



BDO Seidman, LLP
Accountants and Consultants

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Subject:

IRS Directive Makes Audits of IRC §965 Repatriation Mandatory

International Tax Alert

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Issue

The Internal Revenue Service (IRS) has identified documents to be examined and mandatory audit procedures relating to IRC §965 repatriations.

Affecting

All U.S. companies that have made an IRC §965 election.

Timing

Effective immediately.

Details

On October 12, 2007, the IRS issued a detailed industry directive providing guidelines to field agents for planning and completing an examination of U.S. companies that have made an election under IRC §965 to repatriate earnings from their CFCs at a reduced rate. Notably, this is a Tier 1 compliance audit item, which makes it a mandatory audit issue if a U.S. taxpayer is selected for audit. An audit of the IRC §965 benefit contains many fertile areas for controversy, such as the determination of permitted investments, disallowed expenses, foreign tax credit calculations, repatriations of previously taxed income, related party indebtedness, base period dividend calculations and issues relating to corporate restructurings.

For a list of potential documentation identified under the new guidelines, refer to LMSB-04-0907-063. Taxpayers should anticipate that examiners will, at a minimum, perform the following procedures:

- Review Form 8895 (One-Time Dividends Received Deduction for Certain Cash Dividends from Controlled Foreign Corporations), Form 1118 (Foreign Tax Credit-Corporations), and other tax return information for consistency and accuracy;
- Review the domestic reinvestment plan to ensure it meets the requirements of the law and the published guidance;¹

¹ See IRC §965(b)(4), Notice 2005-10 and Notice 2005-38.

- Verify that only cash dividends were used in the 965 calculation; and
- Review the supporting computations to ensure that the base period information, the allowable dividend, related party indebtedness, and the related foreign tax credits were properly computed.

Taxpayers who availed themselves of the IRC §965 benefit should consider gathering the appropriate documentation in anticipation of an actual IDR request upon examination by the IRS. It may be appropriate to consult with legal counsel in some circumstances in light of the recent issues raised by taxpayers and the IRS with respect to the *Textron* tax workpaper litigation.

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