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December 11, 2019

We Got the BEAT: The IRS Issues Final and New Proposed Base Erosion and Anti-Abuse Tax Regulations

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The Go-Go's were a unique early 1980s pop band because it was comprised solely of women who wrote, as well as performed, their own music. Their style was groundbreaking and defined what came to be known as the "new wave." And the songs were very catchy. When the base erosion and anti-abuse tax (commonly known as the "BEAT") was added to Section 59A of the Internal Revenue Code of 1986, as amended (the "Code") at the end of 2017, it too heralded a new wave . . . of taxation. Just like we're always looking to hear what's next from our favorite musicians, the tax bar has been feverishly anticipating more BEAT guidance. Luckily for us, on December 2, 2019, the US Internal Revenue Service (the "IRS") issued final regulations interpreting the BEAT rules[2] (the "Final Regulations") and promulgated new proposed regulations (the "2019 Proposed Regulations") offering additional opportunities for affected taxpayers to address BEAT issues.

The Final Regulations apply to 2019 tax years. For 2018 tax years, taxpayers may elect to apply the Final Regulations or the 2018 Proposed Regulations, so long as either set of regulations is applied in its entirety. Taxpayers may also rely on the 2019 Proposed Regulations for 2018 and subsequent tax years so long as such rules are also applied in their entirety.[3]

I. Background

The BEAT functions as a minimum tax in that it only applies if a taxpayer's liability under the BEAT (referred to as "base erosion minimum tax amount" or "BEMTA") exceeds its regular tax liability.[4] The BEAT is applicable only to taxpayers with 3-year average annual gross receipts of at least $500 million and then only if their "base erosion percentage" exceeds a specified threshold (3% for taxpayer groups without domestic banks and securities dealers and 2% for groups with domestic banks and/or securities dealers that generate more than a *de minimis* amount of income).[5] Although the BEAT potentially applies to all large taxpayers, it is likely to have significant application to banks and insurance companies.

The BEAT adds back most payments made by US taxpayers and US branches of non-US taxpayers to their non-US affiliates (that is, non-US persons connected through 25% or greater common ownership) to taxable income to arrive at "modified taxable income."[6] The BEAT is then applied to this modified taxable income and, if this tax exceeds the taxpayer's regular tax, the excess or BEMTA is owed as an additional tax.

The first step in determining whether the BEAT applies to a particular taxpayer is to ascertain whether the taxpayer is an "applicable taxpayer."[7] A taxpayer will be treated as an applicable taxpayer if it meets three tests:

1. The taxpayer must be a corporation, but not a regulated investment company, a real estate investment trust or an S corporation;
2. The taxpayer must have aggregate average gross receipts for the preceding three years of at least $500 million; and
3. The taxpayer's base erosion percentage for the taxable year must be 3% or higher (2% in the case of US banks and registered securities dealers).[8]

Special, and fairly complex, rules apply to determine whether the second and third tests are satisfied, including calculations on an "aggregate group" basis.

If a taxpayer meets the definition of an applicable taxpayer, the application of the BEAT provisions begins with the determination of "modified taxable income." Modified taxable income is taxable income determined without regard to any "base erosion tax benefit" with respect to any "base erosion payment."[9] A base erosion payment includes any amount paid or accrued by the taxpayer to a related foreign person and with respect to which a deduction is allowable. In general, a foreign person will be treated as a related party if there is a 25% or greater ownership overlap with the taxpayer. A base erosion tax benefit includes a deduction that is allowed with respect to a base erosion payment.

Base erosion tax benefits generally include deductible payments for services, interest, rents and royalties. Depreciation and amortization deductions with respect to property acquired from related foreign persons may also be considered base erosion tax benefits and be disregarded in determining modified taxable income. No amount is generally added back in determining modified taxable income for payments to foreign related persons that are not deductible, but instead reduce gross income, e.g., amounts included in cost of goods sold. Base erosion payments do not include "qualified derivative payments" within the meaning of Code § 59A(h) or payments made by a US taxpayer for services that may be accounted for on the "services cost method" under Code § 482 to the extent such amount constitutes the total services cost without mark-up.[10]

