INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2019–52
December 23, 2019

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

ADMINISTRATIVE

REV. RUL. 2019-28, page 1401.

Interest rates: underpayments and overpayments. The rates for interest determined under Section 6621 of the code for the calendar quarter beginning January 1, 2020, will be 5 percent for overpayments (4 percent in the case of a corporation), 5 percent for underpayments, and 7 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 2.5 percent.

EMPLOYEE PLANS

NOTICE 2019-64, page 1505.

This notice contains the 2019 Required Amendments List for qualified individually designed plans and § 403(b) individually designed plans.

NOTICE 2019-67, page 1510.

This notice specifies updated mortality improvement rates and static mortality tables to be used for defined benefit pension plans under § 430(h)(3)(A) of the Internal Revenue Code and section 303(h)(3)(A) of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, as amended (ERISA), for valuation dates occurring during the 2021 calendar year. This notice also includes a modified unisex version of the mortality tables for use in determining minimum present value under § 417(e)(3) of the Code and section 205(g)(3) of ERISA for distributions with annuity starting dates that occur during stability periods beginning in the 2021 calendar year.

INCOME TAX

REG-112607-19, page 1516.

These proposed regulations that provide guidance regarding the base erosion and anti-abuse tax imposed on certain large corporate taxpayers with respect to certain payments made to foreign related parties. The proposed regulations would affect corporations with substantial gross receipts that make payments to foreign related parties.

T.D. 9885, page 1418.

These final regulations implement the base erosion and anti-abuse tax, designed to prevent the reduction of tax liability by certain large corporate taxpayers through certain payments made to foreign related parties and certain tax credits. This tax was added to the Internal Revenue Code (the "Code") as part of the Tax Cuts and Jobs Act. The final regulations affect corporations with substantial gross receipts that make payments to foreign related parties.

NOTICE 2019-65, page 1507.

This Notice announces that the Department of the Treasury and the Internal Revenue Service intend to amend the regulations under section 987 to defer the applicability date of the final regulations under section 987, as well as certain related final and temporary regulations, by one additional year. Notice 2017-57, published on October 16, 2017, and Notice 2018-57, published on June 25, 2018, each delayed the applicability date of the final regulations, along with the related final and temporary regulations, by 1 year. The Treasury Department and the IRS intend to amend §§1.861-9T, 1.985-5, 1.987-11, 1.988-1, 1.988-4, and 1.989(a)-1 of the 2016 final regulations and §§1.987-2 and 1.987-4 of the 2019 final regulations to apply to taxable years beginning on or after the first day of the first taxable year following December 7, 2020.

Finding Lists begin on page ii.

NOTICE 2019-66, page 1509.

This notice provides that the requirement to report partners' shares of partnership capital on the tax basis method will not be effective for 2019 (for partnership taxable years beginning in calendar 2019) but will be effective beginning in 2020 (for partnership taxable years that begin on or after January 1, 2020). For 2019, partnerships and other persons must report partner capital accounts consistent with the reporting requirements in the 2018 forms and instructions, including the requirement to report negative tax basis capital accounts on a partner-by-partner basis. This notice also clarifies the 2019 requirement for partnerships and other persons to report a partner's share of "net unrecognized Section 704(c) gain or loss" by defining this term for purposes of the reporting requirement. Additionally, this notice exempts publicly traded partnerships from the requirement to report their partners' shares of net unrecognized Section 704(c) gain or loss until further notice. This notice also provides that the requirement added by the draft instructions for 2019 for partnerships to report to partners information about separate "Section 465 at-risk activities" will not be effective until 2020. Finally, this notice provides relief from certain reporting penalties imposed by the Internal Revenue Code (Code).

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Rev. Rul. 2019-28

Section 6621 of the Internal Revenue Code establishes the interest rates on overpayments and underpayments of tax. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621-3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621-3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter. Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after that month. Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during that month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

The federal short-term rate determined in accordance with section 1274(d) during October 2019 is the rate published in Revenue Ruling 2019-25, 2019-45 IRB 1042, to take effect beginning November 1, 2019. The federal short-term rate, rounded to the nearest full percent, based on daily compounding determined during the month of October 2019 is 2 percent. Accordingly, an overpayment rate of 5 percent (4 percent in the case of a corporation) and an underpayment rate of 5 percent are established for the calendar quarter beginning January 1, 2020. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2020 is 2.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2020, is 7 percent. These rates apply to amounts bearing interest during that calendar quarter.

Sections 6654(a)(1) and 6655(a)(1) provide that the underpayment rate established under section 6621 applies in determining the addition to tax under sections 6654 and 6655 for failure to pay estimated tax for any taxable year. Thus, the 5 percent rate also applies to estimated tax underpayments for the first calendar quarter beginning January 1, 2020. Pursuant to section 6621(b)(2)(B), in determining the addition to tax under section 6654 for any taxable year for an individual, the federal short-term rate that applies during the third month following the taxable year also applies during the first 15 days of the fourth month following the taxable year. In addition, pursuant to section 6603(d)(4), the rate of interest on section 6603 deposits is 2 percent for the first calendar quarter in 2020.

Interest factors for daily compound interest for annual rates of 2.5 percent, 4 percent, 5 percent and 7 percent are published in Tables 58, 61, 63, and 67 of Rev. Proc. 95-17, 1995-1 C.B. 612, 615, 617, and 621.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Casey R. Conrad of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue ruling, contact Mr. Conrad at (202) 317-6844 (not a toll-free number).

