CAPITOL TAX PARTNERS

December 9, 2019

Summary of
Final Regulations Related to Base Erosion and Anti-Abuse Tax ("BEAT") Under Sections 59A, 383, 1502, 6038A, and 6655; and
Proposed Regulations Related to BEAT Under Sections 59A and 6031

Overview

On December 2, 2019, the Treasury Department and IRS (collectively, "Treasury") released final and proposed regulations related to BEAT (respectively, "Final Regulations" and "2019 Proposed Regulations"). Both regulations were published in the Federal Register on December 6, 2019. For ease of use, this summary is divided into five parts: (i) a summary of material changes in the Final Regulations; (ii) notable areas of comment unchanged by the Final Regulations; (iii) applicability dates of the Final Regulations; (iv) an executive summary of the 2019 Proposed Regulations; and (v) a detailed summary of the 2019 Proposed Regulations.

Summary of Material Changes in the Final Regulations

The Final Regulations generally retain the approach and structure of the proposed regulations published December 21, 2018, with several revisions. The provisions Treasury identified in the Preamble as materially revised from the proposed regulations include the following: [1]

- **Determining the aggregate group under the with-or-within method.** The Final Regulations modify the rules on how a taxpayer determines the gross receipts and base erosion percentage with respect to its aggregate group. To ease administrative burdens, the Final Regulations provide that the determination for those two tests will be made on the basis of the taxpayer's taxable year and the taxable year of each member of its aggregate group that ends with or within the applicable taxpayer's taxable year (the "with-or-within method"). For rules on how to implement the with-or-within method and rules regarding predecessors and short taxable years, see discussion of the 2019 Proposed Regulations below.
    - To avoid requiring members of an aggregate group to calculate their hypothetical base erosion tax benefits for a year that begins before the effective date of section 59A, the Final Regulations exclude the base erosion tax benefits and deductions attributable to the taxable year of a member of the aggregate group that begins before January 1, 2018, when determining the base erosion percentage of an aggregate group. See §1.59A-2(c)(8).
- **General determination of base erosion payments.** The definition of base erosion payment has been modified to explicitly clarify that payments resulting in a reduction to determine gross income, including COGS, are not treated as base erosion payments within the meaning of section 59A(d)(1) or (2). See §1.59A-3(b)(2)(viii). Also, the determination of whether a payment or accrual is a base erosion payment is made under general U.S. federal income tax law, including agency principles. See §1.59A-3(b)(2)(i).

[1] References to the Preamble from both the Final Regulations and the 2019 Proposed Regulations are to the documents released by Treasury on December 2, 2019, which may vary slightly from the official documents published in the Federal Register.

- **Losses recognized**. The base erosion payment definition is revised to exclude a loss recognized from the form of consideration provided to the foreign related party. Thus, "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." Preamble at pg. 40. If 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.
- **Corporate nonrecognition transactions**. The Final Regulations generally exclude from the definition of a base erosion payment amounts transferred to, or exchanged with, a foreign related party in a corporate non-recognition transaction described in sections 332, 351, and 368. However, this limited exclusion of corporate nonrecognition transactions would not apply to "other property" (i.e., boot) or in certain situations covered by an anti-abuse rule.
    - Solely for this purpose, "other property" has the meaning of other property or money, as used in sections 351(b), 356(a)(1)(B), and 361(b), as applicable, including liabilities described in section 357(b), but does not include the sum of any money and the fair market value of any property to which section 361(b)(3) applies. "Other property" also includes liabilities that are assumed by the taxpayer in a corporate nonrecognition transaction, but only to the extent of the amount of gain recognized under section 357(c).
    - The anti-abuse rule applies to transactions, plans, or arrangements that have a principal purpose of increasing the adjusted basis of property acquired in a nonrecognition transaction to prevent "inappropriate results" resulting from the exclusion of such nonrecognition transactions. The anti-abuse rule also has a per se element to it, stating that if any such transaction, plan, or arrangement 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, there is a deemed principal purpose of increasing the adjusted basis of property. The anti-abuse rule applies in addition to, and in conjunction with, section 357(b), as well as various other doctrines, such as step transaction and economic substance. The effect of the anti-abuse rule does not just result in the denial of the exclusion for the basis increase; rather, if the anti-abuse rule is triggered, the exclusion does not apply to the entire specified nonrecognition transaction.
        - **Example.** According to the Preamble, "an example of an inappropriate result is the sale of depreciable property between foreign related parties shortly before a nonrecognition transaction, which could step up the taxpayer's basis in the property and increase depreciation or amortization deductions of the domestic corporation after the nonrecognition transaction relative to the alternative in which the step-up basis transactions did not occur." Preamble at pg. 48.
- **Interest expense allocable to a foreign corporation's ECI.** The Final Regulations provide a consistent method to apply to determine the portion of interest allocated to a U.S. branch that is treated as paid to a foreign related party—regardless of whether taxpayers apply the three-step method described in §1.882-5(b) through (d) or the separate currency pools method described in §1.882-5(e). Specifically, the Final Regulations provide that the amount of U.S. branch interest expense treated as paid to a foreign related party is the sum of: (1) the directly allocated interest expense that is paid or accrued to a foreign related party, (2) the interest expense on

