Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Proposed Regulations Addressing Section 59A

Dear Commissioner Rettig:

Enclosed please find comments on the Proposed Regulations under and related to Section 59A of the Internal Revenue Code (“Comments”). These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Eric Solomon
Chair, Section of Taxation

Enclosure

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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Proposed Regulations Addressing Section 59A

These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Ari Berk, Alan T. Cathcart, Alden DiIanni-Morton, Jesse Eggert, Jonathan Galin, Lucas Giardelli, Anne R. Gordon, Donald S. Graham, Christopher Hanfling, Morgan Hann, Alexandra Helou, Joshua Kaplan, Laura Kruberg, Scott M. Levine, Kimberly Tan Majure, Carol P. Tello, and Marina Vishnepolskaya. They were reviewed by Edward Tanenbaum of the Committee on Government Submissions and Eric B. Sloan, Vice-Chair for Government Relations for the Tax Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments, or has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section’s diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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I. Executive Summary

Section 59A,¹ was added to the Code as part of Public Law 115-97 (the “Act”), enacted on December 22, 2017.² Section 59A imposes on each applicable taxpayer (an “Applicable Taxpayer”) a tax (the “base erosion and anti-abuse tax” or “BEAT”) equal to the applicable BEAT rate applied against a modified taxable income base. Modified taxable income (“MTI”) is, very generally, taxable income for the taxable year, increased by the amount of deductions and similar tax benefits attributable to certain base erosion payments made to foreign related parties (“base erosion tax benefits” or “BETBs”). Section 59A also imposes reporting obligations regarding the BEAT for 25% foreign-owned corporations subject to section 6038A reporting and foreign corporations subject to section 6038C. On December 21, 2018, the Internal Revenue Service (the “Service”) and the Department of Treasury (“Treasury”) published Proposed Regulations under sections 59A and 6038A.³

We commend Treasury and the Service for issuing the Proposed Regulations in a relatively short period of time, particularly in light of the many guidance projects required to implement the Act, and appreciate the guidance. There are, however, certain portions of the Proposed Regulations that we recommend be reconsidered, and there are areas in which additional clarification would be helpful. To provide context for our recommendations, we provide a detailed summary of section 59A, as well as the Proposed Regulations in Part II. of this letter.

Our recommendations are summarized below and discussed in more detail in Part III. of this letter.

A. Comments regarding Proposed Regulation section 1.59A-2: Applicable Taxpayer

We respectfully recommend that Treasury and the Service issue the following guidance with regard to the application of the Applicable Taxpayer tests:⁴

1. Clarify the application of the Aggregation Rule and the BE Disregarded Transactions Rule, confirming whether the Snapshot Group Rule operates to remove a departing member for the entire year of departure for all purposes, including the application of the disregarded transaction rule.

2. Clarify the application of the gross receipts test when a member of a consolidated group enters a new aggregate group, by explicitly permitting the

¹ References to a “section” or “I.R.C. §” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and regulation references are to the Regulations promulgated thereunder (the “Regulations” or “Reg. §,” “Temporary Regulations” or “Temp. Reg. §,” and “Proposed Regulations” or “Prop. Reg. §”), unless otherwise indicated.


³ The Proposed Regulations also include proposed amendments to sections 383, 1502, and 6655 of the Code.

⁴ The defined terms referred to in these recommendations are as defined below.
acquiring aggregate group to determine the gross receipts of the entering member taking into account its pre-acquisition intercompany eliminations.

3. Simplify Proposed Regulation section 1.59A-2(e)(3)(vii)(C), which requires taxpayers with different taxable years within a single aggregate group to apply the Applicable Taxpayer tests using each taxpayer’s taxable year for all members of the aggregate group.

4. Clarify the order of operation of the Annualization rule and the Predecessor Rule in calculating gross receipts. In particular, we recommend an ordering rule that applies the Predecessor Rule before the Annualization Rule.

5. Clarify the application of the Applicable Taxpayer tests in cases in which an aggregate group subject to the BEAT acquires a corporation from a group not subject to the BEAT.

B. Comments regarding Proposed Regulation section 1.59A-3: The definition of “base erosion payment”

We respectfully recommend that Treasury and the Service issue the following guidance with regard to the definition of the term “base erosion payment” as it relates to transactions involving non-cash consideration:

1. Adopt the following two-prong inquiry, to determine whether a transaction involving issuer stock or the assumption of liabilities to be treated as resulting in an amount paid or accrued for purposes of section 59A:
   - Is the transaction properly treated as a sale or exchange, as opposed to a distribution, for U.S. federal income tax purposes?
   - If the transaction is properly treated as a sale or exchange, should stock used in the exchange or the assumption of liabilities in connection with the exchange be treated as a cash substitute?

2. Clarify that all in form distributions described in section 301 are excluded from the term “base erosion payment,” regardless of whether they are characterized under section 301(c)(1), (2), or (3).

3. Confirm that if a redemption is treated as a distribution under section 301, that characterization will be followed in the application of the BEAT rules.

4. Confirm that if a redemption is treated as an exchange under section 302(a), the BEAT rules apply accordingly, and recognize the surrender of stock as a payment of consideration for the property received.

5. Confirm that the receipt of property in the context of a transaction falling within the scope of section 304 will be treated in the same manner as other redemptions.

6. Provide that an exchange will not be treated as resulting in a base erosion payment if equity is exchanged in the context of a nonrecognition transaction, unless such equity is used to make taxable payments.

7. Provide that the assumption of liabilities in nonrecognition exchanges will not be considered a base erosion payment to the extent the assumption is not
treated as money or other property received by the transferor of the property exchanged, e.g., under section 357(a).

8. Provide that if gain or loss is recognized in a transaction otherwise eligible for nonrecognition treatment (including on a transfer of boot or an assumption of liabilities in excess of basis), the treatment in sections 351 and 368 is mirrored by treating such boot as a base erosion payment to the extent attributable to the acquisition of depreciable property.

9. Provide that section 332 liquidations will be treated as not giving rise to a base erosion payment, whereas section 331 liquidations will involve an amount paid or accrued in exchange for property and, potentially, base erosion payments.

10. Provide that the amount of a base erosion payment made in the form of property is the fair market value of the property transferred, and that any loss recognized by the Applicable Taxpayer with respect to the property transferred is not a BETB.

11. Provide that certain losses subject to section 267(f) be excluded from the definition of BETB until the deferred loss is triggered in the event that Treasury and the Service decide to continue to treat a domestic corporation’s sale of built-in loss assets to a related foreign party as giving rise to a base erosion payment and, if so, the amount of the BETB should be determined taking into account the triggering event.

C. Comments regarding Proposed Regulation Section 1.59A-3(b): The treatment of expenses allocable to a foreign corporation’s effectively connected income (“ECI”)

We respectfully recommend that Treasury and the Service issue the following guidance with regard to the treatment of expenses allocable to a foreign corporation’s ECI:

1. Provide that in cases in which a taxpayer has made simplifying elections for purposes of determining its total interest deductions under Regulations section 1.882-5, the same elections should apply for purposes of determining the portion of the taxpayer’s total interest deduction that will be treated as paid to foreign related persons.

2. Confirm that to the extent the excess interest (i.e., the excess of interest allocable to ECI under Regulation section 1.882-5 over interest paid on U.S.-booked liabilities) of a foreign corporation is subject to the branch-level interest tax (“BLIT”) under section 884(f)(1)(B) and Regulations section 1.884-4(a)(2), it should not also be treated as giving rise to a BETB.

3. Provide that in cases in which a taxpayer uses a treaty method that determines profit on the basis of the functions performed, assets used, and risks assumed, its interest deductions in excess of interest on U.S.-booked liabilities should be treated in the same manner as interest on
excess U.S.-connected liabilities.

D. Comments regarding Proposed Regulation Section 1.59A-3(b): The Services Cost Method (“SCM”) exception to “base erosion payment”

We respectfully recommend that Treasury and the Service provide additional examples or clarification regarding “sufficient documentation” of the methods used to allocate and apportion costs between SCM-eligible services and non-SCM-eligible services.

E. Comments regarding Proposed Regulation Section 1.59A-5: Base Erosion Minimum Tax Amount

We respectfully recommend that Treasury and the Service clarify that application of section 15 will not result in a blended rate for taxable years beginning in 2018 with respect to the transition from the five percent rate to the ten percent rate, but instead will result in a blended rate for the transition from ten to the 12.5% rate.

F. Comments regarding Proposed Regulation Section 1.59A-7: Application to partnerships

We respectfully recommend that Treasury and the Service issue the following guidance with respect to partnerships:

1. Provide that contributions to a partnership described in section 721(a) and distributions by a partnership described in section 731(a) and (b) are generally not treated as amounts “paid or accrued” for purposes of section 59A. Otherwise, if this recommendation is not taken, we further recommend the following:

   a) Modify the effective date of these provisions, as many taxpayers will have contributed property to, or distributed property from, partnerships since December 31, 2017 without reason to believe these transactions would result in BETBs.

   b) Exclude pro-rata contributions and distributions from the scope of section 59A.

   c) Expand the ECI Exception to apply to partnership contributions and distributions.

2. Provide examples that clarify the relevance of the aggregate approach to the ownership of partnership assets for purposes of section 59A.

3. Clarify that the amount of a partner’s distributive share of deductions with respect to property acquired by a base erosion payment (in any amount) that is treated as made by the partner would be a BETB, subject to the limitations for de minimis partners in Proposed Regulation section 1.59A-7(b)(4).

4. Provide examples illustrating the determination of the amounts of a partner’s base erosion payments and BETBs in a partnership that has depreciation (or amortization) that is treated as a BETB.
5. **Provide rules for determining the extent to which a partner is treated as receiving a payment received by a partnership where the payment does not give rise to income but rather results in no income or a deduction or loss.**

**G. Comments regarding Proposed Regulation Section 1.59A-9: Anti-abuse and recharacterization rules**

We respectfully recommend that Treasury and the Service consider issuing the following guidance with regard to the anti-abuse and recharacterization rules:

1. Confirm that the Base Erosion Payment Anti-Abuse Rule and the Base Erosion Percentage Anti-Abuse Rule does not apply to any transaction, plan or arrangement entered into prior to, or pursuant to a binding commitment that was in effect as of, November 9, 2017 (date of release of the Senate Finance Committee “conceptual mark” that included a “base erosion minimum tax”), and that was not significantly modified after that date.

2. Provide that the Bank Status Anti-Abuse Rule does not apply to any transaction, plan or arrangement entered into prior to, or pursuant to a binding commitment that was in effect as of, December 1, 2017 (date of release of the Senate bill amendment that incorporated the special base erosion percentage threshold and rate applicable to banks and registered securities dealers), and that was not significantly modified after that date.

3. Provide, for purposes of the Base Erosion Payment Anti-Abuse Rule, the relevant standard for identifying “corresponding” payments to and from an intermediary.

4. Provide additional guidance regarding cases in which an intermediary is deemed to make a corresponding payment “indirectly” to a foreign related party of the taxpayer.

**II. Background**

**A. Tax Reform and the BEAT, Generally**

New section 59A imposes the BEAT that targets certain deductions and similar tax benefits (collectively, “BETBs”) attributable to base erosion payments made to foreign related parties by “applicable taxpayers.”

An applicable taxpayer is a corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) that (i) has average annual gross receipts of at least $500 million for the three-taxable-year period ending with the taxable year preceding the one for which the BEAT liability is being determined, and (ii) has a “base erosion percentage” (generally the ratio of BETBs to the aggregate deductions (with limited exceptions) allowable to the taxpayer during the taxable year) of three
percent or higher. The base erosion percentage threshold is reduced to two percent in the case of taxpayers that are members of an affiliated group that includes a bank or registered securities dealer. An aggregation rule generally treats all persons that would be treated as a single employer under section 52(a) as a single person, solely for purposes of defining an applicable taxpayer and determining the base erosion percentage.

The BEAT imposes an additional tax (the “base erosion minimum tax amount,” or “BEMTA”) that equals the excess of a tentative BEAT calculated on “modified taxable income” (“MTI”) over regular tax liability. For these purposes, MTI generally is calculated in the same manner as taxable income, but with no deduction allowed for (i) BETBs attributable to base erosion payments paid or accrued to foreign related parties, or (ii) a portion of the NOL deduction allowed during the taxable year. A BETB generally refers to the deduction allowed for the taxable year with respect to a base erosion payment. In addition, the tentative BEAT is calculated without giving any benefit for credits, whereas the regular tax liability to which this amount is compared generally is calculated after taking into account the effect of credits, including the foreign tax credit, with only limited exceptions for taxable years beginning before 2026 for the research and development credit and a portion of certain section 38 credits.

Section 59A defines a base erosion payment to include an amount (paid or accrued by an applicable taxpayer to a foreign related party) that falls into one of four categories: (i) payments for which a deduction is allowable; (ii) payments made in connection with the acquisition of depreciable or amortizable property; (iii) premiums or other consideration paid for reinsurance; and (iv) certain payments with respect to a surrogate foreign corporation or its expanded affiliated group that result in a reduction of the taxpayer’s gross receipts. Specifically excluded from this definition, however, are “qualified derivative payments,” as well as certain amounts paid for services that meet the requirements for eligibility for use of the services cost method in Regulation section 1.482-9(b) (without regard to the so called “business judgment rule” in Regulation section 1.482-9(b)(5)). An exception also applies to the extent that a payment is subject

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5 I.R.C. § 59A(e).
7 I.R.C. § 59A(e)(1)(C).
8 I.R.C. § 59A(b).
9 I.R.C. § 59A(c).
14 I.R.C. § 59A(d).
15 I.R.C. § 59A(h).
16 I.R.C. § 59A(c)(5).
to full U.S. withholding tax.\textsuperscript{17}

The BEAT applies at a five percent rate for taxable years beginning in 2018.\textsuperscript{18} The rate increases to ten percent rate for subsequent taxable years,\textsuperscript{19} and increases to 12.5\% for taxable years beginning after December 31, 2025.\textsuperscript{20} In each case, the rate is one percent higher for any applicable taxpayer that is a member of an affiliated group that includes a bank or registered securities dealer.\textsuperscript{21}

Section 59A(i) authorizes the Secretary to prescribe regulations or guidance as may be necessary or appropriate to carry out the provisions of section 59A, including regulations that provide such adjustments to its application as are necessary to prevent the avoidance of its purposes.\textsuperscript{22}

B. Proposed Regulations

The Proposed Regulations provide guidance on a wide range of issues, including which taxpayers will be subject to the BEAT (including guidance on how to determine gross receipts and base erosion percentage); the scope of what is included as a base erosion payment and a BETB; and the method for calculating MTI and the BEMTA. The Proposed Regulations also provide guidance on reporting requirements, the application of the BEAT to consolidated groups and partnerships, and the interaction of section 59A with the interest expense limitation under section 163(j). To the extent relevant to our comments in Part III., the Proposed Regulations are discussed in detail in this Part II.B.

