



TaxNewsFlash

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

The U.S. Treasury Department and IRS yesterday released proposed regulations under section 59A, the “base erosion and anti-abuse tax” (BEAT) that was enacted as part of the new U.S. tax law (Pub. L. No. 115-97) (also referred to as the “Tax Cuts and Jobs Act” (TCJA)).

The [proposed regulations](#) [PDF 827 KB] (193 pages) provide guidance regarding which taxpayers will be subject to section 59A; the determination of what is a base erosion payment; the method for calculating the base erosion minimum tax amount; and the required base erosion and anti-abuse tax resulting from that calculation.

Initial impressions of BEAT proposed regulations

More detailed impressions on these proposed regulations will be provided in a future edition of *TaxNewsFlash*. As an initial matter, however, a few features of the proposed regulations are noteworthy:

- **Add-back approach for modified taxable income (MTI) calculation.** The BEAT statute could be read to contemplate a full recalculation of taxable income in order to arrive at MTI. The proposed regulations provide instead that MTI is computed by starting from taxable income or loss as computed for regular income tax purposes, then simply adding back any gross base erosion tax benefits and the base erosion percentage of the net operating loss (NOL) deduction allowed under section 172 for the tax year. This means, for example, that the amount of interest allowed under section 163(j) would not be redetermined to take into account any increase to MTI.
- **Broad scope of “amounts paid or accrued.”** The proposed regulations provide that an “amount paid or accrued” for purposes of defining a base erosion payment subject to the BEAT is not limited to cash payments, and would also include

amounts paid or accrued using any other form of consideration including property, stock or the assumption of a liability. The preamble to the proposed regulations notes that no specific exception is provided for transactions eligible for nonrecognition treatment, and comments are requested on the appropriate treatment of non-cash consideration.

- **Services cost method (SCM) exception.** Consistent with the position taken by KPMG tax professionals, the proposed regulations provide that the exception for services that are eligible to be priced using the services cost method under Reg. section 1.482-9(b), but for the business judgment rule in Reg. section 1.482-9(b)(5), is available even if a mark-up is in fact charged, but that the portion of the payment exceeding the total services cost will not be eligible for the exception. The proposed regulations provide books and records requirements that apply for purposes of the SCM exception.
- **Aggregation rule.** The BEAT statute provides for an aggregation rule treating members of the same controlled group as a single person for purposes of determining whether a taxpayer is an applicable taxpayer and what base erosion percentage will apply to that taxpayer. The proposed regulations clarify that the aggregation rule will exclude foreign members of the controlled group except to the extent that they are subject to U.S. income taxation on their net income. The proposed regulations also provide rules for calculating gross receipts and the base erosion percentage within the aggregate group, including rules when taxpayers within an aggregate group have different tax years.
- **Treatment of NOLs for BEAT purposes.** The proposed regulations provide that the base erosion percentage applicable to NOLs for purposes of the MTI calculation is the “vintage” year in which the NOL was incurred, rather than that of the year in which it is applied to reduce taxable income. With respect to pre-2017 NOLs, the proposed regulations would limit the amount of the NOL that can be taken into account for BEAT purposes to the amount that is necessary to reduce regular taxable income to zero (\$0). Thus, while a current year loss would result in negative taxable income as a starting point for the MTI calculation, an NOL would not reduce taxable income below zero for that purpose.
- **ECI exception.** The proposed regulations provide an exception from the scope of base erosion payments for amounts that are subject to tax on a net basis in the United States because they are treated as effectively connected with a trade or business or as profits attributable to a permanent establishment under a U.S. tax treaty.
- **Interaction with section 163(j).** The proposed regulations reverse the rule announced in Notice 2018-28 for 163(j) carryforwards from pre-effective date tax years. The proposed regulations provide that such interest will be treated as made in the year in which such interest was originally paid or accrued—rather than in the year in which the interest deduction is ultimately allowed—with the result that such interest would not constitute a base erosion payment when allowed. The proposed regulations also provide detailed rules regarding the interaction with section 163(j),

including how to classify the remaining interest for which deductions are allowed when section 163(j) applies.

- **Qualified derivative payments.** The proposed regulations narrow the broad definition of derivatives provided in the BEAT statute by removing securities lending transactions, sale-repurchase transactions, and substantially similar transactions from the scope of derivatives covered by the exception.
- **Allocation of expenses.** The proposed regulations provide that a foreign corporation with interest or other expenses that are allocable to effectively connected income will be treated as making base erosion payments to the extent the expense results from a payment or accrual to a foreign related party. In the case of interest, the proposed regulations provide that the allocation would depend on the interest expense allocation method otherwise used by the taxpayer. Notably, in the case of a taxpayer relying on a tax treaty method that would recognize payments between a branch and a foreign home office for purposes of determining taxable profits, such payments would be treated as subject to the BEAT even though they are not otherwise recognized for U.S. tax purposes.
- **Aggregate approach to partnerships.** The proposed regulations generally adopt an aggregate approach for both payments received and payments made by a partnership. That is, payments made by a partnership with corporate partners would generally be treated as made by those corporate partners. Consistent with this aggregate approach, whether a recipient of a payment is a foreign related person would also be determined at the partner level, rather than at the partnership level.

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