U.S.-booked liabilities that is paid or accrued to a foreign related party, and (3) the interest expense on U.S.-connected liabilities in excess of interest expense on U.S.-booked liabilities multiplied by the ratio of average foreign related-party interest over average total interest (excluding from this ratio interest expense on U.S.-booked liabilities and interest expense directly allocated). See §1.59A-3(b)(4)(i)(A). The amount of a U.S. branch's interest expense treated as a base erosion payment is determined based on the foreign corporation's worldwide interest ratio, rather than a worldwide ratio of liabilities. See §1.59A-3(b)(4)(i)(A)(3).

- **Internal dealings.** The Final Regulations generally retain the rules in the proposed regulations regarding internal dealings. However, the Final Regulations treat interest expense determined in accordance with a U.S. tax treaty (including interest expense determined by internal dealings) in a manner consistent with the treatment of interest expense determined under §1.882-5, to the extent of the hypothetical amount of interest expense that would have been allocated to the permanent establishment under §1.882-5 (the "hypothetical §1.882-5 interest expense"). For purposes of this calculation, the hypothetical §1.882-5 interest expense cannot exceed the amount of interest expense determined under the U.S. tax treaty. Interest expense in excess of the hypothetical §1.882-5 interest expense is treated as interest expense paid by the permanent establishment to the home office or another branch of the foreign corporation, and therefore is treated as a base erosion payment. See §1.59A-3(b)(4)(i)(E).

- **SCM exception.** As in the proposed regulations, the Final Regulations allow the services cost method ("SCM") exception to apply even if there is a markup (provided the requirements are satisfied). Only the cost portion, however, is excluded from treatment as a base erosion payment and the amount of any markup is treated as a base erosion payment. The Final Regulations clarify the requirement in §1.59A-3(b)(3)(i)(C) that taxpayers' books and records provide sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services in question in accordance with §1.482-9(k).

- **Exchange loss from a section 988 transaction**. The 2018 Proposed Regulations excluded exchange losses from section 988 transactions from the definition of base erosion payments, as well as from the denominator when calculating the base erosion percentage. In contrast, the Final Regulations provide that section 988 losses are excluded from the denominator only with respect to transactions with foreign related parties that are also excluded from the numerator. See §1.59A-2(e)(3)(ii)(D).

- **TLAC exception**. The TLAC exception is expanded to include internal securities issued by Global Systemically Important Banks (GSIBs) pursuant to laws of a foreign country that are comparable to the rules established by the Federal Reserve Board ("foreign TLAC"), where those securities are properly treated as indebtedness for U.S. federal income tax purposes. (No inference is provided as to whether any such foreign TLAC qualifies as debt). "In order to provide consistency between interest and deductions on TLAC of a domestic subsidiary and a U.S. branch or permanent establishment, the Final Regulations limit the foreign TLAC exception to interest expense of GSIBs, and determine the limitation on the exception by reference to the specified minimum amount of TLAC debt that would be required pursuant to rules established by the Federal Reserve Board for TLAC if the branch or permanent establishment were a domestic subsidiary that is subject to Federal Reserve Board requirements. In addition, to ensure that the limitation is not greater than the amount required under foreign law, the Final Regulations express the limitation as the lesser of the hypothetical Federal Reserve Board limitation described in the preceding sentence and the specified minimum amount of TLAC debt that is required pursuant to bank regulatory requirements of a

foreign country that are comparable to the requirements established by the Federal Reserve Board." Preamble at pp. 77-78.