APPENDIX A

365 Day Year

0.5% Compound Rate 184 Days

Days	Factor	Days	Factor	Days	Factor
1	0.000013699	63	0.000863380	125	0.001713784
2	0.000027397	64	0.000877091	126	0.001727506
3	0.000041096	65	0.000890801	127	0.001741228
4	0.000054796	66	0.000904512	128	0.001754951
5	0.000068495	67	0.000918223	129	0.001768673
6	0.000082195	68	0.000931934	130	0.001782396
7	0.000095894	69	0.000945646	131	0.001796119
8	0.000109594	70	0.000959357	132	0.001809843
9	0.000123294	71	0.000973069	133	0.001823566
10	0.000136995	72	0.000986781	134	0.001837290
11	0.000150695	73	0.001000493	135	0.001851013
12	0.000164396	74	0.001014206	136	0.001864737
13	0.000178097	75	0.001027918	137	0.001878462
14	0.000191798	76	0.001041631	138	0.001892186
15	0.000205499	77	0.001055344	139	0.001905910
16	0.000219201	78	0.001069057	140	0.001919635
17	0.000232902	79	0.001082770	141	0.001933360
18	0.000246604	80	0.001096484	142	0.001947085
19	0.000260306	81	0.001110197	143	0.001960811
20	0.000274008	82	0.001123911	144	0.001974536
21	0.000287711	83	0.001137625	145	0.001988262
22	0.000301413	84	0.001151339	146	0.002001988
23	0.000315116	85	0.001165054	147	0.002015714
24	0.000328819	86	0.001178768	148	0.002029440
25	0.000342522	87	0.001192483	149	0.002043166
26	0.000356225	88	0.001206198	150	0.002056893
27	0.000369929	89	0.001219913	151	0.002070620
28	0.000383633	90	0.001233629	152	0.002084347
29	0.000397336	91	0.001247344	153	0.002098074
30	0.000411041	92	0.001261060	154	0.002111801
31	0.000424745	93	0.001274776	155	0.002125529
32	0.000438449	94	0.001288492	156	0.002139257
33	0.000452154	95	0.001302208	157	0.002152985
34	0.000465859	96	0.001315925	158	0.002166713
35	0.000479564	97	0.001329641	159	0.002180441
36	0.000493269	98	0.001343358	160	0.002194169
37	0.000506974	99	0.001357075	161	0.002207898
38	0.000520680	100	0.001370792	162	0.002221627
39	0.000534386	101	0.001384510	163	0.002235356
40	0.000548092	102	0.001398227	164	0.002249085
41	0.000561798	103	0.001411945	165	0.002262815

42	0.000575504	104	0.001425663	166	0.002276544
43	0.000589211	105	0.001439381	167	0.002290274
44	0.000602917	106	0.001453100	168	0.002304004
45	0.000616624	107	0.001466818	169	0.002317734
46	0.000630331	108	0.001480537	170	0.002331465
47	0.000644039	109	0.001494256	171	0.002345195
48	0.000657746	110	0.001507975	172	0.002358926
49	0.000671454	111	0.001521694	173	0.002372657
50	0.000685161	112	0.001535414	174	0.002386388
51	0.000698869	113	0.001549133	175	0.002400120
52	0.000712578	114	0.001562853	176	0.002413851
53	0.000726286	115	0.001576573	177	0.002427583
54	0.000739995	116	0.001590293	178	0.002441315
55	0.000753703	117	0.001604014	179	0.002455047
56	0.000767412	118	0.001617734	180	0.002468779
57	0.000781121	119	0.001631455	181	0.002482511
58	0.000794831	120	0.001645176	182	0.002496244
59	0.000808540	121	0.001658897	183	0.002509977
60	0.000822250	122	0.001672619	184	0.002523710
61	0.000835960	123	0.001686340		
62	0.000849670	124	0.001700062		

366 Day Year

0.5% Compound Rate 184 Days

Days	Factor	Days	Factor	Days	Factor
1	0.000013661	63	0.000861020	125	0.001709097
2	0.000027323	64	0.000874693	126	0.001722782
3	0.000040984	65	0.000888366	127	0.001736467
4	0.000054646	66	0.000902040	128	0.001750152
5	0.000068308	67	0.000915713	129	0.001763837
6	0.000081970	68	0.000929387	130	0.001777522
7	0.000095632	69	0.000943061	131	0.001791208
8	0.000109295	70	0.000956735	132	0.001804893
9	0.000122958	71	0.000970409	133	0.001818579
10	0.000136620	72	0.000984084	134	0.001832265
11	0.000150283	73	0.000997758	135	0.001845951
12	0.000163947	74	0.001011433	136	0.001859638
13	0.000177610	75	0.001025108	137	0.001873324
14	0.000191274	76	0.001038783	138	0.001887011
15	0.000204938	77	0.001052459	139	0.001900698
16	0.000218602	78	0.001066134	140	0.001914385
17	0.000232266	79	0.001079810	141	0.001928073
18	0.000245930	80	0.001093486	142	0.001941760
19	0.000259595	81	0.001107162	143	0.001955448
20	0.000273260	82	0.001120839	144	0.001969136
21	0.000286924	83	0.001134515	145	0.001982824
22	0.000300590	84	0.001148192	146	0.001996512
23	0.000314255	85	0.001161869	147	0.002010201
24	0.000327920	86	0.001175546	148	0.002023889
25	0.000341586	87	0.001189223	149	0.002037578
26	0.000355252	88	0.001202900	150	0.002051267
27	0.000368918	89	0.001216578	151	0.002064957
28	0.000382584	90	0.001230256	152	0.002078646
29	0.000396251	91	0.001243934	153	0.002092336
30	0.000409917	92	0.001257612	154	0.002106025
31	0.000423584	93	0.001271291	155	0.002119715
32	0.000437251	94	0.001284969	156	0.002133405
33	0.000450918	95	0.001298648	157	0.002147096
34	0.000464586	96	0.001312327	158	0.002160786
35	0.000478253	97	0.001326006	159	0.002174477
36	0.000491921	98	0.001339685	160	0.002188168
37	0.000505589	99	0.001353365	161	0.002201859
38	0.000519257	100	0.001367044	162	0.002215550
39	0.000532925	101	0.001380724	163	0.002229242
40	0.000546594	102	0.001394404	164	0.002242933
41	0.000560262	103	0.001408085	165	0.002256625
42	0.000573931	104	0.001421765	166	0.002270317

43	0.000587600	105	0.001435446	167	0.002284010
44	0.000601269	106	0.001449127	168	0.002297702
45	0.000614939	107	0.001462808	169	0.002311395
46	0.000628608	108	0.001476489	170	0.002325087
47	0.000642278	109	0.001490170	171	0.002338780
48	0.000655948	110	0.001503852	172	0.002352473
49	0.000669618	111	0.001517533	173	0.002366167
50	0.000683289	112	0.001531215	174	0.002379860
51	0.000696959	113	0.001544897	175	0.002393554
52	0.000710630	114	0.001558580	176	0.002407248
53	0.000724301	115	0.001572262	177	0.002420942
54	0.000737972	116	0.001585945	178	0.002434636
55	0.000751643	117	0.001599628	179	0.002448331
56	0.000765315	118	0.001613311	180	0.002462025
57	0.000778986	119	0.001626994	181	0.002475720
58	0.000792658	120	0.001640678	182	0.002489415
59	0.000806330	121	0.001654361	183	0.002503110
60	0.000820003	122	0.001668045	184	0.002516806
61	0.000833675	123	0.001681729		
62	0.000847348	124	0.001695413		

