



TaxNewsFlash

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KPMG report: Initial impressions, final regulations and additional proposed regulations under section 59A (“BEAT”)

The U.S. Treasury Department and IRS earlier today, December 2, 2019, released for publication in the Federal Register final regulations (T.D. 9885) and additional proposed regulations (REG-112607-19) under section 59A—the Code provision referred to as the “BEAT” (the base erosion and anti-abuse tax) as enacted as part of the 2017 U.S. tax law (Pub. L. No. 115-97, enacted December 22, 2017, and often referred to as the “Tax Cuts and Jobs Act”).

This report provides early impressions and observations about these regulations and does not cover in detail provisions relating to partnerships, insurance, qualified derivative payments (QDPs), or consolidated returns. A more detailed report on these regulations will be provided in a future edition of *TaxNewsFlash*.

Read text of:

- The [final regulations](#) [PDF 1 MB] (343 pages) referred to in this report as the “final regulations” or “final rules”
- The [additional proposed regulations](#) [PDF 333 KB] (59 pages) and referred to in this report as the “proposed regulations” or “proposed rules”

BEAT final regulations

- **No carve-out for GILTI/subpart F inclusions.** Despite comments requesting a broad exception from base erosion payment for payments made by a domestic corporation to a CFC or PFIC, the final regulations do not adopt such an exception. In response to comments requesting an exception for subpart F, GILTI, and PFIC inclusions, the preamble to the final regulations notes certain policy and practical reasons for declining to extend the exceptions to such income inclusions.

- Relief for non-recognition transactions.** In response to various comments received, the final regulations generally exclude amounts transferred to, or exchanged with, a foreign related party in a transaction described in sections 332, 351, and 368 from the definition of base erosion payment. However, any such transactions involving “other property” are not excepted, with other property generally defined as under sections 351(b), 356(a)(1)(B), and 361(b), as applicable, including liabilities described in section 357(b) (as well as gain recognized to the extent of liabilities under section 357(c)). The final regulations also clarify that section 301 distributions are not exchanges, and so not base erosion payments. However, the final rules also provide that redemptions of stock as defined in section 317(b) are exchanges that potentially give rise to base erosion payments, including redemptions described in section 302(a) and (d) or section 306(a)(2)), or an exchange of stock described in section 304 or section 331.
- Allowed vs. allowable deductions.** Comments suggested that use of the term "allowed" in defining base erosion tax benefits in both the Code and 2018 proposed regulations should lead to a conclusion that no base erosion tax benefit results from an otherwise allowable deduction that a taxpayer fails to claim on its tax return. The final regulations do not explicitly address this point one way or the other and simply continue to use the term "allowed" in defining base erosion tax benefits. As discussed further below, however, the 2019 proposed regulations provide a mechanism by which "allowable" deductions can be irrevocably waived so as not to be considered as "allowed." The preamble indicates that the government believes that a mechanism that makes the waiver irrevocable is necessary to impose a consistent treatment that would prevent taxpayers from potentially using some or all of the foregone deductions in a later year. Importantly, the preamble to the 2019 proposed regulations permits taxpayers to rely on this aspect of the proposed regulations for any tax year to which BEAT applies.
- Aggregate group members with different tax years.** In response to comments, the final regulations provide that the determination of gross receipts and the base erosion percentage of a taxpayer’s aggregate group is made on the basis of the taxpayer’s tax year and the tax year of each member of its aggregate group that ends with or within the applicable taxpayer’s tax year (the “with-or-within method”). The proposed regulations contain additional rules designed to implement the with-or-within method, summarized below. The final regulations also clarify that the base erosion tax benefits and deductions of a member of an aggregate group with a fiscal year beginning before January 1, 2018, are not included in determining the base erosion percentage of the aggregate group.
- Transactions between members of an aggregate group.** The final regulations clarify that a transaction between parties is disregarded for purposes of the BEAT, when determining the gross receipts and base erosion percentage of an aggregate group, if both parties were members of the aggregate group at the time of the transaction – without regard to whether the parties were members of the aggregate group on the last day of the taxpayer’s tax year.
- Losses with respect to the sale or transfer of property are not base erosion payments.** In response to comments, the final regulations exclude such losses from the definition of base erosion payment. The preamble clarifies that the term “base erosion payment” does not include the amount of "built-in-loss" because that built-in-loss is unrelated to the payment made to the foreign related party. Further, to the extent that a transfer of built-in-loss property results in a deductible payment to a foreign related party that is a base erosion payment, the final regulations clarify that the amount of the base erosion payment is limited to the fair market value of that property.
- Interest expense allocable to a foreign corporation’s ECI.** In response to comments, the final regulations replace the worldwide liability ratio of the proposed regulations with a worldwide interest expense ratio (average worldwide interest expense due to foreign related parties over total average worldwide interest expense) for purposes of determining what U.S. branch interest

expense is treated as paid to a foreign related party. The final regulations provide that the same ratio will apply regardless of whether a taxpayer applies the adjusted U.S. booked liabilities method described in Reg. section 1.882-5(b) through (d) or the separate currency pools method described in Reg. section 1.882-5(e). The final regulations do not, however, adopt a fixed ratio or safe harbor for the worldwide interest ratio.