1. Proposed Regulation Section 1.59A-2: Applicable taxpayer

Proposed Regulation section 1.59A-2 generally provides rules for determining whether a taxpayer is treated as an Applicable Taxpayer. As discussed above, Applicable Taxpayer status generally is evaluated based on the aggregated information of the aggregate group (\textit{i.e.}, corporations that are aggregated to be treated as a single person under section 59A(e)(3)) of which the taxpayer is a member (generally, the “Aggregation Rule”). Proposed Regulation section 1.59A-2 provides rules clarifying the application of the Aggregation Rule and also clarifies the operation of the gross receipts test and base erosion percentage test in the context of the Aggregation Rule.

Generally, Proposed Regulation section 1.59A-2(b) provides that a taxpayer is an Applicable Taxpayer if the taxpayer is a corporation that is not a regulated investment company (“RIC”), a real estate investment trust (“REIT”), or an S corporation, satisfies the gross receipts test as defined in section 59A(e)(2) and explained in Proposed Regulation section 1.59A-2(d), and satisfies the base erosion percentage test as defined in section 59A(c)(4) and explained in Proposed Regulation section 1.59A-2(e).

\begin{footnotesize}
\textsuperscript{17} I.R.C. § 59A(c)(2)(B).
\textsuperscript{18} I.R.C. § 59A(b)(1)(A).
\textsuperscript{19} I.R.C. § 59A(b)(1)(A).
\textsuperscript{20} I.R.C. § 59A(b)(2)(A).
\textsuperscript{21} I.R.C. § 59A(b)(3).
\textsuperscript{22} I.R.C. § 59A(i).
\end{footnotesize}
Proposed Regulation section 1.59A-2(c) provides that a taxpayer that is a member of an aggregate group determines gross receipts and base erosion percentage by reference to the aggregate group in existence as of the end of the taxpayer’s taxable year (the “Snapshot Group Rule”). Furthermore, for these purposes, transactions that occur between members of the aggregate group as of the time of the transaction are not taken into account (the “BE Disregarded Transactions Rule”).

Proposed Regulation section 1.59A-2(d) generally provides rules for calculating gross receipts for purposes of the gross receipts test set forth in section 59A(e)(2) (the “Gross Receipts Test”). Specifically, Proposed Regulation section 1.59A-2(d)(1) provides that a taxpayer satisfies the gross receipts test for a taxable year if it has average annual gross receipts of at least $500 million for the three-taxable-year period ending with the preceding taxable year.

Proposed Regulation section 1.59A-2(d)(2)(i) provides that calendar year taxpayers that are members of an aggregate group should apply the gross receipts test with respect to their own taxable year (i.e., without regard to the taxable year of any other member of the aggregate group). Proposed Regulation section 1.59A-2(d)(2)(ii) similarly provides that fiscal year taxpayers that are members of an aggregate group should apply the gross receipts test with respect to their own fiscal years (i.e., without regard to the taxable year of any other member of the aggregate group).

For purposes of the gross receipts test under Proposed Regulation section 1.59A-2(d)(1), Proposed Regulation 1.59A-2(d)(3) requires foreign corporations to take into account only gross receipts that are considered in determining income that is effectively connected with the conduct of a trade or business within the United States under section 882(a). Similarly, Proposed Regulation section 1.59A-2(d)(3) provides that if a foreign corporation is a member of an aggregate group and benefits from the provisions of an applicable U.S. income tax treaty, only gross receipts that are attributable to transactions taken into account in determining its net taxable income are taken into account. In other words, the gross receipts of a foreign corporation are taken into account only to the extent they are subject to net income tax in the United States.

The Proposed Regulations also provide specific operating rules for determining gross receipts in certain fact patterns to which the general rules do not clearly apply. Proposed Regulation section 1.59A-2(d)(6) provides that if a taxpayer was not in existence for the entire prior-three-year period, the taxpayer must determine average gross receipts based on the period that it was in existence, taking into account the Annualization Rule, defined below.

Proposed Regulation section 1.59A-2(d)(7) provides that if a taxpayer has a short taxable year (i.e., a taxable year that is a period of less than 12 months), gross receipts are to be annualized by multiplying gross receipts of the short period by 365 days and dividing the product by the number of days in the short period (the “Annualization Rule”).

For purposes of calculating gross receipts under Proposed Regulation section 1.59A-2(d), Proposed Regulation section 1.59A-2(d)(8) defines a taxpayer to include any predecessor of the taxpayer (the “Predecessor Rule”). A predecessor includes the distributor or transferor corporation in a transaction described in section 381(a) in which
the taxpayer is the acquiring corporation.

Proposed Regulation section 1.59A-2(e) generally provides rules for determining whether the taxpayer meets the base erosion percentage test of section 59A(c)(4). As discussed above, a taxpayer, or the aggregate group of which the taxpayer is a member, generally satisfies the base erosion percentage test if its base erosion percentage is at least three percent for the taxable year. Section 59A(e)(1)(C) reduces the applicable threshold to two percent if the taxpayer is a member of an affiliated group that includes a bank or a registered securities dealer.

Proposed Regulation section 1.59A-2(e)(3) provides rules for computing a taxpayer’s base erosion percentage. Specifically, Proposed Regulation section 1.59A-2(e)(3) provides that the base erosion percentage is calculated by dividing the aggregate amount of the taxpayer’s BETBs (as defined in Proposed Regulation section 1.59A-3(c)(1)) by the sum of the aggregate amount of deductions allowable to the taxpayer (or when the taxpayer is part of an aggregate group, any member of the aggregate group) under chapter 1 of Subtitle A for the taxable year, the BETBs described in Proposed Regulation section 1.59A-3(c)(1)(iii) with respect to reinsurance payments taken into account under sections 803(a)(1)(B) or 832(b)(4)(A) for the taxable year, and any amount paid or accrued by the taxpayer resulting in a reduction of gross receipts described in Proposed Regulation section 1.59A-3(c)(1)(iv) for the taxable year (payments to related foreign corporations that became surrogate foreign corporations after November 9, 2017, or to members of the same expanded affiliated group).

Proposed Regulation section 1.59A-2(e)(3)(vii) addresses the manner of computing the base erosion percentage when members of an aggregate group have different taxable years. When calendar year taxpayers are members of an aggregate group, Proposed Regulation section 1.59A-2(e)(3)(vii)(A) requires a taxpayer to calculate its base erosion percentage for the calendar year, without regard to the taxable year of any other member of the aggregate group. Proposed Regulation section 1.59A-2(e)(3)(vii)(B) provides an analogous rule for fiscal year taxpayers that are members of an aggregate group. Proposed Regulation section 1.59A-2(e)(3)(vii)(C) provides a transition rule in cases in which a taxpayer has a different taxable year than another member of the aggregate group. Although amounts paid or accrued in taxable years beginning before January 1, 2018 are not subject to the BEAT, they are taken into account for the narrow purpose of calculating a taxpayer’s base erosion percentage.

2. Proposed Regulation Section 1.59A-3: Base erosion payments and base erosion tax benefits

a) Specific Types of Base Erosion Payments: Payments or Accruals that Consist of Non-Cash Consideration

A base erosion payment includes “any amount paid or accrued” by the taxpayer to a foreign related party and with respect to which a deduction is allowable under chapter 1 of the Code, as well as “any amount paid or accrued” by the taxpayer to a foreign related party in connection with the acquisition of depreciable or amortizable property by the taxpayer from the foreign related party.23

23 Prop. Reg. § 1.59A-3(b)(1)(i) and (ii).
Proposed Regulation section 1.59A-3(b)(2) provides that for purposes of Proposed Regulation section 1.59A-3(b)(1), an “amount paid or accrued includes an amount paid or accrued using any form of consideration, including cash, property, stock, or the assumption of a liability.”

b) Specific Types of Base Erosion Payments: Interest Allocable to a Foreign Corporation’s ECI

Proposed Regulation section 1.59A-3(b)(3)(iii) provides an exception to the definition of a base erosion payment for amounts paid or accrued to a foreign related party that are subject to U.S. taxation on a net basis as ECI or as income attributable to a U.S. permanent establishment. Proposed Regulation section 1.59A-3(b)(4)(i) provides detailed rules that treat a portion of the interest that is allocated against ECI under section 1.882-5 as a base erosion payment. Proposed Regulation section 1.59A-3(b)(4)(ii) similarly treats as base erosion payments all other amounts paid to foreign related parties that are allowed as deductions against ECI under section 1.882-4.

Proposed Regulation section 1.59A-3(b)(4)(v) provides special rules for foreign corporations that elect to determine taxable income pursuant to the business profits provisions of an income tax treaty and do not apply Regulation sections 1.882–5 and 1.861–8 to allocate interest and other deductions. Proposed Regulation section 1.59A-3(b)(4)(v)(B) provides that if, pursuant to the terms of an applicable income tax treaty, a foreign corporation determines the profits attributable to a U.S. permanent establishment based on assets used, risks assumed, and functions performed by the permanent establishment, then any deduction attributable to any amount paid or accrued (or treated as paid or accrued) by the permanent establishment to the foreign corporation’s home office or to another branch of the foreign corporation (an “internal dealing”) is a base erosion payment to the extent the payment or accrual meets the general definition of a base erosion payment.

c) Exceptions from the Base Erosion Payment Definition: Exception for Certain Amounts with respect to Services

Among other things, base erosion payments do not include “any amount paid or accrued by a taxpayer for services” if the services meet the requirements for eligibility for use of the “services cost method” in Regulation section 1.482-9 (the “SCM”) for purposes of section 482, without regard to the business judgment rule.24

Proposed Regulation section 1.59A-3 excepts payments that are otherwise eligible for the SCM, but have a “mark-up component,” from consideration as base erosion payments to the extent of the total services cost.

Proposed Regulation section 1.59A-3 requires that in order to be eligible for the SCM exception, the taxpayer must maintain “adequate books and records.”25 Proposed Regulation section 1.59A-3(b)(3)(i)(C) indicates that the books and records requirement

24 I.R.C. § 59A(c)(5).
will be met for allocation and apportionment between eligible and ineligible payments, if
the taxpayer has sufficient documentation to allow verification of the allocation and
apportionment methods used.

3. Proposed Regulation Section 1.59A-4: Modified taxable income

Proposed Regulation section 1.59A-4 provides rules for calculating modified
taxable income.

Proposed Regulation section 1.59A-4(b)(1) generally provides that MTI means a
taxpayer’s taxable income, as defined in section 63(a), increased by BETBs and the
product of the any net operating loss (“NOL”) deduction allowed to the taxpayer under
section 172 for the taxable year, multiplied by the applicable base erosion percentage.

Proposed Regulation section 1.59A-4(b)(2)(ii) provides that the base erosion
percentage of any NOL deduction is the base erosion percentage for the taxable year in
which the NOL arose, and further provides that an NOL that arose in a taxable year
beginning before January 1, 2018 has a base erosion percentage of zero.

4. Proposed Regulation Section 1.59A-5: Base erosion minimum tax
amount

Section 15 generally requires that where there is a change in a rate of tax imposed
by chapter 1 of the Code that has an effective date other than the first day of a taxable
year, taxes will be calculated by using a blended rate.

The Proposed Regulations provide that “[f]or a taxpayer using a taxable year
other than the calendar year, section 15 applies to any taxable year beginning after
January 1, 2018.” 26

5. Proposed Regulation Section 1.59A-7: Application of base erosion and
anti-abuse tax to partnerships

Proposed Regulation section 1.59A-7 clarifies how the base erosion test set forth
in section 59A and Proposed Regulation section 1.59A-2 applies in the context of
partnerships. The Proposed Regulations adopt an aggregate approach to partnerships.
For purposes of determining whether an amount paid or accrued by a partnership is a
base erosion payment, Proposed Regulation section 1.59A-7(b)(2) provides that such an
amount “is treated as paid or accrued by each partner based on the partner’s distributive
share of items of deduction (or other amounts that could be BETBs) with respect to that
amount (as determined under section 704).” Similarly, Proposed Regulation section
1.59A-7(b)(3) provides that payments received by a partnership are treated as received by
each partner by reference to each partner’s distributive share of the income or gain with
respect to that amount.

An exception to aggregate treatment with respect to BETBs is provided if a
partner’s interest in the partnership represents less than ten percent of the capital and
profits of the partnership at all times during the taxable year, the partner is allocated less
than ten percent of each partnership item, and the partner’s interest in the partnership has

a fair market value of less than $25 million on the last day of the partner’s taxable year. The Proposed Regulations do not, however, provide an exception for nonrecognition transactions involving a partnership and one or more of its partners.27

Proposed Regulation section 1.59A-7(c) provides that in the partnership context, the foreign related party determination is made at the partner level by looking at the relationship (if any) between (i) a person that makes a payment to a partnership or receives a payment from a partnership and (ii) a partner in the partnership.

6. Proposed Regulation Section 1.59A-9: Anti-abuse and recharacterization rules

Proposed Regulation section 1.59A-9 includes three specific anti-abuse rules.

First, Proposed Regulation section 1.59A-9(b)(1) provides that if a taxpayer pays or accrues an amount to one or more intermediaries (including an intermediary unrelated to the taxpayer) that would have been a base erosion payment if paid or accrued to a foreign related party, and one or more of the intermediaries makes (directly or indirectly) corresponding payments to or for the benefit of a foreign related party as part of a transaction (or series of transactions), plan or arrangement that has as a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment), the role of the intermediary or intermediaries is disregarded as a conduit, or the amount paid or accrued to the intermediary is treated as a base erosion payment, as appropriate (the “Base Erosion Payment Anti-Abuse Rule”).

