Consolidated Return Aspects of the Tax Code's Jazziest Acronyms (otherwise known as the TCJA)—GILTI, FDII, 163J, and BEAT

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American Bar Association Tax Section
2019 May Meeting
May 10, 2019
Washington, DC
Agenda

<table>
<thead>
<tr>
<th>GILTI</th>
<th>Section 951A</th>
</tr>
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<tbody>
<tr>
<td>FDII</td>
<td>Section 250</td>
</tr>
<tr>
<td>163J</td>
<td>Business Interest Expense Limitation Under Section 163(j)</td>
</tr>
<tr>
<td>BEAT</td>
<td>Section 59A</td>
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</tbody>
</table>
GILTI – Section 951A
GILTI – The big picture

• In constructing the TCJA, Congress recognized that, without any base protection measures, the participation exemption system established under new section 245A could create an incentive for U.S. corporations to allocate income that otherwise would be subject to the full U.S. corporate tax rate to foreign affiliates operating in low-tax or zero-tax jurisdictions, where the income potentially could be distributed back to the U.S. corporation with no U.S. tax imposed.

− As a result, U.S. corporations could have an incentive to serve the U.S. market and foreign markets through their foreign affiliates rather than U.S. affiliates.

• To address this possible source of erosion of the U.S. tax base, and the potential migration of economic activity from the United States to other countries, new section 951A subjects certain income earned by controlled foreign corporations to current U.S. tax.

− Subjecting that income to current U.S. tax reduces the tax benefit of allocating that income to low-tax or zero-tax jurisdictions.

− However, Congress recognized that taxing that income at the full U.S. corporate tax rate may hurt the competitive position of U.S. corporations relative to their foreign counterparts, and decided to tax that income at a reduced rate via new section 250 (with a portion of foreign tax credits also available to offset U.S. tax).
New section 951A

• Under section 951A(a), a **U.S. shareholder** (as defined in section 951(b)) of a controlled foreign corporation (a **CFC**) is required to include its "**global intangible low-taxed income**" (GILTI) for any taxable year in gross income.

  − Effective for taxable years of foreign corporations **beginning after December 31, 2017**, and taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

  − Intended to act as an anti-base erosion measure that reduces incentives for holding intangible assets in low-tax jurisdictions.

• No guidance is provided in the statute concerning the application of section 951A in the context of a consolidated group.

• Under section 250(a)(1) (discussed further below), a domestic corporation generally is allowed a 50% deduction for the sum of its GILTI and any deemed dividend under section 78 attributable to GILTI.
Proposed regulations

• On September 13, 2018, Treasury and the IRS released proposed regulations under new section 951A and related provisions.

− Consistent with the applicability date of section 951A, the proposed regulations generally have been proposed to apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

Structure of the proposed regulations

- **Prop. Treas. Reg. § 1.951A-2: Determination of tested income or tested loss.**
- Prop. Treas. Reg. § 1.951A-4: Determination of tested interest expense and tested interest income.
- **Prop. Treas. Reg. § 1.951A-6: Treatment of GILTI for certain purposes and adjustments to earnings and profits and basis.**
- **Prop. Treas. Reg. § 1.1502-51: Consolidated section 951A.**
- Proposed amendments to Treas. Reg. § 1.1502-32.
- Proposed regulations also provided under section 6038.
CFCs and U.S. shareholders

• A foreign corporation is a CFC if more than 50% of the total vote or total value of the corporation's stock is owned (within the meaning of section 958) by U.S. shareholders at any time during the year. See § 957(a); see also § 951A(e)(3).

• A U.S. shareholder is a United States person that owns (within the meaning of section 958) at least 10% of the total vote or total value of the stock of a foreign corporation. See § 951(b).

Furthermore, for purposes of section 951A, the U.S. shareholder must own stock of the CFC within the meaning of section 958(a), i.e., directly or indirectly through a foreign entity, on the last day in the taxable year of such foreign corporation on which such foreign corporation is a CFC. See § 951A(e)(2).
Determination of GILTI inclusion amount

- **GILTI**: A U.S. shareholder's "net CFC tested income" reduced by its "net deemed tangible income return."

- **Net CFC tested income**: The excess (if any) of: (i) the U.S. shareholder's pro rata share of the "tested income" of each of its CFCs, over (ii) the U.S. shareholder's pro rata share of the "tested loss" of each of its CFCs.

- **Tested income and tested loss.**
  - Tested income where \( A - B > 0 \) or tested loss where \( A - B < 0 \). For this purpose:
    - \( A = \) Gross income (with certain exclusions); and
    - \( B = \) Deductions (including taxes) properly allocable to that gross income.
  - Exclusions from gross income for purposes of calculating tested income and tested loss: (i) effectively connected income already subject to tax; (ii) Subpart F income; (iii) gross income excluded from Subpart F and insurance income by reason of the high tax exception; (iv) any dividend from a related person (i.e., more than 50% vote or value, directly or by attribution); and (v) any foreign oil and gas extraction income.

- **Net deemed tangible income return**: Generally, the excess of:
  - 10% of the aggregate "qualified business asset investment" (QBAI), over
  - Interest expense taken into account in determining a U.S. shareholder's net CFC tested income to the extent interest income attributable to that expense is not taken into account in determining such shareholder's net CFC tested income.

- **QBAI**: The quarterly average of a CFC's aggregate adjusted basis in depreciable tangible property used in its trade or business in the production of tested income (using straight line depreciation).
  - If the CFC does not have positive tested income for the year, it has no QBAI.
Principal consolidated return considerations: Determination of the GILTI inclusion amount

• Although the statute does not provide a consolidated approach to the determination of the GILTI inclusion amount, the proposed regulations provide such an approach.

• Under Prop. Treas. Reg. § 1.1502-51(b), each member of a consolidated group that is a U.S. shareholder of any CFC includes in gross income the member's GILTI inclusion amount, if any, for the U.S. shareholder inclusion year.

  − The **GILTI inclusion amount of a member** for a U.S. shareholder inclusion year is the excess (if any) of the member's net CFC tested income for the U.S. shareholder inclusion year, **over the member's net deemed tangible income return** for the U.S. shareholder inclusion year, determined using the definitions provided in Prop. Treas. Reg. § 1.1502-51(e).

  − The determination of a member's GILTI inclusion amount takes into account a ratio equal to its **aggregate tested income** divided by the **consolidated group's aggregate tested income** (the "GILTI allocation ratio").

  − The GILTI allocation ratio is used to allocate **tested losses, QBAI, and interest expense** among the members of the consolidated group.

  − For purposes of calculating a member's GILTI allocation ratio, only a member's pro rata share of tested income is included (i.e., a member's pro rata share of tested loss is ignored).
Principal consolidated return considerations:
Determination of the GILTI inclusion amount (cont.)

- **GILTI inclusion amount of a member – Prop. Treas. Reg. § 1.1502-51(b):** The GILTI inclusion amount of a member for a U.S. shareholder inclusion year is the excess (if any) of the member's net CFC tested income for the U.S. shareholder inclusion year, over the member's net deemed tangible income return for the U.S. shareholder inclusion year, determined using the definitions provided in Prop. Treas. Reg. § 1.1502-51(e).

- **Net CFC tested income of a member – Prop. Treas. Reg. § 1.1502-51(e)(12):** With respect to a member, the term net CFC tested income means the excess (if any) of (i) the member's aggregate tested income, over (ii) the member's allocable share of the consolidated group tested loss.

  - **Aggregate tested income of a member – Prop. Treas. Reg. § 1.1502-51(e)(1):** With respect to a member, the term aggregate tested income means the aggregate of the member's pro rata share (determined under Prop. Treas. Reg. § 1.951A-1(d)(2)) of the tested income of each tested income CFC for a U.S. shareholder inclusion year.

  - **Allocable share of consolidated group tested loss – Prop. Treas. Reg. § 1.1502-51(e)(3)(iii):** The term allocable share means, with respect to a member that is a U.S. shareholder and a U.S. shareholder inclusion year, and with respect to consolidated group tested loss, the product of the consolidated group tested loss of the member's consolidated group and the member's GILTI allocation ratio.

    - **Consolidated group tested loss – Prop. Treas. Reg. § 1.1502-51(e)(7):** With respect to a consolidated group, the term consolidated group tested loss means the sum of each member's aggregate tested loss for a U.S. shareholder inclusion year.

    - **Aggregate tested loss of a member – Prop. Treas. Reg. § 1.1502-51(e)(2):** With respect to a member, the term aggregate tested loss means the aggregate of the member's pro rata share (determined under Prop. Treas. Reg. § 1.951A-1(d)(4)) of the tested loss of each tested loss CFC for a U.S. shareholder inclusion year.

    - **GILTI allocation ratio – Prop. Treas. Reg. § 1.1502-51(e)(10):** With respect to a member, the term GILTI allocation ratio means the ratio of (i) the aggregate tested income of the member for a U.S. shareholder inclusion year, to (ii) the consolidated group tested income of the consolidated group of which the member is a member for the U.S. shareholder inclusion year.

    - **Consolidated group tested income – Prop. Treas. Reg. § 1.1502-51(e)(6):** With respect to a consolidated group, the term consolidated group tested income means the sum of each member's aggregate tested income for a U.S. shareholder inclusion year.
**Example 1** – Calculation of net CFC tested income (Prop. Treas. Reg. § 1.1502-51(f)(1), Ex. 1)

**Aggregation**

<table>
<thead>
<tr>
<th>Group</th>
<th>USS1</th>
<th>USS2</th>
<th>USS3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tested income</td>
<td>0</td>
<td>200</td>
<td>600</td>
</tr>
<tr>
<td>Tested loss</td>
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<td>(200)</td>
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**Allocation**

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<th>25%</th>
<th>75%</th>
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<tr>
<td>Tested loss</td>
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<td>(75)</td>
<td>(225)</td>
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**Net CFC tested income**

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<th>Group</th>
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**Attribute**

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<th>CFC3</th>
<th>CFC4</th>
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<tbody>
<tr>
<td>Tested income</td>
<td>0</td>
<td>200</td>
<td>0</td>
<td>600</td>
</tr>
<tr>
<td>Tested loss</td>
<td>(100)</td>
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<td>(200)</td>
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<tr>
<td>QBAI</td>
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<tr>
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<td>Tested interest income</td>
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Example 2 – Calculation of net CFC tested income
(Prop. Treas. Reg. § 1.1502-51(f)(2), Ex. 2)
Example 3 – Calculation of GILTI inclusion amount (Prop. Treas. Reg. § 1.1502-51(f)(3), Ex. 3)

### Attribute

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<tr>
<th>Attribute</th>
<th>CFC1</th>
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<th>CFC3</th>
<th>CFC4</th>
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<tr>
<td>Tested income</td>
<td>0</td>
<td>200</td>
<td>0</td>
<td>600</td>
</tr>
<tr>
<td>Tested loss</td>
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<td>(200)</td>
<td>0</td>
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<tr>
<td>QBAI</td>
<td>0</td>
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<td>2000</td>
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<tr>
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<tr>
<td>Tested interest income</td>
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### Aggregation

<table>
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<th>USS2</th>
<th>USS3</th>
<th>Group</th>
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<td>Tested income</td>
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<td>600</td>
<td>800</td>
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<tr>
<td>Tested loss</td>
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<td>(200)</td>
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<td>(300)</td>
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<tr>
<td>QBAI</td>
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<td>Tested interest expense</td>
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<td>(25)</td>
<td>(50)</td>
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### Allocation

<table>
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<tr>
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<tbody>
<tr>
<td>GILTI allocation ratio</td>
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<tr>
<td>Tested loss</td>
<td>0</td>
</tr>
<tr>
<td>QBAI</td>
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<tr>
<td>Tested interest expense</td>
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<table>
<thead>
<tr>
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<tr>
<td>Net CFC tested income</td>
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<tr>
<td>- Less NDTIR</td>
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<tr>
<td><strong>GILTI inclusion amount</strong></td>
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### Used tested loss

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<tr>
<td>(100)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(200)</td>
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### Offset tested income

<table>
<thead>
<tr>
<th></th>
<th>CFC2</th>
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<tbody>
<tr>
<td>75</td>
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</tr>
<tr>
<td>225</td>
<td></td>
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</table>
Principal consolidated return considerations: Investment adjustments and stock basis

• **Basis increase for GILTI inclusion.**
  - Under section 951(a), if a U.S. shareholder owns stock of a CFC on the last day of the CFC's taxable year, the shareholder takes its pro rata share of the CFC's Subpart F income into account for the shareholder's taxable year in or with which the CFC's taxable year ends.
    - Under section 961(a), a U.S. shareholder increases its basis in the stock of a CFC by the amount that it includes in income under section 951(a).
    - Although GILTI is included in gross income under section 951A(a), GILTI generally is treated as an amount included under section 951(a) for purposes of section 961. See § 951A(f)(1).
    - Accordingly, a U.S. shareholder also increases its basis in the stock of a CFC by the amount that it includes in income under section 951A(a).
  - A corresponding positive investment adjustment is made under Treas. Reg. § 1.1502-32(b)(3)(i) with respect to the stock of a subsidiary member of a consolidated group that takes into account a **GILTI inclusion amount**.
    - **Note:** As discussed further below, the section 250 deduction effectively operates to convert a portion of the GILTI inclusion amount to tax-exempt income for purposes of the investment adjustment rules of Treas. Reg. § 1.1502-32(b)(3). See Treas. Reg. § 1.1502-32(b)(3)(ii)(B) (treating as tax-exempt income S's taxable income or gain permanently offset by a deduction or loss that does not reduce the basis of S's assets); Prop. Treas. Reg. § 1.1502-50(d) (would treat the section 250 deduction allowed to a member under Prop. Treas. Reg. § 1.1502-50(b)(1) as giving rise to tax-exempt income that is taken into account in the basis of the member's stock pursuant to Treas. Reg. § 1.1502-32(b)(3)(ii)(B)).
Principal consolidated return considerations: Investment adjustments and stock basis (cont.)

