



FOREIGN TRANSITION TAX REPRIEVE

American shareholders of a foreign controlled corporation have been given a reprieve by the US Department of Treasury and the IRS. A US Person living abroad who is an individual US shareholder of a controlled foreign corporation shall encounter no acceleration of the 8-year payment plan, or other penalties, for failing to make the June 15, 2018 deadline. This reprieve is for those with a total tax due under the transitional tax is less than \$1,000,000.

In other words, if the US Person has less than total tax liability of \$1,000,000, there is no requirement to make the June 15, 2018 payment! However, the reprieve does not allow the taxpayer to file their income tax declarations to the IS because to obtain this relief, they are required to make the 965(h) election. See Q&A #7 in the IRS link here so see how and when to make the election.

In order to reach \$1,000,000 in total tax liability, a US Person must have at least \$6.5M in earnings and profits held in cash form, or \$12.5M in non-cash form. The reprieve has no impact on filing and 965 election deadlines, which remain unchanged – June 15, 2018. A US taxpayer may want to consider the benefits of filing for the October 15 extension by June 15, 2018 however.

What is the Transitional Tax? The Tax Cuts and Jobs Act of 2017 (TCJA) introduced the largest tax cuts for American taxpayers in decades for both individuals and corporations. However, Americans that own at least 10% of a foreign controlled corporation would have been subjected to a transitional tax on the earnings and profits (E&P) of the foreign controlled corporations.

What is a foreign controlled corporation? These are entities that would be any foreign organization that would fit the definition of a U.S. limited liability corporation, S or C corporations and includes a US Shareholder holding at least 10% of ownership.

The U.S. taxpayer owning at least 10% of a foreign company is responsible to complete the Form 5471, or the “Information Return of U.S. Persons With Respect To Certain Foreign Corporations” form to the IRS. The Form 5471 is mainly for



reporting the information to the U.S. on your foreign business entity. On the Form 5471, Schedule H would be utilized to calculate the earnings and profits (E&P). The importance of the E&P for Tax Year 2017 is that it would have faced a transitional tax of 15.5% under the TCJA.

What is E&P? Accumulated earnings and profits is an accounting term pertaining to stockholders of corporations. Accumulated E&P are a company's net profits after paying dividends to the stockholders. The amount is the measurement of the economic ability of a corporation to pay cash distributions.

However, the E&P of the foreign entity is liable for the one-time transitional tax for the year ended December 31, 2017. The tax is calculated on the highest rate even though the U.S. Person is an individual. An election to pay the transitional tax can be in one payment or in installments beginning June 15, 2018. Section 965 states a U.S. shareholder may elect to pay the Transition Tax over 8 years in installments.

Questions?

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