Second, Proposed Regulation section 1.59A-9(b)(2) provides that a transaction (or component of a transaction or series of transactions), plan or arrangement that has a principal purpose of increasing the deductions taken into account for purposes of the denominator of the base erosion percentage will be disregarded for purposes of the calculation of the base erosion percentage (the “Base Erosion Percentage Anti-Abuse Rule”).

Finally, Proposed Regulation section 1.59A-9(b)(3) provides that a transaction (or series of transactions), plan or arrangement that occurs among related parties that has a principal purpose of avoiding the special base erosion percentage threshold and rate applicable to banks and registered securities dealers will be disregarded for purposes of determining the applicable base erosion percentage and rate (the “Bank Status Anti-Abuse Rule”).

III. Comments

A. Comments regarding the Application of the Applicable Taxpayer Tests

Generally, the BEAT is intended to apply to large corporations that reach a certain level of taxable base erosion in the United States through payments to foreign related parties. Section 59A provides several rules for determining whether a taxpayer is an Applicable Taxpayer. Specifically, Proposed Regulation section 1.59A-2 aims to provide clarity with respect to the aggregate group concept in the context of determining the gross

receipts and base erosion percentage tests, with special regard given to aggregate groups with multiple taxpayers having different features relevant to the determinations, or the composition of which changes during the testing period.\(^{28}\)

Treasury and the Service have requested comments addressing the aggregate group rules.\(^{29}\) Our comments below recommend a number of clarifications that would allow for greater administrability and for greater consistency across taxpayers. In particular, our comments address the following points:

1. The need for clarification regarding application of the Aggregation Rule and the BE Disregarded Transactions Rule;

2. The need for clarification regarding application of the gross receipts test when a member of a consolidated group enters a new aggregate group;

3. The need for simplification with respect to Proposed Regulation section 1.59A-2(e)(3)(vii), which requires taxpayers with different taxable years within a single aggregate group to apply the Applicable Taxpayer tests by using the taxpayer’s taxable year for all members of the taxpayer’s aggregate group;

4. The need for clarification regarding the order of operation of the Annualization Rule and the Predecessor Rule; and

5. The need for certain clarifications regarding application of the Applicable Taxpayer rules in cases in which an aggregate group subject to the BEAT acquires a corporation from a group not subject to the BEAT.

These points are each discussed in the following sections.

1. Clarification regarding application of the Disregarded Transaction Rule

As noted above, the Snapshot Group Rule provides that the Applicable Taxpayer tests apply to the aggregate group, determined as of the end of the year in which the BEAT liability is tested.\(^{30}\) Once the composition of the aggregate group is determined for a taxable year, the Snapshot Group Rule requires calculation (including re-calculation, e.g., of gross receipts used in previous years’ tests) of the taxpayer’s gross receipts and base erosion percentage with respect to the group.

Proposed Regulation section 1.59A-2(c) next provides that transactions between taxpayers that were members of an aggregate group “at the time of the transaction” are not taken into account for purposes of the gross receipts or base erosion percentage tests. As a general matter, this rule eliminates deductions arising from intra-group transactions from the base erosion percentage calculation. We respectfully request clarification regarding application of this rule as it relates to the Snapshot Group Rule. In particular, it


\(^{29}\) Id.

would be helpful to confirm whether the Snapshot Group Rule operates to remove a departing member for the entire year of departure for all purposes, including application of the BE Disregarded Transactions Rule; or, alternatively, whether the disregarded transactions test should be applied solely in light of the actual membership (if any) of the departing member when the transaction in question occurs. Absent such clarification, taxpayers could take varying approaches that could lead to significantly different outcomes.

For example, consider a situation in which a foreign corporation (“FP”) owns all of the stock of three domestic corporations, US1, US2, and US3. US1, US2, and US3 are all calendar year taxpayers. US1 and US2 make deductible payments to US3 on the 20th day of every month. On December 15, 2019, FP sells all of the stock of US3 to an unrelated purchaser.

For purposes of determining whether the taxpayers achieve Applicable Taxpayer status for calendar year 2019, the Snapshot Group Rule would identify the members of the aggregate group as of December 31, 2019, consequently applying the tests with respect only to US1 and US2. The aggregate group gross receipts do not, therefore, include the gross receipts of US3 for any time during the prior-three-year testing period. In addition, none of US3’s 2019 deductions are taken into account for purposes of the base erosion percentage test. The specific point on which we seek clarification is the extent to which deductions for payments made by US1 and US2 to US3 are taken into account. While none of US1’s and US2’s deductions arising from payments to US3 are included in the numerator of the base erosion percentage calculation, as payments to US3 are to a domestic person, the application of the Snapshot Group Rule can significantly change the extent to which the denominator of the calculation includes these deductions.

If the Snapshot Group Rule applies, and US3 is treated as a non-member of the aggregate group for the entire year, the denominator includes deductions for US1’s and US2’s payments made for the entire year. In contrast, if the Snapshot Group Rule does not apply, and the monthly transactions are evaluated based on the facts and circumstances at the time of each transaction, only the deduction arising from the final 2019 payment is included in the denominator.

The inverse problem arises when applying these rules to a situation in which a new taxpayer enters an aggregate group prior to year-end. Consider, for example, the same facts as above, except that US3 is not an aggregate group member prior to December 15, 2019. On that date, FP acquires 100 percent of the stock of US3.

For purposes of determining Applicable Taxpayer status in calendar year 2019, the gross receipts of the aggregate group are calculated by including US3 for the prior-three-year testing period, and US3’s 2019 deductions are included for purposes of determining the base erosion percentage. As above, the numerator of the base erosion percentage calculation does not include any deductions for monthly payments made by US1 and US2 to US3. For purposes of testing US1’s and US2’s deductions, potential application of the Snapshot Group Rule again makes a significant difference. If US3 is treated as an aggregate group member for the entire year, none of the deductions for US1’s and US2’s payments are included in the denominator. Otherwise, as US3 did not in fact become an aggregate group member until December 15, 2019, deductions arising
from US1’s and US2’s first 11 payments to US3 are included in the denominator and only the December 20, 2019 deduction is disregarded.

We request clarification and examples on how these two rules should be reconciled when both apply.

2. Application of the Gross Receipts Test when a member of a consolidated group enters a new Aggregate Group

Proposed Regulation section 1.59A-2(c) provides that an aggregate group is determined as of the last day of the taxable year for which the BEAT liability is being determined. As mentioned, this rule requires recalculation of gross receipts for the three preceding years when an aggregate group changes through a disposition or acquisition of one or more members.

If an acquired entity was a member of a consolidated group and engaged in intercompany transactions, certain intercompany transactions would be eliminated when reporting gross receipts of the acquired entity (e.g., certain income from an intercompany sale that has not yet been recognized due to a timing issue). The Code and the Proposed Regulations are silent on whether an acquiring aggregate group would be required to add back intercompany eliminations for purposes of determining whether an aggregate group meets the gross receipts test.

Reflecting intercompany transactions in gross receipts (i.e., reversing certain intercompany eliminations) of an acquired entity would require the acquiring group to request this information from the selling group. This task, particularly after the fact, would impose an onerous and challenging compliance burden on the acquiring aggregate group.

We recommend that the acquiring aggregate group determine whether it meets the gross receipts test by retaining intercompany eliminations made as part of the acquired company’s prior consolidated group.

3. Impact on taxpayers in an aggregate group that contains members with different taxable years

Proposed Regulation section 1.59A-2(e)(3) requires a taxpayer in an aggregate group that includes members that have different taxable years to apply the gross receipts and base erosion percentage tests using relevant data from the aggregate group in respect of gross receipts and deductions arising within the taxpayer’s taxable year. The Preamble states that taxpayers may adopt a reasonable method for determining gross receipts and BETBs in this context, rather than directly tracing these items.

We welcome this approach, as a specific tracing requirement would be onerous and in many cases not administrable. However, the lack of a specific rule creates the potential for significant inconsistency, even among similarly situated taxpayers, which poses its own administrability challenges. We considered recommending an annualization

rule, such as the one prescribed in Proposed Regulation section 1.59A-2(d)(2)(7). Ultimately, however, we decided against this recommendation, as it may not reach a reasonable result for every taxpayer (e.g., annualization of taxpayer results in cases presenting only one month of actual gross receipts for a tested year).

As an alternative to a test that requires determination of the base erosion payments of aggregate group members on the basis of a different taxable year, we recommend that Treasury and the Service adopt a rule allowing taxpayers to apply the Applicable Taxpayer tests for a given taxable year using other aggregate group members’ data for taxable years ending with or within such taxable year. For example, assume that an aggregate group has two members: U.S. Sub 1, a calendar year taxpayer, and U.S. Sub 2, which has a taxable year ending June 30. Under this proposal, for purposes of determining whether U.S. Sub 1 is an applicable taxpayer for its taxable year ending December 31, 2019, U.S. Sub 1 would use the information for U.S. Sub 2’s taxable year ending June 30, 2019. Correlatively, for its taxable year ending June 30, 2019, U.S. Sub 2 would use information for U.S. Sub 1’s taxable year ending December 31, 2018. This approach would allow timely and accurate capture of data, and provide an administrable rule that eliminates contentions regarding reasonability of the taxpayer’s adopted method.

To address the transition into the application of the BEAT, Proposed Regulation section 1.59A-2(e)(3)(vii)(C) (the “transition rule”) would require each taxpayer in an aggregate group to include other members’ deductions within the taxpayer’s taxable year in the taxpayer base erosion percentage calculation, notwithstanding that such deductions may arise prior to the BEAT becoming effective for those other members. For example, if a taxpayer (US1) were applying the base erosion percentage test for calendar year 2018, including data for another aggregate group member having a June 30 year end (US2), the transition rule would require US1 to take into account US2’s deductions arising in the January 1, 2018 through June 30, 2018 period – before the BEAT went into effect for US2. The transition rule thus requires US1 to account for US2 items that are out of scope for US2’s own BEAT determinations.

Regardless of whether our recommendation to modify the general approach for treatment of taxpayers with different taxable years is adopted, we recommend elimination of the transition rule. Eliminating the transition rule would be more consistent with other provisions in the Proposed Regulations that use taxable years beginning on or after January 1, 2018, as the benchmark date for application of the BEAT regime as a whole, including the exception provided in Proposed Regulation section 1.59A-3(b)(3)(vi) (regarding amounts paid or accrued in taxable years beginning before January 1, 2018) and Proposed Regulation section 1.59A-4(b)(2)(ii) (providing that, for an NOL arising in a taxable year beginning before January 1, 2018, the base erosion percentage for the taxable year is zero).

4. Coordination of the Annualization and the Predecessor Rules

As discussed above, Proposed Regulation section 1.59A-2(d) provides operating rules for calculating gross receipts, in cases where aggregate group members’ facts do not fit cleanly within the general rules. As relevant here, the Annualization Rule requires a taxpayer having a taxable year shorter than 12 months to annualize its gross receipts for the short period. In addition, the Predecessor Rule defines a taxpayer to include any
predecessor, \(i.e.,\) a distributor or transferor corporation) in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation.

A taxpayer may encounter a situation in which both rules are implicated. We therefore request clarification regarding the order in which the two rules apply.

For example, assume US1 and US2 are both calendar year taxpayers, are wholly owned by Foreign Parent (“FP”), and are the only taxpayers in the FP aggregate group. US1 was incorporated on July 1, 2015, and had gross receipts as follows: $200 million from its incorporation date to December 31, 2015, and $300 million during calendar year 2016. On December 31, 2016, US1 merged with US2, with US2 surviving. US2 was incorporated on July 1, 2016, and, on a standalone basis, had gross receipts as follows: $150 million from its incorporation date to December 31, 2016, and $600 million in calendar year 2017. The FP aggregate group’s gross receipts are being tested for the calendar year 2018.

If the Annualization Rule applies before the Predecessor Rule, US1 has annualized gross receipts of $400 million for 2015. In addition, US2 has annualized gross receipts of $300 million for 2016, which would be combined with US1’s $300 million of gross receipts for the full 2016 calendar year for a total of $600 million. The FP aggregate group’s average gross revenue for the testing period exceeds the $500 million threshold, calculated as follows:

\[
\frac{400\text{ million} + 600\text{ million} + 600\text{ million}}{3} = \text{approx.} \ 533\text{ million}
\]

Alternatively, if the Predecessor Rule applies first, US1 and US2 are effectively combined for purposes of the analysis and would have only one short year (2015) to which annualization applies. For the 2016 year, US2 would inherit the attributes of US1 and would therefore have a 12 month year not requiring annualization. Thus, US2’s $150 million of gross receipts would be combined with its predecessor US1’s $300 million in gross receipts to reach a single result for the taxable year.\(^{34}\) In that case, the FP aggregate group’s average annual gross revenue for the testing period falls short of the $500 million threshold, calculated as follows:

\[
\frac{400\text{ million} + 450\text{ million} + 600\text{ million}}{3} = \text{approx.} \ 483\text{ million}
\]

The purpose of the gross receipts test is to limit the taxpayers subject to the BEAT rules to large aggregate groups, and the special operating rules provide practical mechanisms for doing so in cases in which the facts do not fit cleanly into the gross receipts test. While these rules are necessary for effective implementation, they should not be applied in a way that artificially increases an aggregate group’s gross receipts. Accordingly, we recommend that Treasury and the Service provide an ordering rule that applies the Predecessor Rule before the Annualization Rule.

\(^{34}\) We also note that, if the merger had taken place mid-year in 2016, it seems inappropriate to annualize US1’s gross receipts for that year, since its business assets would presumably continue to generate gross receipts post-merger and would be reflected in US2’s results.
5. Application of the Applicable Taxpayer tests when an aggregate group that satisfies the Applicable Taxpayer tests acquires a domestic corporation from an aggregate group that had not satisfied those tests

a) Impact of NOL carryforward and the Snapshot Group Rule with respect to Base Erosion Percentage

Proposed Regulation section 1.59A-4(b)(2)(ii) provides that, with respect to NOL carryforwards, a taxpayer should apply the base erosion percentage for the year in which the losses arose (the “vintage year” and “vintage year base erosion percentage”), as opposed to the base erosion percentage for the year or years in which the NOL carryforward is used.