- **Excess interest**. Under section 884(f) and § 1.884-4, a portion of interest expense allocated to income of a foreign corporation that is, or is treated as, effectively connected with the conduct of a U.S. trade or business ("excess interest") is treated as interest paid by a wholly-owned domestic corporation to the foreign corporation. While the 2018 Proposed Regulations did not exclude excess interest from treatment as a base erosion payment, the Final Regulations reduce any base erosion tax benefit of a foreign corporation attributable to interest in excess of interest on U.S.-connected liabilities to the extent that tax is imposed on the foreign corporation with respect to the excess interest under section 884(f) and §1.884-4, and the tax is properly reported on the foreign corporation's income tax return and paid in accordance with §1.884-4(a)(2)(iv). §1.59A-3(c)(2)(ii). If an income tax treaty reduces the amount of tax imposed on the excess interest, the amount of base erosion tax benefit under this rule is reduced in proportion to the reduction in tax.
- **Computation of base erosion minimum tax amount**.
    - AMT credits. Because AMT credits represent income taxes imposed in a previous tax year that are allowed as credits in a subsequent tax year, 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 section 59A." §1.59A-5(b)(3); Preamble at pg. 116.
    - Affiliated group with de minimis banking and securities dealer activities. The additional one percent add-on to the BEAT rate applicable to banks and registered securities dealers will not apply to a taxpayer that is part of an affiliated group with de minimis banking and securities dealer activities (i.e., less than two percent of the total gross receipts of the aggregate group, or consolidated group if there is no aggregate group.) §1.59A-5(c)(2).
    - Blended rate. The Final Regulations provide that the blended rate in section 15 applies only to the change in tax rate set forth in section 59A(b)(2) and does not apply to the change in tax rate included in section 59A(b)(1)(A) for taxable years beginning in calendar year 2018. §1.59A-5(c)(3). The Final Regulations provide no inference as to the application of section 15 to other provisions of the Code that do not set forth an explicit effective date.

- **Qualified derivative payments exception.** For purposes of the QDP exception, the proposed regulations provided that a derivative does not include any securities lending transaction, sale-repurchase transaction, or substantially similar transaction. The Final Regulations make several changes to this rule.
    - Securities lending transaction. The Final Regulations provide that the securities leg of a securities lending transaction is treated as a derivative that qualifies for the QDP exception, subject to an anti-abuse rule described below to address such transactions with a significant financing component. §1.59A-6(d)(2)(iii). As a result, payments (such as a borrow fee) made with respect to the securities leg of a securities lending transaction may qualify as a QDP. The cash leg of a securities lending transaction is expressly excluded from the definition of a derivative.

- Anti-abuse rule. The anti-abuse rule prevents derivative treatment for any securities lending transaction (or substantially similar transaction) that (a) provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing, and (b) is part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to the transaction as a base erosion payment. See §1.59A-6(d)(2)(iii)(C).
- Sale-repurchase transaction. The Final Regulations clarify that a derivative does not include a sale-repurchase transaction (or substantially similar transaction) that is treated as a secured loan for U.S. federal income tax purposes.
- QDP reporting. The Final Regulations clarify that the QDP reporting requirements under §1.59A-6(b)(2)(i) apply to all taxpayers and the information required by §1.6038A-2(b)(7)(ix) must be reported for a payment to be eligible for QDP status. The Final Regulations provide that a taxpayer satisfies the reporting requirement by including a QDP in the aggregate amount of all QDPs (rather than the aggregate amount as determined by type of derivative contract as provided in proposed §1.6038A- 2(b)(7)(ix)(A)) on Form 8991 or a successor form. §1.59A-6(b)(2)(i).
    - The Final Regulations provide a good faith standard that applies during the QDP transition period before the reporting set forth in §1.6038A-2(b)(7)(ix) is required. In addition, the transition period has been extended to 18 months, i.e., until taxable years beginning on or after June 7, 2021.