The BEAT rate varies by year and by whether the taxpayer is a US bank or a registered securities dealer. Specifically, the BEAT rate is 10% in 2019 through 2025 and 12.5% thereafter.[11] These rates are increased by one percentage point for US banks and registered securities dealers.[12]

II. Threshold Issue – The Determination of Gross Receipts

As noted above, only taxpayers with average annual gross receipts of at least $500 million (measured on an "aggregate group" basis) are subject to the BEAT.[13] Following the 2018 Proposed Regulations, the Final Regulations generally define "gross receipts" by reference to Code §448(c)(3) and the regulations thereunder.[14] Thus, gross receipts include total sales (net of returns and allowances), all amounts received for services and income from investments. Gross receipts are not reduced by cost of goods sold and do not include repayment of a loan (notably, however, gross receipts would generally include the gross proceeds from the sale of a loan by a bank).

III. Aggregate Group Calculations

Code § 59A determines the status of a corporation as an "applicable taxpayer" by measuring gross receipts and the base erosion percentage by reference to the corporation's "aggregate group." A question arises as to how these items should be measured when members of the aggregate group have different taxable years than the tested taxpayer. The 2018 Proposed Regulations provided that each taxpayer determines its gross receipts and base erosion percentage by reference to its own taxable year, taking into account the results of other members of the aggregate group during such taxable year (regardless of such other members' own respective taxable years). This approach raised administrability concerns because many companies do not maintain detailed monthly accounting records. Heeding this concern, the Final Regulations change to a "with-or-within method": the gross receipts and base erosion percentage are calculated on the basis of the tested taxpayer's taxable year and the taxable year of each member of its aggregate group that ends with or within the tested taxpayer's taxable year.[15]

The Final Regulations clarify that a transaction between members of the same aggregate group is disregarded when determining the gross receipts and base erosion percentage, so long as both parties were members of the same aggregate group at the time of the transaction. It is irrelevant whether the parties were members of the same group on the last day of the taxpayer's taxable year.[16] In addition, for purposes of calculating the base erosion percentage, the Final Regulations exclude deductions attributable to a taxable year of a member that began before January 1, 2018.[17]

Treasury also addressed certain mechanical aspects of the aggregate group calculations in the 2019 Proposed Regulations. Recognizing that the existing rules may lead to over- or under-counting in the case of taxpayers with short taxable years, the 2019 Proposed Regulations would require such taxpayers to use a "reasonable approach" in determining the base erosion percentage and gross receipts of their aggregate group.[18] The 2019 Proposed Regulations would also provide that, in the case of members that join or leave the aggregate group, only items accrued during the period they were members shall be taken into account.[19]

IV. Mark-to-Market Transactions

As discussed above, a taxpayer will be subject to the BEAT only if its base erosion percentage exceeds 3% (2% for aggregate groups that include domestic banks or broker dealers). The fraction compares base erosion tax benefits (the numerator) with the aggregate amount of deductions (the denominator).[20] Deductions for mark-to-market losses increase the denominator of the fraction and are therefore helpful to taxpayers in avoiding breaching this threshold. The Final Regulations retain an unfavorable rule, however, for determining mark-to-market losses. Although under general mark-to-market accounting, income earned on a position is not taken into account in determining the mark-to-market adjustment,[21] such items are netted against the amount of loss that may be added to the denominator of the base erosion percentage.[22] Accordingly, if a taxpayer receives a $10x interest payment on a debt instrument and has a $100x mark-to-market loss with respect to such debt instrument at the end of the year in which the payment is received, only $90x of losses are added to the denominator of the base erosion percentage.