A compliance burden arises with respect to an NOL carryforward that originates in a taxable year beginning after December 31, 2017, in certain situations in which the taxpayer generating the NOL carryforward was not an Applicable Taxpayer during the vintage year, but joins an aggregate group that satisfies the Applicable Taxpayer tests in the year the NOL is used (a “problematic target”). In that case, the problematic target may not have sufficient information to determine its base erosion percentage for the vintage year, raising compliance issues for taxpayers and increasing the government’s administrative and enforcement burden. Admittedly, this would be the case for any number of data points in the acquisition context (e.g., acquisition by a U.S. person of a non-U.S. corporation that had historically been solely foreign-owned, with respect to earnings and profits, depreciation). We believe, however, that due to the complexity of the calculation and the need for additional data from other entities within the selling group, a reliable base erosion percentage may be more difficult to obtain or recreate than is normally the case.

Consequently, we recommend that, in the problematic target scenario, the acquiring aggregate group should be allowed an election to use its current year base erosion percentage in measuring the base erosion portion of the problematic target’s NOL.

b) Impact of the Section 163(j)(2) carryforward and the Snapshot Group Rule with respect to Base Erosion Percentage

The section 163(j) interest expense carryforward presents similar issues as the NOL carryforward discussed above, when generated by a problematic target. Generally, the section 163(j) interest limitation is determined on a consolidated basis.35 Section 59A(c)(3) provides a rule (the “classification rule”) for characterizing interest that is subject to both section 163(j) and section 59A. Under the classification rule, an Applicable Taxpayer is required to track foreign related business interest expense, domestic related business interest expense, and unrelated business interest expense based on the year in which the business interest expense was paid or accrued.36 At a very high level, consolidated groups must maintain data regarding their ratios of foreign-to-

domestic and related-to-unrelated business interest expense, while interest expense is tracked separately for each entity. Interest expense is characterized at the entity level based on the consolidated group data, and deductibility is determined under a set of complex ordering rules provided in the section 163(j) Proposed Regulations.\textsuperscript{37}

If a problematic target has a section 163(j) interest expense carryover, it would be required to characterize its interest expense using the ratios of its selling group, even if the selling group had not met the Applicable Taxpayer tests and, consequently, had not determined and maintained this information.\textsuperscript{38} As with the NOL carryforward data discussed above, we believe that without a simplifying rule, this approach could cause compliance and administrability issues, the cost of which could outweigh the benefit.

In this case, we would recommend that the acquiring aggregate group be allowed to elect use of its own group ratios arising in the year of the acquisition.

**B. Comments regarding Base Erosion Payments and Base Erosion Tax Benefits**

1. **Background**

   Within the last several years, multiple jurisdictions have focused significantly on anti-base erosion measures. In 2015, the Organization for Economic Cooperation and Development (the “OECD”) issued a series of reports providing insight and proposed guidance on how jurisdictions should approach base erosion and profit shifting (“BEPS”) activities.\textsuperscript{39} The OECD has defined base erosion as “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions where there is little or no economic activity (i.e., no substance).”\textsuperscript{40}

   In similar fashion, and consistent with the articulated goals of the Act, section 59A was enacted to discourage base erosion activity and encourage both U.S. and non-U.S. multinationals to conduct business in the United States. In the Senate Finance Committee’s unofficial summary of the Senate Bill, the policy problem was described as follows: “foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent . . . This often results in earnings stripping . . . . Foreign parents often take advantage of these deductions through the use of interest, royalties, management fees, or reinsurance payments from the U.S. subsidiary.”\textsuperscript{41}

   At the same time, the various principles of tax reform as encompassed in the Act


\textsuperscript{39} See OECD, OECD/G20 INCLUSIVE FRAMEWORK ON BEPS: A GLOBAL ANSWER TO A GLOBAL ISSUE (Jul. 2018).

\textsuperscript{40} OECD, OECD/G20 INCLUSIVE FRAMEWORK ON BEPS: PROGRESS REPORT JULY 2017-JUNE 2018 4 (2018).

\textsuperscript{41} STAFF OF S. COMM. ON FINANCE, 115TH CONG., TAX CUTS AND JOBS ACT: CHAIRMAN’S MARK, SECTION-BY-SECTION SUMMARY 71 (Nov. 16, 2017) (hereinafter “Senate Finance Committee Summary”).
as a whole reflect a balance of considerations. As much as certain provisions, such as the BEAT, section 163(j), and section 267A are meant to protect U.S. fiscal interests against base erosion, other provisions such as section 168(k) (regarding bonus depreciation) and section 250 (regarding foreign-derived intangible income) incentivize taxpayers to increase their U.S. economic activities. In addition, the Proposed Regulations reflect a general intent to rely on existing tax principles to determine the treatment of payments or accruals as base erosion payments. Taking these factors into account, we believe that the definition of “base erosion payment” should reflect a balance of the BEAT and broader tax reform policy considerations, while adopting an approach consistent with existing tax principles related to the use of stock as consideration.

As noted above, base erosion payments are defined in section 59A(d)(1) as “any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable” under Chapter 1 of the Code (a “(d)(1) base erosion payment”). Base erosion payments include “any amount paid or accrued by the taxpayer” to a related foreign person “in connection with the acquisition by the taxpayer from such person of property” that is depreciable or amortizable (a “(d)(2) base erosion payment”).

A BETB is (i) any deduction described in the definition of a (d)(1) base erosion payment which is allowed under Chapter 1 of the Code for the taxable year with respect to any base erosion payment; and (ii) in the case of a (d)(2) base erosion payment, any deduction allowed Chapter 1 of the Code for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with such payment.

2. Application of the Definition of “Base Erosion Payment” in Transactions Involving Non-Cash Consideration

Neither section 59A nor the Proposed Regulations define or fully address the meaning of an “amount paid or accrued” in the context of the BEAT, although the Proposed Regulations indicate an expansive scope of the term that includes certain non-cash consideration. In particular, Proposed Regulation section 1.59A-3(b)(2)(i)

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In light of existing tax law dealing with identifying who is the beneficial owner of income, who owns an asset, and the related tax consequences (including under principal-agent principles, reimbursement doctrine, case law conduit principles, assignment of income or other principles of generally applicable tax law), the proposed regulations do not establish any specific rules for purposes of section 59A for determining whether a payment is treated as a deductible payment or, when viewed as part of a series of transactions, should be characterized in a different manner.

43 I.R.C. § 59A(d)(1).
44 I.R.C. § 59A(d)(2).
46 Section 59A(i) specifically authorizes Treasury to “prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions” of section 59A. Although Congress used the term “provisions” rather than “purposes” in section 59A(i), this does not appear to act as a limitation on Treasury’s authority. Indeed, it would be odd to construe authority to carry out the “provisions” of a statute
provides that the term includes “any form of consideration, including cash, property, stock, or the assumption of a liability.”47 The Proposed Regulations provide no further guidance, however, as to the specific transactional contexts in which such non-cash consideration would be treated as giving rise to a base erosion payment. In this regard, it is important to note that the Preamble to the Proposed Regulations indicates an intent to rely on existing tax principles to determine the treatment of payments or accruals as base erosion payments.48

Additional nuance is contained in the Preamble, which acknowledges that there are nonrecognition transactions that include a non-cash payment or accrual that fall within the definition of a base erosion payment,49 and notes that the Proposed Regulations include no exceptions for such transactions. The Preamble cites several examples: liquidations described in section 332, the receipt of assets in a section 351 exchange, and reorganizations as described in section 368. In addition, the Preamble notes that if a partner contributes property to a partnership in a section 721 transaction, the partnership would be treated as acquiring the property in exchange for an interest in the partnership.50

Significantly, the Preamble provides safe-harbor treatment for section 301 distributions of property.

[F]or transactions in which a taxpayer that owns stock in a foreign related party receives depreciable property from the foreign related party as an in-kind distribution subject to section 301, there is no base erosion payment because there is no consideration provided by the taxpayer to the foreign related party in exchange for the property. Thus, there is no payment or accrual.51

Effectively, a shareholder receiving a distribution of property (whether

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47 Prop. Reg. § 1.59A-3(b)(2)(i) (emphasis added). Section 7701(a)(25) provides, however, that the terms “paid or incurred” and “paid or accrued” are construed according to the accounting method that is used in computing taxable income.


50 See Part II.D.1, below, for a more detailed discussion of the Proposed Regulations as they relate to section 721 contributions.

depreciable or not) does not pay any consideration for the property; it is a passive recipient, and therefore, the base erosion “payment” concept is inapplicable. Notably, in a distribution to which section 311(b) applies, the shareholder receives appreciated property with a stepped up basis, which is subsequently depreciable or amortizable, reducing the U.S. taxpayer’s U.S. federal income tax liability, without BEAT implications. Consequently, we have analyzed various types of transactions that may involve non-cash consideration and, as discussed further below, have identified instances in which, as in section 301 distributions, no consideration is provided by the recipient for U.S. federal income tax purposes, and respectfully requests confirmation that these types of transactions also would fall outside the scope of base erosion payments.

In addition, we have analyzed transactions in which the consideration provided has been generally viewed as not sufficiently meaningful to trigger recognition of gain or loss. In particular, we note that transactions involving issuer stock and the assumption of liabilities have received special treatment across various operative provisions of the Code. In this regard, we believe that the definition of “base erosion payment” in the context of transactions involving non-cash consideration should reflect a balance of the BEAT policy considerations intended to discourage base erosion activity and encourage both U.S. and non-U.S. multinationals to conduct business in the United States, and to the extent consistent with those considerations, also should adopt an approach consistent with existing tax principles that govern the use of stock as consideration. In keeping with the existing (non-BEAT) statutory framework, it is our recommendation that the following two-prong inquiry should be performed in order for a transaction involving issuer stock or assumption of liabilities to result in an amount paid or accrued for purposes of section 59A.

1. Is the transaction properly treated as a sale or exchange, as opposed to a distribution, for U.S. federal income tax purposes?

2. If the transaction is properly treated as a sale or exchange, should stock used in the exchange or the assumption of liabilities in connection with the exchange be treated as a cash substitute?

We believe that, unless both of these questions are answered in the affirmative, the transaction should not be treated as resulting in a base erosion payment under section 59A(d).

We discuss two separate groups of transactions below: Transactions in which no consideration is provided by the taxpayer (including transactions in which consideration is generally viewed as not meaningful for U.S. federal income tax purposes), and transactions in which corporate stock is used to acquire amortizable or depreciable property.

a) Transactions Involving No Consideration or Consideration That Is Not Meaningful

i. Section 301 distributions of property

Section 301(a) generally provides that “a distribution of property . . . made by a

52 See, e.g., I.R.C. §§ 351, 357(a), 361, 1032.
corporation to a shareholder with respect to its stock shall be treated in the manner provided in [section 301(c)].” (Emphasis added.) The remaining subsections of section 301(c) retain the characterization of the underlying transaction as a “distribution” and merely provide how different portions of the distribution are to be treated for U.S. federal income tax purposes. Section 301(c)(1) provides that “[i]n the case of a distribution to which [section 301(a)] applies, that portion of the distribution which is a dividend (as defined in 316) shall be included in gross income.” Section 301(c)(2) provides that “that portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock [upon which such property was distributed].” Section 301(c)(3)(A) provides that “... that portion of the distribution which is not a dividend, to the extent it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.”

The Preamble is ambiguous as to whether all distributions subject to section 301 are excluded from the definition of base erosion payments or, alternatively, whether only distributions in which the distributing corporation receives no consideration should be so excluded. At least with respect to ordinary distributions with respect to stock, the distributing corporation does not receive any consideration. That is, the shareholder does not surrender any stock in exchange for the property or provide any other form of consideration to the distributing corporation. Even in a distribution subject to section 301(c)(3), there is no deemed sale or exchange of the underlying stock; instead, section 301(c)(3) only characterizes the relevant portion of the distribution as gain from the sale or exchange of property.

Consequently, we recommend that Treasury and the Service clarify that all in form distributions subject to section 301 are excluded from the base erosion payment definition regardless of whether they are characterized under section 301(c)(1), (2), or (3).

ii. Section 302 distributions in redemption of stock

In contrast to a section 301 distribution, a redemption of shareholder’s stock involves an actual exchange of stock for other property. We believe, however, that the mechanical act of providing consideration should not be taken into account for BEAT purposes, but rather that the effect of a redemption for BEAT purposes should follow the treatment provided in section 302. When a surrender of stock is deemed insufficiently meaningful to be treated as a sale or exchange of the stock (e.g., when a 100 percent shareholder redeems a portion of its stock and, following the redemption, retains its 100 percent ownership), section 302(d) refers to section 301 for the consequences of the transaction. The same is true in other instances in which, even if the shareholder’s ownership interest is affected, its position is not meaningfully changed;53 again, the transaction is treated as a distribution to which section 301 applies. We believe, and respectfully recommend, that if a redemption is treated as a section 301 distribution for U.S. federal income tax purposes, that characterization should be followed in the application of the BEAT rules.

53 See I.R.C. § 302(b); Rev. Rul. 78-401, 1978-2 C.B. 127 (redemption that reduced shareholder’s interest from 90 percent to 60 percent was essentially equivalent to a dividend).
In contrast, if a redemption falls within the scope of section 302(a), so that the transaction is treated as an exchange for U.S. federal income tax purposes, we recommend that the BEAT rules apply accordingly, and that the surrender of stock should be treated as a payment of consideration for the property received.

iii. Section 304 transactions

Similarly, neither the Preamble nor the Proposed Regulations directly address whether section 304 transactions involve consideration and, consequently, give rise to “amounts paid or accrued” under section 59A. As relevant here, section 304(a)(1) characterizes sales or exchanges involving stock of related parties as a two-step transaction. In step one, the transferor (“Transferor”) is treated as contributing shares of the target corporation (“Issuing”) to the acquiring corporation (“Acquiring”) in a section 351(a) non-taxable transfer solely in exchange for shares of Acquiring stock (the “Deemed Contribution”). Immediately thereafter, Acquiring is treated as redeeming the shares deemed issued in step one, in exchange for the consideration actually paid in the transaction (the “Deemed Redemption”). The tax consequences of the Deemed Redemption are governed by section 302.\^54

We respectfully recommend that the receipt of property in the context of a transaction falling within the scope of section 304 (and, by extension, section 302), be treated in the same manner as other redemptions discussed above. That is, if the redemption is treated as a distribution to which section 302(d) and section 301 apply, it should not be viewed as resulting in a base erosion payment. However, if the redemption is treated as an exchange, the use of stock to acquire depreciable property should be treated as a base erosion payment.

iv. Section 351 transfers and Section 368 reorganizations

We have also considered transactions in which a corporation uses non-cash consideration (e.g., stock or assumption of liabilities) to acquire depreciable property.