- **Aggregate approach with respect to partnerships.** The Final Regulations continue to treat contributions to and distributions from partnerships as "payments" that could be base erosion payments under the aggregate approach. The Final Regulations provide a number of clarifications regarding the application of the aggregate approach to partnerships:
    - Partnership interests are added to the non-exclusive list of examples of the types consideration in §1.59A-3(b)(2)(ii) to confirm that contributions to and distributions from a partnership are considered amounts paid or accrued in cash and other consideration for base erosion payment purposes.
    - For purposes of determining what assets were transferred from (or to) a partner in a partnership, the partner's proportionate share of the assets is determined based on all of the facts and circumstances. See §1.59A-7(c)(2), (3), and (4).
    - Each partner will be treated as receiving its proportionate share of property described in §1.59A-3(b)(1)(ii) or (iv) (depreciable or amortizable property or property that results in reductions to determine gross income) transferred to a partnership, for purposes of determining if it has a base erosion payment. Similarly, if the partnership transfers property described in §1.59A-3(b)(1)(ii) or (iv), each partner is treated as transferring its proportionate share of the property for purposes of determining if the recipient has a base erosion payment. See §1.59A-7(c)(2).
    - The amount of a deduction resulting from a payment is not impacted by the gain or loss arising from the consideration used to make the payment. See §1.59A-3(b)(2)(ix), and §1.59A-7(c)(5)(iv) and (d)(1).

- If a distribution of property from a partnership to a partner causes an increase in the tax basis of property that either continues to be held by the partnership or is distributed from the partnership to a partner, such as under section 732(b) or 734(b), the increase in tax basis for the benefit of a taxpayer that is attributable to a foreign related party is treated as if it was newly purchased property by the taxpayer from the foreign related party that is placed in service when the distribution occurs for purposes of determining if a taxpayer has a base erosion payment. See §1.59A-7(c)(4).
- Operating rules are provided, including an ordering rule to determine how the base erosion payment rules apply and rules requiring separate consideration of each transfer of property if both parties to a transaction use non-cash consideration.
- A partner's base erosion tax benefits are the partner's distributive share of any deductions described in §1.59A-3(c)(1)(i) or (ii) or reductions to determine gross income described in §1.59A-3(c)(1)(iii) or (iv) attributable to the base erosion payment.
- A taxpayer's base erosion tax benefits resulting from a base erosion payment include the partner's distributive share of any deduction or reduction to determine gross income attributable to the base erosion payment, including as a result of section 704(c), section 734(b), section 743(b) or certain other sections. See §1.59A-7(d)(1).

- **Anti-abuse and recharacterization rules.**
  - With respect to the anti-abuse rules, the Final Regulations clarify the "principal purpose" standard by adding new examples that illustrate: (i) the differences between transactions that Treasury finds abusive or non-abusive, (ii) the treatment of transactions entered into in the ordinary course of a taxpayer's business, and (iii) the types of disaffiliation transactions with respect to banks and securities dealers that are considered abusive. See §1.59A-9(c)(5), (7), (8), (9).

- **Application to insurance companies.**
  - Reinsurance claims payments. The Final Regulations provide a specific exception from the definition of base erosion payment for deductible amounts for losses incurred (as defined in section 832(b)(5)) and claims and benefits under section 805(a) paid pursuant to reinsurance contracts that would otherwise be within the definition of section 59A(d)(1), to the extent the amounts paid or accrued to the related regulated foreign insurance company are properly allocable to amounts required to be paid by such company (or indirectly through another regulated foreign insurance company), pursuant to an insurance, annuity, or reinsurance contract, to a person other than a related party. See §1.59A-3(b)(3)(ix). The Final Regulations also clarify that all claims payments are included in the denominator of the base erosion percentage, except to the extent excepted from the definition of a base erosion payment under Treas. Reg. § 1.59A-3(b)(3)(ix). See §1.59A-2(e)(3)(vii).
  - Netting. The Final Regulations do not permit netting of payments made under a reinsurance contract for purposes of determining the amount of a base erosion payment, unless netting would otherwise be permitted for U.S. federal income tax

purposes. For purposes of determining whether payments under particular types of reinsurance contracts (e.g., modco arrangements) may be netted for purposes of the BEAT based on existing tax rules, the Preamble specifically notes that "The subchapter L provisions cited in section 59A(d)(3) (section 803(a)(1)(B) for life insurance companies and section 832(b)(4)(A) for non-life insurance companies) do not provide for netting of ceding commissions, claims payments or other expenses against premiums." Preamble at pg. 173.

