and Treas. Reg. section 1.965-7(b)(1)(ii)(C) do not provide an exception in cases of disclosure of a disregarded rule. Further, the same conclusion would apply if the domestic corporation's deficiency was due to its negligence or intentional disregard of any other rule or regulation that would increase the section 965(h) net tax liability. Also, the timing of the filing of the return is not relevant to the conclusion.

Please call (202) 317-4667 if you have any further questions.