• Basis increase for offset tested income.
  
  − Under Prop. Treas. Reg. § 1.1502-32(b)(3)(ii)(E), a subsidiary member of a consolidated group (S) is treated as recognizing tax-exempt income for a taxable year equal to its cumulative amount of "offset tested income" with respect to a CFC.
    
    ◦ As a result, the basis in S's stock is increased.
    
    ◦ However, the amount of this increase is not to exceed the aggregate of S's "used tested losses" with respect to such CFC, less the aggregate of S's offset tested income amounts with respect to such CFC previously treated as tax-exempt income.
    
    ◦ Offset tested income generally refers to tested income that is offset by a tested loss i.e., a used tested loss, of a consolidated group member, including the same member with the tested income if from a different CFC.
    
    ◦ The suspended basis adjustment for offset tested income of a member can effect later dispositions of the member.
  
  − Under Prop. Treas. Reg. § 1.1502-32(b)(3)(ii)(F), S is treated as recognizing tax-exempt income immediately prior to a transaction in which another member of the consolidated group recognizes income, gain, loss, or deduction with respect to a share of S's stock.
    
    ◦ The amount of tax-exempt income recognized by S is equal to the portion of the "allocable amount," i.e., the net offset tested income amount allocable to the CFC shares owned or considered as owned by S that are indirectly transferred as part of the recognition event (the "transferred shares"), that would have been characterized as a dividend to which section 245A, but not section 1059, would have applied if such amount had been distributed by the CFC to the owner of the transferred shares immediately before the recognition event.
    
    ◦ The premise of this basis increase is to afford similar treatment between a sale of a CFC's stock held by a member and the sale of the member holding such CFC stock.
Principal consolidated return considerations: Investment adjustments and stock basis (cont.)

• **Basis decrease for used tested loss.**

  - Under Prop. Treas. Reg. § 1.1502-32(b)(3)(iii)(C), S is treated as recognizing a noncapital, nondeductible expense equal to its used tested loss amount with respect to a CFC in a U.S. shareholder inclusion year (within the meaning of Prop. Treas. Reg. § 1.951A-1(e)(4)).

    ◦ As a result, the basis in S's stock is **decreased**.

    ◦ However, no current adjustment would be made to the basis of the CFC stock to which the used tested loss relates; that adjustment would be **deferred** and taken into account in accordance with Prop. Treas. Reg. § 1.951A-6(e).

  - The decrease in the basis of the stock of a consolidated group member that would be required under the proposed regulations for a used tested loss creates a disparity between basis in the stock of that member and the basis in that member's assets, *i.e.*, here, the stock of the CFC to which the used tested loss relates.

• **Intercompany nonrecognition transactions involving CFC stock.**

  - Under Prop. Treas. Reg. § 1.1502-51(c)(5), if a member of a consolidated group engages in a nonrecognition transaction with another member of the consolidated group in which the stock of a CFC with a net used tested loss amount is transferred, the adjusted basis of the nonrecognition property received in such transaction is **reduced** by the amount of the net used tested loss amount.
Example 4 – Determination of stock basis consequences

Facts

• USP, USS1, and USS2 are members of a consolidated group.
• USP, USS1, USS2, CFC1, and CFC2 are calendar year taxpayers.
• Neither CFC1 nor CFC2 has QBAI, tested interest expense, or tested interest income.
• Year 1 is the initial year of GILTI application, and the Year 1 results are shown to the left.

Analysis – GILTI inclusion in Year 1

• GILTI allocation ratio
  – USS1: (200/200) = 100%
  – USS2: (0/200) = 0
• Allocable share of consolidated group tested loss
  – USS1: 100% x $150 = $150
• USS1's GILTI inclusion amount = $200 – $150 = $50
• Used tested loss: USS2 has a used tested loss with respect to CFC2 of $150.
• Offset tested income: USS1 has offset tested income with respect to CFC1 of $150.
Example 4 – Determination of stock basis consequences (cont.)

Analysis – Stock basis consequences

• USS1's basis in CFC1's stock is adjusted under section 961(a) by the $50 of GILTI inclusion amount with respect to CFC1.

  – USS1's basis in CFC1 is not adjusted by the $150 of offset tested income.

• Under Treas. Reg. § 1.1502-32(b)(2)(i), USP's basis in USS1 is increased by $50 (i.e., USS1's GILTI inclusion amount).

  – USS1's offset tested income of $150 with respect to CFC1 does not increase USP's basis in USS1 immediately.

  – Rather, the adjustment for the offset tested income is taken into account under the provisions of Prop. Treas. Reg. § 1.1502-32(b)(3)(ii)(E) and (F).

• USS2's basis in CFC2's stock is not reduced for the $150 used tested loss until there is a disposition of CFC2's stock, as determined under Prop. Treas. Reg. § 1.951A-6(e).

• Under Prop. Treas. Reg. § 1.1502-32(b)(3)(iii)(C), USP reduces its basis in USS2 by $150, i.e., the amount of USS2's used tested loss with respect to CFC2.
Example 5 – Sales in Year 2

Facts

- Same facts as Example 4, except that USP sells all of the stock of USS1 to an unrelated third-party on January 1, Year 2, for $700, and USS2 sells all of the stock of CFC2 to an unrelated third party on January 1, Year 2, for $250.

- Neither CFC1 nor CFC2 have tested income or tested loss for Year 2.

<table>
<thead>
<tr>
<th></th>
<th>USS1 Basis</th>
<th>CFC1 Basis</th>
<th>USS2 Basis</th>
<th>CFC2 Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Year 1</td>
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<td>$400</td>
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<tr>
<td>GILTI Inclusion</td>
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<td>$50</td>
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<tr>
<td>Used Tested Loss Reduction</td>
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<td>$(150)</td>
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<tr>
<td>Beginning Year 2</td>
<td>$550</td>
<td>$550</td>
<td>$250</td>
<td>$400</td>
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### Example 5 – Sales in Year 2 (cont.)

#### Analysis – Stock basis consequences

**Sale of USS1**

- Assuming that section 245A, but not section 1059, would have applied to a distribution of the allocable amount, i.e., the net offset tested income amount allocable to the CFC1 shares owned by USS1 that are indirectly transferred as part of the recognition event, by CFC1 to USS1 immediately before the recognition event, USP's basis in the stock of USS1 increases by $150, i.e., by the amount of the offset tested income from Year 1, immediately before the recognition event under Prop. Treas. Reg. § 1.1502-32(b)(3)(ii)(F).

- As a result, USP recognizes no gain or loss on the disposition of the stock of USS1.

**Sale of CFC2**

- Under Prop. Treas. Reg. § 1.951A-6(e) and Prop. Treas. Reg. § 1.1502-51(c), the basis of CFC2's stock is reduced by the used tested loss amount, i.e., $150, immediately prior to the disposition.

- As a result, USS2 recognizes no gain or loss on the disposition of the stock of CFC2.

<table>
<thead>
<tr>
<th></th>
<th>USS1 Basis</th>
<th>CFC1 Basis</th>
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<tbody>
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<td>Beginning Year 2</td>
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<tr>
<td>Offset Tested Income</td>
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<td>--</td>
</tr>
<tr>
<td>Used Test Loss Reduction</td>
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<tr>
<td>Basis Prior to Sale</td>
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<td>$250</td>
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### Analysis – A few additional considerations

- **Is there a basis adjustment for offset tested income at an upper-tier member of the consolidated group, e.g., if USS owned USS1, and USS's stock was sold?**

- **Treatment of basis adjustments in the stock of a subsidiary under Treas. Reg. § 1.1502-36 upon the transfer of such subsidiary's stock at a loss, e.g., if USS1 is sold at a loss.**

<table>
<thead>
<tr>
<th></th>
<th>USS1 Basis</th>
<th>CFC1 Basis</th>
<th>USS2 Basis</th>
<th>CFC2 Basis</th>
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<td><strong>Beginning Year 2</strong></td>
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<td>$400</td>
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<td><strong>Offset Tested Income</strong></td>
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<td><strong>Used Test Loss Reduction</strong></td>
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<td><strong>Basis Prior to Sale</strong></td>
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<td>$550</td>
<td>$250</td>
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</tbody>
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FDII – Section 250
FDII – The big picture

• In developing the TCJA, Congress recognized that the former U.S. system of worldwide taxation (with deferral), and its 35% corporate tax rate, encouraged U.S. corporations to locate intangible income abroad, particularly in low-tax or zero-tax jurisdictions.

  − The location of intangible income in those jurisdictions could have required, or otherwise been facilitated by, the location of valuable economic activity in those jurisdictions.

• One of Congress' goals in tax reform was to remove the tax incentive to locate intangible income abroad and encourage U.S. taxpayers to locate intangible income, and potentially valuable economic activity, in the United States.

  − In particular, Congress believed that offering similar, preferential rates for intangible income derived from serving foreign markets, whether through U.S.-based operations or through CFCs, may reduce or eliminate the tax incentive to locate or move intangible income abroad, thereby limiting one margin where the Code arguably distorted business investment decisions.

• In addition, Congress recognized that many countries in the OECD have preferential tax regimes for income related to certain forms of intellectual property, and that these regimes, sometimes referred to as patent box, put the United States at a competitive tax disadvantage.

  − Therefore, Congress believed that establishing a deduction for foreign-derived intangible income earned by domestic corporations would help the United States better compete with other countries that offer preferential rates for intellectual property.
New section 250

• Section 250(a)(1) allows as a deduction for a domestic corporation the sum of:
  – 37.5% of the domestic corporation's foreign-derived intangible income (FDII) (21.875% beginning in 2026), plus
  – 50% of the sum of the domestic corporation's GILTI inclusion amount and the section 78 amount with respect to such inclusion (37.5% beginning in 2026).

• FDII is defined under section 250(b)(1) and generally is equal to a domestic corporation's "deemed intangible income" (DII) multiplied by the percentage of its "deduction eligible income" (DEI) that is foreign derived (FDDEI).

• Section 250(a)(2) directs that, if the sum of a domestic corporation's FDII and GILTI amounts exceeds its taxable income determined without regard to section 250, the amount of FDII and GILTI for which a deduction is allowed is reduced by an amount determined by such excess.
  – The reduction in FDII for which a deduction is allowed equals such excess multiplied by a percentage equal to the corporation's FDII divided by the sum of its FDII and GILTI.
  – The reduction in GILTI for which a deduction is allowed equals the remainder of such excess.

• Effective for taxable years beginning after December 31, 2017.

• No guidance is provided in the statute concerning the application of section 250 in the context of a consolidated group.
Proposed regulations

• On March 4, 2019, Treasury and the IRS released proposed regulations under new section 250 and related provisions.

  − The proposed regulations under section 250 (i.e., Prop. Treas. Reg. §§ 1.250–1 through 1.250(b)–6) are proposed to apply to taxable years ending on or after March 4, 2019.

  − Prop. Treas. Reg. § 1.1502–50, which would address the application of section 250 to a member of a consolidated group, is proposed to apply to consolidated return years ending on or after the date of publication in the Federal Register of the Treasury decision adopting these rules as final regulations.

    o **Note:** As described in the preamble to the proposed regulations, taxpayers may rely on Prop. Treas. Reg. § 1.1502–50 for taxable years ending before the date of publication in the Federal Register of the Treasury decision adopting these rules as final regulations.