V. Base Erosion Payments

There are generally three types of payments that when made by a US taxpayer (including a US branch of a non-US corporation) to a foreign related party are treated as base erosion payments: (i) deductible payments, (ii) a payment for the acquisition of depreciable or amortizable property, (iii) reinsurance premiums.[23] The Final Regulations clarify that other reductions to gross income (including cost of goods sold) are not base erosion payments.[24] The question as to whether a payment or accrual is deductible is made under general federal income tax principles.[25]

The Final Regulations prescribe that general federal income tax principles (including the assignment of income, agency, reimbursement and conduit doctrines) shall be applied first to characterize a payment when determining whether such payment is considered a base erosion payment. For example, if a US taxpayer reimburses its foreign affiliate for depreciable supplies purchased from an unrelated party under a common paymaster arrangement, the payment to the foreign affiliate should not be viewed as a base erosion payment. The US taxpayer is not acquiring property from the foreign affiliate in this case; it should be viewed as having acquired the property directly from the unrelated vendor. Concomitantly, if a US taxpayer makes a deductible payment to a foreign affiliate that is acting as an agent or a conduit for the US taxpayer to pay an unrelated party, the payment should not be considered to be a base erosion payment. The preamble to the Final Regulations cautions taxpayers, however, that payments to foreign affiliates will not be considered to be conduit payments merely because the foreign affiliate makes a corresponding payment to a third party. Taxpayers must apply existing case law to the facts and contractual relationships involved in a given payment to establish that the payment is being made to an affiliate as a conduit.[26]

According to the preamble to the 2018 Proposed Regulations, a base erosion payment would have included a loss recognized on the transfer of property to a foreign related party (e.g., if a taxpayer transfers built-in loss property to a foreign related party as a payment for goods or services). Commentators rejected this idea noting that, in those cases, the loss deduction is not properly attributable to the payment, but rather to the taxpayer's basis in the built-in loss property. Adopting these comments, the Final Regulations clarify that a loss realized from the transfer of property to a foreign related party is *not* itself a base erosion payment. To the extent the transfer of property was the form of consideration for a base erosion payment, the amount of the base erosion payment will be limited to the fair market value of the transferred property.[27]

The Final Regulations adopt the exception in the 2018 Proposed Regulations for the cost component of amounts paid for services that are eligible for the SCM exception under Treas. Reg. §1.482-9. In other words, the tempest in a teapot over whether services will cease to be eligible for the exception if a mark-up is charged has been favorably resolved. The Final Regulations further elaborate on the documentation that taxpayers must maintain to validly rely on this exception.[28]

Following the issuance of the 2018 Proposed Regulations, one of the most sought after changes was the inclusion of an exception to the definition of base erosion payments for payments made by a US corporation to a CFC are not treated as base erosion payments to the extent they result in Subpart F income or GILTI. The Final Regulations decline to include such an exception.

The 2018 Proposed Regulations provided that exchange losses from a Code § 988 transaction were excluded from the definition of base erosion payments. Further, all such exchange losses (including those resulting from transactions with persons other than foreign related parties) were excluded from the denominator when calculating the base erosion percentage. In a taxpayer-friendly change, the Final Regulations only exclude from the denominator exchange losses that result from Code § 988 transactions with foreign related parties (that is, those also excluded from the numerator).[29] Other exchange losses would be included in the denominator, thus helping reduce the base erosion percentage.

The Final Regulations offer good news for the insurance industry. If a US reinsurer makes a claims payment to a non-US insurer, the payment is not treated as a base erosion payment to the extent that the non-US insurer itself has an obligation to pay a claim.[30] If, however, a US insurer makes a premium payment to a non-US reinsurer and the non-US insurer retrocedes the risk to a third party reinsurer, there is no look-through or netting of the initial reinsurance payment.

VI. Deduction Waivers

The 2019 Proposed Regulations allow taxpayers to selectively waive deductions that could be treated as base erosion payments.[31] A waived deduction is not a base erosion payment and therefore is excluded from the computation of the base erosion percentage and is not added back in determining modified taxable income.[32] Deductions can be waived even during a tax audit.[33] The amount of waived deductions can be adjusted upwards but not downwards. The election to waive deductions would not constitute a method of accounting under Code §446, and, accordingly, no IRS consent is required.[34] Detailed rules are provided regarding the effect of the waiver on earnings and profits, transfer pricing and the ability to claim tax credits.

VII. Global Dealing and Profit Split Arrangements

The preamble to the Final Regulations acknowledges that global dealing, that is, when multiple taxpayers all book transactions into the same ledger account, does not give rise to base erosion payments even when a US taxpayer makes a payment to a foreign affiliate pursuant to such an arrangement.[35] However, the IRS desired to leave open its ability to challenge such a position when the contractual arrangements among the parties create deductible payments in connection with such a dealing operation. For this reason, the Final Regulations do not contain a blanket rule that exempts payments made in connection with global dealing operations from being considered base erosion payments. For the same reason, payments made by US taxpayers pursuant to profit split arrangements (while acknowledged as avenues not giving rise to base erosion payments) are not carved out from the definition of such payments.