As discussed above, the Preamble indicates that “a non-cash payment or accrual to a foreign related party” may be treated as a base erosion payment notwithstanding that such payment or accrual may qualify for non-recognition under the Code. The Preamble mentions section 351 transactions, section 332 liquidations, section 368 reorganizations, and section 721 contributions as examples of transactions involving non-cash payments that may be treated as base erosion payments. We agree that it would be inappropriate to limit the definition of base erosion payments to only those transactions that are settled in cash. However, while it is clear that there are transactions in which a corporate issuer’s use of its own stock to acquire property or obtain services may be viewed in the same way as if the corporation had used cash (e.g., use of stock to purchase assets from an unrelated party or to compensate employees), there are also instances in which the issuer’s use of its own stock is treated differently. We respectfully recommend that final Regulations adopt an approach to the use of stock or an assumption of liabilities in the BEAT context that is consistent with existing law.

Specifically, we believe that where the use of equity falls outside the general

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\^54 See I.R.C. § 304(b).
understanding of “payment or accrual” – and, in particular, where its use does not give rise to a recognition event – it is appropriate to regard those transactions as outside the meaning of “payment or accrual” for purposes of section 59A. Section 7701(a)(25) provides that “[t]he terms ‘paid or incurred’ and ‘paid or accrued’ shall be construed according to the method of accounting upon the basis of which the taxable income is computed under subtitle A.” This statutory language has remained unchanged since the Internal Revenue Code of 1939.55 A case interpreting the meaning of the phrase “paid or accrued,” De Soto Securities Company v. Commissioner,56 observed “that ‘accrued’ relates to the incidence of a tax or interest obligation, while ‘incurred’ relates to the incidence of any other obligation.”57 Thus, the meaning of the term “paid or accrued” apparently includes the transfer of an asset (i.e., a payment) and the incidence of creating an obligation or liability (i.e., an accrual or incurrence). In contrast, a change in a shareholder’s equity position does not necessarily indicate that a payment or accrual has occurred.

In the context of a transfer of property to a corporation or a partnership, each of Subchapters C and K of the Code has a robust set of provisions that determines when a transfer of property to a corporation or a partnership, as the case may be, is treated as a taxable sale or exchange rather than as a non-taxable contribution. Where non-taxable treatment is allowed, equity may be issued to the contributing parties, but their indirect entitlement to the contributed assets is not different enough from their previously direct entitlement to merit gain or loss recognition. The same is true of reorganizations involving the use of stock to acquire assets under section 368. Indeed, Regulation section 1.1002-1(c) provides that:

[Sections 351(a), 354, 361(a), 371(a)(1), 371(b)(1), 721, 1031, 1035, and 1036] describe certain specific exchanges of property in which at the time of the exchange particular differences exist between the property parted with and the property acquired, but such differences are more formal than substantial. As to these, the Code provides that such differences shall not be deemed controlling, and that gain or loss shall not be recognized at the time of the exchange. The underlying assumption of these exceptions is that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure, and the new property are substantially continuations of the old still unliquidated.

In light of the existing differences between transactions in which the use of equity has the same effect as the use of cash or other consideration, and those in which the use of equity has merited special, i.e., nonrecognition, treatment, we respectfully recommend that final Regulations take a consistent view. That is, where equity is used in the context of a nonrecognition transaction, we recommend that the exchange not be treated as resulting in a base erosion payment. This treatment should not, however, extend to transactions in which the corporation or partnership uses its equity interests instead of

55 I.R.C. § 48(c) of the Internal Revenue Code of 1939.
56 235 F.2d 409, 411 (7th Cir. 1956).
57 303 U.S. 564 (1938).
cash to make taxable payments, such as the payment of compensation or the purchase of property in a taxable transaction.

In our analysis, we also considered the consequences of the assumption of a foreign related party’s liabilities in connection with a nonrecognition transaction. Although the assumption of a liability generally is considered a payment, Congress has specifically provided exceptions to this treatment for the assumption of certain liabilities in the context of nonrecognition transactions. Subject to significant limitations, section 357(a) provides that the assumption of liabilities pursuant to a section 351 or 361 transfer is not treated as the payment of money or other property.58 Similarly, the assumption of liabilities by a corporate shareholder pursuant to a section 332 liquidation generally does not result in any gain or loss to the liquidating subsidiary.59 Consistent with the policies behind these provisions, we further recommend that the assumption of liabilities in nonrecognition exchanges also be excluded from the definition of a base erosion payment to the extent the assumption is not treated as money or other property.60

However, we also recognize that the ability to assume liabilities in a nonrecognition transaction without triggering a base erosion payment could be seen as opening the door to potentially abusive situations. For example, a foreign corporation transferring depreciable property to an applicable taxpayer in a section 351 transaction could borrow funds from a third party, retain the borrowed funds, and contribute the property to the applicable taxpayer subject to the new liability. We believe that the existing exceptions to section 357(a), in particular section 357(b), ought to be sufficient to prevent any such abuses. If Treasury and the Service determine that the existing rules are not sufficient in this context, however, it may be possible to construct an anti-abuse rule under which the assumption of liabilities otherwise qualifying for nonrecognition under section 357(a) would nonetheless be deemed to be a payment for purposes of section 59A if the liabilities are not directly associated with the property acquired in the nonrecognition transaction. The rules relating to qualified liabilities under Regulation section 1.707-5 may provide a useful template for such an anti-abuse rule.

In addition, we recommend that, if gain or loss is recognized in a transaction otherwise eligible for nonrecognition treatment (including on a transfer of boot or an assumption of liabilities in excess of basis), final Regulations mirror the recommended treatment in sections 351 and 368 by treating such boot as a base erosion payment to the extent attributable to the acquisition of depreciable property. This would retain the

58 Section 357(a) supersedes the Supreme Court case of United States v. Hendler, 303 U.S. 564 (1938), which generally held that the assumption of a transferor's liability by a transferee corporation pursuant to a plan of reorganization should be regarded as a transfer of cash, and evidences congressional intent to provide nonrecognition treatment in section 351 and 361 exchanges even where the assets acquired are subject to liabilities. See H.R. REP. NO. 76-855, at 18, 19 (1939) (noting that Hendler's broad interpretation "will largely nullify the provisions of existing law" and seeking to "enable bona fide transactions . . . to be carried on without the recognition of gain" for transactions under now-sections 361 and 351 of the Code by enacting now-section 357(a) to the Code); see also GCM 34483 (Apr. 21, 1971) (describing the enactment of now-section 357(a) as "the anti-Hendler amendments").

59 I.R.C. § 337(b)(1).

60 Compare I.R.C. § 357(a) (assumption of liability not treated as boot) with I.R.C. § 357(b), (c).
partial nonrecognition treatment of the transaction, and allow allocation of the taxable boot between depreciable or amortizable property received, and other property.  

Below we list three alternative methods for determining the amount of basis in property described in section 59A(d)(2) that is attributable to base erosion payments. Under any of these approaches, the basis of a given item of property described in section 59A(d)(2) would be split, because the depreciation or amortization deductions related to a portion of the basis would be BETBs, while the depreciation or amortization deductions related to the remaining basis would not. We recommend that the regulations establish rules to clarify when a depreciation or amortization deduction with respect to property results in a BETB. We further recommend providing that a pro rata portion of the depreciation relating to the aggregate basis be treated as a BETB in each taxable year that the applicable asset is otherwise eligible for depreciation or amortization.

The “Gain Recognized” Approach

Under the first approach, basis in property acquired by a domestic corporation in a nonrecognition transaction would be treated as a base erosion payment—and the future depreciation or amortization of such basis would give rise to a BETB—to the extent that the domestic acquiring corporation’s basis in property described in section 59A(d)(2) is increased as a result of gain recognized by the foreign related transferor under section 362(a) (with respect to a section 351 transaction) or section 362(b) (with respect to a reorganization).

The “Boot to Qualified Consideration” Approach

Under the second approach, the domestic acquiring corporation’s basis in property described in section 59A(d)(2) would be bifurcated based on the ratio of the fair market value of the boot issued in the nonrecognition transaction to the fair market value of the qualified property issued in the transaction.

The “Boot First” Approach

Under the third approach, basis in property acquired by a domestic corporation in a nonrecognition transaction would be treated as a base erosion payment in an amount no

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61 See Rev. Rul. 68-55, 1968-1 C.B. 140 (allocating boot pro rata to the assets transferred to a corporation in a section 351 exchange for purposes of determining the amount of gain recognized under section 351(b)).

62 Even if our recommendation to exclude equity issuances in nonrecognition transactions is not adopted, a rule along the lines of the approaches outlined below will likely be required for distributions subject to section 301 of property subject to liabilities. Assuming that the distribution and liability assumption are not disaggregated into a separate distribution and capital contribution, an applicable taxpayer that is a distributee will be considered to have received the property partially in exchange for a base erosion payment.

63 I.R.C. § 362(a) (provides that “[i]f property was acquired … by a corporation in a transaction to which section 351 … applies, or as paid-in surplus or as a capital contribution, then the basis shall be same as it would be in the hands of the transferor, increased in the amount of gain recognized on such transfer”) (emphasis added); I.R.C. § 362(b) (similar); see also Rev. Rul. 68-55, 1968-1 C.B. 140 (addressing the allocation of boot received in a section 351 exchange, and generally requiring that gain recognized be computed on an asset-by-asset basis and allocated in proportion to relative asset value).
less than the amount of boot issued. Only basis in excess of the boot issued would belong to the category of basis with respect to which depreciation or amortization deductions would not be BETBs. Under this approach, a rule would be required to allocate the boot among all of the property received.64

v. Inbound liquidations

As noted above, the Preamble specifically identifies a section 332 liquidation as an example of a transaction that may give rise to a base erosion payment. As discussed below, however, we believe that a shareholder’s surrender of stock in the context of a corporate liquidation should not be treated as meaningful for purposes of applying the base erosion payment rules.

In the liquidation context, although the shareholders technically engage in an exchange, in that their stock is redeemed and cancelled by the liquidating corporation, the “payment” of that stock has little or no substance as the surrendered stock never becomes “property” in the hands of the liquidating corporation. More significantly, existing U.S. federal income tax rules treat a liquidation falling within the scope of section 332 as not only a non-taxable event, but, as discussed below, more akin to a distribution than a sale or exchange.

Section 332 provides that no gain or loss is recognized by a corporate distributee on the receipt of property distributed in the “complete liquidation” of its subsidiary.65 In describing the character of the liquidation transaction under section 332, the statutory language consistently describes the transfer of property as a “distribution.”66 While section 332 does not provide for the application of section 301 to such distributions, the explicit distributee-level treatment of the liquidating transfers as distributions should be considered analogous to the treatment afforded section 302(d) redemptions for purposes of determining whether a transaction results in a “payment or accrual.”

Section 337 prescribes the U.S. federal tax treatment of the liquidating corporation with respect to a liquidating distribution to its controlling corporate shareholder. Specifically, section 337(a) affords nonrecognition treatment to the liquidating corporation with respect to property transferred to an 80% corporate distributee. The nonrecognition treatment provided under section 337 is notable in that no similar treatment is afforded with respect to sections 301 and 302(d) distributions. Thus, even as compared to a section 302 redemption, it would seem that the legal surrender of corporate stock by an 80% corporate distributee upon the distribution of property in a section 332 liquidation should be given no meaningful effect for purposes of the BEAT. The corporate distributee’s control over the distributed property remains unchanged – the transaction merely results in a change from indirect ownership to direct ownership of such property.

64 Such an ordering rule could follow the principles of Rev. Rul. 68-55, 1968-1 C.B. 140, described in note 63 supra.
65 I.R.C. § 332(a)-(b) (emphasis added).
66 See, e.g., I.R.C. § 332(b)(3) (“such distribution is one of a series of distributions by such corporation in complete cancellation or redemption of all its stock . . . .”).
In contrast, a section 331 liquidation is treated by the Code as an exchange. Section 331 refers to the transaction as a distribution in “payment in exchange for the stock” (emphasis added). Moreover, section 331(b) provides that section 301 shall not apply to any distribution of property in complete liquidation. Accordingly, we recognize that the statutory treatment of a liquidating distribution described in section 331 is meaningfully distinguishable from the treatment of a liquidation governed by section 332.

In keeping with the existing statutory framework for the treatment of liquidations, we respectfully recommend that final Regulations provide that section 332 liquidations be treated as not giving rise to a base erosion payment, while section 331 liquidations involve an amount paid of accrued in exchange for property and, potentially, base erosion payments.

b) Treatment of Losses

As discussed above, the Preamble indicates that the definition of a base erosion payment includes a payment resulting in a recognized loss.67 We believe that it is reasonable, with respect to such an exchange, that the fair market value of the property transferred should be characterized as a payment for the purposes of determining whether “an amount [has been] paid or accrued” (subject to the discussion herein regarding equity transactions). We do not believe, however, that it is appropriate to treat a loss incurred by a domestic corporation in such an exchange as a payment or accrual for the purposes of the BEAT.

For example, where a domestic corporation transfers property with a basis of $100x and a fair market value of $10x to a related foreign party, the “amount paid or accrued by the taxpayer to a foreign person” should be $10x, not $100x. Although the domestic corporation may realize a $90x loss, the domestic corporation parts with, and the foreign party receives, only $10x of value, and, in our view, no additional amount (i.e., the $90x loss) has been “paid or accrued” to the foreign related party. Further, the $90x loss is not allowable “with respect to” the $10x payment (i.e., the “amount paid or accrued”), as required by the definition of a base erosion payment. Instead, the loss was economically incurred as the result of a change in value of the relevant property prior to its transfer, while the transfer itself resulted only in the recognition of that economic loss. We believe that the appropriate interpretation of the statute is that the $90x deduction is allowed with respect to the $90x economic loss, and not the $10x payment. In addition to being more consistent with the plain meaning of the statute, this approach is more consistent with the policy objectives of section 59A and eliminates a range of complications that arise under the Preamble’s discussion of losses, as discussed below.