Structure of the proposed regulations

- Prop. Treas. Reg. § 1.250(a)-1: Deduction for FDII and GILTI.
- Prop. Treas. Reg. § 1.250(b)-1: Computation of FDII.
- Prop. Treas. Reg. § 1.250(b)-5: FDDEI services.
- Proposed regulations also provided under sections 6038 and 6038A.
Determination of FDII

Foreign-Derived Intangible Income = Deemed Intangible Income × \( \frac{\text{Foreign Derived Deduction Eligible Income}}{\text{Deduction Eligible Income}} \)

- **Deemed Intangible Income** = Deduction Eligible Income – Deemed Tangible Income Return
- **Deemed Tangible Income Return** = 10% x Qualified Business Asset Investment
- **Deduction Eligible Income** = Gross Income – Exclusions – Deductions (including taxes)
  - **Exclusions**: Subpart F income, GILTI, financial services income, dividends from a CFC of the domestic corporation, domestic oil and gas extraction income, and foreign branch income.
- **Foreign-derived** generally means either:
  - Property sold to a foreign person for foreign use, or
  - Services provided to any person, or with respect to property, not located in the U.S.
Ordering rules for purposes of applying §§ 163(j), 172, and 250

• Under the proposed regulations, a domestic corporation's allowable business interest expense under section 163(j), net operating loss deduction under section 172(a), and section 250 deduction would be determined in the following manner:

  – **Step 1:** A domestic corporation would compute the tentative amount of its FDII and the tentative amount of its section 250 deduction ("**tentative section 250 deduction**") taking into account all deductions, **but without regard to** any carryforwards or disallowances under section 163(j), the amount of any net operating loss deduction under section 172(a), **or** the taxable income limitation of section 250(a)(2) and Prop. Treas. Reg. § 1.250(a)-1(b)(2).

  – **Step 2:** The corporation would compute the amount of its business interest expense allowed after the application of section 163(j), for this purpose taking into account the amount of its tentative section 250 deduction **but without regard to** the amount of any net operating loss deduction under section 172(a). See § 163(j)(8)(A)(iii); Prop. Treas. Reg. § 1.163(j)-1(b)(1)(i)(B) and (b)(37)(ii).

  – **Step 3:** The corporation would compute the amount of its net operating loss deduction under section 172(a), for this purpose taking into account the amount of its business interest expense allowed after application of section 163(j) and the taxable income limitation of section 172(a)(2), **but without regard to** the amount of its section 250 deduction (including its tentative section 250 deduction). See § 172(d)(9).

  – **Step 4:** The corporation would compute the amount of its FDII, for this purpose taking into account the amount of its business interest expense allowed after application of section 163(j) and the amount of its net operating loss deduction under section 172(a) (determined in steps two and three, respectively).

  – **Step 5:** The corporation would compute the amount of its section 250 deduction after the application of the taxable income limitation of section 250(a)(2) and Prop. Treas. Reg. § 1.250(a)-1(b)(2), for this purpose taking into account the amount of its business interest expense allowed after application of section 163(j) and the amount of its net operating loss deduction under section 172(a).

• **See, e.g.,** Prop. Treas. Reg. § 1.250(a)-1(f)(2), Ex. 2.
Principal consolidated return considerations:
Determination of the section 250 deduction

• Although the statute does not provide a consolidated approach to the determination of the deduction allowed under section 250, the proposed regulations set forth such an approach.

• Prop. Treas. Reg. § 1.1502-50 would provide that a member's section 250 deduction is determined by reference to the relevant items of all members of the same consolidated group. Cf. Prop. Treas. Reg. § 1.250(a)-1(e) (cross-referencing Prop. Treas. Reg. § 1.1502-50(b) for purposes of a consolidated group member's determination of the section 250 deduction); Prop. Treas. Reg. § 1.250(b)-1(f) (also cross-referencing Prop. Treas. Reg. § 1.1502-50 for purposes of a consolidated group member's determination of FDII).

  - Definitions in Prop. Treas. Reg. § 1.1502-50(e) would result in the aggregation of the **DEI**, **FDDEI**, **deemed tangible income return (DTIR)**, **and GILTI** of all members.

  - These aggregate numbers and the consolidated group's consolidated taxable income then would be used to calculate an overall deduction amount for the consolidated group.

  - Prop. Treas. Reg. § 1.1502-50(b) then would allocate this overall deduction amount among the members on the basis of their respective contributions to the consolidated group's aggregate amount of FDDEI and the consolidated group's aggregate amount of GILTI.

• For purposes of the investment adjustment rules of Treas. Reg. § 1.1502-32, Prop. Treas. Reg. § 1.1502-50(d) would treat the section 250 deduction allowed to a member under Prop. Treas. Reg. § 1.1502-50(b)(1) as giving rise to tax-exempt income that is taken into account in the basis of the member's stock pursuant to Treas. Reg. § 1.1502-32(b)(3)(ii)(B).
Example 6 – Calculation of deduction attributable to FDII (Prop. Treas. Reg. § 1.1502-50(f)(1), Ex. 1)

**Facts**

- **P** is the common parent of a consolidated group and owns all of the only class of stock of two domestic subsidiaries – **USS1** and **USS2**.
- In 2018:
  - **P** has DEI of $400x, FDDEI of $0, and QBAI of $0;
  - **USS1** has DEI of $200x, FDDEI of $200x, and QBAI of $600x; and
  - **USS2** has DEI of ($100x), FDDEI of $100x, and QBAI of $400x.
- The **P** group has consolidated taxable income that is sufficient to make inapplicable the limitation in Prop. Treas. Reg. § 1.1502-50(b)(2).
- No member of the **P** group has GILTI.
- The taxable year of the **P** group is the calendar year.
Example 6 – Calculation of deduction attributable to FDII (cont.) (Prop. Treas. Reg. § 1.1502-50(f)(1), Ex. 1)

### Analysis

- **Consolidated DEI.** Under Prop. Treas. Reg. § 1.1502-50(e)(1), the P group's **consolidated DEI** is $500x, the greater of the sum of the DEI (whether positive or negative) of all members ($400x + $200x + ($100x)) or zero.

- **Consolidated FDDEI.** Under Prop. Treas. Reg. § 1.1502-50(e)(5), the P group's **consolidated FDDEI** is $300x, the greater of the sum of the FDDEI (whether positive or negative) of all members ($0 + $200x + $100x) or zero.

- **Consolidated DTIR.** Under Prop. Treas. Reg. § 1.1502-50(e)(12), a member's **DTIR** is 10% of its QBAI.
  - Therefore, P's DTIR is $0 (0.10 x $0), USS1's DTIR is $60x (0.10 x $600x), and USS2's DTIR is $40x (0.10 x $400x).
  - Under Prop. Treas. Reg. § 1.1502-50(e)(3), the P group's **consolidated DTIR** is $100x, the sum of the DTIR of all members ($0 + $60x + $40x).

- **Consolidated DII.** Under Prop. Treas. Reg. § 1.1502-50(e)(2), the P group's **consolidated DII** is $400x, the excess of its consolidated DEI over its consolidated DTIR ($500x – $100x).
Example 6 – Calculation of deduction attributable to FDII (cont.)
(Prop. Treas. Reg. § 1.1502-50(f)(1), Ex. 1)

Analysis (cont.)

- Consolidated FDII. Under Prop. Treas. Reg. § 1.1502-50(e)(7), the P group's consolidated foreign-derived ratio is 0.60, the ratio of its consolidated FDDEI to its consolidated DEI ($300x / $500x).

  - Under Prop. Treas. Reg. § 1.1502-50(e)(6), the P group's consolidated FDII is $240x, the product of its consolidated DII and its consolidated foreign-derived ratio ($400x x 0.60).

- Consolidated FDII deduction amount. Under Prop. Treas. Reg. § 1.1502-50(e)(4), the P group's consolidated FDII deduction amount is $90x, the product of the FDII deduction rate and the consolidated FDII (0.375 x $240x).

- Member's deduction attributable to consolidated FDII deduction amount. Under Prop. Treas. Reg. § 1.1502-50(b)(1), a member is allowed a deduction equal, in part, to the product of the consolidated FDII deduction amount of the consolidated group to which the member belongs and the member's FDII deduction allocation ratio.

  - Under Prop. Treas. Reg. § 1.1502-50(e)(13), a member's FDII deduction allocation ratio is the ratio of its positive FDDEI to the sum of each member's positive FDDEI for such consolidated return year.

  - As a result, the FDII deduction allocation ratios of P, USS1, and USS2 are 0 ($0 / $300x), 2/3 ($200x / $300x), and 1/3 ($100x / $300x), respectively.

  - Therefore, P, USS1, and USS2 are permitted deductions under Prop. Treas. Reg. § 1.1502-50(b)(1) in the amount of $0 (0 x $90x), $60x (2/3 x $90x), and $30x (1/3 x $90x), respectively.
**Example 7 – Limitation on consolidated FDDEI**
(Prop. Treas. Reg. § 1.1502-50(f)(2), Ex. 2)

**Facts**
- Same as Example 6, except that P's FDDEI is $300x.

**Analysis**
- **Consolidated DEI and consolidated DTIR.** As in Example 6, the P group's consolidated DEI is $500x, and the P group's consolidated DTIR is $100x.
- **Consolidated FDDEI.** Under Prop. Treas. Reg. § 1.1502-50(e)(5), the P group's consolidated FDDEI is $600x, the greater of the sum of the FDDEI (whether positive or negative) of all members ($300x + $200x + $100x) or zero.
- **Consolidated DII and consolidated FDII.** Under Prop. Treas. Reg. § 1.1502-50(e)(2), the P group's consolidated DII is $400x ($500x – $100x).
  - Under Prop. Treas. Reg. § 1.1502-50(e)(7), the P group's consolidated foreign-derived ratio is **1.00** ($600x / $500x, **but not in excess of one**).
  - Under Prop. Treas. Reg. § 1.1502-50(e)(6), the P group's consolidated FDII is $400x ($400x x 1.00).
Example 7 – Limitation on consolidated FDDEI (cont.)
(Prop. Treas. Reg. § 1.1502-50(f)(2), Ex. 2)

Analysis (cont.)

- Consolidated FDII deduction amount and member's deduction attributable to consolidated FDII deduction amount.
  - Under Prop. Treas. Reg. § 1.1502-50(e)(4), the P group's consolidated FDII deduction amount is $150x (0.375 x $400x).
  - Under Prop. Treas. Reg. § 1.1502-50(e)(13), the FDII deduction allocation ratios of P, USS1, and USS2 are 1/2 ($300 / $600x), 1/3 ($200x / $600x), and 1/6 ($100x / $600x), respectively.
  - Therefore, P, USS1, and USS2 are permitted deductions under Prop. Treas. Reg. § 1.1502-50(b)(1) in the amounts of $75x (1/2 x $150x), $50x (1/3 x $150x), and $25x (1/6 x $150x), respectively.
Example 8 – Member with negative FDDEI (Prop. Treas. Reg. § 1.1502-50(f)(3), Ex. 3)

**Facts**

- Same as Example 6, except that P's FDDEI is ($100x).

**Analysis**

- **Consolidated DEI and consolidated DTIR.** As in Example 6, the P group's consolidated DEI is $500x and the P group's consolidated DTIR is $100x.

- **Consolidated FDDEI.** Under Prop. Treas. Reg. § 1.1502-50(e)(5), the P group's consolidated FDDEI is $200x, the greater of the sum of the FDDEI (whether positive or negative) of all members (($100x) + $200x + $100x) or zero.

- **Consolidated DII and consolidated FDII.** Under Prop. Treas. Reg. § 1.1502-50(e)(2) and (6), the P group's consolidated DII is $400x ($500x – $100x), and the P group's consolidated FDII is $160x ($400x x ($200x / $500x)).
Example 8 – Member with negative FDDEI (cont.)
(Prop. Treas. Reg. § 1.1502-50(f)(3), Ex. 3)

Analysis (cont.)

- Consolidated FDII deduction amount and member's deduction attributable to consolidated FDII deduction amount.
  - Under Prop. Treas. Reg. § 1.1502-50(e)(4), the P group's consolidated FDII deduction amount is $60x (0.375 x $160x).
  - Under Prop. Treas. Reg. § 1.1502-50(e)(13), the FDII deduction allocation ratios of P, USS1, and USS2 are 0 ($0 / $300x), 2/3 ($200x / $300x), and 1/3 ($100x / $300x), respectively.
  - Therefore, P, USS1, and USS2 are permitted deductions under Prop. Treas. Reg. § 1.1502-50(b)(1) in the amounts of $0 (0 x $60x), $40x (2/3 x $60x), and $20x (1/3 x $60x), respectively.
**Example 9 – Calculation of deduction attributable to GILTI**  
(Prop. Treas. Reg. § 1.1502-50(f)(4), Ex. 4)

**Facts**

- Same as Example 6, except that USS1 owns CFC1 and USS2 owns CFC2.
- USS1 and USS2 have GILTI of $65x and $20x, respectively, and amounts treated as dividends received under section 78 attributable to their GILTI of $10x and $5x, respectively.