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD					RATE	In 1995-1 C.B. DAILY RATE TABLE			
Before		Jul.	1,	1975	6%	Table	2,	pg.	557
Jul.	1,	1975–Jan.	31,	1976	9%	Table	4,	pg.	559
Feb.	1,	1976–Jan.	31,	1978	7%	Table	3,	pg.	558
Feb.	1,	1978–Jan.	31,	1980	6%	Table	2,	pg.	557
Feb.	1,	1980–Jan.	31,	1982	12%	Table	5,	pg.	560
Feb.	1,	1982–Dec.	31,	1982	20%	Table	6,	pg.	560
Jan.	1,	1983–Jun.	30,	1983	16%	Table	37,	pg.	591
Jul.	1,	1983–Dec.	31,	1983	11%	Table	27,	pg.	581
Jan.	1,	1984–Jun.	30,	1984	11%	Table	75,	pg.	629
Jul.	1,	1984–Dec.	31,	1984	11%	Table	75,	pg.	629
Jan.	1,	1985–Jun.	30,	1985	13%	Table	31,	pg.	585
Jul.	1,	1985–Dec.	31,	1985	11%	Table	27,	pg.	581
Jan.	1,	1986–Jun.	30,	1986	10%	Table	25,	pg.	579
Jul.	1,	1986–Dec.	31,	1986	9%	Table	23,	pg.	577

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 - Dec. 31, 1998

					OVERPAYMENTS 1995-1 C.B.			UNDERPAYMENTS 1995-1 C.B. RATE		
					RATE	TABLE	PG	RATE	TABLE	PG
Jan.	1,	1987–Mar.	31,	1987	8%	21	575	9%	23	577
Apr.	1,	1987–Jun.	30,	1987	8%	21	575	9%	23	577
Jul.	1,	1987–Sep.	30,	1987	8%	21	575	9%	23	577
Oct.	1,	1987–Dec.	31,	1987	9%	23	577	10%	25	579
Jan.	1,	1988–Mar.	31,	1988	10%	73	627	11%	75	629
Apr.	1,	1988–Jun.	30,	1988	9%	71	625	10%	73	627
Jul.	1,	1988–Sep.	30,	1988	9%	71	625	10%	73	627
Oct.	1,	1988–Dec.	31,	1988	10%	73	627	11%	75	629
Jan.	1,	1989–Mar.	31,	1989	10%	25	579	11%	27	581
Apr.	1,	1989–Jun.	30,	1989	11%	27	581	12%	29	583
Jul.	1,	1989–Sep.	30,	1989	11%	27	581	12%	29	583
Oct.	1,	1989–Dec.	31,	1989	10%	25	579	11%	27	581
Jan.	1,	1990–Mar.	31,	1990	10%	25	579	11%	27	581
Apr.	1,	1990–Jun.	30,	1990	10%	25	579	11%	27	581
Jul.	1,	1990–Sep.	30,	1990	10%	25	579	11%	27	581
Oct.	1,	1990–Dec.	31,	1990	10%	25	579	11%	27	581
Jan.	1,	1991–Mar.	31,	1991	10%	25	579	11%	27	581
Apr.	1,	1991–Jun.	30,	1991	9%	23	577	10%	25	579
Jul.	1,	1991–Sep.	30,	1991	9%	23	577	10%	25	579

Oct.	1,	1991–Dec.	31,	1991	9%	23	577	10%	25	579
Jan.	1,	1992–Mar.	31,	1992	8%	69	623	9%	71	625
Apr.	1,	1992–Jun.	30,	1992	7%	67	621	8%	69	623
Jul.	1,	1992–Sep.	30,	1992	7%	67	621	8%	69	623
Oct.	1,	1992–Dec.	31,	1992	6%	65	619	7%	67	621
Jan.	1,	1993–Mar.	31,	1993	6%	17	571	7%	19	573
Apr.	1,	1993–Jun.	30,	1993	6%	17	571	7%	19	573
Jul.	1,	1993–Sep.	30,	1993	6%	17	571	7%	19	573
Oct.	1,	1993–Dec.	31,	1993	6%	17	571	7%	19	573
Jan.	1,	1994–Mar.	31,	1994	6%	17	571	7%	19	573
Apr.	1,	1994–Jun.	30,	1994	6%	17	571	7%	19	573
Jul.	1,	1994–Sep.	30,	1994	7%	19	573	8%	21	575
Oct.	1,	1994–Dec.	31,	1994	8%	21	575	9%	23	577
Jan.	1,	1995–Mar.	31,	1995	8%	21	575	9%	23	577
Apr.	1,	1995–Jun.	30,	1995	9%	23	577	10%	25	579
Jul.	1,	1995–Sep.	30,	1995	8%	21	575	9%	23	577
Oct.	1,	1995–Dec.	31,	1995	8%	21	575	9%	23	577
Jan.	1,	1996–Mar.	31,	1996	8%	69	623	9%	71	625
Apr.	1,	1996–Jun.	30,	1996	7%	67	621	8%	69	623
Jul.	1,	1996–Sep.	30,	1996	8%	69	623	9%	71	625
Oct.	1,	1996–Dec.	31,	1996	8%	69	623	9%	71	625
Jan.	1,	1997–Mar.	31,	1997	8%	21	575	9%	23	577
Apr.	1,	1997–Jun.	30,	1997	8%	21	575	9%	23	577
Jul.	1,	1997–Sep.	30,	1997	8%	21	575	9%	23	577
Oct.	1,	1997–Dec.	31,	1997	8%	21	575	9%	23	577
Jan.	1,	1998–Mar.	31,	1998	8%	21	575	9%	23	577
Apr.	1,	1998–Jun.	30,	1998	7%	19	573	8%	21	575
Jul.	1,	1998–Sep.	30,	1998	7%	19	573	8%	21	575
Oct.	1,	1998–Dec.	31,	1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