Areas of Comment Unchanged by the Final Regulations

Notable areas where Treasury declined to adopt recommendations made by numerous stakeholders include the following:

- Further expansion of the SCM exception.
- An exception from the definition of a base erosion payment for payments made by a domestic corporation to a CFC or PFIC that result in a subpart F, GILTI or PFIC inclusion.
- An exception from the definition of a base erosion payment for payments for transactions in which a taxpayer serves as a middleman for a payment to a foreign related party or makes a passthrough payment to a foreign related party that may frequently arise in connection with global services and similar businesses.
- An exception from the definition of a base erosion payment for revenue sharing payments or arrangements, including allocations with respect to global dealing operations. The Preamble stated that the proper characterization for these arrangements depends on the underlying facts: "under general tax principles and consistent with proposed §1.863-3(h), a global dealing operation in which participants manage a single book of assets, bear risk, and share in trading profits may be viewed as co-ownership of the trading positions or similar arrangement, with no deductible payments made by any participants for purposes of section 59A. In contrast, where non-U.S. participants are compensated for services performed, the arrangement may be more properly characterized as trading income to the U.S. participant and a deductible payment to the foreign participant for purposes of section 59A." Preamble at pp. 30-31.
- Modify determination of modified taxable income by using the recomputation method (i.e., a recomputation approach that requires attributes that are limited based on taxable income to be recomputed for BEAT purposes) rather than the add-back method adopted by both the 2018 Proposed Regulations and Final Regulations.
- Determine the amount of a base erosion payment on a net (rather than gross) basis by reducing the amount of that payment by the amount of another corresponding obligation.
- An exception from the BEAT for nonrecognition transactions involving partnerships.

Applicability Dates of the Final Regulations

The Final Regulations generally apply to taxable years ending on or after December 17, 2018, other than certain reporting requirements. Taxpayers may apply the Final Regulations in their entirety for taxable years ending before December 17, 2018. Also, taxpayers have the option to apply certain provisions of the 2018 Proposed Regulations (Prop. Reg. §§ 1.59A-1 through -9) for all taxable years ending on or before December 6, 2019, so long as they apply them in their entirety and consistently.

2019 Proposed Regulations – Executive Summary

The 2019 Proposed Regulations propose additional guidance in three primary areas:

- **Election to waive allowable deductions**. The 2019 Proposed Regulations provide that a taxpayer may forego deductions to avoid having those deductions treated as base erosion tax benefits if the taxpayer waives the deductions for all U.S. federal income tax purposes (except as otherwise provided) and follows specified procedures. According to the Economic Analysis, a taxpayer may find waiving certain deductions advantageous if the waived deductions lower the taxpayer's base erosion percentage below the base erosion threshold, thus making the BEAT inapplicable to the taxpayer. Specifically, the Economic Analysis lists four ramifications of this rule:
    - Reduces tax costs of additional U.S. economic activity by those taxpayers when additional U.S. economic activity would tend to increase base erosion payments.
    - Reduces tax-related incentives for economically inefficient business, contractual or accounting changes designed to avoid the taxpayer being subject to the BEAT.
    - Continues to fulfill the general intent and purpose of the statute by not providing tax incentives for certain large corporations to make deductible payments to foreign related parties in excess of 3 percent of the taxpayer's deductions.
    - Reduces the number of taxpayers that are subject to the BEAT and the overall amount of BEAT collected. This revenue effect is likely to be offset to some degree by the waiver of allowable deductions. See Economic Analysis at pg. 35.
- **Modifications to aggregate group determination under the new "with-or-within method"**. The 2019 Proposed Regulations provide guidance regarding application of the aggregate group rules in connection with the "with-or-within method" that was adopted under the Final Regulations, including the treatment of predecessors and short taxable years.
    - *With-or-within method*. For purposes of determining the aggregate group for applying the gross receipts test and the base erosion percentage test, the Final Regulations adopt the with-or-within method. Under that method, 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 taxable year and the taxable year of each member of its aggregate group that ends with or within the applicable taxpayer's taxable year. (This method is different from the method under the 2018 proposed regulations which provided that each taxpayer in an aggregate group determines its gross receipts and base erosion percentage by reference to the taxpayer's own taxable year, taking into account the results of other members of its aggregate group during that taxable year.)
    - The 2019 Proposed Regulations provide rules: (1) relating to the determination of gross receipts for a short taxable year; (2) clarifying the treatment of members that join or leave the aggregate group of a taxpayer; and (3) clarifying the treatment of predecessors to a taxpayer to ensure that gross receipts of those corporations are not double counted in different aggregate groups.
- **Additional rules regarding the BEAT's application to partnerships**. The 2019 Proposed Regulations provide additional guidance with respect to application of the BEAT to partnerships:

