



US International Tax Alert

Treasury, IRS release final BEAT regs on waiving deductions and applicable taxpayer determinations

On September 1, 2020 Treasury and the IRS released guidance under section 59A, the base erosion and anti-abuse tax (BEAT), that finalizes regulations proposed in 2019. This alert provides a summary of the final regulations.

Effective dates

- As was proposed, these amendments to the final regulations are generally prospective. Thus, they apply mandatorily only (except in the case of the anti-abuse rules and the curative method income allocation rule) for years beginning after publication of the final regs in the Federal Register (e.g., for a calendar year taxpayer, 2021 and subsequent years). Unlike the proposed effective date, however, the final regs imply that if taxpayers want to “early-adopt” the new final regulations, they need not start with the first year beginning after 2017; rather, “once applied, taxpayers must continue to apply them in their entirety for all subsequent years.”
- An alternative early-adoption rule is provided for the deduction waiver provision: “taxpayers may apply only § 1.59A-3(c)(5) and (6) for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply § 1.59A-3(c)(5) and (6) in their entirety for all subsequent taxable years.”

Members entering and leaving the aggregate group, short taxable years, and predecessors

- Generally, the final regulations retain the approach adopted in the proposed regulations to compute a taxpayer's gross receipts, base erosion tax benefits, and other deductions in the case of (1) members entering or leaving the taxpayer's aggregate group; (2) taxpayers with short taxable years; and (3) predecessor entities. There are, however, a few notable changes and additions.
- The final regulations now provide that the gross receipts, base erosion tax benefits, and deductions of a corporation that are properly included in the gross receipts and base erosion percentage of the aggregate group of a taxpayer are not reduced as a result of the member leaving the aggregate group of the taxpayer. The version of the rule found in the former proposed regulations only referenced gross receipts.
- The deemed taxable year-end with respect to a corporation that joins or leaves an aggregate group for purposes of determining a taxpayer's gross receipts, base erosion tax benefits, and other deductions now occurs at the end of the day on which the transaction occurs. Under the former proposed regulations, the deemed taxable year-end occurred immediately before joining or leaving the aggregate group.
- Extraordinary items enumerated in Treas. Reg. § 1.1502-76(b)(2)(ii)(C), as well as "any other payment not made in the ordinary course of business that would be treated as a base erosion payment" occurring during the portion of the corporation's day after the event resulting in the corporation joining or leaving the aggregate group are treated as taken into account at the beginning of the following day.
- The final regulations expand the rules applicable to short taxable years of a taxpayer. Under the final regulations, if a taxpayer has a short year, gross receipts, *base erosion tax benefits, and deductions* are annualized. Under the previous rule in the proposed regulations and the current statute, only gross receipts are annualized. The reasonable approach rule for computing gross receipts applicable to taxpayers with a short taxable year is now limited to applying only when a member of a taxpayer's aggregate group does not have a taxable year that ends with or within the taxpayer's taxable year as the result of a taxpayer's short period. The provision contains examples of what constitutes a reasonable approach and provides that it is not reasonable not to take into account the gross receipts, base erosion tax benefits, or deductions of the aggregate group member.
- The final regulations contain new rules for short taxable years of members of a taxpayer's aggregate group, and they address situations where multiple taxable years of a member of the taxpayer's aggregate group, in the aggregate covering more than 12 months, each end with or within a single taxable year of the taxpayer. The rules generally require that the member's gross receipts, base erosion tax benefits, and deductions be annualized in this scenario (as well as in the

scenario in which the member's taxable year-end changes (other than by reason of Treas. Reg. § 1502-76(b)) and, as a result, a *less-than-12-month* period of the member is taken into account in the relevant taxable year of the taxpayer).

- A new anti-abuse rule is included in Treas. Reg. § 1.59A-2(c)(5)(iii), which provides as follows: If a taxpayer or a member of a taxpayer's aggregate group enters into a transaction (or series of transactions), plan, or arrangement 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 under the gross receipts test or the base erosion percentage test to avoid applicable taxpayer status under paragraph (b) of this section, then the gross receipts test or base erosion percentage test, respectively, applies as if that transaction (or series of transactions), plan, or arrangement had not occurred.
- The no duplication rule with respect to predecessor entities now only refers to gross receipts, which conforms to the general predecessor rule only applying to gross receipts.
- The final regulations now expressly cross-reference rules in Treas. Reg. § 1.1502-59A(b) for determining the gross receipts and base erosion tax benefits of a consolidated group for purposes of the aggregation rules by adding a rule at Treas. Reg. § 1.59A-2(c)(9). The rule cross-referencing Treas. Reg. § 1.1502-59A(b) for purposes of determining the gross receipts of a consolidated group also remains in place at Treas. Reg. § 1.59A-2(d)(6). The final regulations otherwise do not tackle issues surrounding the gross receipts history of a deconsolidating member of a consolidated group as it relates to the original consolidated group and the acquiring consolidated group in the context of the aggregate group rules.

Deduction waiver rules

- Insurance companies are now permitted to waive any premium or other consideration paid or accrued for any reinsurance payments that are taken into account under section 803(a)(1)(B) or section 832(b)(4)(A) that would be a base erosion tax benefit. However, a waiver of a reduction to gross premiums and other consideration (or of premium payments that are deductions for federal income tax purposes) is not intended to reduce the amount of any premium payments that are subject to the federal excise tax under section 4371.
- In order to make the election or elect to increase the amount of a deduction waived, the taxpayer must determine that it is an "applicable taxpayer" absent the election. In other words, taxpayers that determine that they are not already applicable taxpayers absent

the election, or that are unable to determine whether they are applicable taxpayers absent the election, cannot elect to waive deductions.

- The final regulations clarify that partial waiver of a deduction is permitted.
- The rules no longer describe the required description of the item or property to which the deduction relates as “detailed.”
- The final regulations clarify that waived deductions attributable to a consolidated group member are treated as noncapital, nondeductible expenses that decrease the tax basis in the member’s stock for purposes of the investment adjustment rules in Treas. Reg. § 1.1502-32. This rule is intended to prevent the shareholder from subsequently benefitting from a waived deduction when disposing of the member’s stock.
- Special rules permit a corporate partner in a partnership to make a BEAT waiver election with respect to partnership items (and clarify that a partnership may not make a BEAT waiver election). There are also rules coordinating a partner’s BEAT waiver election with the centralized partnership audit regime.

Treas. Reg. § 1.59A-9 – Change to the existing final anti-abuse rules

The existing final anti-abuse rule applicable to certain specified nonrecognition transactions in Treas. Reg. § 1.59A-9(b)(4) has been narrowed to 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 acquisition of the property by the taxpayer in a specified nonrecognition transaction. The revised anti-abuse rule also provides that when the rule applies, its effect is to turn off the application of the specified nonrecognition transaction exception only to the extent of the basis step-up amount.

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