						1995-1 C.B.	
					RATE	TABLE	PAGE
Jan.	1,	1999–Mar.	31,	1999	7%	19	573
Apr.	1,	1999–Jun.	30,	1999	8%	21	575
Jul.	1,	1999–Sep.	30,	1999	8%	21	575
Oct.	1,	1999–Dec.	31,	1999	8%	21	575
Jan.	1,	2000–Mar.	31,	2000	8%	69	623
Apr.	1,	2000–Jun.	30,	2000	9%	71	625
Jul.	1,	2000–Sep.	30,	2000	9%	71	625
Oct.	1,	2000–Dec.	31,	2000	9%	71	625
Jan.	1,	2001–Mar.	31,	2001	9%	23	577
Apr.	1,	2001–Jun.	30,	2001	8%	21	575
Jul.	1,	2001–Sep.	30,	2001	7%	19	573
Oct.	1,	2001–Dec.	31,	2001	7%	19	573
Jan.	1,	2002–Mar.	31,	2002	6%	17	571
Apr.	1,	2002–Jun.	30,	2002	6%	17	571
Jul.	1,	2002–Sep.	30,	2002	6%	17	571
Oct.	1,	2002–Dec.	31,	2002	6%	17	571
Jan.	1,	2003–Mar.	31,	2003	5%	15	569
Apr.	1,	2003–Jun.	30,	2003	5%	15	569
Jul.	1,	2003–Sep.	30,	2003	5%	15	569
Oct.	1,	2003–Dec.	31,	2003	4%	13	567
Jan.	1,	2004–Mar.	31,	2004	4%	61	615
Apr.	1,	2004–Jun.	30,	2004	5%	63	617
Jul.	1,	2004–Sep.	30,	2004	4%	61	615
Oct.	1,	2004–Dec.	31,	2004	5%	63	617
Jan.	1,	2005–Mar.	31,	2005	5%	15	569
Apr.	1,	2005–Jun.	30,	2005	6%	17	571
Jul.	1,	2005–Sep.	30,	2005	6%	17	571
Oct.	1,	2005–Dec.	31,	2005	7%	19	573
Jan.	1,	2006–Mar.	31,	2006	7%	19	573
Apr.	1,	2006–Jun.	30,	2006	7%	19	573
Jul.	1,	2006–Sep.	30,	2006	8%	21	575
Oct.	1,	2006–Dec.	31,	2006	8%	21	575
Jan.	1,	2007–Mar.	31,	2007	8%	21	575
Apr.	1,	2007–Jun.	30,	2007	8%	21	575
Jul.	1,	2007–Sep.	30,	2007	8%	21	575
Oct.	1,	2007–Dec.	31,	2007	8%	21	575
Jan.	1,	2008–Mar.	31,	2008	7%	67	621
Apr.	1,	2008–Jun.	30,	2008	6%	65	619
Jul.	1,	2008–Sep.	30,	2008	5%	63	617
Oct.	1,	2008–Dec.	31,	2008	6%	65	619
Jan.	1,	2009–Mar.	31,	2009	5%	15	569

Apr.	1,	2009–Jun.	30,	2009	4%	13	567
Jul.	1,	2009–Sep.	30,	2009	4%	13	567
Oct.	1,	2009–Dec.	31,	2009	4%	13	567
Jan.	1,	2010–Mar.	31,	2010	4%	13	567
Apr.	1,	2010–Jun.	30,	2010	4%	13	567
Jul.	1,	2010–Sep.	30,	2010	4%	13	567
Oct.	1,	2010–Dec.	31,	2010	4%	13	567
Jan.	1,	2011–Mar.	31,	2011	3%	11	565
Apr.	1,	2011–Jun.	30,	2011	4%	13	567
Jul.	1,	2011–Sep.	30,	2011	4%	13	567
Oct.	1,	2011–Dec.	31,	2011	3%	11	565
Jan.	1,	2012–Mar.	31,	2012	3%	59	613
Apr.	1,	2012–Jun.	30,	2012	3%	59	613
Jul.	1,	2012–Sep.	30,	2012	3%	59	613
Oct.	1,	2012–Dec.	31,	2012	3%	59	613
Jan.	1,	2013–Mar.	31,	2013	3%	11	565
Apr.	1,	2013–Jun.	30,	2013	3%	11	565
Jul.	1,	2013–Sep.	30,	2013	3%	11	565
Oct.	1,	2013–Dec.	31,	2013	3%	11	565
Jan.	1,	2014–Mar.	31,	2014	3%	11	565
Apr.	1,	2014–Jun.	30,	2014	3%	11	565
Jul.	1,	2014–Sep.	30,	2014	3%	11	565
Oct.	1,	2014–Dec.	31,	2014	3%	11	565
Jan.	1,	2015–Mar.	31,	2015	3%	11	565
Apr.	1,	2015–Jun.	30,	2015	3%	11	565
Jul.	1,	2015–Sep.	30,	2015	3%	11	565
Oct.	1.	2015–Dec.	31,	2015	3%	11	565
Jan.	1,	2016–Mar.	31,	2016	3%	59	613
Apr.	1,	2016–Jun.	30,	2016	4%	61	615
Jul.	1,	2016–Sep.	30,	2016	4%	61	615
Oct.	1,	2016–Dec.	31,	2016	4%	61	615
Jan.	1,	2017–Mar.	31,	2017	4%	13	567
Apr.	1,	2017–Jun.	30,	2017	4%	13	567
Jul.	1,	2017–Sep.	30,	2017	4%	13	567
Oct.	1,	2017–Dec.	31,	2017	4%	13	567
Jan.	1,	2018–Mar.	31,	2018	4%	13	567
Apr.	1,	2018–Jun.	30,	2018	5%	15	569
Jul.	1,	2018–Sep.	30,	2018	5%	15	569
Oct.	1,	2018–Dec.	31,	2018	5%	15	569
Jan.	1,	2019–Mar.	31,	2019	6%	17	571
Apr.	1,	2019–Jun.	30,	2019	6%	17	571
Jul.	1,	2019–Sep.	30,	2019	5%	15	569
Oct.	1,	2019–Dec.	31,	2019	5%	15	569
Jan.	1,	2020–Mar.	31,	2020	5%	63	617

TABLE OF INTEREST RATES FROM JANUARY 1, 1999 - PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