In other contexts, the preamble to the Final Regulations specifically acknowledges that the apportionment of expenses does not give rise to base erosion payments.

VIII. Netting

The Final Regulations do not permit the taxpayer to net payments to and from foreign affiliates in determining the amount of any base erosion payment, except to the extent that netting is permitted or required under other provisions of the Code or federal income tax principles.[36] This rule applies even if the contractual relationship between the taxpayer and the foreign affiliate permits netting. For example, if a US taxpayer makes a $100x payment to a foreign affiliate under an intercompany agreement and the foreign affiliate makes a $40x to the US taxpayer pursuant to another intercompany transaction, the base erosion payment is $100x, not $60x ($100x - $40x). The inability to net payments will, of course, increase both the likelihood that a US taxpayer will breach the base erosion percentage and that the BEAT will apply. Interestingly, the IRS specifically declined to provide guidance on swap (notional principal contract) transactions. IRS regulations specifically provide for netting swap payments.[37]

IX. Acquisitions of Property in Nonrecognition Corporate Transactions and Distributions

One of the most controversial aspects of the 2018 Proposed Regulations involved the acquisition by a domestic corporation of depreciable or amortizable property from a foreign related person in a nonrecognition transaction (i.e., a Code § 351 contribution, a Code § 332 liquidation, a Code § 368 reorganization). Under the 2018 Proposed Regulations, these types of corporate nonrecognition transactions were viewed as involving base erosion payments and, as a result, the depreciation and amortization deductions subsequently claimed by the domestic corporation would be characterized as base erosion tax benefits. This rule was met with several objections. Comments argued that these transactions should not give rise to base erosion payments because they do not involve an actual "payment." Further, it was noted that the rule provided a disincentive to the on-shoring of intangible and other income-producing property, contrary to the goals of the Tax Cuts and Jobs Act.

Consistent with the comments, the Final Regulations exclude from the definition of a base erosion payment amounts transferred to, or exchanged with, a foreign related party in a corporate nonrecognition transaction.[38] Any "boot" exchanged in such transactions, however, is treated as a base erosion payment.[39] For example, if a non-US corporation transfers depreciable or amortizable property to its wholly-owned US subsidiary in a Code §351 transfer and the non-US parent receives common stock and cash in exchange, the cash may be treated as a base erosion payment, while the common stock is not.

Notwithstanding the above, the Final Regulations include an anti-abuse rule to tackle situations where the general exclusion for nonrecognition transactions is viewed as presenting inappropriate results. If there is a plan or arrangement that has a principal purpose of increasing the adjusted basis of certain property in anticipation of the acquisition of such property in a nonrecognition transaction, the exclusion will not apply. Such principal purpose will be deemed to exist if a transaction between related parties increases the adjusted basis of the property within six months prior to the taxpayer acquiring the property in a nonrecognition transaction.[40]

The Final Regulations also clarify the treatment of depreciable or amortizable property that a shareholder may acquire from a corporation in a distribution transaction. A "pure" Code § 301 distribution for which there is no consideration is not treated as giving rise to a payment by the shareholder to the corporation. In contrast, such a payment will be deemed to exist when a corporation redeems stock in exchange for property. As a result, if a US corporation acquires property from a foreign subsidiary in a stock redemption transaction, the amortization or depreciation deductions claimed with respect to the property may be subject to the BEAT.

X. Interest Expense

The BEAT applies to non-US corporations that have income that is subject to net income taxation in the United States as income effectively connected with the conduct of a US trade or business ("ECI"). In other words, the BEAT generally applies to non-US corporations with a US branch. Subject to the application of the "treaty method" for taxpayers that are entitled to the benefits of an income tax treaty, a foreign corporation generally determines the interest expense allocable to its US branch under one of two sets of rules: the Adjusted US Booked Liability ("AUSBL") method or the Separate Currency

Pool ("SCP").[41] A foreign corporation that has interest expense allocable to its US branch will have a base erosion payment to the extent the interest expense allocable to the branch is treated as paid to a foreign related party.