In our view, treating “a loss recognized on the transfer of property to a foreign related party” as a base erosion payment does not follow from the policy underlying section 59A.68 As discussed in more detail above, the central purpose of section 59A is

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67 Preamble to Prop. Reg. § 1.59A-3, 83 Fed. Reg. 65,960 (2018) (explaining that a base erosion payment includes “a payment to a foreign related party resulting in a recognized loss; for example, a loss recognized on the transfer of property to a foreign related party”).

to prevent the erosion of the U.S. tax base.\textsuperscript{69} The use of a built-in loss asset as payment in no way erodes the U.S. tax base.\textsuperscript{70} Rather, the loss recognized in such transactions is incurred solely by the domestic corporation, with no “erosion” benefit flowing to the foreign related party. Treating such a loss as a base erosion payment does not further section 59A’s policy goals; indeed, it seems to us divorced from Congress’s concerns about base erosion.

Given the policy and implementation issues raised above, we recommend that the final regulations provide that the amount of a base erosion payment made in the form of property is the fair market value of the property transferred, and that any loss recognized by the Applicable Taxpayer with respect to the property transferred is not a BETB.

\textbf{i. Losses and Section 267(f)}

\textbf{A. Overview}

If Treasury and the Service do not accept our recommendation and instead decide to continue to treat the loss recognized by a domestic corporation on the sale of built-in loss assets to a related foreign party as a base erosion payment, we recommend that the determination whether certain losses subject to section 267(f) are BETB should be deferred until the losses are taken into account for tax purposes.

Section 267(f) raises certain unique technical and policy considerations. As background, section 267 disallows or defers the recognition of losses arising from the sale or other transfer of property between certain categories of related persons. In particular, section 267(a)(1) provides that:

\begin{quote}
No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.
\end{quote}

When the seller and buyer are members of the same controlled group, section 267(f), rather than section 267(a), applies to the sale. Section 267(f) is a loss deferral provision, rather than a loss denial provision. For this purpose, the term “control group” has the meaning given to such term in section 1563(a), except that “more than 50 percent” is substituted for “at least 80 percent” each place the latter phrase appears in section 1563(a). Thus, a section 267(f) control group includes a parent corporation and its subsidiary corporation where the parent corporation owns more than 50% of the stock of the subsidiary either by vote or value.

Unlike the rules of sections 267(a) and (d), the rules of section 267(f) generally provide that a loss from a sale of property between members of a controlled group is deferred until it would be taken into account under consolidated return principles, such as

\textsuperscript{69} \textit{Staff of S. Comm. on Finance, 115th Cong., Explanation of the Bill} 391 (2017); \textit{see supra} Section III.B.1.

\textsuperscript{70} \textit{See supra} Section III.B.1. referring to the OECD’s project on base erosion as \textit{shifting} profits.
Section 267(f) is designed to prevent members of a controlled group from taking into account a loss or deduction solely as the result of a transfer of property between a selling member (S) and a buying member (B). Such transfer is generally referred to as an intercompany sale.

Proposed Regulation section 1.267(f)-1(b)(1) defines an intercompany sale as a sale, exchange, or other transfer of property between members of a controlled group, if such sale, exchange or other transfer would be an intercompany transaction under the principles of Proposed Regulation section 1.1502-13, determined by treating references to a consolidated group as references to a controlled group and by disregarding whether any of the members join in the filing of a consolidated return. Proposed Regulation section 1.1502-13(b)(1)(i) defines an intercompany transaction as a transaction between corporations that are members of the same consolidated group immediately after the transaction. Thus, an exchange of property between corporations is not an intercompany transaction where the transferor and transferee members cease to be members of the same consolidated group at the time of the exchange. Based on these principles, an intercompany sale results where one corporation sells property to another corporation, and immediately after the sale, each is a member of the same controlled group of corporations.

### B. Deferral-Related Issues

We recommend that where a loss is recognized between members of the same control group but deferred under section 267(f), the determination of whether such a loss eventually should be treated as BETB and, if so, the amount of the BETB should be determined only once the loss is taken into account and then taking into account the triggering event. Our recommendation is illustrated by the following two examples.

**Example 1.** A foreign corporation, FP, owns 100% of both FS, a foreign corporation, and USS, a domestic corporation. USS owns, among other assets, a capital asset (“Asset 1”) with a basis of $100x and a fair market value of $10x. On date 1, year 1, USS transfers Asset 1 to FS for $10x. On date 2, year 2, FS sells Asset 1 to X, an unrelated party (i.e., a party in which no member of the FP control group owns any equity and which is not related under section 59A(g)) in exchange for $10x.

Pursuant to section 267(f), USS would recognize a $90x loss on date 1, year 1, and that loss would be deferred. On date 2, year 2, upon the sale to X, USS would take the $90x loss into account and FS would recognize no gain or loss. It appears that, pursuant to the Proposed Regulations, USS would have a base erosion payment of $90x in year 1, and a $90x BETB in year 2. If sales of built-in loss assets continue to be treated as giving rise to base erosion payments, we believe that the USS’s BETB in year 2 should instead be $0, because section 59A is generally concerned about deductions.

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71 I.R.C. § 267(f)(2); Treas. Reg. § 1.267(f)-1(a); see also Unionbancal Corp., et al. v. Comm’r, 113 T.C. 309, 320-24 (1999), aff’d, 305 F.3d 976 (9th Cir. 2002).

72 Reg. § 1.267(f)-1(b)(1); Reg. § 1.1502-13(b)(1)(i).
related to amounts paid or accrued to related parties.

We note that base erosion payment is defined in section 59A(d)(1) as “any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under [Chapter 1 of the Code].” 73 We also note that BETB is defined in section 59A(c)(2)(A)(i) as “any deduction described in subsection (d)(1) which is allowed under [Chapter 1 of the Code] for the taxable year with respect to any base erosion payment.” 74 The distinction between “allowed” and “allowable” may be an important one in this context. The Service has concluded, at least in the foreign tax credit context, that the term “allowable” expresses the notion that a deduction is permissible — even if it may be disallowed because of other relevant facts — while the term “allowed” connotes that a deduction is not only permissible but, after looking at all relevant facts, may be taken on the tax return. 75

Thus, the above definitions in the section 267(f) context could be interpreted to provide that a recognized loss that is deferred under section 267(f) is an “allowable” loss in that it may one day result in taking that loss into account. Under such an interpretation, USS would have a base erosion payment equal to $90x, even though it has not reduced its U.S. tax liability. Further, under the same line of reasoning, when Asset 1 is sold to X, the deferred loss of $90x is taken into account and, thus, “allowed.” Under such an interpretation, USS would have a BETB of $90x at that time.

We believe that such an analysis is inconsistent with the policies underlying section 59A. More specifically, even if Congress intended for losses to be treated as base erosion payments, section 59A is concerned with deductions taken by an applicable taxpayer with respect to payments made to foreign related parties. Unlike, for example, a payment made to a foreign related party in exchange for depreciable property where the depreciation deductions are claimed in future years regardless of whether the foreign party remains related to the applicable taxpayer, when a built-in loss asset is sold to a foreign related party and the transaction is subject to section 267(f), the triggering event for the loss is the lack of relatedness. Further, section 267(f) requires the triggering event, as discussed above, to be determined under the intercompany transaction rules of the consolidated return regulations. Those rules provide that the buyer and seller are to be treated as a single economic unit. If USS and FS are viewed as a single unit in Example 1 above, USS would be treated as selling Asset 1 directly to X, an unrelated party, and the transaction would not be a base erosion payment.

We note, however, that exempting all section 267(f) transactions from the definition of base erosion payment could be inappropriately distortive when the built-in loss asset sold to the related foreign party appreciates in the related foreign party’s hands prior to the relevant triggering event. Thus, if the sale of a built-in loss asset to a related foreign party is to be treated as giving rise to a base erosion payment other than in situations in which section 267(f) is applicable, it would be necessary to craft a rule to

73 I.R.C. § 59A(d)(1) (emphasis added).
75 See, e.g., CCA 201204008 (Oct. 21, 2011).
ensure that the applicable taxpayer does not receive a deduction greater than it would have had if it sold the asset to the unrelated third party on the date of the triggering event.

Example 2. Same facts as Example 1 except that on date 2, year 2, FS sells Asset 1 to X in exchange for $30x (i.e., $20x more than FP paid USS for Asset 1).

Pursuant to section 267(f), USS would recognize a $90x loss on date 1, year 1, and that loss would be deferred. On date 2, year 2, upon the sale to X, USS would take the $90x loss into account and FS would recognize a $20x capital gain. Pursuant to the Proposed Regulations, it appears that USS would have a base erosion payment of $90x in year 1, and a $90x BETB in year 2. If sales of built-in loss assets are treated as base erosion payments in the final Regulations, we believe that the USS’s BETB in year 2 should be $20x to take into account that if USS had not sold Asset 1 to FS but rather held the asset and sold it to X on date 2, year 2, it would only be entitled to a deductible loss of $70x.

3. Interest Expense Allocable to a Foreign Corporation’s ECI

As noted above, the Proposed Regulations contain an exception (the “ECI Exception”) from base erosion payment treatment for payments made to a foreign related party if the recipient is subject to U.S. taxation on the income on a net basis as ECI or as income attributable to a permanent establishment. We believe that the provisions of the Proposed Regulations that treat a portion of interest expense that is allocated under Regulation section 1.882-5 against ECI as a base erosion payment appear to be an appropriate complement to the ECI Exception.

Nevertheless, we believe that certain modifications would help accomplish the purposes of these rules more coherently and effectively.

The Preamble notes that Regulation section 1.882-5 provides certain simplifying elections for determining the interest deduction of a foreign corporation, including the election under Regulation section 1.882-5(c)(4) to apply a fixed ratio in lieu of the “actual ratio” calculated under Regulation section 1.882-5(c)(2) (the “fixed ratio election”) and the election under Regulation section 1.882-5(d)(5)(ii)(B) to use the 30-day LIBOR rate to determine the interest deduction on excess U.S.-connected liabilities (the “LIBOR election”), rather than determining the average rate of interest on U.S.-dollar liabilities that are not U.S.-booked liabilities. The Preamble then requests comments about the use of similar simplifying elections for determining the portion of U.S.-connected liabilities that are paid to a foreign related party.


77 Failure to address “excess interest” (i.e., the excess of interest allocable against ECI under Regulation section 1.882-5 over interest paid on U.S.-booked liabilities) while granting a broad ECI Exception would create incentives to funnel funding to U.S. operations through a U.S. branch. On the other hand, treating all such excess interest as a payment to a foreign related party could result in treating interest that was paid to unrelated parties as a base erosion payment. The pro rata approach taken by the Proposed Regulations appears to be a reasonable way to address any incentives that are considered inappropriate while remaining consistent with the language of section 59A(d)(1), which treats as a base erosion payment only amounts paid or accrued by an Applicable Taxpayer to a foreign related party.

We believe that where a taxpayer has made simplifying elections for purposes of determining its total interest deductions under Regulation section 1.882-5, those elections should also apply for purposes of determining the portion of its total interest deduction that will be treated as paid to foreign related persons. Thus, for example, a taxpayer that makes a fixed ratio election for purposes of Regulation section 1.882-5 should apply the same fixed ratio for purposes of determining the amount of its worldwide interest expense, resulting in a pro rata haircut of all of its interest expense to both related and unrelated parties. Similarly, a taxpayer making the LIBOR election should determine its interest deduction on both related and unrelated party debt by applying the 30-day LIBOR rate, rather than being required to calculate its interest rate under Regulation section 1.882-5(d)(5)(ii)(A).

Both of these simplifying elections enable taxpayers to determine the amount of interest expense that will be allocated against ECI without the need to perform calculations that require information that some taxpayers have found difficult to compile. Those elections directly affect the amount of interest that is in fact allocated to ECI, which means that failing to carry their effects through to the determination of the amount of interest that will be treated as a base erosion payment risks breaking the connection between actual deductibility and the definition of a base erosion payment. Failure to carry through the effects of these simplifying elections for BEAT purposes would also result in a potentially challenging data gathering requirement that would apply only for purposes of section 59A.

Separately, we believe that to the extent the excess interest of a foreign corporation is subject to the BLIT under section 884(f)(1)(B) and Regulation section 1.884-4(a)(2), it should not also be treated as giving rise to a BETB. This approach would mirror the exclusion described in section 59A(c)(2)(B) and Regulation section 1.59A-3(c)(2) and (3). While it is not imposed under sections 871 or 881 and is not collected by withholding under sections 1441 or 1442, the BLIT functions as a surrogate for the withholding tax that would be paid if a branch paid interest to a foreign recipient. There does not appear to be any policy reason to treat the tax imposed by the BLIT differently from withholding taxes merely because the BLIT is collected in a different manner.

Finally, we believe that the approach taken in the Proposed Regulations with respect to treaty-based methods that attribute profit based on functions performed, assets used, and risks assumed can reach results that are punitive and are inconsistent with ordinary income tax principles. This section of the Proposed Regulations appears to be directed at treaty methods that follow the authorized OECD approach (“AOA”) for the attribution of profits to permanent establishments, which give effect in some cases to “internal dealings” between the permanent establishment and the rest of the enterprise solely for purposes of attributing profits within the same legal entity. As noted in the Preamble, such an approach does not create legal obligations between the U.S. permanent establishment and the rest of the enterprise. While following the AOA may result in an interest deduction that is greater than the result of U.S. profit attribution rules, it does not in fact create intercompany deductions, and is instead better viewed as an alternative way of arriving at the total amount of excess interest that is deductible by the foreign corporation. We therefore recommend that where a taxpayer uses a treaty method that
determines profit on the basis of the functions performed, assets used, and risks assumed, its interest deductions in excess of U.S.-booked liabilities should be treated in the same manner as interest on excess U.S.-connected liabilities. That is, we recommend that such amounts be treated as base erosion payments on a pro rata basis in accordance with the portion of the foreign corporation’s overall borrowing that is from foreign related parties, rather than being treated as per se base erosion payments.