- Allocations by a partnership of income instead of deductions. The Final Regulations treat deductions allocated by the partnership to an applicable taxpayer resulting from a base erosion payment as a base erosion tax benefit. To prevent a work-around to this rule, the 2019 Proposed Regulations provide that, if a partner in a partnership obtains a similar economic result if the partnership allocates income items away from the partner instead of allocating deductions to the partner, the partner is similarly treated as having a base erosion tax benefit to extent of that substitute allocation.
- Partnership anti-abuse rules. The 2019 Proposed Regulations provide two partnership anti-abuse rules: (1) Derivatives on partnership interests – a rule that treats a taxpayer as having a direct interest in the partnership interest or asset if the taxpayer acquires a derivative on a partnership interest or asset with a principal purpose of eliminating or reducing a base erosion payment; (2) Allocation by a partnership to prevent or reduce a base erosion payment – a rule that prevents a partnership from allocating items of income with a principal purpose of eliminating or reducing the base erosion payments to a taxpayer not acting in a partner capacity on amounts paid to or accrued by a partnership that do not change the economic arrangement of the partners.

The rules in the 2019 Proposed Regulations generally are proposed to be applicable to tax years beginning on or after they are finalized, with elective applicability for tax years beginning after 2017 and before the regulations apply. However, the proposed rules regarding application of the aggregate group rules apply to tax years beginning on or after December 6, 2019 and the proposed rules regarding application of BEAT to partnerships apply to tax years beginning on or after December 2, 2019, both having elective applicability for tax years beginning after 2017 and before final regulations are applicable.

See the detailed summary, below, for more complete descriptions of these items. Comments on the 2019 Proposed Regulations must be received by February 4, 2020, which is 60 days after publication in the Federal Register on December 6, 2019. Specific areas for which Treasury solicited comments are identified in the detailed summary, below.

Detailed Summary of the 2019 Proposed Regulations

1. **Determination of a taxpayer's aggregate group**. The 2019 Proposed Regulations provide guidance regarding certain applications of the aggregate group rules in light of the new with-or-within method under §1.59A-2(c)(3).

    a. Change in the composition of an aggregate group. Any members of the taxpayer's aggregate group before the change in ownership that are no longer members following the change in ownership are treated as having left the taxpayer's aggregate group, and any new members that become members of the taxpayer's aggregate group following the change in ownership are treated as having joined the taxpayer's aggregate group. Prop. Reg. §1.59A-2(c)(2)(ii).

    b. Members leaving and joining an aggregate group. To determine the gross receipts and the base erosion percentage of the taxpayer's aggregate group, a taxpayer takes into account only the portion of another corporation's taxable year during which the corporation is a member of the taxpayer's aggregate group. Solely for purposes of determining which items occurred while a corporation was a member of an aggregate group, a corporation is treated as having a deemed taxable year end immediately before joining or leaving the group. Prop. Reg. §1.59A-2(c)(4).

        i. *Consolidated groups*. The Preamble noted that Treasury is studying whether it is appropriate to continue to eliminate gross receipts resulting from intercompany transactions when members deconsolidate and join a different aggregate group. Furthermore, Treasury is aware of more general questions regarding the proper treatment of gross receipts when members join or deconsolidate from a consolidated group. The 2019 Proposed Regulations reserve on these issues and ***comments requested*** on the appropriate treatment of a deconsolidating member's gross receipts history as it relates to the original consolidated group and the acquiring consolidated group in the context of the BEAT aggregate group.

    c. Treatment of short taxable year. If a taxpayer has a short taxable year, gross receipts are annualized by multiplying gross receipts for the short period by 365 and dividing by the number of days in the short period. When a taxpayer has a taxable year that is a short period, the taxpayer must use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group for the short period. Prop. Reg. §1.59A-2(c)(5).

