

Preliminary highlights from the final BEAT regulations

September 3, 2020

In brief

Treasury and the IRS, on September 1, released [final regulations](#) (the Final Regulations) under Section 59A ('the base erosion and anti-avoidance tax' or 'BEAT'). BEAT, which requires certain US corporations to pay a minimum tax associated with, broadly speaking, deductible payments to non-US related parties, was enacted by the [2017 tax reform act](#). These regulations finalize the previously proposed regulations published in the Federal Register on December 6, 2019 (the 2019 Proposed Regulations). The Final Regulations retain the basic approach and structure of the proposed regulations, with certain revisions.

The Final Regulations cover rules relating 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 possible future guidance relating to the qualified derivative payment (QDP) reporting requirements.

The Final Regulations generally apply to tax years beginning on or after the date the regulations are published in the Federal Register. Taxpayers may apply the Final Regulations, in their entirety, for tax years beginning after December 31, 2017 and before their applicability date, provided that, once applied, taxpayers continue to apply the Final Regulations in their entirety for all subsequent tax years. Alternatively, taxpayers may apply only the 'allowed deductions' and 'waiver' provisions for tax years beginning after December 31, 2017 and before their applicability date, provided that, once applied, taxpayers continue to apply both of these provisions in their entirety for all subsequent taxable years.

The Final Regulations contain 66 pages of preamble language and 37 of regulatory text, including 5 examples. The Final Regulations are effective 60 days after the date of publication in the Federal Register.

A forthcoming PwC Insight will discuss the Final Regulations in more detail.

In detail

Highlights of the Final Regulations

Waiver of deductions

The 2019 Proposed Regulations provided an election for taxpayers to waive allowed deductions in order to reduce their BEAT liability. Under the 2019 Proposed Regulations, a taxpayer that made the election would not treat the waived deduction as a base erosion tax benefit and would not include the waived deduction in its base erosion percentage calculation. The Final Regulations retain the basic approach of the 2019 Proposed Regulations.

Treasury and IRS received comments that when a deduction is waived, consistent with the statutory language of Section 59A, it should be excluded from the numerator of the base erosion percentage fraction but not the denominator. This comment was not adopted. Accordingly, when a deduction is waived, the deduction is removed from both the numerator and the denominator of the base erosion percentage fraction.

Observation: Excluding waived deductions from both the numerator and denominator will require taxpayers to waive a larger amount of deductions in order to reduce their base erosion percentage sufficiently to avoid being subject to the BEAT.

The 2019 Proposed Regulations provided that a taxpayer could increase, but not decrease, the amount of a deduction waived on an amended return or during the course of an IRS examination. Taxpayer comments to the 2019 Proposed Regulations recommended that taxpayers be allowed to reduce the amount of waived deductions on an amended return or during the course of an IRS examination. This comment was not adopted.

Observation: As taxpayers do not have the ability to reduce the amount of deductions waived on an amended return or during the course of an IRS examination, taxpayers will need to closely examine the amount of deductions waived on its current year return (including the impact other adjustments may have on the waiver).

Aggregation rules

The 2019 Proposed Regulations provided that if a taxpayer's tax year is fewer than 12 months, annual gross receipts should be extrapolated by multiplying the gross receipts for the period by 365 and dividing the amount by the number of days in the short period. For determining the gross receipts and base erosion percentage of the aggregate group for a short period, the taxpayer is required to use a reasonable approach (i.e., an approach that does not over-count nor under-count gross receipts, base erosion tax benefits, and deductions). The Final Regulations retain this general approach but provide, when a member of the aggregate group does not have a tax year that ends with or within a short tax year of a taxpayer, such member's activity must still be reflected in the relevant calculations. The Final Regulations also contain a new anti-abuse rule that applies when a taxpayer or a member of a taxpayer's aggregate group enters into a transaction with another corporation that is a member of the aggregate group or a foreign related party, that has a principal purpose of changing the period taken into account for the gross receipts test or the base erosion percentage test.

Observation: When taxpayers have a tax year that is fewer than 12 months, they must determine a 'reasonable approach' to calculate the gross receipts and base erosion percentage of the aggregate group. The Final Regulations provide examples of reasonable approaches; however, these examples are not exhaustive, and taxpayers should ensure that the method used does not over-count nor under-count gross receipts, base erosion tax benefits, and deductions.

Application to partnerships

BEAT Waiver Election. The Final Regulations clarify that the BEAT waiver election is made by a corporate partner of a partnership, not the partnership itself. The Final Regulations also contain coordination rules with the centralized partnership audit regime enacted in the Bipartisan Budget ACT of 2015 and Section 163(j).

Observation: Under the Final Regulations, when a partner waives a deduction that was taken into account by a partnership (to reduce the partnership's adjusted taxable income for purposes of Section 163(j)), the increase in the partner's income resulting from the waiver is added to the partner's Section 163(j) limitation computation.

Effectively Connected Income. In 2019 Treasury and IRS finalized certain regulations related to the BEAT (the 2019 Final Regulations). The 2019 Final Regulations generally exclude from the definition of base erosion payment, payments that are taxable to recipients as effectively connected income (ECI, the 'ECI exception'). However, the 2019 Final Regulations did not provide details for applying the ECI exception to transactions involving partnerships. In response to taxpayer comments, the Final Regulations explicitly expand the ECI exception to apply to certain partnership transactions.

Anti-abuse rule

The 2019 Final Regulations generally exclude from the definition of base erosion payment amounts transferred to, or exchanged with, a foreign related party in a 'specified nonrecognition transaction' (i.e., transactions described in Sections 332, 351, 355, or 368). However, Treasury and the IRS expressed concern that the exclusion of nonrecognition transactions from the definition of base erosion payment could, in certain instances, lead to inappropriate results. Therefore, the 2019 Final Regulations added an 'anti-abuse' rule with respect to specified nonrecognition transactions. The anti-abuse rule provides that if a transaction has a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in the nonrecognition transaction, then the exception from treatment as a base erosion payment with respect to specified nonrecognition transactions does not apply to the specified nonrecognition transaction. Moreover, if a transaction between related parties increases the adjusted basis of property within the six-month period before the taxpayer acquires the property in a specified nonrecognition transaction, the transaction is deemed to have a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a nonrecognition transaction (i.e., taxpayers are not allowed to rebut the presumption that the transaction was undertaken with the principal purpose of increasing the tax basis of the property).

Concerned with the broad applicability and potential 'cliff effect' of the above rule, taxpayers recommended that Treasury and the IRS modify the rule to exclude transactions with a relatively small amount of basis step-up or to provide taxpayers with an election to forego the basis created by the specified nonrecognition transaction. In response, the Final Regulations modify the anti-abuse rule to exclude only the amount of basis that was stepped up in the prior transaction from the specified nonrecognition transaction exception. Additionally, the Final Regulations clarify that the transaction, plan, or arrangement with a principal purpose of increasing the adjusted basis of property must also have a connection to the property that a taxpayer acquired in the specified nonrecognition transaction.

Observation: The helpful modification in the Final Regulations prevents a cliff effect that could have resulted in a material BEAT liability due to an incidental basis step-up.

The takeaway

The Final Regulations provide, among other things, the ability for taxpayers to waive deductions in calculating their base erosion percentage. Taxpayers should review and assess the impact of these provisions. The above-mentioned highlights are not an exhaustive list of the provisions in the Final Regulations. We expect to publish an in-depth Insight in the coming days.

See also

PwC Insight: [Final and proposed BEAT regulations: Additional analysis](#)

Let's talk

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