The 2018 Proposed Regulations laid out different rules to determine the extent to which interest expense allocable to a US branch would be treated as paid to a foreign related party depending on whether the foreign corporation used the AUSBL or SCP method.[42] Commentators had noted that the methods in the 2018 Proposed Regulations may produce meaningfully different amounts of base erosion payments depending on which method the taxpayer uses to determine its branch interest expense under Treas. Reg. §1.882-5—specifically, that taxpayers using the AUSBL method would generally experience a lower amount of base erosion payments than taxpayers using the SCP method. These comments argued that the difference was not supported by tax policy and requested changes to achieve consistent results.[43]

The Final Regulations change the rules to achieve consistency between AUSBL and SCP taxpayers and eliminate the negative impact of the proposed rule on taxpayers using the SCP method. Under the Final Regulations, for taxpayers using either method, the amount of US branch interest expense treated as paid to a foreign related party shall be the sum of (1) the directly allocated interest expense paid to a foreign related party, (2) the interest expense on US-booked liabilities actually owed to foreign related parties, and (3) the interest expense on US-connected liabilities in excess of US-booked liabilities multiplied by the ratio of average foreign related-party interest over average of total interest (excluding from this ratio interest expense on US-booked liabilities and interest expense directly allocated).[44] The Final Regulations also introduce a simplifying election allowing a taxpayer to determine its worldwide interest ratio based on its applicable financial statements instead of US tax principles.[45]

The Final Regulations also change the calculation of base erosion payments for foreign corporations that determine the interest expense attributable to their US permanent establishment under an income tax treaty.[46] The foreign corporation will nonetheless first need to determine the hypothetical amount of interest expense that would have been allocated to the permanent establishment under the Treas. Reg. §1.882-5 methodology (but not in excess of the amount of interest expense attributable under the tax treaty). The "hypothetical 1.882-5 interest expense" is treated in a manner consistent with the rules described above (i.e., to the extent that such hypothetical expense is considered paid to foreign related parties, such interest expense is treated as a base erosion payment). Interest expense in excess of the hypothetical §1.882-5 interest expense is treated as paid by the US permanent establishment to the home office or another branch of the foreign corporation, thus constituting a base erosion payment.[47]

In addition, the Final Regulations provide that "excess interest" shall not be treated as a base erosion payment to the extent it is subject to the "branch level interest tax" under Code §884(f)(1). Accordingly, if an income tax treaty reduces the amount of tax imposed on excess interest, the amount of the base erosion tax benefit is reduced proportionately.[48]

XI. Hedging

Commentators had lobbied for an exception to the definition of base erosion payments for payments pursuant to a transaction treated as a hedge for federal income tax purposes. The IRS denied this request on the ground that neither the statute nor the legislative history provided for any such exception.

XII. Qualified Derivatives Payments

Qualified derivative payments ("QDPs") made by affected taxpayers to foreign affiliates are excluded from the definition of base erosion payments.[49] The Final Regulations track the statute in defining a QDP: (i) the affected taxpayer must use mark-to-market accounting for such derivative, (ii) all recognized gain on the derivative must be ordinary in character and (iii) payments made on the derivative must give rise to ordinary gain or loss.[50] Derivatives for this purpose do not include sale-repurchase transactions.[51] In a surprise reversal from the Proposed 2018 Regulations, the Final Regulations treat borrow fees paid in securities lending transactions as QDPs.[52] However, securities lending transactions structured to essentially replicate cash borrowings with the intent to avoid a base erosion payment will not be treated as giving rise to QDPs.[53]

XIII. Total Loss Absorbing Capacity ("TLAC") Payments

TLACs are securities that regulators require globally systemically important banks ("GSIBs") to issue to be written off or converted into common stock if the bank experiences financial difficulties. Frequently, US branches and US subsidiaries of non-US banks issue TLACs to their foreign parent, creating an issue as to whether interest payments on the TLACs are base erosion payments. The 2018 Proposed Regulations had introduced an exception such that interest payments made on TLAC securities are not treated as base erosion payments. The Final Regulations retain and expand this exception.[54]

