



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Large and Mid-Size  
Business Division

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October 2, 2007

**MEMORANDUM FOR** INDUSTRY DIRECTORS  
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE  
DIRECTOR, FIELD SPECIALISTS

**FROM:** Frank Y. Ng /s/ *Frank Y. Ng*  
Deputy Commissioner International (LMSB)

**SUBJECT:** Tier I Issue – Section 965 Foreign Earnings Repatriation  
Directive #1

This memorandum provides the field direction on the Section 965 foreign earnings repatriation Tier I issue.

**Background/Strategic Importance:**

Section 965 is a temporary provision, enacted by the American Jobs Creation Act of 2004 that allows U.S. companies to repatriate earnings from their controlled foreign corporations (CFCs) at a reduced tax rate provided that specified conditions and restrictions are satisfied. Section 965 provides that a corporation that is a U.S. shareholder of a CFC may elect, for one taxable year, an 85 percent dividends received deduction (DRD) for qualifying cash dividends received from its CFCs. There are numerous limitations and special rules applicable to the DRD.

Section 965 (b) imposes the following four limitations on the DRD.

1. Section 965(b)(1) limits the amount of dividends eligible for the DRD;
2. Section 965(b)(2) limits the DRD to extraordinary dividends;
3. Section 965(b)(3) reduces the dividends otherwise eligible for the DRD by any increase in the indebtedness of the CFC to any related person; and
4. Section 965(b)(4) requires that the U.S. shareholder claiming the DRD must invest the amount of the dividend in the U.S. pursuant to a domestic reinvestment plan (DRIP).

In addition, Section 965 (d) and (e) contain rules limiting the use of the foreign tax credit and the deduction of certain expenses to offset the nondeductible portion of the DRD.

The Section 965 foreign earnings repatriation issue crosses all industries and involves a large number of taxpayers. Areas of controversy that may arise with regard to this provision include 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 mergers, acquisitions and spin-offs.

In recognition of the strategic importance of the Section 965 foreign earnings repatriation issue, an Issue Management Team (IMT) has been formed to help identify, develop, resolve and improve Service-wide coordination of this issue.

### **Issue Tracking:**

This issue should be tracked using the following Uniform Issue List Codes (UILCs):

Foreign Repatriation of Dividends UIL 965.00-00  
Qualifying Dividend UIL 965.01-00  
Base Period Computation UIL 965.01-01  
APB 23 Amount UIL 965.01.02  
Allocation of APB 23 Amount and \$500 Million UIL 965.01-03  
Related Party Indebtedness UIL 965.01-04  
Domestic Reinvestment Plan UIL 965.01-05  
Investments UIL 965.01-06  
Safe Harbor UIL 965.01-07  
Effect of Transactions UIL 965.01-08  
Dividends Received Deduction UIL 965.02-00  
Dividends paid indirectly from CFCs UIL 965.02-01  
Foreign Tax Credit Special Limitation UIL 965.03-00  
Disallowance of Foreign Taxes UIL965.03-01  
Taxable Income Limitation UIL 965.04-00  
US Tax on Non-deductible Dividend UIL 965.05-00

### **Planning and Examination Guidance:**

#### **Issue Identification:**

The Section 965 foreign dividend repatriation issue is identified by Form 8895 which must be attached to the U.S. income tax return to make the required election. In addition, the taxpayer needs to indicate the dividend amount on page 2 of the Form 1120.

#### **Planning and Examination Risk Analysis:**

Since this issue has been designated as a Tier I Compliance issue it is a mandatory examination item for those taxpayers that have elected to repatriate foreign earnings # [REDACTED] # under Section 965. Examiners should utilize the risk analysis process to determine if repatriations # [REDACTED] # should be examined. When addressing this issue, examiners must follow the guidance that has been issued including this Industry Directive. The assistance of an International Examiner should be requested through the Specialist Referral System. Examiners must involve the IMT in the development and resolution of these issues. This will take

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the form of discussions with the Technical Advisor (TA). All Forms 5701 will be provided to the TA for review and concurrence. The TA will be responsible for coordinating with and obtaining the concurrence of the IMT.

**Audit Techniques:**

Detailed published guidance regarding Section 965 is contained in three Notices issued in 2005; Notice 2005-10, Notice 2005-38, and Notice 2005-64.

The attached pro forma Information Document Request should be prepared and submitted by an International Examiner early in the examination process. At a minimum, the following audit techniques should be completed on each case that involves a Section 965 foreign earnings repatriation issue:

- Review the Form 8895, Form 1118 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
- Verify that the dividends were cash dividends
- 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

Questions regarding this directive or the development of any issues involving Section 965 foreign earnings repatriation should be directed to International Technical Advisors, Nancy Johnson (primary), Rich LaRusso (backup) or Section 965 Industry Counsel, Christina Moss.

This Directive is not an official pronouncement of law or the position of the Service and can not be used, cited, or relied upon as such.

cc: Commissioner, LMSB  
Deputy Commissioner, LMSB  
Division Counsel, LMSB  
Commissioner, SBSE  
Chief, Appeals  
Director, Planning Analysis and Support