4. SCM Exception

As noted above, Proposed Regulation section 1.59A-3 allows payments that are otherwise eligible for the “services cost method” in Regulation section 1.482-9 (“SCM”), but have a “mark-up component,” to be exempt from consideration as base erosion payments, but only to the extent of the total services cost of the SCM-eligible services, thus rendering the mark-up component of the payment for such services subject to the BEAT. We agree with this rule as the best interpretation of the statute and concur with the analysis for this interpretation offered by Treasury the Service in the Preamble to the Proposed Regulations.79

Proposed Regulation section 1.59A-3 requires that in order to be eligible for the SCM exception, the taxpayer must maintain “adequate books and records.”80 The Proposed Regulations acknowledge that taxpayers may need to allocate and apportion one payment between a portion that is SCM-eligible and a portion that is not SCM-eligible, indicating that the books and records requirement will be met for such allocation and apportionment if the taxpayer has “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).”81 We request that Treasury and the Service provide additional examples or clarification as to what would constitute “sufficient documentation to allow verification of the methods used to allocate and apportion” such costs between SCM-eligible services and services ineligible for SCM treatment.

C. Comments Regarding Base Erosion Minimum Tax Amount: Application of Section 15 to Section 59A

As noted above, the application of section 15 depends on the effective date of a change in a rate of tax imposed by chapter 1 of the Code. It seems clear, for example, that a change in tax that specified a single effective date that does not depend on a taxable year would be subject to section 15. In addition, section 15(c) provides clear guidance on the effective date of a change in rate for taxable years “beginning after,” “ending after,” or “beginning on or after” a certain date. Thus, it is clear that the change in rate from ten to 12.5%, which applies “[i]n the case of any taxable year beginning after December 31, 2025,” has an effective date of January 1, 2026, and is subject to the blended rate mechanics of section 15.

In contrast, section 59A(b)(1)(A) does not use either approach. Instead, it provides a general rate of ten percent, but specifies that a five percent rate will apply “in


the case of taxable years beginning in calendar year 2018.” That language does not fit squarely with the approach of section 15, which depends on a rate change with a fixed effective date.

In addition, the language used in 59A(b)(1)(A) appears difficult to reconcile with an intent to apply a blended rate to fiscal year taxpayers. While section 59A(b)(1)(A) provides that a five percent rate will apply “in the case of taxable years beginning in calendar year 2018,” applying section 15 would result in that five percent rate applying only for days falling in calendar year 2018. Such an interpretation appears contrary to the language and structure of section 59A, which frames the five percent rate as an exception to the generally applicable ten percent rate, and suggests that the exception will be available for the entirety of any taxable year beginning in 2018. We therefore recommend that the final Regulations clarify that application of section 15 will not result in a blended rate for taxable years beginning in 2018 with respect to the transition from the five percent rate to the ten percent rate, but will result in a blended rate for the transition from ten percent to 12.5%.

D. Comment Regarding Application to Partnerships

1. Partnership Contributions and Distributions

The Proposed Regulations adopt a definition of an amount paid or accrued that applies to non-cash consideration. While the Proposed Regulations include “stock” as an example of non-cash consideration, there is no explicit reference to the treatment of a partnership interest as consideration for purposes of determining whether there is an amount paid or accrued for purposes of section 59A.82 Rather, as described below, by indicating that certain contributions of property to a partnership may give rise to BETBs, the Preamble to the Proposed Regulations suggests that transfers between a partnership and its partners may be intended to be treated as an amount paid or accrued under the Proposed Regulations. This section of the Comments addresses whether and in what circumstances we believe it would be appropriate to treat transfers to or by a partnership as amounts paid or accrued for purposes of section 59A.

a) Contributions to a Partnership

The Preamble to the Proposed Regulations indicates that certain contributions to partnerships may be treated as giving rise to BETBs for purposes of section 59A. Specifically, an example in the Preamble (the “Section 721 Example”) provides that –


[If a foreign related party and a taxpayer form a partnership, and the foreign related party contributes depreciable property, deductions for depreciation of the property generally are base erosion tax benefits, in part, because the partnership is treated as acquiring the property in exchange for an interest in the partnership under section 721.83]

In the Section 721 Example, it appears there is a base erosion payment made to acquire the depreciable property because “the partnership is treated as acquiring the property in exchange for an interest in the partnership” and, under Proposed Regulation


section 1.59A-7(b)(2), each partner is treated as making its share of the payment (in the form of “an interest in the partnership”) to the foreign related party. We respectfully request that Treasury and the Service clarify whether our understanding of the determination of the base erosion payment is correct in the context of the Section 721 Example.84

The Preamble also notes that the approach of the Section 721 Example “is consistent with the approach taken with respect to subchapter C transactions.”85 In the corporate context, there are provisions that override the general nonrecognition treatment of contributions to a corporation. Similarly, subchapter K of the Code (“subchapter K”) has well-developed provisions that, where applicable, treat a transfer of property to (or by) a partnership as a sale or exchange rather than as a contribution (or distribution).86 For instance, if section 707(a)(2)(B) and the Regulations thereunder (the “Disguised Sale Rules”)87 apply to treat a transfer of property to a partnership as a disguised sale of property, the transaction is recharacterized as a sale of the property under section 1001.88 Stated differently, the Disguised Sale Rules provide for a deemed sale of property by the contributing partner to the partnership (and vice versa). We believe the approach described in the Section 721 Example is overly broad and that, for purposes of section 59A, it would be appropriate to treat the transfer of property to a partnership in connection with which the partner is treated as receiving proceeds from the partnership under the Disguised Sale Rules as resulting in a “payment or accrual” only to the extent that the rules of subchapter K provide for a deemed sale, rather than a contribution, of the transferred property by the partner to the partnership (or by the partnership to the partner, as the case may be).89

84 The Proposed Regulations do not provide an explicit rule or example illustrating the effects of the Section 721 Example. If the effects of the Section 721 Example are intended to be included in the final Regulations, we respectfully request that the final regulations clarify whether our understanding of the Section 721 Example is accurate.

85 Id.

86 See, e.g., I.R.C. § 707(a)(2)(B) and the Regulations thereunder.

87 I.R.C. § 707(a)(2)(B) provides that “[i]f (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property, such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership.” See also Reg. §§ 1.707-3 through 1.707-6.

88 Reg. § 1.707-3(a)(2). See also Reg. § 1.707-6(a).

89 Certain other provisions of subchapter K of the Code could result in deemed sales (e.g., Reg. § 1.751-1(b)(2)(i)). Cf. 79 Fed. Reg. 65,151, at 65,155-6 (proposing regulations under section 751(b) that would replace the “asset exchange” approach of the current regulations under section 751(b)). A discussion of the various approaches to section 751(b) and the final and proposed regulations thereunder is beyond the scope of these Comments. See ABA Section of Taxation, Comments on Section 751(b) Proposed Regulations (April 27, 2016), available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/042716comments.pdf
b) Distributions by a Partnership

A distribution of property to a partner that is not treated as part of a disguised sale generally results in a decrease to the distributee partner’s capital account, effectively reducing the partner’s entitlement to the partnership’s remaining undistributed property. In this sense, the distributee partner may be viewed, in substance, as acquiring the distributed property in exchange for some or all of its interest in the partnership.

Although there is no direct indication that the Proposed Regulations would treat a partnership distribution as giving rise to a base erosion payment or BETB, it seems natural that the government might extend the reasoning of the Section 721 Example to a distribution by a partnership. That is, it seems that the government could conclude that, in a partnership distribution, the distributee partner should be treated as acquiring the property of the partnership in exchange for some or all of its interest in the partnership. As in the case of partnership contributions, we do not believe this would be an appropriate result.

The Disguised Sale Rules provide an adequate and well-understood framework for treating transfers of property by a partnership to a partner as sales of property to the partner (or by the partner to the partnership, as the case may be). Thus, subchapter K already provides rules for determining when a transaction that purports to be a distribution is deemed to be a sale of property between a partnership and a partner. We believe it would be appropriate to treat a deemed sale resulting from the application of the Disguised Sale Rules to a partnership distribution as giving rise to an amount paid or accrued for purposes of section 59A.

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c) Primary Recommendation

In light of the foregoing, we recommend that the final regulations provide that contributions to a partnership described in section 721 and distributions\(^{92}\) by a partnership described in section 731 are generally not treated as amounts “paid or accrued” for purposes of section 59A (the “Primary Recommendation”). This Primary Recommendation would not apply to the extent that the transaction would be treated as a deemed sale of property by or to the partnership, which can occur under existing rules that include, but may not be limited to, the Disguised Sale Rules.\(^ {93}\) As outlined above, we believe the Proposed Regulations would result in the application of section 59A to such deemed sales without any modification. If Treasury and the Service choose to adopt this Primary Recommendation, we respectfully request that the Preamble to the final regulations clarify that the provisions defining base erosion payments apply to a deemed sale of property between a partnership and a partner (to the extent that subchapter K deems there to be such a sale), and there is no reason to consider the alternative recommendations in Part III.D.1.d., below.

d) Alternative Recommendations

Alternatively, if the final regulations retain the concept in the Proposed Regulations that would treat certain partnership contributions and distributions eligible for nonrecognition under sections 721(a) and 731(a), respectively, as giving rise to BETBs, we recommend that Treasury and the Service consider modifying the application of this concept and providing special rules that would apply in certain cases, as outlined below.

First, if Treasury and the Service do not adopt our Primary Recommendation, we recommend modifying the effective date of the provisions relating to this treatment because many taxpayers engaged in contributions to (or distributions by) partnerships between December 31, 2017 and December 21, 2018, without any indication from the government that such transactions could result in the creation of BETBs.

Second, if the final regulations do not incorporate our Primary Recommendation, we also recommend that Treasury and the Service consider a special rule that would exclude pro rata contributions (i.e., contributions made by each partner of the partnership in proportion to its interest in the partnership) from the definition of an amount paid or accrued.\(^ {94}\) We acknowledge that if Treasury and the Service reject our Primary

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\(^{92}\) This recommendation applies to current and liquidating distributions made by a partnership to one or more of its partners under section 731(a).

\(^{93}\) Specifically, where the Disguised Sale Rules apply, there would be an amount—equal to the consideration that is deemed to be paid in exchange for the property that is deemed to be sold to the partner or the partnership (as the case may be)—that is treated as an amount paid or accrued for purposes of section 59A; and that amount paid or accrued would be a base erosion payment if the other conditions of the base erosion payment definition were satisfied (e.g., payment by an applicable taxpayer to a foreign related party for which a deduction is allowed or for certain property or insurance).

\(^{94}\) Similarly, we recommend that this special rule exclude pro rata distributions by partnerships from the definition of an amount paid or accrued.
Recommendation, the final regulations may generally treat a transfer of partnership equity in exchange for property as a payment. However, in this instance, we believe this special rule would reach an appropriate result because each partner would effectively contribute or receive its share of partnership property.

Finally, the Proposed Regulations include a provision that excludes certain payments by a taxpayer to a foreign related party from the definition of a base erosion payment to the extent that the amount paid or accrued to the foreign related party is “subject to federal income taxation as income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States” (the “ECI Exception”). If Treasury and the Service do not adopt our Primary Recommendation, we recommend providing that the ECI Exception applies to partnership contributions and distributions, as outlined below.\(^\text{95}\) If a foreign person transfers depreciable property to a partnership in exchange for an interest in a partnership, the receipt of the partnership interest is generally not treated as ECI, and the ECI Exception would not be satisfied.\(^\text{96}\) We believe that it would be appropriate for the ECI Exception to be modified to cover the receipt of property that (directly or indirectly) gives rise to ECI in the hands of the foreign related party.

Accordingly, if the final regulations retain the concept that even nontaxable contributions to and distributions by partnerships may be treated as giving rise to BETBs for purposes of section 59A, we recommend that the ECI Exception be expanded to exclude contributions of depreciable (or amortizable) property by a foreign related party to a partnership (in which an applicable taxpayer is a partner) from the meaning of a base erosion payment to the extent that the contributing foreign related party would receive (or would be expected to receive) allocations of income from that partnership interest that would be taxable to the foreign related party as ECI.\(^\text{97}\) Similarly, we recommend that the


\(^{96}\) In certain cases, the receipt of a partnership interest could be ECI. For example, if a foreign person transferred property used in a U.S. trade or business in exchange for a partnership interest, gain or loss recognized by the foreign person, if any, may be ECI. A full discussion of situations in which ECI may be recognized is beyond the scope of these Comments. Prop. Reg. § 1.59A-3(b)(3)(iii)(A) also requires a withholding certificate under section 1441 or 1442 and the withholding provisions applicable to a partnership with ECI (i.e., section 1446) may not satisfy the withholding certificate requirement.

\(^{97}\) We made a similar recommendation in our comments to Notice 2015-54 relating to transactions subject to section 721(c), which is another provision intended to prevent base erosion in the partnership context. See ABA Section of Taxation, Comments on Notice 2015-54 (May 23, 2016), available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/052316comments.pdf. The Preamble to T.D. 9814, 82 Fed. Reg. 7,582 (January 19, 2017), referred to our comment (“that property that gives rise to income effectively connected with a U.S. trade or business (ECI property) be excluded from the definition of section 721(c) property, because the income will be subject to U.S. federal income tax even if it is allocated to a related foreign person”) and noted that Treasury and the Service agreed with “the reasoning behind this comment.” 82 Fed. Reg. 7,582, at 7,586. The underlying principles of this recommendation are reflected in the Temporary Regulations under section 721(c) which provide, in part, that the remedial and consistent allocation method requirements of the gain deferral method are generally not applied to section 721(c) property if the allocations of income and loss from the section 721(c) property are taxable as ECI to the related foreign partners of the section 721(c) partnership. See Temp. Reg. § 1.721(c)-3T(b)(1)(ii).
ECI Exception be expanded to exclude distributions of depreciable (or amortizable) property by a partnership (in which foreign related party is a partner) to an applicable taxpayer from the meaning of a base erosion payment to the extent that the foreign related party that would be deemed to receive the payment of the partnership interest would have (or would be expected to have) allocations of income from the partnership interest that would be taxable to the foreign related party as ECI.