First, recognizing that banks frequently issue more TLACs than are actually required in order to hedge against a potential shortfall in their minimum TLAC requirement, the Final Regulations provide a 15% buffer on the specified minimum amount of interest eligible for the exception. As such, interest on up to 115% of the amount of required TLACs may be excluded from being treated as base erosion payments.[55]

Second, the Final Regulations expand the scope of the TLAC exception to include securities issued by GSIBs pursuant to laws of a foreign country that are comparable to the rules established by the Federal Reserve Board in the US.[56] The exception for "foreign TLAC securities" will be limited to interest on 115% of the lesser of (i) the specified minimum amount of TLAC debt required by the foreign regulator or (ii) the minimum amount that would be required if the branch were a US subsidiary subject to the Federal Reserve Board rules.

Internal TLACs are often issued in back-to-back structures in which the US branch or subsidiary issues TLACs to the foreign parent and the foreign parent issues TLACs to the market. In these circumstances, and assuming the foreign parent is not a conduit under general federal income tax principles, the Final Regulations exclude the US branch interest payment from both the numerator and the denominator when computing the base erosion percentage.[57] Taxpayers had requested that, in all cases, the IRS permit the US internal TLAC issuer to "look-through" the internal holder to the unrelated persons who held the TLACs issued by the foreign parent, such that the US taxpayer could include the interest deductions corresponding to such TLACs in the denominator. The IRS declined to issue such a rule.

XIV. Computation of Modified Taxable Income

Code §59A(c)(1) defines "modified taxable income" as the taxable income of the corporation determined without regard to any base erosion tax benefits and to the base erosion percentage of any net operating loss ("NOL") deduction allowed for the taxable year. The 2018 Proposed Regulations provided that modified taxable income would be determined under the "add-back method," that is, following a *static* approach where the base erosion tax benefits are simply added back to the taxable income determined under the applicable rules of the Code. In doing so, the 2018 Proposed Regulations rejected a *dynamic* "recomputation method" where the disallowance of a deduction under BEAT would, for example, result in an increased capacity to utilize NOLs under Code §172 or an increased "adjusted taxable income" under Code §163(j). The Final Regulations retain the add-back method, noting in the preamble that the approach is consistent with the statutory language and simpler to administer than a recomputation method.

If, however, current taxable income is a positive number and the taxpayer has a net operating loss ("NOL") carryover, taxable income is floored at zero.[58] NOLs arising before 2018 may be claimed without limitation. NOLs arising in 2018 and after must be reduced by the base erosion percentage applicable to such NOL.[59] The base erosion percentage is based upon the year in which the NOL arose, not the year in which it is utilized.[60] In addition, if the taxpayer is part of an aggregate group, the base erosion percentage of an NOL is determined based on the group's base erosion percentage.

XV. Application to Partnerships

The Final Regulations adopt an aggregate approach to characterize payments made or received by a partnership for purposes of the BEAT.[61] This is consistent with the approach taken the 2018 Proposed Regulations. The Final Regulations provide a more detailed explanation of the mechanics of this aggregate approach, together with illustrative examples. In this respect:

- If depreciable or amortizable property is transferred *to* a partnership, each partner is treated as receiving its proportionate share of the property for purposes of determining if it has a base erosion payment. Similarly, if depreciable or amortizable property is transferred *by* a partnership, each partner is treated as transferring its proportionate share of the property.
- If a person transfers a partnership interest, the transferor is generally treated as transferring its proportionate share of the partnership's assets. When a partnership interest is transferred by the partnership itself, each partner whose proportionate share of assets is reduced is treated as transferring the amount of such reduction.

The preamble to the Final Regulations clarifies that there is no exception for nonrecognition transactions involving partnerships. Consistent with the aggregate approach, partners are treated as engaging in transactions directly with each other and not with the partnership as a separate entity. For example, if a US corporation and a foreign related party each contribute depreciable property to a new partnership in exchange for partnership interests in a Code § 721(a) exchange, the transaction is treated as a partner-to-partner exchange that may result in a base erosion payment for the US corporation.