					OVERPAYMENTS			UNDERPAYMENTS		
					1995-1 C.B.			1995-1 C.B.		
					RATE	TABLE	PG	RATE	TABLE	PG
Jan.	1,	1999–Mar.	31,	1999	6%	17	571	7%	19	573
Apr.	1,	1999–Jun.	30,	1999	7%	19	573	8%	21	575
Jul.	1,	1999–Sep.	30,	1999	7%	19	573	8%	21	575
Oct.	1,	1999–Dec.	31,	1999	7%	19	573	8%	21	575
Jan.	1,	2000–Mar.	31,	2000	7%	67	621	8%	69	623
Apr.	1,	2000–Jun.	30,	2000	8%	69	623	9%	71	625
Jul.	1,	2000–Sep.	30,	2000	8%	69	623	9%	71	625
Oct.	1,	2000–Dec.	31,	2000	8%	69	623	9%	71	625
Jan.	1,	2001–Mar.	31,	2001	8%	21	575	9%	23	577
Apr.	1,	2001–Jun.	30,	2001	7%	19	573	8%	21	575
Jul.	1,	2001–Sep.	30,	2001	6%	17	571	7%	19	573
Oct.	1,	2001–Dec.	31,	2001	6%	17	571	7%	19	573
Jan.	1,	2002–Mar.	31,	2002	5%	15	569	6%	17	571
Apr.	1,	2002–Jun.	30,	2002	5%	15	569	6%	17	571
Jul.	1,	2002–Sep.	30,	2002	5%	15	569	6%	17	571
Oct.	1,	2002–Dec.	31,	2002	5%	15	569	6%	17	571
Jan.	1,	2003–Mar.	31,	2003	4%	13	567	5%	15	569
Apr.	1,	2003–Jun.	30,	2003	4%	13	567	5%	15	569
Jul.	1,	2003–Sep.	30,	2003	4%	13	567	5%	15	569
Oct.	1,	2003–Dec.	31,	2003	3%	11	565	4%	13	567
Jan.	1,	2004–Mar.	31,	2004	3%	59	613	4%	61	615
Apr.	1,	2004–Jun.	30,	2004	4%	61	615	5%	63	617
Jul.	1,	2004–Sep.	30,	2004	3%	59	613	4%	61	615
Oct.	1,	2004–Dec.	31,	2004	4%	61	615	5%	63	617
Jan.	1,	2005–Mar.	31,	2005	4%	13	567	5%	15	569
Apr.	1,	2005–Jun.	30,	2005	5%	15	569	6%	17	571
Jul.	1,	2005–Sep.	30,	2005	5%	15	569	6%	17	571
Oct.	1,	2005–Dec.	31,	2005	6%	17	571	7%	19	573
Jan.	1,	2006–Mar.	31,	2006	6%	17	571	7%	19	573
Apr.	1,	2006–Jun.	30,	2006	6%	17	571	7%	19	573
Jul.	1,	2006–Sep.	30,	2006	7%	19	573	8%	21	575
Oct.	1,	2006–Dec.	31,	2006	7%	19	573	8%	21	575
Jan.	1,	2007–Mar.	31,	2007	7%	19	573	8%	21	575
Apr.	1,	2007–Jun.	30,	2007	7%	19	573	8%	21	575
Jul.	1,	2007–Sep.	30,	2007	7%	19	573	8%	21	575
Oct.	1,	2007–Dec.	31,	2007	7%	19	573	8%	21	575
Jan.	1,	2008–Mar.	31,	2008	6%	65	619	7%	67	621
Apr.	1,	2008–Jun.	30,	2008	5%	63	617	6%	65	619
Jul.	1,	2008–Sep.	30,	2008	4%	61	615	5%	63	617
Oct.	1,	2008–Dec.	31,	2008	5%	63	617	6%	65	619
Jan.	1,	2009–Mar.	31,	2009	4%	13	567	5%	15	569

Apr.	1,	2009–Jun.	30,	2009	3%	11	565	4%	13	567
Jul.	1,	2009–Sep.	30,	2009	3%	11	565	4%	13	567
Oct.	1,	2009–Dec.	31,	2009	3%	11	565	4%	13	567
Jan.	1,	2010–Mar.	31,	2010	3%	11	565	4%	13	567
Apr.	1,	2010–Jun.	30,	2010	3%	11	565	4%	13	567
Jul.	1,	2010–Sep.	30,	2010	3%	11	565	4%	13	567
Oct.	1,	2010–Dec.	31,	2010	3%	11	565	4%	13	567
Jan.	1,	2011–Mar.	31,	2011	2%	9	563	3%	11	565
Apr.	1,	2011–Jun.	30,	2011	3%	11	565	4%	13	567
Jul.	1,	2011–Sep.	30,	2011	3%	11	565	4%	13	567
Oct.	1,	2011–Dec.	31,	2011	2%	9	563	3%	11	565
Jan.	1,	2012–Mar.	31,	2012	2%	57	611	3%	59	613
Apr.	1,	2012–Jun.	30,	2012	2%	57	611	3%	59	613
Jul.	1,	2012–Sep.	30,	2012	2%	57	611	3%	59	613
Oct.	1,	2012–Dec.	31,	2012	2%	57	611	3%	59	613
Jan.	1,	2013–Mar.	31,	2013	2%	9	563	3%	11	565
Apr.	1,	2013–Jun.	30,	2013	2%	9	563	3%	11	565
Jul.	1,	2013–Sep.	30,	2013	2%	9	563	3%	11	565
Oct.	1,	2013–Dec.	31,	2013	2%	9	563	3%	11	565
Jan.	1,	2014–Mar.	31,	2014	2%	9	563	3%	11	565
Apr.	1,	2014–Jun.	30,	2014	2%	9	563	3%	11	565
Jul.	1,	2014–Sep.	30,	2014	2%	9	563	3%	11	565
Oct.	1,	2014–Dec.	31,	2014	2%	9	563	3%	11	565
Jan.	1,	2015–Mar.	31,	2015	2%	9	563	3%	11	565
Apr.	1,	2015–Jun.	30,	2015	2%	9	563	3%	11	565
Jul.	1,	2015–Sep.	30,	2015	2%	9	563	3%	11	565
Oct.	1,	2015–Dec.	31,	2015	2%	9	563	3%	11	565
Jan.	1,	2016–Mar.	31,	2016	2%	57	611	3%	59	613
Apr.	1,	2016–Jun.	30,	2016	3%	59	613	4%	61	615
Jul.	1,	2016–Sep.	30,	2016	3%	59	613	4%	61	615
Oct.	1,	2016–Dec.	31,	2016	3%	59	613	4%	61	615
Jan.	1,	2017–Mar.	31,	2017	3%	11	565	4%	13	567
Apr.	1,	2017–Jun.	30,	2017	3%	11	565	4%	13	567
Jul.	1,	2017–Sep.	30,	2017	3%	11	565	4%	13	567
Oct.	1,	2017–Dec.	31,,	2017	3%	11	565	4%	13	567
Jan.	1,	2018–Mar.	31,	2018	3%	11	565	4%	13	567
Apr.	1,	2018–Jun.	30,	2018	4%	13	567	5%	15	569
Jul.	1,	2018–Sep.	30,	2018	4%	13	567	5%	15	569
Oct.	1,	2018–Dec.	31,	2018	4%	13	567	5%	15	569
Jan.	1,	2019–Mar.	31,	2019	5%	15	569	6%	17	571
Apr.	1,	2019–Jun.	30,	2019	5%	15	569	6%	17	571
Jul.	1,	2019–Sep.	30,	2019	4%	13	567	5%	15	569
Oct.	1,	2019–Dec.	31,	2019	4%	13	567	5%	15	569
Jan.	1,	2020–Mar.	31,	2020	4%	61	615	5%	63	617

