# Final BEAT regulations - An inbound perspective

October 20, 2020

## In brief

Treasury and the IRS on September 1 released Final Regulations (the 2020 Final Regulations) for the Base Erosion and Anti-Abuse Tax (BEAT) under Section 59A as enacted by the 2017 tax reform legislation (the Act). The BEAT rules require certain corporations to pay a minimum tax on taxable income as computed without certain deductions for certain payments to foreign related parties.

The BEAT is of importance for US inbound companies, with the characterization of base eroding payments being especially significant. The 2020 Final Regulations contain additional changes that may have a material impact on US inbound companies. US inbound companies may find BEAT relief in the form of a waiver election, and also will be interested in clarifications to the aggregate group rules.

## In detail

### Background

Section 59A imposes a minimum tax on certain US taxpayers that broadly speaking, make deductible payments to foreign affiliates. In December 2019, Treasury and the IRS released final regulations (2019 Final Regulations) as well as a set of new proposed regulations (2019 Proposed Regulations). Some of the highlights of the 2019 Proposed Regulations included aggregate group rules for computing gross receipts and the base erosion percentage, as well as the procedure with respect to disclaiming deductions.

### Waiver election

#### 2019 Proposed Regulations

The waiver of deductions under the 2019 Proposed Regulations allows a taxpayer to waive or forgo allowed deductions in calculating its base erosion percentage. Domestic case law permits the waiver of deductions, but in response to taxpayer comments, the 2019 Proposed Regulations provided an election (the BEAT waiver election).

### 2020 Final Regulations

The 2020 Final Regulations generally retain the rules from the 2019 Proposed Regulations, but with some minor modifications. The 2020 Final Regulations provide that a taxpayer that makes the waiver election will not treat the waived deductions as base erosion tax benefits. Stated differently, if the deduction is waived, it is as if the deduction never existed, and is not taken into account for purposes of the various computations required under the BEAT rules.

The time and manner of making the election remains generally the same as in the 2019 Proposed Regulations. The BEAT waiver election may be made on an originally filed or amended return, or during the course of an IRS examination. A taxpayer may increase the amount of any waived deductions on an amended return (or during the course of an examination of the taxpayer's tax return); however, taxpayers cannot later revoke or decrease the amount of previously waived deductions once the BEAT waiver election is made.

The 2020 Final Regulations clarify that the BEAT waiver election can only be made by a taxpayer that otherwise might be subject to BEAT. For example, a US corporation or a foreign corporation with effectively connected income to a US trade or business can make the election.

***Observation:*** An amount waived under the BEAT election is waived for all purposes of the tax code. For example, if a US subsidiary waives a deduction for an interest payment to its foreign parent, that deduction would not exist for purposes of computing the US company's Section 163(j) limitation and similarly would not be treated as a base erosion tax benefit for BEAT purposes.

***Observation:*** The waiver election may be most effective for those US inbound companies that are hovering around the three% base erosion percentage, since in general, a company with a base erosion percentage of less than three% is not considered an applicable taxpayer and not subject to BEAT. Companies with a higher base erosion percentage may wish to consider other potential restructuring options.

## Anti-abuse rule - Nonrecognition transaction

### 2019 Final Regulations

The 2019 Final Regulations generally excluded from the definition of 'base erosion payment' amounts transferred to, or exchanged with, a foreign related party in a 'specified nonrecognition transaction.' An anti-abuse rule provided that if a transaction had a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in the nonrecognition transaction, then the specified nonrecognition transaction will not be excepted from treatment as a base erosion payment.

***Observation*:** Treasury and the IRS were concerned that the specified nonrecognition exception could be susceptible to abuse by taxpayers. For example, entering into a transaction to step-up the basis of intellectual property prior to inbounding the property would provide a US company with a higher basis to depreciate or amortize.

### 2020 Final Regulations

A potential 'cliff effect' existed under the 2019 Final Regulations where a nominal amount of pre-transaction basis step-up at any point in time, and specifically within the six months prior to the nonrecognition transaction, could disqualify an entire transaction from the specified nonrecognition transaction exception. The 2020 Final Regulations mitigate this cliff effect by revising the anti-abuse rule and clarifying that a transaction, plan, or arrangement with a principal purpose of stepping up the adjusted basis of property also must have a connection to the acquisition of the property by the taxpayer in a specified nonrecognition transaction. Further, if the transaction is subject to the anti-abuse rule, only the amount of the basis step-up is subject to the BEAT rules.

Treasury and the IRS recognized that some taxpayers had interpreted the anti-abuse rule in the 2019 Proposed Regulations to apply to certain basis step-up transactions even if the transaction had no factual connection with a later specified nonrecognition transaction.

## Aggregation Rules

### 2019 Proposed Regulations

The 2019 Proposed Relations adopted a with-or-within approach for computing the gross receipts and base erosion percentage of a taxpayer's aggregate group. That is, a taxpayer had to consider the gross receipts and base erosion items of each member of the aggregate group for the tax year of the aggregate group member that ends with or within the taxpayers tax year.