The Final Regulations retain the "small partner exception" from the 2018 Proposed Regulations for payments made by a partnership. A partner is not required to take into account its distributive share of any base erosion tax benefit that result from the partnership's payment if the partner's interest (i) represents less than 10% of the capital and profits of the partnership, (ii) represents less than 10% of each item of income, gain, loss, deduction and credit, and (iii) has a fair market value of less than $25 million.[62]

Finally, the preamble to the 2019 Proposed Regulations requests comments regarding the application of the BEAT to partnerships, including as it relates to partnerships that have ECI.

XVI. Anti-Abuse and Recharacterization Rules

The Final Regulations retain the anti-abuse and recharacterization rules from the 2018 Proposed Regulations relating to (i) transactions involving intermediaries acting as a conduit if there is a principal purpose of avoiding a base erosion payment, (ii) transactions with a principal purpose of increasing the deductions in the denominator of the base erosion percentage, and (iii) transactions among related parties entered into with a principal purpose of avoiding the application of the special rules for banks and registered securities dealers. In addition, as explained above, the Final Regulations add a new anti-abuse rule for (iv) transactions with a principal purpose of increasing the adjusted basis of certain property in anticipation of the acquisition of such property in a nonrecognition transaction.[63] The Final Regulations add new examples illustrating the application of these anti-abuse rules.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers or any other member of our Tax and Tax Controversy practice.

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Endnotes

1 Mark Leeds is a partner and Lucas Giardelli is a senior associate in the New York office of Mayer Brown. Mark will be presenting on the Final BEAT Regulations at the International Bar Association Annual Finance & Capital Markets Tax Conference in London on January 21, 2020. Lucas will be presenting on the Final BEAT Regulations at the American Bar Association meeting in Boca Raton, FL, on January 31, 2020.

2 The Final Regulations replace proposed regulations that were issued in December 2018 (the "2018 Proposed Regulations"). For a discussion of the 2018 Proposed Regulations, please see https://www.mayerbrown.com/en/perspectives-events/publications/2019/01/irs-issues-proposed-regulations-implementing-base.

3 Treas. Reg. § 1.59A-10.

4 Code § 59A(b).

5 Code § 59A(e); Treas. Reg. § 1.59A-2(e).

6 Code § 59A(c).

7 Code § 59A(a).

8 Code § 59A(e)(1).

9 Code § 59A(c).

10 Code § 59A(d)(5).

11 Code § 59A(b).

12 Code § 59A(b)(3).

13 Code §59A(e)(2)(B).

14 Treas. Reg. §1.59A-1(b)(13).

15 Treas. Reg. §1.59A-2(c)(3).

16 Treas. Reg. §1.59A-2(c)(1).

17 Treas. Reg. §1.59A-2(c)(8).

18 Prop. Treas. Reg. §1.59A-2(c)(5).

19 Prop. Treas. Reg. §1.59A-2(c)(4).

[20] Code §59A(c)(4).

[21] See Treas. Reg. § 1.475(a)-1(b), (c) (interest on a debt instrument subject to mark-to-market accounting is taken into account before the mark-to-market adjustment).

[22] Treas. Reg. § 1.59A-2(e)(vi).

[23] Treas. Reg. § 1.59A-3(b)(1). Inverted corporations are subject to a fourth possible type of base erosion payment for any amount paid to a foreign affiliate which reduces the corporation's gross receipts.

[24] Treas. Reg. § 1.59A-3(b)(2)(viii).

[25] Treas. Reg. § 1.59A-3(b)(2)(i).

[26] *See Del Commercial Properties, Inc. v. Comm'r,* 251 F.3d 210 (2001); *Aiken Industries, Inc. v. Comm'r,* 56 T.C. 925 (1971); *Northern Indiana Public Service Co. v. Comm'r,* 115 F.3d 506 (1997); *SDI Netherlands B.V. v. Comm'r,* 107 T.C. 161 (1996); *Anthony Teong-Chan Gaw,* T.C. Memo 1995-531; *see also Indianapolis Power & Light Co.,* 493 U.S. 203 (1990); *Illinois Power Co. v. Comm'r,* 792 F.2d 683 (7th Cir. 1981).