TABLE OF INTEREST RATES FOR LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT

						1995-1 C.B.	
					RATE	TABLE	PG
Jan.	1,	1991–Mar.	31,	1991	13%	31	585
Apr.	1,	1991–Jun.	30,	1991	12%	29	583
Jul.	1,	1991–Sep.	30,	1991	12%	29	583
Oct.	1,	1991–Dec.	31,	1991	12%	29	583
Jan.	1,	1992–Mar.	31,	1992	11%	75	629
Apr.	1,	1992–Jun.	30,	1992	10%	73	627
Jul.	1,	1992–Sep.	30,	1992	10%	73	627
Oct.	1,	1992–Dec.	31,	1992	9%	71	625
Jan.	1,	1993–Mar.	31,	1993	9%	23	577
Apr.	1,	1993–Jun.	30,	1993	9%	23	577
Jul.	1,	1993–Sep.	30,	1993	9%	23	577
Oct.	1,	1993–Dec.	31,	1993	9%	23	577
Jan.	1,	1994–Mar.	31,	1994	9%	23	577
Apr.	1,	1994–Jun.	30,	1994	9%	23	577
Jul.	1,	1994–Sep.	30,	1994	10%	25	579
Oct.	1,	1994–Dec.	31,	1994	11%	27	581
Jan.	1,	1995–Mar.	31,	1995	11%	27	581
Apr.	1,	1995–Jun.	30,	1995	12%	29	583
Jul.	1,	1995–Sep.	30,	1995	11%	27	581
Oct.	1,	1995–Dec.	31,	1995	11%	27	581
Jan.	1,	1996–Mar.	31,	1996	11%	75	629
Apr.	1,	1996–Jun.	30,	1996	10%	73	627
Jul.	1,	1996–Sep.	30,	1996	11%	75	629
Oct.	1,	1996–Dec.	31,	1996	11%	75	629
Jan.	1,	1997–Mar.	31,	1997	11%	27	581
Apr.	1,	1997–Jun.	30,	1997	11%	27	581
Jul.	1,	1997–Sep.	30,	1997	11%	27	581
Oct.	1,	1997–Dec.	31,	1997	11%	27	581
Jan.	1,	1998–Mar.	31,	1998	11%	27	581
Apr.	1,	1998–Jun.	30,	1998	10%	25	579
Jul.	1,	1998–Sep.	30,	1998	10%	25	579
Oct.	1,	1998–Dec.	31,	1998	10%	25	579
Jan.	1,	1999–Mar.	31,	1999	9%	23	577
Apr.	1,	1999–Jun.	30,	1999	10%	25	579
Jul.	1,	1999–Sep.	30,	1999	10%	25	579
Oct.	1,	1999–Dec.	31,	1999	10%	25	579
Jan.	1,	2000–Mar.	31,	2000	10%	73	627
Apr.	1,	2000–Jun.	30,	2000	11%	75	629
Jul.	1,	2000–Sep.	30,	2000	11%	75	629
Oct.	1,	2000–Dec.	31,	2000	11%	75	629
Jan.	1,	2001–Mar.	31,	2001	11%	27	581
Apr.	1,	2001–Jun.	30,	2001	10%	25	579

Jul.	1,	2001–Sep.	30,	2001	9%	23	577
Oct.	1,	2001–Dec.	31,	2001	9%	23	577
Jan.	1,	2002–Mar.	31,	2002	8%	21	575
Apr.	1,	2002–Jun.	30,	2002	8%	21	575
Jul.	1,	2002–Sep.	30,	2002	8%	21	575
Oct.	1,	2002–Dec.	31,	2002	8%	21	575
Jan.	1,	2003–Mar.	31,	2003	7%	19	573
Apr.	1,	2003–Jun.	30,	2003	7%	19	573
Jul.	1,	2003–Sep.	30,	2003	7%	19	573
Oct.	1,	2003–Dec.	31,	2003	6%	17	571
Jan.	1,	2004–Mar.	31,	2004	6%	65	619
Apr.	1,	2004–Jun.	30,	2004	7%	67	621
Jul.	1,	2004–Sep.	30,	2004	6%	65	619
Oct.	1,	2004–Dec.	31,	2004	7%	67	621
Jan.	1,	2005–Mar.	31,	2005	7%	19	573
Apr.	1,	2005–Jun.	30,	2005	8%	21	575
Jul.	1,	2005–Sep.	30,	2005	8%	21	575
Oct.	1,	2005–Dec.	31,	2005	9%	23	577
Jan.	1,	2006–Mar.	31,	2006	9%	23	577
Apr.	1,	2006–Jun.	30,	2006	9%	23	577
Jul.	1,	2006–Sep.	30,	2006	10%	25	579
Oct.	1,	2006–Dec.	31,	2006	10%	25	579
Jan.	1,	2007–Mar.	31,	2007	10%	25	579
Apr.	1,	2007–Jun.	30,	2007	10%	25	579
Jul.	1,	2007–Sep.	30,	2007	10%	25	579
Oct.	1,	2007–Dec.	31,	2007	10%	25	579
Jan.	1,	2008–Mar.	31,	2008	9%	71	625
Apr.	1,	2008–Jun.	30,	2008	8%	69	623
Jul.	1,	2008–Sep.	30,	2008	7%	67	621
Oct.	1,	2008–Dec.	31,	2008	8%	69	623
Jan.	1,	2009–Mar.	31,	2009	7%	19	573
Apr.	1,	2009–Jun.	30,	2009	6%	17	571
Jul.	1,	2009–Sep.	30,	2009	6%	17	571
Oct.	1,	2009–Dec.	31,	2009	6%	17	571
Jan.	1,	2010–Mar.	31,	2010	6%	17	571
Apr.	1,	2010–Jun.	30,	2010	6%	17	571
Jul.	1,	2010–Sep.	30,	2010	6%	17	571
Oct.	1,	2010–Dec.	31,	2010	6%	17	571
Jan.	1,	2011–Mar.	31,	2011	5%	15	569
Apr.	1,	2011–Jun.	30,	2011	6%	17	571
Jul.	1,	2011–Sep.	30,	2011	6%	17	571
Oct.	1,	2011–Dec.	31,	2011	5%	15	569
Jan.	1,	2012–Mar.	31,	2012	5%	63	617
Apr.	1,	2012–Jun.	30,	2012	5%	63	617
Jul.	1,	2012–Sep.	30,	2012	5%	63	617