**Analysis**

- **Consolidated GILTI.** Under Prop. Treas. Reg. § 1.1502-50(e)(9), the P group's **consolidated GILTI** is $85x, the sum of the GILTI of all members ($0 + $65x + $20x).

- **Consolidated GILTI deduction amount.** Under Prop. Treas. Reg. § 1.1502-50(e)(8), the P group's **consolidated GILTI deduction amount** is $50x, the product of the **GILTI deduction rate** and the sum of its consolidated GILTI and the amounts treated as dividends received by the members under section 78 that are attributable to their GILTI for the consolidated return year (0.50 x ($85x + $10x + $5x)).
Example 9 – Calculation of deduction attributable to GILTI (cont.)
(Prop. Treas. Reg. § 1.1502-50(f)(4), Ex. 4)

Analysis (cont.)

- Member's deduction attributable to consolidated GILTI deduction amount.

- Under Prop. Treas. Reg. § 1.1502-50(b)(1), a member is allowed a deduction equal, in part, to the product of the consolidated GILTI deduction amount of the consolidated group to which the member belongs and the member's GILTI deduction allocation ratio.

- Under Prop. Treas. Reg. § 1.1502-50(e)(16), a member's GILTI deduction allocation ratio is the ratio of the sum of its GILTI and the amount treated as a dividend received by the member under section 78 that is attributable to its GILTI for the consolidated return year to the sum of the consolidated GILTI and the amounts treated as dividends received by the members under section 78 that are attributable to their GILTI for the consolidated return year.

- As a result, the GILTI deduction allocation ratios of P, USS1, and USS2 are 0 ($0 / ($85x + $10x + $5x)), 3/4 (($65x + $10x) / ($85x + $10x + $5x)), and 1/4 (($20x + $5x) / ($85x + $10x + $5x)), respectively.

- Therefore, P, USS1, and USS2 are permitted deductions of $0 (0 x $50x), $37.50x (3/4 x $50x), and $12.50x (1/4 x $50x), respectively.
**Example 9** – Calculation of deduction attributable to GILTI (cont.)
(Prop. Treas. Reg. § 1.1502-50(f)(4), Ex. 4)

**Analysis (cont.)**

- **Member's deduction under section 250.**

  - Under Prop. Treas. Reg. § 1.1502-50(b)(1), a member is allowed a deduction equal to the sum of the member's deduction attributable to the consolidated FDII deduction amount and the member's deduction attributable to the consolidated GILTI deduction amount.

  - Recall that, as described in Example 6, P, USS1, and USS2 are permitted deductions attributable to FDII under Prop. Treas. Reg. § 1.1502-50(b)(1) in the amount of $0 (0 x $90x), $60x (2/3 x $90x), and $30x (1/3 x $90x), respectively.

  - As a result, in this Example 9, P, USS1, and USS2 are entitled to deductions under Prop. Treas. Reg. § 1.1502-50(b)(1) equal to $0 ($0 + $0), $97.50x ($60x + $37.50x), and $42.50x ($30x + $12.50x), respectively.
### Example 10 – Taxable income limitation
(Prop. Treas. Reg. § 1.1502-50(f)(5), Ex. 5)

#### Facts
- Same as Example 9, except that the P group's consolidated taxable income – determined with regard to all items of income, gain, deduction, or loss, except for the deduction allowed under section 250 – is \( \$300x \).

#### Analysis
- **Determination of whether the limitation described in Prop. Treas. Reg. § 1.1502-50(b)(2) applies.** Under Prop. Treas. Reg. § 1.1502-50(b)(2), in the case of a consolidated group with a **consolidated section 250(a)(2) amount** for a consolidated year, the amount of the consolidated FDII and the consolidated GILTI otherwise taken into account in the determination of the consolidated FDII deduction amount and the consolidated GILTI deduction amount are subject to reduction.
  - As in Example 6, the P group's consolidated FDII is \( \$240x \).
  - As in Example 9, the P group's consolidated GILTI is \( \$85x \).
  - The P group's consolidated taxable income is \( \$300x \).
- **Consolidated section 250(a)(2) amount.** Under Prop. Treas. Reg. § 1.1502-50(e)(10), the P group's **consolidated section 250(a)(2) amount** is \( \$25x \) \( \left( \$240x + \$85x \right) - \$300x \), the excess of the sum of the consolidated FDII and the consolidated GILTI, over the P group's consolidated taxable income.
  - Therefore, the limitation described in Prop. Treas. Reg. § 1.1502-50(b)(2) applies.
Principal consolidated return considerations:
Application of the attribute redetermination rule

• The proposed regulations would add new Example 20 to Treas. Reg. § 1.1502-13(c)(7)(ii) in order to demonstrate the applicability of the attribute redetermination rule of Treas. Reg. § 1.1502-13(c)(1)(i) to the determination of FDDEI.

• In this example, the attribute redetermination rule would be applied to gross DEI and gross FDDEI, which would be treated as attributes of an intercompany item or corresponding item.

  – **Note:** As discussed in the preamble to the proposed regulations, Treasury and the IRS were concerned that applying Treas. Reg. § 1.1502-13(c) to the net amounts of DEI and FDDEI could result in circular computations due to the allocation and apportionment of certain expenses on a gross income basis.

• In addition, the example illustrates the applicability of the attribute redetermination rule in the context of an intercompany loss.
**Example 11 – Redetermination of attributes**  
(Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(T), Ex. 20(2))

**Facts**

- P is the common parent of a consolidated group.
- P owns all of the only class of stock of two domestic subsidiaries – S and B.
- X is a person unrelated to any member of the P group.
- S manufactures Asset in the U.S. at a cost of $25 and recognizes $75 of gross income that is included in gross DEI (as defined in Prop. Treas. Reg. § 1.250(b)-1(c)(14)) on the sale of Asset, which is not depreciable property, to B in Year 1 for $100.
- In Year 2, B sells Asset to X for $125 and recognizes $25 of gross income.
  - This sale is a FDDEI sale (as defined in Prop. Treas. Reg. § 1.250(b)-1(c)(8)).
  - Thus, the $25 of gross income is included in B's gross FDDEI (as defined in Prop. Treas. Reg. § 1.250(b)-1(c)(15)) for Year 2.
- The taxable year of all persons is the calendar year, all persons use the accrual method of accounting, no member has any special status, and the transactions are not otherwise subject to recharacterization.
Example 11 – Redetermination of attributes (cont.) (Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(T), Ex. 20(2))

Analysis

- S's $75 of intercompany income is taken into account in Year 2 under the matching rule to reflect the $75 difference between B's $25 corresponding item taken into account (based on B's $100 cost basis in Asset) and the recomputed corresponding item (based on the $25 basis that B would have if S and B were divisions of a single corporation and B's basis were determined by reference to S's $25 of costs to manufacture Asset).

- In determining the amount of income included in gross DEI that is included in gross FDDEI, the attributes of S's intercompany item and B's corresponding item may be redetermined to the extent necessary to produce the same effect on consolidated taxable income (and consolidated tax liability) as if S and B were divisions of a single corporation. See Treas. Reg. §§ 1.1502-13(a)(6), 1.1502-13(c)(1)(i).

- On a separate entity basis, S would have $75 of gross income included in gross DEI that is included in gross non-FDDEI (as defined in Prop. Treas. Reg. § 1.250(b)-1(c)(16)), and B would have $25 of gross income included in gross DEI that is included in gross FDDEI.

- Thus, on a separate entity basis, S and B would have, in the aggregate, $100 of gross income included in gross DEI, of which only $25 would be included in gross FDDEI.

- However, when section 250 and Prop. Treas. Reg. § 1.1502-50 are applied on a single entity basis, all $100 of income included in gross DEI would be gross FDDEI.

- Accordingly, under single entity treatment, S's $75 of gross income included in gross DEI is redetermined to be included in gross FDDEI.
**Example 12** – Intercompany sale at a loss (Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(T), Ex. 20(3))

### Facts

- Same as Example 11, except that S recognizes a $25 loss on the sale of Asset to B.

### Analysis

- S's $25 of intercompany loss is taken into account under the matching rule to reflect the $25 difference between B's $25 corresponding item taken into account (based on B's $100 basis in Asset) and the recomputed corresponding item (based on the $125 basis that B would have if S and B were divisions of a single corporation and B's basis were determined by reference to S's $125 of costs to manufacture Asset).

- Applying section 250 and Prop. Treas. Reg. § 1.1502-50 on a single entity basis, **$0 of income would be included in gross DEI**.
  - In order to reflect this result, under the matching rule, S's $25 loss is allocated and apportioned **solely to B's $25 of gross income from the sale of Asset** for purposes of determining B's DEI and FDDEI.
  - Furthermore, B's $25 of gross income is **not** taken into account for purposes of apportioning any other deductions under section 861 and the Treasury regulations under that section for purposes of determining any member's DEI or FDDEI.
Example 13 – Sale by S to a foreign branch / foreign DRE of B

**Facts**

- Same as Example 11, except that, in Year 1, S sells Asset to a foreign branch / foreign disregarded entity of B ("FDE"), and, then, in Year 2, FDE sells Asset to X.

- The Year 2 sale by FDE to X gives rise to a gross amount of foreign branch income (as defined in Prop. Treas. Reg. § 1.250(b)-1(c)(11)), i.e., $25, that is excluded from DEI pursuant to section 250(b)(3)(A)(i)(VI).

**Considerations**

- Does the analysis set forth in Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(T), Ex. 20(2), as shown above in Example 11, continue to apply under these facts and cause S's $75 of gross income to be redetermined to be gross FDDEI?

- When S and B are treated as divisions of a single corporation for purposes of redetermining the attributes of S's intercompany item and B's corresponding item, do the rules of Prop. Treas. Reg. § 1.904-4(f)(2), concerning the determination of gross income attributable to a foreign branch, and, more specifically, Prop. Treas. Reg. § 1.904-4(f)(2)(vi), concerning the attribution of gross income to which "disregarded payments" are allocable, find application in this instance?
Principal consolidated return considerations:
Determination of a member's QBAI

• Prop. Treas. Reg. § 1.1502-50(c)(1) would provide that, for purposes of determining a member's QBAI, the basis of specified tangible property is not affected by an intercompany transaction (as defined in Treas. Reg. § 1.1502-13(b)(1)).

  − Each member's QBAI is taken into account in the determination of the member's DTIR, which is equal to 10% of the member's QBAI.

  − Accordingly, under the proposed regulations, an intercompany transaction would **not** result in the increase or decrease of a consolidated group's aggregate amount of DTIR or, correspondingly, the aggregate amount of the consolidated group's section 250 deduction.

• Prop. Treas. Reg. § 1.1502-50(c)(1) would offer the following example:

  [F]or example, if a selling member owns specified tangible property with an adjusted basis (within the meaning of section 1011) of $60x and an adjusted basis (for purposes of calculating qualified business asset investment) of $80x, and sells it for $50x to the purchasing member, the basis of such property for purposes of computing the purchasing member's qualified business asset investment is $80x.
163J – Business Interest Expense Limitation Under Section 163(j)
163J – The big picture

• The TCJA repealed former section 163(j) and that provision's limitation on the deductibility of a corporation's disqualified interest expense, which generally included interest paid or accrued to a related person that is not subject to U.S. federal income tax (e.g., a foreign person).

• Although Congress repealed former section 163(j), it nevertheless believed that the general deductibility of interest payments on debt may result in businesses undertaking more leverage than they would in the absence of the tax system.

  − Limiting the deductibility of interest – along with reducing the corporate tax rate – was thought to narrow the disparity in the effective marginal tax rates applicable to different sources of financing.

  − Congress also believed it necessary to apply the limitation on the deductibility of interest to businesses regardless of the form in which such businesses are organized so as not to create distortions in the choice of entity.
New section 163(j)

• New section 163(j) limits deductions for "business interest" and generally applies to all taxpayers, including individuals, partnerships, and corporations, with average gross receipts in excess of $25 million over the preceding three taxable years.


• Section 163(j)(1) provides that the amount allowed as a deduction for any taxable year for business interest may not exceed the sum of:

  – The business interest income of such taxpayer for such taxable year;
  – 30% of the adjusted taxable income of such taxpayer for such taxable year; and
  – The floor plan financing interest of such taxpayer for such taxable year.

• Under section 163(j)(2), disallowed business interest deductions are carried forward indefinitely as interest deductions in each subsequent year, subject to the section 163(j) limitation in each such year.
Proposed regulations

• On November 26, 2018, Treasury and the IRS released proposed regulations under new section 163(j) and related provisions.