[27] Treas. Reg. §1.59A-3(b)(2)(ix).

[28] Treas. Reg. §1.59A-3(b)(3)(i)(C).

[29] Treas. Reg. §1.59A-2(e)(3)(ii)(D).

[30] Treas. Reg. § 1.59A-3(b)(3)(ix).

[31] Prop. Treas. Reg. § 1.59A-3(c)(6).

[32] Prop. Treas. Reg. § 1.59A-3(c)(6)(ii)(A)(1).

[33] Prop. Treas. Reg. § 1.59A-3(c)(6)(iii).

[34] Prop. Treas. Reg. § 1.59A-3(c)(6)(ii)(C).

[35] See Treas. Reg. § 1.863-3(h).

[36] Treas. Reg. § 1.59A-3(b)(2)(iii).

[37] Treas. Reg. § 1.446-3(d).

[38] Treas. Reg. §1.59A-3(b)(3)(viii)(A)

[39] Treas. Reg. §1.59A-3(b)(3)(viii)(B)

[40] Treas. Reg. §1.59A-9(b)(4).

[41] Treas. Reg. § 1.882-5(b)-(d), (e).

[42] Under the 2018 Proposed Regulations, the base erosion payments of taxpayers using the AUSBL method equal the sum of three items. First, the US branch determines its interest on qualified nonrecourse indebtedness and integrated financial products that is attributable to US assets (directly allocable liabilities) to the extent owed to foreign related parties. Second, interest paid or accrued on US-booked liabilities that are owed to foreign related parties is determined. Third, excess interest is considered to be paid to foreign related parties in the same ratio that worldwide liabilities of the whole corporation are due to foreign related parties.

In the case of a taxpayer using the SCP method, the 2018 Proposed Regulations provided that the base erosion payments equal the sum of two items. First, like in the AUSBL method, the US branch determines its interest on qualified nonrecourse indebtedness and integrated financial products that is attributable to US assets (directly allocable liabilities) to the extent owed to foreign related parties. Second, the interest expense attributable to the US-connected liabilities in each currency pool is considered to be paid to foreign related parties in the same ratio that worldwide liabilities of the whole corporation in that same currency are due to foreign related parties.

[43] *See* February 15, 2019, comment letter submitted by Mayer Brown, available at Tax Notes Doc 2019-9362.

[44] Treas. Reg. §1.59A-3(b)(4)(i). It should be noted that the ratio in step (3) is now determined by reference to a worldwide ratio of interest *expense*, rather than a worldwide ratio of *liabilities* as in the 2018 Proposed Regulations.

[45] Treas. Reg. §1.59A-3(b)(4)(i)(D).

[46] In the case of expenses other than interest attributable to a US permanent establishment under a tax treaty, the Final Regulations provide that internal dealings (i.e., transactions between the permanent establishment and the home office or other branches of the foreign corporation) can give rise to base erosion payments. Treas. Reg. §1.59A-3(b)(4)(v)(B).

[47] Treas. Reg. §1.59A-3(b)(4)(i)(E).

[48] Treas. Reg. §1.59A-3(c)(2)(ii).

[49] Code § 59A(h)(2).

[50] Treas. Reg. § 1.59A-6(b).

[51] Treas. Reg. § 1.59A-6(d)(2)(iii).

[52] Treas. Reg. § 1.59A-6(d)(2)(iii)(B).

[53] Treas. Reg. § 1.59A-6(d)(2)(iii)(C).

[54] Treas. Reg. § 1.59A-3(b)(3)(v).

[55] Treas. Reg. § 1.59A-3(b)(3)(v)(C).

[56] Treas. Reg. § 1.59A-3(b)(3)(v)(E).

[57] Treas. Reg. § 1.59A-2(e)(3)(ii)(E).

[58] Treas. Reg. § 1.59A-4(b)(1); *but see* GCM 39701.

[59] Treas. Reg. § 1.59A-4(b)(2)(ii).

[60] *Id.*

[61] Treas. Reg. § 1.59A-7(b) and (c).

[62] Treas. Reg. § 1.59A-7(d)(2).

[63] Treas. Reg. § 1.59A-9.

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