        i. The Preamble noted Treasury's concern that the with-or-within method (1) would completely exclude the taxable year of certain aggregate group members if the taxable year of those members did not end with or within the taxpayer's short taxable year; or (2) might over-count the gross receipts of other aggregate group members if the method is applied by annualizing the full taxable years of other aggregate group members that end with or within the taxpayer's short taxable year. Thus, a reasonable approach should neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group.

ii. ***Comments requested*** on whether more specific guidance is needed, and if so, the best approach for determining the gross receipts and base erosion percentage of an aggregate group for BEAT purposes when the applicable taxpayer or another aggregate group member has a short taxable year.

d. Treatment of predecessors. In general, any reference to a taxpayer includes a reference to any predecessor of a taxpayer (including the distributor or transferor in a section 381(a) transaction in which the taxpayer is the acquiror). Prop. Reg. §1.59A-2(c)(6).

i. *No duplication*. If the taxpayer or any of member of its aggregate group is also a predecessor of the taxpayer or any member of its aggregate group, the gross receipts, base erosion tax benefits, and deductions of each member are taken into account only once.

ii. ***Comments requested*** on appropriate methods of taking into account predecessors for purposes of determining gross receipts of an applicable taxpayer's aggregate group.

2. **Election to waive allowable deductions**. The 2019 Proposed Regulations provide that taxpayers may forego deductions to avoid treatment of those foregone deductions as base erosion tax benefits if the taxpayer waives the deductions for all U.S. federal income tax purposes (subject to a few specified exceptions) and follows specified procedures. Prop. Reg. §1.59A-3(c)(6).

a. Allowed deduction. All deductions that could be properly claimed by a taxpayer for the taxable year (determined after giving effect to the taxpayer's permissible method of accounting and to any election) are treated as allowed deductions. Prop. Reg. §1.59A-3(c)(5).

b. Election to waive allowed deductions and specified procedures. If a taxpayer elects to waive certain deductions, the amount of allowed deductions under Prop. Reg. § 1.59A-3(c)(5) is reduced by the amount of deductions properly waived. To make this election, a taxpayer must provide information related to each deduction waived as required by applicable forms and instructions, including:

i. detailed description of the item/property to which the deduction relates;

ii. date on which, or period in which, the waived deduction was paid or accrued;

iii. the Code provision that allows the deduction;

iv. amount of the deduction claimed;

v. amount of deduction being waived;

vi. a description of where deduction is reflected (or would have been reflected) on the Federal income tax return;

vii. and the name, EIN, and country of organization of the foreign related party that is or will be recipient of payment that generates the deduction.

c. Effect of election to waive deduction.

i. *In general*, any deduction waived is treated as having been waived for all purposes of the Code and regulations.

ii. *No allocation and apportionment of waived deductions.* The waiver of deductions is treated as occurring before the allocation and apportionment of deductions under §§1.861-8 through -14T and 1.861-17.

iii. *Effect of waiver of deductions on allocations of interest expense.* To the extent that any waived deduction is interest expense that would have been directly allocated and would have resulted in the reduction of value on any assets for purposes of allocating other interest expense, the value of the assets is reduced to the same extent as if the taxpayer had not elected to waive the deduction.

d. Effect of election to waive deduction disregarded for certain purposes. Election is disregarded for determining all of the following:

i. A taxpayer's overall method of accounting under section 446 and regulations;

ii. Whether a change in the taxpayer's overall plan of accounting or taxpayer's treatment of a material item is a change in method of accounting under section 446(e) and regulations;

iii. The amount allowable for depreciation or amortization for purposes of section 167(c) and section 1016(a)(2)-(3) and any other adjustment to basis under section 1016(a);

iv. The geographic source where the R&E activities which account for more than 50 percent of the amount of the deduction for R&E was performed, for purposes of applying the exclusive apportionment rule in §1.861-17(b);

v. Application of section 482 and regulations thereunder;

vi. The amount of taxpayer's E&P; and

vii. Any other item as necessary to prevent a taxpayer from receiving the benefit of a waived deduction.

e. Not a method of accounting. The election to waive is not a method of accounting under section 446 and regulations.

