Slow Down and Avoid Payment Acceleration Events for Section 965 Installment Payments and Transfer Agreements

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Taxpayers that elected to spread out transition tax payments over an eight-year period are in danger of triggering all remaining payments. This article considers both common and less visible acceleration events, describes the use of transfer agreements to protect installment treatment, and warns taxpayers to exercise caution.

Many taxpayers elected under sections 965(h) and 1.965-7(b)¹ to pay their section 965(a) liability under the installment method over a period of eight years. Nevertheless, if an “acceleration event” occurs, the taxpayer’s section 965(a) liability becomes immediately due and payable.

An acceleration event is defined in section 1.965-7(b)(3)(ii) and generally includes:

(1) An assessment of an addition to tax for failure to pay a section 965(a) liability installment

(2) A liquidation, sale, exchange, or other disposition of substantially all of the assets of the person, including by reason of the death of an individual

(3) A cessation of business by a non-individual person

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¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).
(4) The change of an individual’s status as a U.S. person

(5) A transaction in which a U.S. corporation joins a U.S. consolidated group

(6) A transaction that causes a U.S. consolidated group to cease to exist

To prevent the section 965(a) liability from becoming immediately due, in the case of certain “covered acceleration events,” an “eligible section 965(h) transferor” and an “eligible section 965(h) transferee” may enter into a transfer agreement. In the transfer agreement, the eligible section 965(h) transferee and the eligible section 965(h) transferor (to the extent it is still in existence) agree to be jointly and severally liable for the remaining section 965(h) liability over the remaining eight-year period. The eligible section 965(h) transferor and eligible section 965(h) transferee can elect this treatment by filing a statement with the IRS that meets the requirements in section 1.965-7(b)(3)(iii)(B)(4).

These transfer agreements are available only for a “covered acceleration event,” which generally only includes certain acceleration events listed in (2), (5), and (6) above: a liquidation, sale, exchange, or other disposition of substantially all of the assets of the person, including by reason of the death of an individual; a transaction in which a U.S. corporation joins a U.S. consolidated group; and a transaction that causes a U.S. consolidated group to cease to exist. An “eligible section 965(h) transferor” is the person that engages in a transaction that is a covered acceleration event. An “eligible section 965(h) transferee” is, among other things, a U.S. person.

In general, whenever a taxpayer with remaining section 965(a) installment payments engages in a significant transaction it should consider whether the transaction constitutes an acceleration event. Nevertheless, there are a number of less obvious events that may constitute an acceleration event, including:

- The death of an individual with a section 965(a) installment liability

- A change in a person’s status from resident alien to non-resident alien

- Related party transfers of substantially all assets outside the consolidated group, including:
  - A transfer to a related foreign corporation in a section 351 exchange
  - An inbound reorganization under section 368(a)(1)(F) in which the stock of the foreign corporation deemed exchanged by the U.S. person is considered substantially all of the assets of the U.S. person
  - A contribution to an internal partnership

An acceleration event resulting from a person’s change from a resident alien to a non-resident alien can be difficult to track when the individual became a resident alien based on the “substantial presence test” described in section 7701(b)(3). Because this test is based on the number of days the individual is present in the United States, the individual’s status could change during a year when the individual’s presence is the United States is reduced (e.g., an extended job assignment in the United States that ends).
Moreover, the acceleration events from related party transactions may be easy to overlook—especially if they do not result in any outbound transfer of assets—because it appears that the general purpose of section 965(h) acceleration events is to police the possibility that the transferor may have reduced its assets subject to collection by the IRS. Indeed, this result in the case of an inbound F reorganization is especially counterintuitive given that the transaction actually brings assets more directly within the IRS’s collection jurisdiction. Compounding these unfortunate results is the fact that neither an outbound section 351 exchange nor an inbound F reorganization involves an “eligible section 965(h) transferee” (because in each case the transfer by the section 965(h) transferor is made to a foreign person), and thus the acceleration events are not eligible for further deferral via a transfer agreement.

Perhaps the one silver lining to this set of concerns is that a U.S. consolidated group is viewed as a single shareholder for these purposes. Accordingly, the substantially all requirement will be less likely to be implicated in most internal transactions—assuming that the U.S. consolidated group holds other significant assets that are not part of the transaction.

An eligible section 965(h) transferee assumes responsibility for making any unpaid installment payments related to a section 965(a) liability of an eligible section 965(h) transferor. As a result, an eligible section 965(h) transferee must also be aware of the acceleration events described above and, to the extent eligible, enter into a new transfer agreement upon a subsequent acceleration event to prevent the section 965(a) liability from becoming immediately due.

FAQs on Section 965(h) Transfer Agreements

Q.1 What is the form prescribed for a section 965(h) transfer agreement?

There is no prescribed form to be used to file a transfer agreement. However, section 1.965-7(b)(3)(iii)(B)(4) provides a list of requirements that must be included in the transfer agreement. The transfer agreement must also be signed under penalties of perjury by a person who is authorized to sign a return on behalf of the eligible section 965(h) transferor and a person who is authorized to sign a return on behalf of the eligible section 965(h) transferee. The IRS FAQs, Question 19, also provides additional language that should be included prior to the attestation clause in the transfer agreement.

Q.2 Where should the section 965(h) transfer agreement be filed?

The section 965(h) transfer agreement should be filed with the IRS’s Memphis Compliance Service Collection Operations at the following address:

Memphis CSCO
5333 Getwell Road MS 81
Memphis, TN 38118

In addition, the transfer agreement should be filed in duplicate with the eligible section 965(h) transferor’s and eligible section 965(h) transferee’s U.S. federal income tax returns.
Q.3  What is the filing deadline for the section 965(h) transfer agreement?

For transfer agreements arising from acceleration events that occurred prior to February 5, 2019, the final regulations require the transfer agreement to be filed by March 7, 2019. Note that this is an extension from the January 31, 2019 deadline that was originally prescribed in the final section 965 regulations. For transfer agreements arising from acceleration events that occur after February 5, 2019, the transfer agreement must be filed within 30 days of the date that the acceleration event occurs.

Q.4  If the taxpayer already filed a transfer agreement under the proposed regulations under section 965, should the taxpayer file a new agreement including the additional requirements set forth in the final regulations under section 965?

Although the section 965 proposed regulations permitted the taxpayer to rely on the procedures relating to transfer agreements, the best practice would be for the taxpayer to file a new transfer agreement that incorporates the changes in the section 965 final regulations.

Q.5  If the taxpayer already filed its return for the year in which the acceleration event occurred, is the taxpayer required to amend its return and attached a duplicate copy of the transfer agreement?

Section 1.965-7(b)(3)(iii)(B)(2)(i) provides that the duplicate copy should be attached to the returns of both the eligible section 965(h) transferor and eligible section 965(h) transferee for the tax year during which the acceleration event occurs filed by the due date for those returns. However, the transition rule in section 1.965-7(b)(3)(iii)(B)(2)(ii) provides that a transfer agreement is timely when it is filed by the March 7, 2019 deadline. The best practice, however, would be to amend the return for the year in which the acceleration event occurred and attach the duplicate copy to that return.

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