– Except as otherwise provided in the proposed regulations, these regulations generally have been proposed to be effective for taxable years ending after the date that the Treasury decision adopting the regulations as final is published in the Federal Register.

– A taxpayer would be allowed to apply the rules set forth in the proposed regulations to taxable years beginning after December 31, 2017, provided that the taxpayer and all parties related to the taxpayer within the meaning of sections 267(b) or 707(b)(1) consistently apply all of the rules of the proposed regulations, as applicable, to those taxable years.


• The proposed regulations would provide certain ordering and operating rules to guide the interaction of section 163(j) with other provisions of the Code affecting the deductibility of interest expense.
Structure of the proposed regulations

- Prop. Treas. Reg. § 1.163(j)-3: Relationship of business interest deduction limitation to other provisions affecting interest.
- Prop. Treas. Reg. § 1.163(j)-4: General rules applicable to C corporations, including consolidated groups.
- Prop. Treas. Reg. § 1.163(j)-8: Application of business interest deduction limitation to foreign persons with effectively connected income.
- Prop. Treas. Reg. § 1.163(j)-9: Elections for excepted trades or businesses.
- Prop. Treas. Reg. § 1.163(j)-10: Allocation of interest expense, interest income, and other items of expense and gross income to an excepted trade or business.
Structure of the proposed regulations (cont.)

- Prop. Treas. Reg. § 1.381(c)(20)-1: Carryforward of disallowed business interest.
- **Proposed amendments to Treas. Reg. §§ 1.382-2, 1.382-5, 1.382-6, 1.383-1, 1.1502-91, 1.1502-95, 1.1502-98, and 1.1502-99.**
- **Proposed amendments to Treas. Reg. § 1.1502-13.**
- **Proposed amendments to Treas. Reg. §§ 1.1502-21 and 1.1502-79 for SRLY considerations.**
- **Proposed amendment to Treas. Reg. § 1.1502-36.**
- **Proposed amendment to Treas. Reg. § 1.1504-4.**
- Proposed regulations also provided under sections 263A, 446, 469, and 882.
Definitions of "interest," "interest expense," and "business interest expense"

• The proposed regulations would define "interest" expansively, including items not traditionally considered interest, and would set forth four categories of items treated as interest, with specific items identified.

1. **Interest on indebtedness and items treated as interest under the Code or Treasury regulations.** This category would include items such as original issue discount (OID), market discount, repurchase premium, and deferred payments treated as interest under section 483.

2. **Significant, non-periodic payments on swaps.** This category would apply to non-cleared swaps, and would follow prior law regarding the treatment of a significant, non-periodic payment as a loan and an on-market swap.

3. **Other items treated as interest.** This category would cover items not traditionally considered interest, **including certain items deductible under section 162.** This category includes, but is not limited to *(i)* substitute interest payments under securities lending and repo transactions, *(ii)* items from derivatives that alter a taxpayer's cost of borrowing or effective yield, *(iii)* loan commitment fees if any portion of the financing is actually provided, *(iv)* debt issuance costs subject to Treas. Reg. § 1.446-5, *(v)* guaranteed payments for the use of capital under section 707(c), and *(vi)* income on factored receivables.

4. **Anti-avoidance rule.** This category would cover any deductible expense or loss incurred in a transaction or series of related transactions in which the taxpayer secures the use of funds for a period of time if such expense or loss is predominantly incurred in consideration for the time value of money.

• The proposed regulations would define "interest expense" as interest that is paid or accrued, or that is treated as paid or accrued, for the taxable year, and "business interest expense" as interest expense that is properly allocated to a "non-excepted trade or business" or that is floor plan financing interest expense.

• Compare section 163(j)(5), which defines "business interest" as "any interest paid or accrued on indebtedness properly allocable to a trade or business" and does not include "investment interest" under section 163(d).
Character of a C corporation's interest expense and interest income

• Under the proposed regulations, a C corporation would have **business items** for purposes of section 163(j).

  − **Business interest expense (BIE) and business interest income (BII).** A C corporation would only have BIE and BII for purposes of section 163(j).

  − **Adjusted taxable income.** A C corporation's items of income, gain, deduction, or loss would be properly allocable to a trade or business for purposes of section 163(j) and, thus, taken into account in determining adjusted taxable income (unless allocable to an **excepted** trade or business).

  − **Corporate partners.** In general, this treatment extends to items allocated from a partnership to a corporate partner notwithstanding any different characterization given to such items at the partnership level, with special rules applying to certain items of a domestic partnership.

• **Analogizing disallowed BIE to a net operating loss.** The proposed regulations have used much of the architecture of the rules of sections 172, 381, and 382 applicable to net operating losses as a guide for purposes of developing the rules applicable to "current-year" BIE and disallowed BIE that is treated as a carryforward into a taxable year.
Determination of adjusted taxable income

• Under section 163(j)(8), **adjusted taxable income** is defined as the taxable income of the taxpayer computed without regard to (i) items not properly allocable to a trade or business; (ii) business interest or business interest income; (iii) net operating loss deductions under section 172; (iv) deductions under section 199A; (v) depreciation, amortization, or depletion deductions, but only for taxable years beginning **before January 1, 2022**; and (vi) any other adjustments provided by Treasury.

• The proposed regulations generally track the statute with certain clarifications and additional adjustments, including (i) defining "taxable income" by reference to section 63, (ii) instituting an addition for a capital loss carryback or carryover, and (iii) requiring a subtraction in the case of certain dispositions of property, partnership interests, or **stock of a consolidated group member**, generally where deductions for depreciation, amortization, or depletion were added back to taxable income, but operated to reduce the basis of the property, partnership interest, or **stock of the consolidated group member**.

  − The proposed regulations provide that depreciation, amortization, or depletion deductions capitalized to "**inventory**" under section 263A are **not** added back to taxable income.

  − The proposed regulations also provide special rules for partnerships and controlled foreign corporations (and their U.S. shareholders).
Excepted trades or businesses

• Interest expense allocable to one of the trades or businesses described in section 163(j)(7) is not subject to limitation under section 163(j).

− The trades or businesses described in section 163(j)(7) are (i) the trade or business of performing services as an employee, (ii) an electing real property trade or business, (iii) an electing farming business, or (iv) the trade or business of furnishing or sale of (a) electrical energy, water, or sewage disposal services, (b) gas or steam through a local distribution system, or (c) transportation of gas or steam by pipeline, if the rates for such furnishing or sale have been established or approved by a regulatory body.

− With respect to an electing real property trade business or an electing farming business, the election is contemplated to be irrevocable.

• The proposed regulations would provide that interest expense and interest income generally are allocated between excepted trades or businesses and non-excepted trades or businesses based upon the relative amounts of the taxpayer's adjusted basis in the assets used in such trades or businesses.

• The proposed regulations also would provide rules for the allocation of tax items other than interest expense and interest income for purposes of calculating adjusted taxable income, and generally would allocate a taxpayer's (i) gross income (other than dividends and interest income) to the trade or business that generated that gross income and (ii) expenses (other than interest expense) and deductions to the trade or business to which they relate.
General treatment of disallowed BIE

- Section 163(j)(2) provides that any BIE limited under section 163(j) will be carried forward as a **disallowed BIE carryforward** and treated as paid or accrued in the succeeding taxable year.

- Proposed regulations would provide that a C corporation's current-year BIE (i.e., interest expense deductible in current year without regard to the section 163(j) limitation and carryforwards) is deducted **before** any carryforwards from a prior taxable year.

- Carryforwards deducted in **the order in which they arose**, with the earliest taxable year first.
  - Carryforwards are subject to applicable limitations (e.g., section 382, SRLY).
  - Similar rules for consolidated groups.

- Proposed regulations generally would provide that a C corporation's E&P is determined without regard to BIE disallowance under section 163(j).
  - Thus, a C corporation generally would reduce its E&P by disallowed BIE.
Principal consolidated return considerations:

Determination of the section 163(j) limitation and related matters

- **General approach of the proposed regulations.** In keeping with the legislative history to section 163(j) and Notice 2018-28, the proposed regulations would apply the section 163(j) limitation at the consolidated group level, with the consolidated group having a single section 163(j) limitation.

- **Determining a consolidated group's section 163(j) limitation.**
  - To determine a consolidated group's adjusted taxable income, the proposed regulations would begin with consolidated taxable income under Treas. Reg. § 1.1502-11 and make necessary adjustments.
  
  - When determining a consolidated group's adjusted taxable income, the proposed regulations would disregard (i) items arising from intercompany transactions to the extent that such items offset in amount and (ii) intercompany obligations (as described in Treas. Reg. § 1.1502-13(g)).

- **Identifying members with BIE, BII, and floor plan financing interest expense.** Intercompany obligations would be disregarded in determining a member's BIE and BII, which would need to be done with specificity for each taxable year.

- **Allocation to excepted and non-excepted trades or businesses.** Allocation of tax items between excepted and non-excepted trades or businesses would apply on a consolidated basis, i.e., all members of a consolidated group would be treated as a single corporation.
  
  - For example, the group, rather than a particular member, would be treated as engaged in excepted or non-excepted trades or businesses.
Example 14 – Calculation of section 163(j) limitation (Prop. Treas. Reg. § 1.163(j)-4(d)(5), Ex. 1)

**Facts**
- U.S. Parent borrowed money from Bank.
  - For the 2019 taxable year, U.S. Parent has interest expense of $65, depreciation of $35, and separate taxable income (STI) of $50.
  - For the 2019 taxable year, Sub has $10 of depreciation and $40 of STI.

**Analysis**
- Without regard to section 163(j), the U.S. Parent group's consolidated taxable income is $90 for 2019.
- Under the proposed regulations, $200 (i.e., $50 + $40 + $35 + $10 + $65) is used as the group's adjusted taxable income, and the consolidated section 163(j) limitation is $60 (i.e., $200 x 30%).
- Disallowed BIE = $5 (BIE of $65 exceeds the consolidated section 163(j) limitation of $60).
- U.S. Parent carries over the $5 of disallowed BIE to the succeeding taxable year, i.e., the 2020 taxable year.

**Consideration**
- Consider external financing conditions, e.g., co-obligors, guarantors, etc., in determining location of interest expense within the group.

For simplicity, it is assumed that (i) the debtor does not meet the small business exception as applied under section 448(c) and (ii) neither U.S. Parent nor Sub has BII or floor plan financing interest expense.
Example 15 – Intercompany obligations
(Prop. Treas. Reg. § 1.163(j)-4(d)(5), Ex. 2)

Facts

- U.S. Parent borrowed $100 from Bank at a 10% interest rate and then loaned 100% of such borrowing to Sub at a 12% interest rate.
  - For the 2019 taxable year, U.S. Parent has $10 of interest expense, $30 of other deductible expenses, and $12 of interest income.
  - For the 2019 taxable year, Sub has $12 of interest expense, and $40 of income.

Analysis

- Under the proposed regulations, the U.S. Parent group would disregard the intercompany obligation in determining its BIE, BII, and adjusted taxable income.
  - Accordingly, U.S. Parent has $10 of BIE and a $30 deduction related to other business expenses, and Sub has $40 of income.

- Under the proposed regulations, $10 is used as the group's adjusted taxable income for 2019 (i.e., $40 – $30), and the consolidated section 163(j) limitation is $3 (i.e., $10 x 30%).

- Disallowed BIE = $7 (BIE of $10 exceeds the consolidated section 163(j) limitation of $3).

- U.S. Parent carries over the $7 of disallowed BIE to the succeeding taxable year, i.e., the 2020 taxable year.

For simplicity, it is assumed that (i) the debtor does not meet the small business exception as applied under section 448(c) and (ii) neither U.S. Parent nor Sub has BII or floor plan financing interest expense.
Principal consolidated return considerations: Allocation of section 163(j) limitation to consolidated group members

- **General approach.** The proposed regulations would provide a methodology to allocate a consolidated group’s section 163(j) limitation to individual members for purposes of deducting BIE.
  
  - If the consolidated section 163(j) limitation $\geq$ aggregate BIE of the members (including disallowed BIE carryforwards), no limitation applies.
  
  - If the consolidated section 163(j) limitation $<$ aggregate BIE of the members, the limitation generally applies as follows:
    
    ◦ The consolidated section 163(j) limitation is applied first to current-year BIE.
      
      - If the consolidated section 163(j) limitation $\geq$ aggregate current-year BIE of the members, the members deduct current-year BIE without limitation, and the remaining limitation is applied to disallowed BIE carryforwards.
      
      - If the consolidated section 163(j) limitation $<$ aggregate current-year BIE of the members, a member deducts its current-year BIE up to its BII and floor plan financing interest expense, with any remaining current-year BIE absorbed on a pro rata basis with respect to the remaining limitation.
    