2. Treatment of Partners as Owning Assets of the Partnership

The Preamble to the Proposed Regulations explains that, with a few limited exceptions, the Proposed Regulations apply an aggregate approach to partnerships. For instance, payments made or received by a partnership are treated as made or received by the partners of the partnership in proportion to the partners’ interests in the deductions or income of the partnership with respect to the payments.98 In addition, “[f]or purposes of section 59A” each partner is treated “as owning its share of the partnership items determined under section 704, including the assets of the partnership.”99 We agree that the Proposed Regulations appropriately cause the allocation of certain expenses or amortization and depreciation to a domestic partner to be treated as a BETB. However, the relevance of this rule with respect to other partnership items (broadly construed to include assets of a partnership) is not immediately clear in the Proposed Regulations.

In general, partners are allocated a distributive share of the partnership’s income, gain, deduction, loss, and credit under section 704 consistent with their interest in the partnership.100 It appears, but is not entirely clear, that the treatment of each partner “as owning its share of the partnership items determined under section 704” means that each partner would take into account its distributive share of the partnership’s items of income, gain, deduction, and loss (including BETBs) for purposes of section 59A.101 If our understanding is correct, we would recommend removing the phrase “including assets of the partnership” from the proposed rule. However, if the Proposed Regulations are intended to treat partners as owning partnership items or assets for other purposes, we respectfully request that the final regulations include examples that clarify the purposes of section 59A for which the aggregate approach to the ownership of partnership assets is relevant.

3. Determining a Partner’s Share of a Partnership’s Payment

As noted above, the Proposed Regulations apply an aggregate approach for purposes of determining the extent to which a partner of a partnership is treated as making or receiving a payment that is made or received by the partnership. The primary relevance of this rule appears to be for purposes of determining whether a payment is a base erosion payment.

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98 Prop. Reg. § 1.59A-7(b)(2) and (3).
99 The aggregate approach of Prop. Reg. § 1.59A-7(b)(5)(i) that treats the partners as owning their share of the partnership’s assets appears to apply notwithstanding whether each partner would qualify for the small partner exception of Prop. Reg. § 1.59A-7(b)(4).
100 See generally I.R.C. § 704(b) and Reg. § 1.704-1(b)(1)(i).
101 Prop. Reg. § 1.59A-7(b)(5)(i).
a) Determining a Partner’s Share of a Payment Made by a Partnership

For purposes of applying an aggregate approach to payments made by a partnership, the Proposed Regulations provide:

Except as provided in paragraph (b)(4) of this section, for purposes of determining whether a payment or accrual by a partnership is a base erosion payment, any amount paid or accrued by a partnership is treated as paid or accrued by each partner based on the partner’s distributive share of items of deduction (or other amounts that could be base erosion tax benefits) with respect to that amount (as determined under section 704).102

Where a partnership makes a payment that is immediately deductible in determining the partnership’s taxable income under section 703(a), it is clear that Proposed Regulation section 1.59A-7(b)(2) would treat each partner as making the payment to the extent of the partner’s distributive share of the deduction with respect to that payment. However, the Proposed Regulations do not indicate how a partner’s distributive share of “other amounts that could be BETBs” would be determined if such amounts would be treated as BETBs in more than one taxable year (when each partner’s allocation of certain partnership items may change over time). The following example illustrates the uncertainty of determining a partner’s share of a payment made by a partnership when the payment is made to acquire a depreciable asset.

Example 1. Facts. FC, a foreign corporation, owns all of the stock of US, a domestic corporation that is an applicable taxpayer for purposes of section 59A. US owns a preferred interest in PRS, a foreign partnership, that entitles US to a priority return of $20 of PRS’s net income for each taxable year. The remaining interests in PRS are common interests and are owned by unrelated persons. PRS purchases Property A, a depreciable asset, from FC for a $30 cash payment. The depreciation of Property A is $10 per year (for 3 years).103 Taking into account the depreciation deduction for Property A, PRS’s net income is $40 in Year 1, $100 in Year 2, and $20 in Year 3.

Analysis. US’s overall share of PRS’s income is 50%, 20%, and 100% in Years 1, 2, and 3, respectively. The depreciation of Property A is allocated in the same manner as the partnership’s other items of net income,104 and US has a distributive share of depreciation from Property A of $5, $2, and $10 in Years 1, 2, and 3, respectively (for a total of $17). For purposes of determining the extent to which US is treated as making the $30 payment to FC for Property A in Year 1, the Proposed Regulations refer to US’s distributive share of “amounts that could be BETBs” (i.e., depreciation) with respect to the payment.105 If US had perfect foresight, it likely would have been treated as making a payment of $17 to FC. In this case, because FC is a foreign related party with respect to US, the $17 payment would have been a base erosion payment. Furthermore, the depreciation deductions allocated to US ($17 in aggregate over 3 taxable years) would

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102 Prop. Reg. § 1.59A-7(b)(2).
103 A three-year straight-line depreciation method is used, for simplicity in the example.
104 See Reg. § 1.704-1(b)(1)(vii) (the “bottom-line” allocation rule).
105 Prop. Reg. § 1.59A-7(b)(2).
have been BETBs.

However, at the end of Year 1, neither US nor PRS may know with any degree of certainty what the future net income (and the related allocations of depreciation to US) would be. Even though, at the time US must file its tax return for the year of the payment, US will know that its distributive share of depreciation from Property A for Year 1 ($5) equaled 50% of the total depreciation from Property A for Year 1 ($10), it is not clear from the text of the Proposed Regulations whether US would be treated as making 50% of the payment to FC (i.e., $15 = $30 payment * 50%). If US were treated as making a base erosion payment to FC, in the amount of $15, one may think that the total amount of US’s distributive share of depreciation deductions “with respect to the property acquired with that payment”106 that are treated as BETBs would be limited to the amount of the base erosion payment (i.e., $15).

However, assuming that US is treated as making a payment to FC with respect to Property A (in Year 1 when the payment was actually made by PRS), it seems that the appropriate result may be that all amounts of US’s distributive share of depreciation deductions with respect to Property A would be treated as BETBs, regardless of the amount of the payment that is treated as made by US. We believe the Proposed Regulations may be read to apply in this manner because there is no provision that explicitly links the amount of a base erosion payment to the amount of a BETB, and a BETB is defined, in part, as a deduction allowed for depreciation “with respect to the property acquired with [a base erosion payment defined in Proposed Regulation section 1.59A-3(b)(1)(ii)].”107

Thus, it appears that the amount of a partner’s distributive share of a deduction that is treated as a BETB is defined by reference to the presence, but not the amount, of the base erosion payment that the partner may be treated as making under Proposed Regulation section 1.59A-7(b)(2). Stated differently, we believe that the amount of the partner’s distributive share of deductions with respect to property acquired by the partner’s base erosion payment that is treated as a BETB may (1) not be limited to the amount of the partner’s base erosion payment with respect to that property and (2) may be an amount that is greater than or less than the partner’s base erosion payment with respect to that property. Accordingly, we recommend that the final regulations clarify whether any amount of the partner’s distributive share of deductions with respect to property acquired by a base erosion payment (in any amount) that is treated as made by the partner would be a BETB, subject to the limitations for de minimis partners in Proposed Regulation section 1.59A-7(b)(4).108 In this regard, we also respectfully recommend that the final regulations include one or more examples illustrating the determination of the amounts of base erosion payments and BETBs of a partner in a partnership that has a distributive share of depreciation (or amortization) that is treated as

107 Id.
108 We notice that reference in Prop. Reg. § 1.59A-7(b)(2) to Prop. Reg. § 1.59A-7(b)(4) seems out of place because paragraph (b)(4) applies to BETBs and paragraph (b)(2) applies to base erosion payments. Accordingly, it is not clear for what purposes Prop. Reg. § 1.59A-7(b)(4) would prevent the application of the general aggregate rule in Prop. Reg. § 1.59A-7(b)(2).
a BETB.

b) Determining a Partner’s Share of a Payment Received by a Partnership

For purposes of applying an aggregate approach to payments received by a partnership, the Proposed Regulations provide:

For purposes of determining whether a payment or accrual to a partnership is a base erosion payment of the payor, any amount paid or accrued to a partnership is treated as paid or accrued to each partner based on the partner’s distributive share of the income or gain with respect to that amount (as determined under section 704).109

Where a partnership receives a payment that is immediately includable as income or gain in determining the partnership’s taxable income under section 703(a), it is clear that Proposed Regulation section 1.59A-7(b)(3) would treat each partner as receiving the payment to the extent of the partner’s distributive share of the income or gain with respect to that payment. However, the Proposed Regulations do not address how to determine each partner’s share of a payment received by a partnership if the payment results in no income or gain or results in a deduction or loss. For example, a partnership may sell depreciable or amortizable property to an applicable taxpayer in exchange for an amount realized that is equal to or less than the partnership’s adjusted basis in the property. Accordingly, we recommend that the final regulations provide rules for determining the extent to which a partner is treated as receiving a payment received by a partnership where the payment results in no income or a deduction or loss. We believe it would be appropriate to allow taxpayers to use a reasonable method to determine each partner’s share of the payment received by the partnership if the payment results in no income.110 We further believe it would be appropriate, in circumstances where a payment results in a deduction or loss, for the partner’s share of the payment to be determined by the partner’s share of the deduction or loss.

In addition, similar to the issues presented by depreciation in the context of payments made to a partnership, the partners may not know with certainty their distributive share of income or gain with respect to a payment if the income or gain is recognized in multiple taxable years (over which the partners’ allocations of income or gain from the partnership may vary). For example, it is not clear how each partner would determine the extent to which it is treated as receiving a payment received by a partnership if the partnership’s receipt of the payment is pursuant to an installment sale or a deferral for advance payments.111 We therefore also recommend that the final

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109 Prop. Reg. § 1.59A-7(b)(3).

110 The Proposed Regulations include a rule allowing for a reasonable method to be used to determine each partner’s share of the assets of the partnership. See Prop. Reg. § 1.59A-7(b)(5)(i). Alternatively, a partner’s share of a payment that results in no income could be determined by reference to (i) the partner’s hypothetical share of the payment if there had been income or gain or (ii) the principles of the regulations for allocating creditable foreign tax expenditures. Cf. Reg. § 1.704-1(b)(4)(vii)(c)(5).

111 See I.R.C. § 453(a); Rev. Proc. 2004-34, 2004-1 C.B. 911. See also I.R.C. § 451(b), as amended by the Act. This is an illustrative, but not exhaustive, list of transactions that could result in income recognized in
regulations provide rules for determining the extent to which a partner is treated as receiving a payment received by a partnership where the payment results in income or gain that is recognized by the partnership and allocated to the partners over more than one taxable year. Again, we believe it would be appropriate to allow taxpayers to use a reasonable method to determine each partner’s share of the payment received by the partnership where the income or gain is recognized over multiple taxable years.\textsuperscript{112}

E. Comments Regarding Anti-abuse and Recharacterization Rules

1. Transactions Entered into Prior to the Enactment of the Act

As noted above, each of the anti-abuse rules of Proposed Regulation section 1.59A-9 requires the existence of a transaction, plan or arrangement that has a principal purpose of achieving a particular result under the BEAT rules, \textit{i.e.}, avoiding the existence of a base erosion payment, increasing the denominator of the base erosion percentage, or avoiding the application of the special rules for banks or registered securities dealers. We believe that taxpayers cannot be treated as having undertaken a transaction, plan or arrangement with “a principal purpose” of avoiding specific aspects of the BEAT provisions if the transaction were undertaken at a time when those provisions had not even been released to the public as part of the legislative process.

We therefore respectfully request that Treasury and the Service confirm that the Base Erosion Payment Anti-Abuse Rule and the Base Erosion Percentage Anti-Abuse Rule does not apply to any transaction, plan or arrangement entered into prior to, or pursuant to a binding commitment that was in effect as of, November 9, 2017, and that was not significantly modified after that date. This is the date of release of the Senate Finance Committee “conceptual mark” that included a “base erosion minimum tax.”

We further request that final Regulations provide that the Bank Status Anti-Abuse Rule not apply to any transaction, plan or arrangement entered into prior to, or pursuant to a binding commitment that was in effect as of, December 1, 2017. This is the date of release of the Senate bill amendment that incorporated the special base erosion percentage threshold and rate applicable to banks and registered securities dealers.

2. Clarifications on the Base Erosion Payment Anti-Abuse Rule

The Base Erosion Payment Anti-Abuse Rule assumes that, as part of a plan with a principal purpose of avoiding a base erosion payment, an intermediary receives a payment from a taxpayer and makes “corresponding payments” to or for the benefit of a foreign related party of the taxpayer.

We recommend that final Regulations specify the standard to be used for determining when a payment made by an intermediary are treated as “corresponding”

\textsuperscript{112} Because there must be a base erosion payment in order to have a BETB with respect to that payment, we note that it may be appropriate for Treasury and the Service to consider an anti-abuse rule that would prevent the avoidance of section 59A in situations in which (1) a partnership makes a special allocation to avoid treating a particular partner as making or receiving a payment in the year of the payment and (2) the partnership allocates the related deduction or income from that payment to the same partner in other years.
with a payment made by the taxpayer to such intermediary. For example, we believe that Treasury and the Service could treat an intermediary as having made a “corresponding payment” to a foreign related party if the intermediary would not have made such payment but for a payment received by the intermediary from the taxpayer.\footnote{See generally Reg. 1.881-3 (defining a conduit entity as including an intermediate entity that “would not have participated in the financing arrangement on substantially the same terms \textit{but for} the fact that the financing entity engaged in the financing transaction with the intermediate entity.”) (emphasis added).}

In addition, we respectfully request that final Regulations include further guidance or an example clarifying when an intermediary could be deemed to have “indirectly” made a corresponding payment to a foreign related party of the taxpayer.

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\footnote{See generally Reg. 1.881-3 (defining a conduit entity as including an intermediate entity that “would not have participated in the financing arrangement on substantially the same terms \textit{but for} the fact that the financing entity engaged in the financing transaction with the intermediate entity.”) (emphasis added).}