Oct.	1,	2012–Dec.	31,	2012	5%	63	617
Jan.	1,	2013–Mar.	31,	2013	5%	15	569
Apr.	1,	2013–Jun.	30,	2013	5%	15	569
Jul.	1,	2013–Sep.	30,	2013	5%	15	569
Oct.	1,	2013–Dec.	31,	2013	5%	15	569
Jan.	1,	2014–Mar.	31,	2014	5%	15	569
Apr.	1,	2014–Jun.	30,	2014	5%	15	569
Jul.	1,	2014–Sep.	30,	2014	5%	15	569
Oct.	1,	2014–Dec.	31,	2014	5%	15	569
Jan.	1,	2015–Mar.	31,	2015	5%	15	569
Apr.	1,	2015–Jun.	30,	2015	5%	15	569
Jul.	1,	2015–Sep.	30,	2015	5%	15	569
Oct.	1,	2015–Dec.	31,	2015	5%	15	569
Jan.	1,	2016–Mar.	31,	2016	5%	63	617
Apr.	1,	2016–Jun.	30,	2016	6%	65	619
Jul.	1,	2016–Sep.	30,	2016	6%	65	619
Oct.	1,	2016–Dec.	31,	2016	6%	65	619
Jan.	1,	2017–Mar.	31,	2017	6%	17	571
Apr.	1,	2017–Jun.	30,	2017	6%	17	571
Jul.	1,	2017–Sep.	30,	2017	6%	17	571
Oct.	1,	2017–Dec.	31,	2017	6%	17	571
Jan.	1,	2018–Mar.	31,	2018	6%	17	571
Apr.	1,	2018–Jun.	30,	2018	7%	19	573
Jul.	1,	2018–Sep.	30,	2018	7%	19	573
Oct.	1,	2018–Dec.	31,	2018	7%	19	573
Jan.	1,	2019–Mar.	31,	2019	8%	21	575
Apr.	1,	2019–Jun.	30,	2019	8%	21	575
Jul.	1,	2019–Sep.	30,	2019	7%	19	573
Oct.	1,	2019–Dec.	31,	2019	7%	19	573
Jan.	1,	2020–Mar.	31,	2020	7%	67	621

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 – PRESENT

						1995-1 C.B.	
					RATE	TABLE	PG
Jan.	1,	1995–Mar.	31,	1995	6.5%	18	572
Apr.	1,	1995–Jun.	30,	1995	7.5%	20	574
Jul.	1,	1995–Sep.	30,	1995	6.5%	18	572
Oct.	1,	1995–Dec.	31,	1995	6.5%	18	572
Jan.	1,	1996–Mar.	31,	1996	6.5%	66	620
Apr.	1,	1996–Jun.	30,	1996	5.5%	64	618
Jul.	1,	1996–Sep.	30,	1996	6.5%	66	620
Oct.	1,	1996–Dec.	31,	1996	6.5%	66	620
Jan.	1,	1997–Mar.	31,	1997	6.5%	18	572
Apr.	1,	1997–Jun.	30,	1997	6.5%	18	572
Jul.	1,	1997–Sep.	30,	1997	6.5%	18	572
Oct.	1,	1997–Dec.	31,	1997	6.5%	18	572
Jan.	1,	1998–Mar.	31,	1998	6.5%	18	572
Apr.	1,	1998–Jun.	30,	1998	5.5%	16	570
Jul.	1.	1998–Sep.	30,	1998	5.5%	16	570
Oct.	1,	1998–Dec.	31,	1998	5.5%	16	570
Jan.	1,	1999–Mar.	31,	1999	4.5%	14	568
Apr.	1,	1999–Jun.	30,	1999	5.5%	16	570
Jul.	1,	1999–Sep.	30,	1999	5.5%	16	570
Oct.	1,	1999–Dec.	31,	1999	5.5%	16	570
Jan.	1,	2000–Mar.	31,	2000	5.5%	64	618
Apr.	1,	2000–Jun.	30,	2000	6.5%	66	620
Jul.	1,	2000–Sep.	30,	2000	6.5%	66	620
Oct.	1,	2000–Dec.	31,	2000	6.5%	66	620
Jan.	1,	2001–Mar.	31,	2001	6.5%	18	572
Apr.	1,	2001–Jun.	30,	2001	5.5%	16	570
Jul.	1,	2001–Sep.	30,	2001	4.5%	14	568
Oct.	1,	2001–Dec.	31,	2001	4.5%	14	568
Jan.	1,	2002–Mar.	31,	2002	3.5%	12	566
Apr.	1,	2002–Jun.	30,	2002	3.5%	12	566
Jul.	1,	2002–Sep.	30,	2002	3.5%	12	566
Oct.	1,	2002–Dec.	31,	2002	3.5%	12	566
Jan.	1,	2003–Mar.	31,	2003	2.5%	10	564
Apr.	1,	2003–Jun.	30,	2003	2.5%	10	564
Jul.	1,	2003–Sep.	30,	2003	2.5%	10	564
Oct.	1,	2003–Dec.	31,	2003	1.5%	8	562
Jan.	1,	2004–Mar.	31,	2004	1.5%	56	610
Apr.	1,	2004–Jun.	30,	2004	2.5%	58	612

Jul.	1,	2004–Sep.	30,	2004	1.5%	56	610
Oct.	1,	2004–Dec.	31,	2004	2.5%	58	612
Jan.	1,	2005–Mar.	31,	2005	2.5%	10	564
Apr.	1,	2005–Jun.	30,	2005	3.5%	12	566
Jul.	1,	2005–Sep.	30,	2005	3.5%	12	566
Oct.	1,	2005–Dec.	31,	2005	4.5%	14	568
Jan.	1,	2006–Mar.	31,	2006	4.5%	14	568
Apr.	1,	2006–Jun.	30,	2006	4.5%	14	568
Jul.	1,	2006–Sep.	30,	2006	5.5%	16	570
Oct.	1,	2006–Dec.	31,	2006	5.5%	16	570
Jan.	1,	2007–Mar.	31,	2007	5.5%	16	570
Apr.	1,	2007–Jun.	30,	2007	5.5%	16	570
Jul.	1,	2007–Sep.	30,	2007	5.5%	16	570
Oct.	1,	2007–Dec.	31,	2007	5.5%	16	570
Jan.	1,	2008–Mar.	31,	2008	4.5%	62	616
Apr.	1,	2008–Jun.	30,	2008	3.5%	60	614
Jul.	1,	2008–Sep.	30,	2008	2.5%	58	612
Oct.	1,	2008–Dec.	31,	2008	3.5%	60	614
Jan.	1,	2009–Mar.	31,	2009	2.5%	10	564
Apr.	1,	2009–Jun.	30,	2009	1.5%	8	562
Jul.	1,	2009–Sep.	30,	2009	1.5%	8	562
Oct.	1,	2009–Dec.	31,	2009	1.5%	8	562
Jan.	1,	2010–Mar.	31,	2010	1.5%	8	562
Apr.	1,	2010–Jun.	30,	2010	1.5%	8	562
Jul.	1,	2010–Sep.	30,	2010	1.5%	8	562
Oct.	1,	2010–Dec.	31,	2010	1.5%	8	562
Jan.	1,	2011–Mar.	31,	2011	0.5%*		
Apr.	1,	2011–Jun.	30,	2011	1.5%	8	562
Jul.	1,	2011–Sep.	30,	2011	1.5%	8	562
Oct.	1,	2011–Dec.	31,	2011	0.5%*		
Jan.	1,	2012–Mar.	31,	2012	0.5%*		
Apr.	1,	2012–Jun.	30,	2012	0.5%*		
Jul.	1,	2012–Sep.	30,	2012	0.5%*		
Oct.	1,	2012–Dec.	31,	2012	0.5%*		
Jan.	1,	2013–Mar.	31,	2013	0.5%*		
Apr.	1,	2013–Jun.	30,	2013	0.5%*		
Jul.	1,	2013–Sep.	30,	2013	0.5%*		
Oct.	1,	2013–Dec.	31,	2013	0.5%*		
Jan.	1,	2014–Mar.	31,	2014	0.5%*		
Apr.	1,	2014–Jun.	30,	2014	0.5%*		
Jul.	1,	2014–Sep.	30,	2014	0.5%*		