    ◦ Disallowed BIE carryforwards of the members are deducted only if section 163(j) limitation remains after deducting aggregate current-year BIE.
      
      - Disallowed BIE carryforwards generally deducted on a pro rata basis with respect to the remaining limitation, with the oldest disallowed BIE carryforwards used first.

- **Basis adjustments.** In general, stock basis adjustments would apply under Treas. Reg. § 1.1502-32 at the time disallowed BIE is absorbed by the group.
Example 16 – Allocation of section 163(j) limitation
(Prop. Treas. Reg. § 1.163(j)-5(b)(3)(iv), Ex.)

Year 1

U.S. Parent group's section 163(j) limitation = $100

Analysis

• The aggregate amount of U.S. Parent group's BIE of $200 ($150 + $50), exceeds its limitation of $100.

• Accordingly, U.S. Parent's allocable share is $75 ($100 x ($150/$200)), and Sub's allocable share is $25 ($100 x ($50/$200)).

• Disallowed interest expense in Year 1 for U.S. Parent = $75 (interest expense of $150 exceeds the limit of $75).

• Disallowed interest expense in Year 1 for Sub = $25 (interest expense of $50 exceeds the limit of $25).

• Each of U.S. Parent and Sub carries over their disallowed BIE to the succeeding taxable year.

For simplicity, it is assumed that (i) the debtor does not meet the small business exception as applied under section 448(c) and (ii) neither U.S. Parent nor Sub has BII or floor plan financing interest expense.
Example 16 – Allocation of section 163(j) limitation (cont.)
(Prop. Treas. Reg. § 1.163(j)-5(b)(3)(iv), Ex.)

**Year 2**

**U.S. Parent group's section 163(j) limitation = $120**

- **$60 interest**
  - **U.S. Parent**
  - **Bank**

- **$90 interest**
  - **Sub**
  - **Bank**

**Analysis**

- The aggregate amount of U.S. Parent group's BIE of $150 ($60 + $90) and its disallowed BIE carryforwards of $100 ($75 + $25), exceeds its limitation of $120.

- Accordingly, U.S. Parent's allocable share is $48 ($120 x ($60/150)), and Sub's allocable share is $72 ($120 x ($90/150)).

- Disallowed interest expense in Year 2 for U.S. Parent = $12 (interest expense of $60 exceeds its limit of $48).

- Disallowed interest expense in Year 2 for Sub = $18 (interest expense of $90 exceeds its limit of $72).

- Each of U.S. Parent and Sub carries over their disallowed BIE to the succeeding taxable year.
  - This amount includes their Year 2 and Year 1 disallowed BIE.

For simplicity, it is assumed that (i) the debtor does not meet the small business exception as applied under section 448(c) and (ii) neither U.S. Parent nor Sub has BII or floor plan financing interest expense.
Example 16 – Allocation of section 163(j) limitation (cont.)
(Prop. Treas. Reg. § 1.163(j)-5(b)(3)(iv), Ex.)

U.S. Parent group's section 163(j) limitation = $185

**Year 3**

<table>
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<table>
<thead>
<tr>
<th>Bank</th>
<th>Sub</th>
</tr>
</thead>
<tbody>
<tr>
<td>$50 interest</td>
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</tbody>
</table>

Analysis

- The aggregate amount of U.S. Parent group's BIE of $75 ($25 + $50) and its disallowed BIE carryforwards of $130, exceeds its limitation of $185.

- Each of U.S. Parent and Sub will deduct its Year 3 BIE in full.

  - Accordingly, the U.S. Parent group will have $110 of section 163(j) limitation remaining.

- Each of U.S. Parent and Sub will deduct its Year 1 disallowed BIE carryforward in full.

  - Accordingly, the U.S. Parent group will have $10 of section 163(j) limitation remaining.

- Each of U.S. Parent and Sub will deduct its Year 2 disallowed BIE carryforward on a pro rata basis.

  - Accordingly, U.S. Parent's allocable share is $4 ($10 x ($12/30)), and Sub's allocable share is $6 ($10 x ($18/$30)).

- For Year 4, each of U.S. Parent and Sub have $8 and $12 of disallowed BIE carryforwards from Year 2, respectively.

For simplicity, it is assumed that (i) the debtor does not meet the small business exception as applied under section 448(c) and (ii) neither U.S. Parent nor Sub has BII or floor plan financing interest expense.
Principal consolidated return considerations:
Application of SRLY principles to disallowed BIE

• Separate return limitation year (SRLY) rules may limit the use of a corporation's attributes that accrue when the corporation is not a member of the group.
  − SRLY limit for purposes of taking into account net operating losses is the corporation's cumulative contribution to consolidated taxable income of the group.
  − SRLY limit also applies to built-in losses recognized within 5 years.

  − Deduction of SRLY carryforward BIE would be available only if the group has any remaining section 163(j) limitation for the current year after the deduction of current-year BIE and only to the extent that section 163(j) SRLY limitation for the current year exceeds the amount of the member's BIE already deducted by the group.
  − SRLY-limited disallowed BIE carryforwards are deducted on a pro rata basis with non-SRLY-limited disallowed business interest expense carryforwards.

• Prop. Treas. Reg. § 1.163(j)-5(f) would apply the principles of the overlap rule of Treas. Reg. § 1.1502-21(g) to disallowed BIE carryforwards when the application of the SRLY limitation would result in an overlap with the application of section 382.
Example 17 – Disallowed BIE carryforwards arising in a SRLY (Prop. Treas. Reg. § 1.163(j)-5(d)(3), Ex. 2)

**Facts**
- Sub has $100 of disallowed BIE carryforwards that arose in a SRLY.
- Sub has $150 current-year BIE.
- The section 163(j) SRLY limitation determined solely by reference to Sub's items for that year is $200.
- Assume that the P group's section 163(j) limitation would be sufficient to absorb S's current-year BIE and disallowed BIE carryforwards.

**Analysis**
- The section 163(j) SRLY limitation exceeds S's current-year BIE by $50.
- Accordingly, in the current year, the P group can take into account $50 of S's disallowed BIE carryforward.
Principal consolidated return considerations:
Departing members with disallowed BIE

- **Departing members.** A departing member would be able to retain (and carry forward to the member's first separate return year) its current-year BIE (through the date of departure) and disallowed BIE carryforwards, to the extent not used by the consolidated group for the taxable year including the departure date or otherwise reduced (e.g., under the unified loss rule of Treas. Reg. § 1.1502-36).

- **Treas. Reg. § 1.1502-36.** Disallowed BIE would be treated as a "deferred deduction" and, thus, could be reduced or reattributed under Treas. Reg. § 1.1502-36(d) (addressing "duplicated loss" in a member's stock and its inside tax attributes, upon a transfer of such stock).
Principal consolidated return considerations:
Members that own a partnership interest

• Special rules would apply to a member that owns a partnership interest and is allocated "excess business interest expense" (EBIE) from that partnership.

  − EBIE means, with respect to a partnership, the amount of disallowed BIE of the partnership for a taxable year.

  − If BIE is limited at the partnership level, partners receive an allocation of EBIE that is carried forward at the partner level.

  − Such EBIE is treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated excess taxable income from such partnership, but only to the extent of such excess taxable income, and any portion of such EBIE remaining is generally treated as business interest paid or accrued in succeeding taxable years.

• **Basis adjustments.** Under the proposed regulations, the adjusted basis of a partner's interest in a partnership would be reduced by the amount of EBIE allocated to the partner, and would be increased upon a "disposition" of the partnership interest by the amount of any such EBIE that was not treated as paid or accrued at the partner level. See, *e.g.*, Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(R), Ex. 18; Prop. Treas. Reg. § 1.1502-13(c)(7)(ii)(S), Ex. 19.

  − **Note:** With respect to the latter outcome, public comments offered approaches that would give effect to successor principles found in the consolidated return regulations where a partnership interest is transferred by way of an intercompany transaction.

• **E&P adjustments.** A C corporation partner also would be required to reduce its E&P to reflect allocations of EBIE from a domestic partnership and would increase its E&P upon a "disposition" of the partnership interest to reflect the amount of EBIE that the partner did not take into account while it held the partnership interest.
Principal consolidated return considerations:
Anti-avoidance rules

• Prop. Treas. Reg. § 1.163(j)-2(h) would provide that arrangements entered into with a principal purpose of avoiding the rules of section 163(j) or the section 163(j) regulations, including the use of multiple entities to avoid the gross receipts test of section 448(c), may be disregarded or recharacterized by the IRS to the extent necessary to carry out the purposes of section 163(j).

• A proposed amendment to Treas. Reg. § 1.1502-13 also would add a new example to the anti-avoidance rules of Treas. Reg. § 1.1502-13(h) concerning the limitation under section 163(j). See Prop. Treas. Reg. § 1.1502-13(h)(2)(vi), Ex. 6.
BEAT – Section 59A
BEAT – The big picture

• In developing the base erosion and anti-abuse tax, *i.e.*, the BEAT, Congress aimed to "level the playing field" between U.S. and foreign-owned multinational corporations in an "administrable" way.

− To the extent that corporations with significant gross receipts are able to utilize deductible related-party payments to foreign affiliates to reduce their U.S. corporate tax liability below 10% (5% for 2018; 12.5% beginning 2026), Congress generally intended the BEAT to function as a minimum tax to preclude such companies from significantly reducing their corporate tax liability by virtue of these payments.

− Congress also concluded that this minimum tax should limit the extent to which tax credits permit large, profitable corporations with significant base erosion payments to avoid virtually all tax liability in the reformed corporate tax system.

− The BEAT applies to a corporation irrespective of whether it is owned, directly or indirectly, by a parent corporation that is U.S. or foreign-headquartered.

• Overall, Congress believed that the new paradigm offered by the BEAT, along with a globally competitive corporate tax rate, would encourage economically efficient direct investment in the United States.
New section 59A

- Under new section 59A(a), an additional tax may be imposed on an "applicable taxpayer" making "base erosion payments" to related foreign persons and deriving "base erosion tax benefits" (e.g., deductions) with respect to such payments.

  - The new tax was imposed at a 5% rate in 2018; that rate increased to 10% beginning in 2019, and is scheduled to further increase to 12.5% beginning in 2026.

  - A higher rate of tax (1% higher) applies where the applicable taxpayer is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a "bank" or a "registered securities dealer."

  - Section 59A applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

- The "base erosion minimum tax amount," i.e., the BEAT tax liability, is equal to the excess (if any) of:

  - The percentage noted above (i.e., 5%, 10%, or 12.5%) of the applicable taxpayer's "modified taxable income;" over

  - The applicable taxpayer's regular tax liability, as defined in section 26(b), reduced by allowable credits, including foreign tax credits, but not R&D and certain other credits (at least for taxable years beginning before January 1, 2026).
Proposed regulations

• On December 13, 2018, Treasury and the IRS released proposed regulations under new section 59A and related provisions.

  – The proposed regulations have been proposed to apply to taxable years beginning after December 31, 2017.

  – Until finalization, a taxpayer may rely on the proposed regulations for taxable years beginning after December 31, 2017, provided the taxpayer and all related parties of the taxpayer (as defined in Prop. Treas. Reg. § 1.59A-1(b)(17)) consistently apply the proposed regulations for all those taxable years that end before the finalization date.

  – The preamble to the proposed regulations suggests a possible alternative effective/applicability date, depending on the date of the finalization of a proposed rule: "If any provision is finalized after June 22, 2019, the Treasury Department and the IRS generally expect that such provision will apply only to taxable years ending on or after December 17, 2018. See section 7805(b)(1)(B)."

Structure of the proposed regulations

- Prop. Treas. Reg. § 1.59A-8: Application of BEAT to certain expatriated entities (reserved).
- Proposed amendment to Treas. Reg. § 1.383-1.
- Proposed regulations also provided under sections 6038A and 6655.
Determination of the applicable taxpayer

- The definition of "applicable taxpayer" for purposes of section 59A is set forth in section 59A(e), which sets out three components to the definition of that term; specifically, a taxpayer:

  - That is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation (see section 59A(e)(1)(A));

  - The average annual gross receipts of which for the 3-taxable-year period ending with the preceding taxable year are at least $500,000,000 (see section 59A(e)(1)(B)); and

  - The base erosion percentage (as determined under section 59A(c)(4)) of which for the taxable year is 3% or higher (2% or higher in an instance where a bank (as defined in section 581) or a registered securities dealer under section 15(a) of the Securities Exchange Act of 1934 is a member of the relevant group) (see section 59A(e)(1)(C)).

- Notably, aggregation rules are provided in section 59A(e)(3), which provides as follows:

  **(3) Aggregation rules.** All persons treated as a single employer under subsection (a) of section 52 shall be treated as 1 person for purposes of this subsection and subsection (c)(4), except that, in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) shall be disregarded.