- **Section 988 losses.** In response to comments, for purposes of the base erosion percentage, the final regulations exclude from the denominator the section 988 losses that are excluded from the numerator, in an attempt to create symmetry with TLAC securities and the SCM exception.
- **Expand TLAC securities exception.** In accordance with comments, the final regulations expand the scope of the TLAC exception (subject to certain limitations) to include internal securities issued by global systemically important banking organizations pursuant to laws of a foreign country that are comparable to the rules established by the Federal Reserve Board, where those securities are properly treated as indebtedness for U.S. federal income tax purposes.
- **“Add-back” method for computing MTI retained.** Despite comments, the final regulations retain the add-back method, as opposed to the recomputation or any other method, to determine modified taxable income without regard to both the base erosion tax benefits and the base erosion percentage of net operating loss deductions.
- **Exclusion for AMT credits.** In response to comments, the final regulations provide that AMT credits, like overpayment of taxes and for taxes withheld at source, do not reduce adjusted regular tax liability for purposes of computing BEMTA.
- **Exception for groups with de minimis banking and securities dealer activities.** In response to comments, the final regulations provide that the additional 1% add-on to the BEAT rate will not apply to a taxpayer that is part of an affiliated group with de minimis banking and securities dealer activities.
- **No section 15 blending for FY 2018.** The final rules clarify that section 15 does not apply to require a blended BEAT rate for taxpayers with fiscal years beginning in calendar year 2018 and ending in 2019. Accordingly, the rate for any tax year beginning in calendar year 2018 is 5%.
- **Anti-abuse rules finalized largely unchanged.** The final regulations add new examples aimed at clarifying the “principal purpose” standard and treatment of ordinary course transactions.
- **Applicability dates.** The final regulations (other than the reporting requirements for QDPs in Reg. sections 1.6038A-2(b)(7), 1.1502-2, and 1.1502-59A) apply to tax years ending on or after *December 17, 2018*. Taxpayers are also permitted to apply the final regulations *in their entirety* for tax years ending before December 17, 2018, but must do so consistently and cannot selectively choose which particular provisions to apply.

BEAT additional proposed regulations

- **Election to waive allowable deductions.** The proposed regulations provide an election to waive deductions, and clarify deductions for which no election is made are treated as “allowed” deductions even if not claimed by the taxpayer. A taxpayer may make the election to waive deductions on its original filed Federal income tax return, by an amended return, or during the course of an examination of the taxpayer’s income tax return for the relevant tax year pursuant to procedures prescribed by the IRS Commissioner. Further, until the proposed regulations are finalized, a taxpayer choosing to rely on the proposed regulations may make this election by attaching a statement with the required information to its Form 8991. The election is made on an

annual basis and a taxpayer is not bound by the prior year's election. Additionally, the election is not a method of accounting for purposes of section 446.

- **Aggregate group rules.** The proposed regulations provide rules for determining a taxpayer's aggregate group based on the "with-or-within" method adopted by the final regulations, including how the rule applies to short years and when members join or leave the group. For short years, the proposed regulations provide that a taxpayer must use a "reasonable approach" that "neither over-counts nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group of the taxpayer." With respect to entry/exit of members, the proposed rules clarify that only items occurring while a member was in the group are counted for purposes determining a taxpayer's gross receipts and base erosion percentage (i.e., items from before the member joined or after the member left are not counted). The proposed regulations also clarify that there is no double counting of a corporation's gross receipts, base erosion tax benefits, or deductions, by application of the predecessor rule.
- **Application to partnerships.** The proposed regulations provide several new rules aimed at clarifying the application of the BEAT to partners and partnerships. Noting that curative allocations can provide a partner with the benefits of a deduction in the partnership setting, the proposed regulations provide that a partner is treated as having a base erosion tax benefit to the extent the partnership places a taxpayer in an "economically equivalent position by allocating less income to that partner in lieu of a deduction to that partner." There are also new anti-abuse rules aimed at derivatives on partnership interests and targeting allocations by a partnership to prevent or reduce a base erosion payment. Additionally, the proposed regulations request comments on the application of ECI to partners and partnerships and provide rules for filing partnership returns.
- **Applicability date.** The proposed regulations generally apply to tax years beginning on or after the date that final regulations are filed with the Federal Register. Taxpayers are expressly permitted to rely on the proposed regulations *in their entirety* for tax years beginning after December 31, 2017, and before the regulations are finalized. However, if a taxpayer chooses to apply the 2018 proposed regulations to a tax year ending on or before the date the regulations are filed with the federal register, the determination as to whether the taxpayer is applying the additional proposed regulations in their entirety to such tax year is made without regard to the aggregate group rules in Prop. Reg. sections 1.59A-2(c)(2)(ii), (c)(4), (c)(5), and (c)(6). Additionally, the rules in proposed §§1.59A-7(c)(5)(v) (regarding partnership allocations in lieu of deductions) and (g)(2)(x) (curative allocation example) and 1.59A-9(b)(5) (anti-abuse – partner derivative rule) and (6) (anti-abuse – allocation to eliminate or reduce base erosion payment) apply to tax years ending on or after the date the regulations are filed with Federal Register.

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Definition of terms

CFC = controlled foreign corporation
PFIC = passive foreign investment company
GILTI = global intangible low-taxed income
ECI = effectively connected income
TLAC = total loss-absorbing capacity
AMT = alternative minimum tax
MTI = modified taxable income

BEMTA = base erosion minimum tax amount

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