f. Effect of the election in determining section 481(a) adjustments. A waived deduction has no effect on the amount of a section 481(a) adjustment compared to what the adjustment would have been if the deduction had not been waived.

i. The Preamble noted that Treasury is (1) more generally studying treatment of accounting method changes and related section 481 adjustments for BEAT purposes; and (2) considering other consequences of section 481(a) adjustments.

ii. ***Comments requested*** on the effect of section 481(a) adjustment on the BEAT, including in the context of waived items.

g. ***Comments requested*** regarding the election to waive deductions, including reporting requirements and additional rules necessary to prevent a taxpayer from claiming a waived deduction in a subsequent year.

h. Time and manner for election to waive deduction.

i. *Time*. A taxpayer may make the election on its original filed tax return. Additionally, a taxpayer may elect to waive deductions or increase the amount of deductions waived pursuant to the election on (1) an amended return; or (2) during the course of an examination of a taxpayer's income tax return for the relevant year. However, a taxpayer may not decrease the amount of deductions waived by the election, or otherwise revoke the election on any amended return or during the course of an examination.

ii. *Manner*. A taxpayer makes the election on an annual basis and must complete the appropriate part of Form 8991, *Tax on Base Erosions Payments With Substantial Gross Receipts*. No consent of the Commissioner required.

iii. ***Comments requested*** related to the process for submitting an election during the course of an examination.

3. **Application of the BEAT to partnerships**.

a. Allocation by a partnership of income instead of deductions. If a partnership adopts the curative method of making section 704(c) allocations, the allocation of income to the contributing partner in lieu of a deduction allocation to the non-contributing partner is treated as a deduction for BEAT purposes in an amount equal to the income allocation. Prop. Reg. §1.59A-7(c)(5)(v).

b. Effectively connected income (ECI). The Preamble noted that Treasury is considering additional guidance to address the treatment of a contribution by a foreign person to a partnership engaged in a U.S. trade or business, as well as transfers of partnership interests by a foreign person as a partner to a related U.S. person. ***Comments requested*** on how to address these issues, including rules to ensure that a foreign partner is treating the items allocated with respect to the property and any gain from the property as ECI.

c. Partnership anti-abuse rules.

i. *Transactions involving derivatives on a partnership interest*. If a taxpayer acquires a derivative on a partnership interest (or assets) as part of a transaction (or series of transactions), plan or arrangement that has as a principal purpose avoiding a base erosion payment (or reducing the amount of a base erosion payment) and the partnership interest (or assets) would have resulted in a base erosion payment had the taxpayer acquired that interest (or asset) directly, then the taxpayer is treated as having a direct interest instead of a derivative interest for BEAT purposes. Prop. Reg. §1.59A-9(b)(5).

1. A derivative interest in a partnership includes any contract (including any financial instrument), the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined in whole or in part by reference to the partnership.

ii. *Allocations to eliminate or reduce a base erosion payment*. If a partnership receives (or accrues) income from a person not acting in a partner capacity and allocates that income to its partners with a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment), then the taxpayer transacting with the partnership will determine its base erosion payment as if the allocation had not been made and the items of income had been allocated proportionately. Prop. Reg. §1.59A-9(b)(6).

4. **Applicability dates: Prop. Reg. §1.59A-10.**

   a. In general. Applicable to tax years ending on or after December 17, 2018. Elective applicability for tax years beginning after 2017 and ending before December 17, 2018.

   b. Exceptions. Proposed rules regarding application of the aggregate group rules apply to tax years beginning on or after December 6, 2019 and proposed rules regarding application of the BEAT to partnerships apply to tax years beginning on or after December 2, 2019. Elective applicability for tax years beginning after 2017 and before the final regulations are applicable.

5. **Partnership return with respect to base erosion payments and base erosion tax benefits**.

   a. Filing obligations for certain partners of certain foreign partnerships. If a foreign partnership is not required to file a partnership return and the foreign partnership has made a payment or accrual that is treated as a base erosion payment of a partner, a partner in the partnership required to file Form 8891 must provide the information necessary to report any base erosion payments on Form 8891 or the related instructions. Prop. Reg. § 1.6031(a)-1(b)(7). This rule would apply to tax years ending on or after the final regulations are filed.