- Pursuant to section 59A(e)(3), the base erosion percentage under section 59A(c)(4) is computed on the basis of the same controlled group of corporations as that used for purposes of determining the applicable taxpayer under section 59A(e)(1).
Introduction of the "aggregate group" concept

- The proposed regulations would provide that a taxpayer must apply the gross receipts test and the base erosion percentage test using the "aggregate group" consisting of members of the same controlled group of corporations for purposes of section 52(a) that are (i) domestic C corporations and (ii) foreign corporations, but, in the latter instance, only with regard to gross receipts taken into account in determining income that is effectively connected with the conduct of a trade or business in the United States and subject to tax under section 882(a).

- Prop. Treas. Reg. § 1.59A-2(c) would direct that (i) these tests are applied on the basis of the composition of the aggregate group as of the end of the relevant taxable year and (ii) transactions that occur between aggregate group members that were members of the aggregate group as of the time of the transaction would not be taken into account.
  - This rule appears directed to circumstances in which a corporation experiences a mid-year change in aggregate group membership, i.e., the corporation departs one aggregate group and joins another.
  - Further consideration of the potential impacts of this rule are warranted in the context of a potential acquisition or disposition of a domestic C corporation or a foreign corporation with effectively connected income.

- Prop. Treas. Reg. § 1.1502-59A(b)(2) would provide that a consolidated group is treated as a single member of an aggregate group for purposes of Prop. Treas. Reg. § 1.59A-2(c).
A base erosion payment generally is any amount paid or accrued by the taxpayer to a "foreign person" that is a "related party" in relation to the taxpayer if:

- A deduction is allowable for such amount (see section 59A(d)(1)); or
- Such amount is paid or accrued in connection with the acquisition of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation) (see section 59A(d)(2)).

The proposed regulations would refine the notion of a base erosion payment.

- An amount paid or accrued in taxable years beginning before January 1, 2018, would not be treated as a base erosion payment.
- For purposes of the base erosion payment determination, an "amount paid or accrued" includes an amount paid or accrued using any form of consideration, including cash, property, stock, or assumption of liabilities, and consideration received in nonrecognition transactions.
- Amount of a base erosion payment generally would be determined on a gross basis.
- Relief would be provided with respect to the "services cost method exception" by directing that the cost component of a cost-plus payment for services need not be treated as a base erosion payment.
- Payments that result in effectively connected income generally would not be treated as paid to a foreign related party.
- A partnership generally would be treated as an aggregate of its partners for purposes of determining whether a payment is a base erosion payment.
- No specific rules included in the proposed regulations for purposes of determining whether (i) a payment is a deductible payment, or, when viewed as part of a series of transactions, should be viewed in a different manner under principal-agent principles, the reimbursement doctrine, case law conduit principles, assignment of income principles, or other principles of generally applicable tax law or (ii) base erosion payments are treated as included in COGS.
Base erosion tax benefits

• In general, a base erosion tax benefit is the amount of any deduction relating to a base erosion payment that is allowed under the Code for the taxable year.

• The proposed regulations generally follow the approach of the statute and would:

  – Give effect to the exception provided for amounts subject to U.S. withholding tax.

  – Exclude a deduction described in section 59A(c)(2)(A)(i) (deduction allowed for the taxable year with respect to any base erosion payment) or section 59A(c)(2)(A)(ii) (deduction allowed for the taxable year for depreciation or amortization with respect to any property acquired with such a payment) that is allowed in a taxable year beginning after December 31, 2017, if it relates to a base erosion payment that occurred in a taxable year beginning before January 1, 2018.

    ◦ For example, if, in 2015, a calendar year taxpayer makes a payment or accrual to a foreign related party to acquire depreciable property, the 2015 payment is excluded from the definition of a base erosion payment.

    ◦ As a result, the taxpayer's depreciation deduction allowed in 2018 with respect to this property would not be a base erosion tax benefit.
Base erosion percentage

• The proposed regulations would provide that the base erosion percentage test is satisfied with respect to a taxpayer if the taxpayer (or if the taxpayer is a member of an aggregate group, the aggregate group of which the taxpayer is a member) has a base erosion percentage of 3% or more.

  − Generally, a lower threshold of 2% would apply if the taxpayer, or a member of the taxpayer's aggregate group, is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a domestic bank or a registered securities dealer.

  − The proposed regulations would provide that the lower 2% threshold does not apply, however, in the case of an aggregate group or consolidated group that has de minimis banking activities or registered securities dealer activities.

• Under the proposed regulations, the numerator of the base erosion percentage only would take into account base erosion tax benefits.

  − Similarly, the proposed regulations would direct that the denominator of the base erosion percentage only takes into account deductions allowed under the Code, except for those deductions and losses specifically carved out of the denominator, e.g., any deduction allowed under section 172, section 245A, or section 250 for the taxable year.

  − The proposed regulations generally would provide that payments between members of an aggregate group are not taken into account for purposes of the numerator or the denominator in the base erosion percentage calculation.
Interaction of section 59A and section 163(j)

• In the case of any disallowed business interest expense described in section 163(j)(2) that is carried forward from a taxable year beginning before January 1, 2018, the proposed regulations would provide that such amount does not constitute a base erosion payment.

− Accordingly, the proposed regulations would provide that any disallowed disqualified interest under former section 163(j) that resulted from a payment or accrual to a foreign related party and that is carried forward from a taxable year beginning before January 1, 2018, is not a base erosion payment.

• The proposed regulations also would provide that any disallowed business interest carryforward under new section 163(j) that resulted from a payment or accrual to a foreign related party is treated as a base erosion payment in the year that the interest was actually paid or accrued even though the interest may be deemed to be paid or accrued again in the year in which it is actually deducted.

• Section 59A(c)(3) and Prop. Treas. Reg. § 1.59A-3(c)(4) would provide rules coordinating section 163(j) with the determination of the amount of base erosion tax benefits. See, e.g., Prop. Treas. Reg. § 1.59A-3(d)(3) through (6), Exs. 3 through 6.

− For example, the proposed regulations would provide that, when a corporation has current-year business interest expense paid or accrued to both unrelated parties and related parties, the amount of allowed business interest expense is treated first as the business interest expense paid to related parties, proportionately between foreign and domestic related parties, and then as business interest expense paid to unrelated parties.

− The proposed regulations also (i) would follow a year-by-year convention in the allocation of business interest expense and carryforwards among the related and unrelated party classifications and (ii) would provide that an acquiring corporation in a transaction described in section 381(a) would succeed to and take into account the classification of any disallowed business interest expense carryforward for purposes of section 59A.
Modified taxable income computation

• Under the proposed regulations, modified taxable income would be determined by adding back base erosion tax benefits and the base erosion percentage of the net operating loss (NOL) deduction to the applicable taxpayer's taxable income (as determined under section 63), not by recomputing the applicable taxpayer's taxable income for purposes of section 59A.

− Stated differently, the computation would start with taxable income (or taxable loss) of the taxpayer as computed for regular tax purposes, and would add to that amount (i) the gross amount of base erosion tax benefits for the taxable year, and (ii) the base erosion percentage of any NOL deduction under section 172 for the taxable year.

• The proposed regulations would provide a rule applicable to situations in which there is an NOL deduction from an NOL carryover or carryback to the taxable year and that NOL deduction exceeds the amount of positive taxable income before that deduction (because, for example, the loss arose in a year beginning before January 1, 2018).

− In such a situation, the proposed regulations would provide that the excess amount of the NOL deduction does not reduce taxable income below zero when determining the starting point for computing modified taxable income.
Modified taxable income computation (cont.)

• Portion of NOL deduction added back to taxable income = Base erosion percentage for the year that the NOL is originally incurred (0% for pre-2018 NOLs) \times NOL absorbed in the year of the NOL deduction.

  − Prop. Treas. Reg. § 1.59A-4(b)(2)(ii) would apply the base erosion percentage of the year in which the NOL arose, i.e., the "vintage year," because the base erosion percentage of the vintage year reflects the portion of the base eroding payments that actually comprise the NOL carryover.

    ◦ Based on this approach, the proposed regulations also would provide that, in the case of NOLs that arose in taxable years beginning before January 1, 2018, and that are deducted as carryovers in taxable years beginning after December 31, 2017, the base erosion percentage would be zero because section 59A only applies to base erosion payments that are paid or accrued in taxable years beginning after December 31, 2017.

    ◦ As a result, there would be no add-back to modified taxable income for the use of those NOL carryovers.

  − The proposed regulations also would provide that, in computing the add-back for the NOL deduction, the relevant base erosion percentage is the base erosion percentage for the aggregate group that is used to determine whether the taxpayer is an applicable taxpayer.
Example 18 – Current year loss (Prop. Treas. Reg. § 1.59A-4(c)(1), Ex. 1)

Facts

• A domestic corporation (DC) is an applicable taxpayer that has a calendar year taxable year.

• In 2020, DC has gross income of $100x, a deduction of $80x that is not a base erosion tax benefit, and a deduction of $70x that is a base erosion tax benefit.

• In addition, DC has an NOL carryforward to 2020 of ($400x) that arose in 2016.

Analysis

• DC's starting point for computing modified taxable income is ($50x), computed as gross income of $100x, less a deduction of $80x (non-base erosion tax benefit) and a deduction of $70x (base erosion tax benefit).

• Under Prop. Treas. Reg. § 1.59A-4(b)(2)(ii), DC's starting point for computing modified taxable income would not take into account the $400x NOL carryforward because the allowable deductions for 2020, not counting the NOL deduction, exceed gross income for 2020.

• Therefore, DC's modified taxable income for 2020 is $20x, computed as ($50x) + $70x base erosion tax benefit.
Example 19 – NOL deduction  
(Prop. Treas. Reg. § 1.59A-4(c)(2), Ex. 2)

**Facts**

- The facts are the same as in Example 18, except that DC's gross income in 2020 is $500x.

**Analysis**

- DC's starting point for computing modified taxable income is $0x, computed as gross income of $500x, **less**:
  - A deduction of $80x (non-base erosion tax benefit);
  - A deduction of $70x (base erosion tax benefit); and
  - An NOL deduction of $350x (which is the amount of taxable income before taking into account the NOL deduction, as provided in Prop. Treas. Reg. § 1.59A-4(b)(2)(ii) (i.e., $500x – $150x)).

- DC's modified taxable income is **not** increased as a result of the $350x NOL deduction in 2020 because the base erosion percentage of the NOL that arose in 2016 is **zero** under Prop. Treas. Reg. § 1.59A-4(b)(2)(ii).

- Therefore, DC's **modified taxable income** for 2020 is $70x, computed as $0x + $70x base erosion tax benefit.
Principal consolidated return considerations:
Application of section 59A to a consolidated group

- Prop. Treas. Reg. § 1.1502-59A(b) would provide that the tax under section 59A is determined on a consolidated basis by treating the consolidated group "as a single taxpayer," rather than being determined separately for each member of the group.

- Members' deductions would be aggregated in making the required computations under section 59A, although items arising from intercompany transactions would not be taken into account for purposes of making those computations.

- When the consolidated group has a consolidated net operating loss (a CNOL) available for deduction, the CNOL absorbed in the year of the CNOL deduction would be multiplied by the relevant base erosion percentage and added back to consolidated taxable income when determining the consolidated group's modified taxable income.

- This single taxpayer treatment of members of a consolidated group applies separately from the aggregate group concept, which also treats all members of the aggregate group as a single entity, but, in that case, only for purposes of applying the gross receipts test and base erosion percentage test for determining the applicable taxpayer.

- A consolidated group would be treated as a single member of an aggregate group.

- If a person is a related party with respect to any member of a consolidated group, that person would be a related party with respect to each member of the consolidated group.

- Treas. Reg. § 1.1502-2 would be amended to include a reference to section 59A as a tax included in the computation of consolidated tax liability.

- Allocation of the tax under section 59A to members of the consolidated group would be determined under section 1552.
Example 20 – Computation of section 59A tax liability (Prop. Treas. Reg. § 1.1502-59A(f)(1), Ex. 1(i))

**Facts**

- A foreign corporation (FP) wholly owns a domestic corporation (P), which, in turn, wholly owns two domestic subsidiaries – S1 and S2.
  
- P, S1, and S2 are members of a consolidated group.
  
- The P group uses a calendar year taxable year.
  
- The members of the P group have never engaged in intercompany transactions.
  
- For the 2019 taxable year, P, S1, and S2 have the following amounts of deductions for purposes of determining the base erosion percentage under section 59A(c)(4): $2,400x, $1,000x, and $2,600x, respectively.
  
  - Such deductions for P, S1, and S2 include base erosion tax benefits of $180x, $370x, and $230x, respectively.