***Observation:*** While the 2019 Proposed Regulations seemed straightforward, there were complexities that the taxpayer had to consider. These included situations involving aggregate group members that have short tax years due to members joining or leaving an aggregate group, changing year ends, and aggregate group members with different tax years than the taxpayer.  Adherence to the with-or-within rule can be difficult for inbound companies that have multiple tax filers in their structure.

Under the 2019 Proposed Regulations, a taxpayer that had a tax year shorter than 12 months was required to annualize the gross receipts and base erosion items and use any reasonable method to do so. A reasonable method was considered to be a method that neither undercounted nor overcounted the gross receipts and base erosion items. The 2020 Final Regulations retain the reasonable method approach and include specific examples of methods that may or may not be considered reasonable.

### 2020 Final Regulations

The 2020 Final Regulations aggregate group rules primarily focuses on the impact to a taxpayer's gross receipts calculations and base erosion percentage when members of the aggregate group have tax years that are different than the taxpayer’s.

#### Reasonable approach

The 2020 Final Regulations retain the 'reasonable approach' method for determining the gross receipts and base erosion percentage of a taxpayer’s aggregate group members when there is a short tax year. The 2020 Final Regulations clarify that when a member does not have a tax year that ends with or within a short tax year, exclude gross receipts and base erosion items of the member from the taxpayers aggregate group would be considered unreasonable.

Whatever reasonable approach a taxpayer takes, they must follow that approach consistently. Examples of a reasonable approach may include an approach that takes into account 12 months of gross receipts of base erosion tax benefits and deductions of the member by reference to the 12-month period ending on the last day of the short period, the member’s tax year that ends nearest to the last day of a short period or that begins nearest to the first day of the short period, or an average of the two tax years of the member ending before and after the short period.

#### Changes to the composition of the aggregate group

With respect to members joining or leaving the group, the 2020 Final Regulations retain the approach of the 2019 Proposed Regulations. Generally, if a member joins or leaves the group and the tax year is not closed, the 2019 regulations deemed the year to be closed. In contrast to the 2019 Proposed Regulations, the 2020 Final Regulations deem the year to be closed at the end of the day of the transaction, which is consistent with other provisions of the code.

#### Different tax years

The 2020 Final Regulations provide several new rules dealing with members that have different tax years. The first rule is with respect to a member that has multiple years that end with or within a taxpayer's tax year-end due to a short tax year because a member left the aggregate group. In this circumstance, the gross receipts and the base erosion items are to be annualized to avoid including more than 12 months of gross receipts and base erosion items.

#### Less than 12-month period

The 2020 Final Regulations also adopt a corresponding rule to address situations when there is a less than a 12-month period that ends with or within the taxpayer’s tax year due to a change in tax year-end of another member. Specifically, if the taxpayer’s aggregate group members change their tax year-end and, as a result, the member’s tax year or years ending with or within the taxpayer’s tax year is comprised of fewer than 12 months, for purposes of determining the gross

receipts and base erosion percentage of the taxpayer's aggregate group, the member's gross receipts and base erosion items must be annualized to 12 months.

### Anti-abuse rule

A corresponding anti-abuse rule addresses other types of transactions that may achieve a similar result of excluding gross receipts or base erosion items of a taxpayer or member of the taxpayer's aggregate group when the transaction has a principal purpose of avoiding applicable taxpayer status.

### Successors and predecessors

The 2020 Final Regulations generally adopt the 2019 Proposed Regulations regarding successors and predecessors. The 2020 Final Regulations clarify that gross receipts of foreign predecessor corporations are included in the calculation of gross receipts of an aggregate group to the extent the gross receipts were included as income effectively connected with a US trade or business of the predecessor.

***Observation:*** Inbound companies that have more than one US tax filing group (stand-alone US entity or multiple US consolidated groups) should consider the impact of the final aggregation rules, particularly if the filing groups have different year-ends.

Inbounds also should consider modeling their BEAT calculation prior to the end of the year, especially if one of the members of the aggregate group changes their tax year-end, or the taxpayer is entering into a transaction with other members of the aggregate group that causes the taxpayer no longer to be an applicable taxpayer.

## The takeaway

The BEAT essentially is intended to ensure that taxpayers doing business within the United States pay a 10% minimum tax if deductions from base erosion payments exceed a threshold percentage of total deductions in any tax year with certain limitations.

The 2020 Final Regulations provide additional guidance related to the determination of a taxpayer's aggregate group for purposes of determining gross receipts and the base erosion percentage; an election to waive deductions for purposes of the BEAT; the application of the BEAT to partnerships; the anti-abuse rule with respect to certain basis step-up transactions; and reference the possibility for future guidance relating to the qualified derivative payment (QDP) reporting requirements. Taxpayers should assess the impact of the 2020 Final Regulations on their structures.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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