  
- The P group's consolidated taxable income for the year is $150x.
  
- In addition, the P group satisfies the gross receipts test in Prop. Treas. Reg. § 1.159A-2(d).
Example 20 – Computation of section 59A tax liability (cont.)
(Prop. Treas. Reg. § 1.1502-59A(f)(1), Ex. 1(i))

**Analysis**

- Pursuant to Prop. Treas. Reg. § 1.1502-59A(b), the receipts and deductions of P, S1, and S2 are aggregated for purposes of making the computations under section 59A.

- The group's base erosion percentage is **13%**:

\[
\frac{(180x + 370x + 230x)}{(2,400x + 1,000x + 2,600x)}
\]

- The consolidated group is an applicable taxpayer under Prop. Treas. Reg. § 1.59A-2(b) because the group satisfies the gross receipts test and the group's base erosion percentage (13%) is greater than 3%.

- The consolidated group's modified taxable income is computed by adding back the members' base erosion tax benefits to the consolidated taxable income of $150x; such amount in this example is equal to $930x (i.e., $150x + $180x + $370x + $230x).

- The group's base erosion minimum tax amount is then computed as 10% of modified taxable income less the regular tax liability, which amount is equal to $61.50x (i.e., ($930x × 10%) – ($150x × 21%)).

**Example**

- **P (2019)**
  - Deductions: $2,400x
  - Base erosion tax benefit: $180x

- **S1 (2019)**
  - Deductions: $1,000x
  - Base erosion tax benefit: $370x

- **S2 (2019)**
  - Deductions: $2,600x
  - Base erosion tax benefit: $230x

- **P Consolidated Group (2019)**
  - Consolidated taxable income: $150x

**Facts**

- The facts are the same as those in Example 20, except that S1 sold various inventory items to S2 during 2019.
- Such items are depreciable in the hands of S2 (but would not have been depreciable in the hands of S1) and continued to be owned by S2 during 2019.

**Analysis**

- The result is the same as in Example 20.
- Pursuant to Prop. Treas. Reg. § 1.1502-59A(b), items resulting from the intercompany sale (for example, gross receipts and depreciation deductions) are **not** taken into account in computing the group's gross receipts under Prop. Treas. Reg. § 1.59A-2(d) and base erosion percentage under Prop. Treas. Reg. § 1.59A-2(e)(3).
Principal consolidated return considerations:
Interaction of section 59A with section 163(j)

- In general. Prop. Treas. Reg. § 1.1502-59A(c) would provide extensive rules to coordinate the interaction of sections 59A and 163(j) in a consolidated group.

  - The proposed regulations would implement the classification approach of Prop. Treas. Reg. § 1.59A-3(c)(4) on a consolidated basis in order to identify which interest deductions are allocable to domestic related party payments, foreign related party payments, and unrelated party payments and, correspondingly, to what extent the group's section 163(j) interest deduction is a base erosion tax benefit.

  - The proposed regulations would provide a single-entity classification rule with regard to the deduction of the consolidated group's aggregate current year business interest expense (BIE), but a separate-entity classification rule for the deduction of the consolidated group's disallowed BIE carryforwards.


  - Prop. Treas. Reg. § 1.1502-59A(c)(4) then would allocate to specific members of the group the domestic related current year BIE deduction, foreign related current year BIE deduction, and unrelated current year BIE deduction taken in the taxable year.

- Disallowed BIE carryforward. Under Prop. Treas. Reg. § 1.1502-59A(c)(5), any member's current year BIE that is carried forward to the succeeding taxable year as a disallowed BIE carryforward would be allocated a status as domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward.

  - The status of any disallowed BIE carryforward deducted by a member in a later year is classified on a separate-entity basis by the deducting member under Prop. Treas. Reg. § 1.1502-59A(c)(3), based on the status allocated to the member's disallowed BIE carryforward under Prop. Treas. Reg. § 1.1502-59A(c)(5).
Example 22 – BIE subject to section 163(j) (Prop. Treas. Reg. § 1.1502-59A(f)(2), Ex. 2)

**Facts**

- A foreign corporation (FP) wholly owns a domestic corporation (P), which, in turn, wholly owns two domestic subsidiaries – S1 and S2.
- P, S1, and S2 are members of a consolidated group.
- The P group uses a calendar year taxable year.
- The P group is an "applicable taxpayer" for purposes of section 59A.
- During Year 1:
  - P incurred $150x of BIE to domestic related parties;
  - S1 incurred $150x of BIE to foreign related parties;
    and
  - S2 incurred $150x of BIE to unrelated parties.
- The P group's section 163(j) limitation for the year is $300x.
- After applying the rules in Prop. Treas. Reg. § 1.163(j)-5(b)(3), the P group deducts $150x of P's Year 1 BIE, and $75x each of S1 and S2's Year 1 BIE.
Example 22 – BIE subject to section 163(j) (cont.)
(Prop. Treas. Reg. § 1.1502-59A(f)(2), Ex. 2)

**Analysis**

- **Application of the absorption rule in Prop. Treas. Reg. § 1.1502-59A(c)(2)**
  - Following the rules in section 163(j), the P group's section 163(j) interest deduction for Year 1 is $300x, and the entire amount is from members' Year 1 BIE.

- **Application of the classification rule in Prop. Treas. Reg. § 1.1502-59A(c)(3)**
  - The P group's aggregate current-year BIE deduction of $300x is **first** classified as payments or accruals to related parties (pro-rata among domestic related parties and foreign related parties), and **second** as payments or accruals to unrelated parties.
  
  - For Year 1, the P group has $150x of domestic related current-year BIE and $150x of foreign related current-year BIE, and the P group's aggregate current-year BIE deduction will be classified equally among the related party expenses.

  - Therefore, $150x of the P group's deduction is classified as domestic related current-year BIE deduction and $150x is classified as a foreign related current-year BIE deduction.
Example 22 – BIE subject to section 163(j) (cont.)
(Prop. Treas. Reg. § 1.1502-59A(f)(2), Ex. 2)

• Application of the allocation rule in Prop. Treas. Reg. § 1.1502-59A(c)(4)
  - After the application of the classification rule in Prop. Treas. Reg. § 1.1502-59A(c)(3), the P group has $150x each of domestic related current-year BIE deduction and foreign related current-year BIE deduction from the group’s aggregate current-year BIE in Year 1.
  - The domestic related current-year BIE deduction and foreign related current-year BIE deduction would be allocated to P, S1, and S2 based on each member’s deduction of its Year 1 BIE.
  - **Allocations to P**
    - The percentage of current-year BIE deduction allocable to P is 50% (P’s deduction of its Year 1 current-year BIE, $150x, divided by the P group’s aggregate current-year BIE deduction for Year 1, $300x).
    - Thus, the amount of **domestic related current-year BIE deduction status** allocated to P is **$75x** (the P group’s domestic related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to P, 50%); and the amount of **foreign related current-year BIE deduction status** allocated to P is **$75x** (the P group’s foreign related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to P, 50%).

P (Year 1)
BIE to domestic related parties: $150x

S1 (Year 1)
BIE to foreign related parties: $150x

S2 (Year 1)
BIE to unrelated parties: $150x

Consolidated Group (Year 1)
§ 163(j) limitation: $300x
  - Deduction of P’s BIE: $150x
  - Deduction of S1’s BIE: $75x
  - Deduction of S2’s BIE: $75x

Analysis (cont.)

- After the application of the classification rule in Prop. Treas. Reg. § 1.1502-59A(c)(3), the P group has $150x each of domestic related current-year BIE deduction and foreign related current-year BIE deduction from the group’s aggregate current-year BIE in Year 1.
- The domestic related current-year BIE deduction and foreign related current-year BIE deduction would be allocated to P, S1, and S2 based on each member's deduction of its Year 1 BIE.
- **Allocations to P**
  - The percentage of current-year BIE deduction allocable to P is 50% (P’s deduction of its Year 1 current-year BIE, $150x, divided by the P group’s aggregate current-year BIE deduction for Year 1, $300x).
  - Thus, the amount of **domestic related current-year BIE deduction status** allocated to P is **$75x** (the P group’s domestic related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to P, 50%); and the amount of **foreign related current-year BIE deduction status** allocated to P is **$75x** (the P group’s foreign related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to P, 50%).
Example 22 – BIE subject to section 163(j) (cont.)
(Prop. Treas. Reg. § 1.1502-59A(f)(2), Ex. 2)

Analysis (cont.)
• Application of the allocation rule in Prop. Treas. Reg. § 1.1502-59A(c)(4) (cont.)
  – Allocations to S1 and S2

o The percentage of current-year BIE deduction allocable to S1 is 25% (S1's deduction of its Year 1 current-year BIE, $75x, divided by the P group's aggregate current-year BIE deduction for Year 1, $300x).

o Thus, the amount of domestic related current-year BIE deduction status allocated to S1 is $37.50x (the P group's domestic related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to S1, 25%); and the amount of foreign related current-year BIE deduction status allocated to S1 is $37.50x (the P group's foreign related current-year BIE deduction, $150x, multiplied by the percentage of current-year BIE deduction allocable to S1, 25%).

o Because S2 also deducted $75 of its Year 1 current-year BIE, S2’s deductions are allocated the same pro-rata status as those of S1.

\[ \begin{align*}
\text{FP} \\
\text{P} \\
\text{S1} \\
\text{S2}
\end{align*} \]
Example 22 – BIE subject to section 163(j) (cont.)
(Prop. Treas. Reg. § 1.1502-59A(f)(2), Ex. 2)

### Analysis (cont.)

- Application of the allocation rule in Prop. Treas. Reg. § 1.1502-59A(c)(5)
  
  - Although the P group would have disallowed BIE carryforwards after Year 1 (the P group's aggregate current-year BIE of $450x ($150x + $150x + $150x) exceeds the section 163(j) limitation of $300x), all of the domestic related current-year BIE and foreign related current-year BIE in Year 1 has been taken into account pursuant to the classification rule in Prop. Treas. Reg. § 1.1502-59A(c)(3).

  - Thus, under Prop. Treas. Reg. § 1.1502-59A(c)(5)(iv), each member's disallowed BIE carryforward is treated as from payments or accruals to **unrelated parties**.
Principal consolidated return considerations:
Interaction of section 59A with section 163(j) (cont.)

- **Coordination with section 381.** If a disallowed BIE carryforward is allocated a status as a domestic related party, foreign related party, or unrelated party carryforward under the allocation rule, the acquiring corporation in a transaction described in section 381(a) would succeed to and take into account the allocated status of the carryforward for purposes of section 59A.

- **Departing member.** If a member that is allocated a foreign related party status, domestic related party status, or unrelated party status to its disallowed BIE carryforward deconsolidates from the consolidated group, the departing member's carryforward would retain the allocated status.

- **Joining member.** If a corporation joins a consolidated group (the acquiring group), and that corporation was allocated a domestic related party status, foreign related party status, or unrelated party status from another consolidated group (the original group) under the allocation rule, or separately has a disallowed BIE carryforward that is classified as from payments or accruals to a domestic related party, foreign related party, or unrelated party, the status of the carryforward would be taken into account in determining the acquiring group's base erosion tax benefits when the acquired corporation's disallowed BIE carryforward is absorbed.
Principal consolidated return considerations: Anti-avoidance rules

• Pursuant to the authority provided by section 59A(i), Prop. Treas. Reg. § 1.59A-3(b)(2)(vi) would provide that, if a taxpayer owns property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation) that would be treated as a base erosion tax benefit under Prop. Treas. Reg. § 1.59A-3(c)(1)(ii), and the taxpayer sells, exchanges, or otherwise transfers the property to another taxpayer that is a member of an aggregate group that includes the taxpayer, any deduction for depreciation (or amortization in lieu of depreciation) by the transferee taxpayer remains subject to Prop. Treas. Reg. § 1.59A-3(c)(1)(ii) to the same extent the amounts would have been so subject in the hands of the transferor. See, e.g., Prop. Treas. Reg. § 1.59A-3(d)(7), Ex. 7.

• Prop. Treas. Reg. § 1.59A-9(b) would provide that certain transactions (noted below) that have a principal purpose of avoiding section 59A would be disregarded or deemed to result in a base erosion payment; specifically:

− Transactions involving intermediaries acting as a conduit to avoid a base erosion payment;

− Transactions entered into in order to increase the deductions taken into account in the denominator of the base erosion percentage; and

− Transactions among related parties entered into in order to avoid the application of the rules applicable to banks and registered securities dealers.

◦ As discussed in the preamble to the proposed regulations, causing a bank or registered securities dealer to disaffiliate from an affiliated group so as to avoid the requirement that it be a member of such a group is contemplated to be subject to this anti-avoidance provision.
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