Oct.	1,	2014–Dec.	31,	2014	0.5%*		
Jan.	1,	2015–Mar.	31,	2015	0.5%*		
Apr.	1,	2015–Jun.	30,	2015	0.5%*		
Jul.	1,	2015–Sep.	30,	2015	0.5%*		
Oct.	1,	2015–Dec.	31,	2015	0.5%*		
Jan.	1,	2016–Mar.	31,	2016	0.5%*		
Apr.	1,	2016–Jun.	30,	2016	1.5%	56	610
Jul.	1,	2016–Sep.	30,	2016	1.5%	56	610
Oct.	1,	2016–Dec.	31,	2016	1.5%	56	610
Jan.	1,	2017–Mar.	31,	2017	1.5%	8	562
Apr.	1,	2017–Jun.	30,	2017	1.5%	8	562
Jul.	1,	2017–Sep.	30,	2017	1.5%	8	562
Oct.	1,	2017–Dec.	31,	2017	1.5%	8	562
Jan.	1,	2018–Mar.	31,	2018	1.5%	8	562
Apr.	1,	2018–Jun.	30,	2018	2.5%	10	564
Jul.	1,	2018–Sep.	30,	2018	2.5%	10	564
Oct.	1,	2018–Dec.	31,	2018	2.5%	10	564
Jan.	1,	2019–Mar.	31,	2019	3.5%	12	566
Apr.	1,	2019–Jun.	30,	2019	3.5%	12	566
Jul.	1,	2019–Sep.	30,	2019	2.5%	10	564
Oct.	1,	2019–Dec.	31,	2019	2.5%	10	564
Jan.	1,	2020–Mar.	31,	2020	2.5%	58	612

* The asterisk reflects the interest factors for daily compound interest for annual rates of 0.5 percent published in Appendix A of this Revenue Ruling.

26 CFR 1.59A-1 through 1.59A-10

T.D. 9885

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Base Erosion and Anti-Abuse Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations implementing the base erosion and anti-abuse tax, designed to prevent the reduction of tax liability by certain large corporate taxpayers through certain payments made to foreign related parties and certain tax credits. These final regulations also provide reporting requirements related to this tax. This tax was added to the Internal Revenue Code (the "Code") as part of the Tax Cuts and Jobs Act. This document finalizes the proposed regulations published on December 21, 2018. The final regulations affect corporations with substantial gross receipts that make payments to foreign related parties. The final regulations also affect any reporting corporations required to furnish information relating to certain related-party transactions and information relating to a trade or business conducted within the United States by a foreign corporation.

DATES: *Effective date*: The final regulations are effective on December 6, 2019.

Applicability dates: For dates of applicability, see §§1.59A-10, 1.1502-2(d), 1.1502-59A(h), and 1.6038A-2(g).

FOR FURTHER INFORMATION CONTACT: Concerning §§1.59A-1 through 1.59A-10, Azeka J. Abramoff, Sheila Ramaswamy, or Karen Walny at (202) 317-6938; concerning the services cost method exception, L. Ulysses Chatman at (202) 317-6939; concerning §§1.383-1, 1.1502-2, 1.1502-4, 1.1502-43, 1.1502-47, 1.1502-59A, 1.1502-100, and 1.6655-5, Julie Wang at (202) 317-6975 or John P. Stemwedel at (202) 317-5024; concerning §§1.6038A-1, 1.6038A-2, and 1.6038A-4, Brad McCormack or Anand Desai at (202) 317-6939 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On December 21, 2018, the Department of the Treasury ("Treasury Department") and the IRS published proposed regulations (REG-104259-18) under section 59A, and proposed amendments to 26 CFR part 1 under sections 383, 1502, 6038A, and 6655 in the **Federal Register** (83 FR 65956) (the "proposed regulations"). The base erosion and anti-abuse tax ("BEAT") in section 59A was added to the Code by the Tax Cuts and Jobs Act, Pub. L. 115-97 (2017) (the "Act"), which was enacted on December 22, 2017. The Act also added reporting obligations regarding this tax for 25-percent foreign-owned corporations subject to section 6038A and foreign corporations subject to section 6038C.

A public hearing was held on March 25, 2019. The Treasury Department and the IRS also received written comments with respect to the proposed regulations. Comments outside the scope of this rulemaking are generally not addressed but may be considered in connection with future guidance projects. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request.

Summary of Comments and Explanation of Revisions

I. *Overview*

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions discusses those revisions as well as comments received in response to the solicitation of comments in the notice of proposed rulemaking accompanying the proposed regulations.

II. *Comments and Changes to Proposed §1.59A-1—Overview and Definitions*

Proposed §1.59A-1 provides general definitions under section 59A. Proposed §1.59A-1(b)(17) provides a definition of the term "related party." The proposed regulations generally define a related party with respect to an applicable taxpayer as (a) any 25-percent owner of the taxpayer, (b) any person related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer, or (c) a controlled taxpayer within the meaning of §1.482-1(i)(5).

The proposed regulations' definition of "related party" is identical to the definition provided by section 59A(g), except with respect to the relatedness standard under section 482. Specifically, the proposed regulations provide a more precise citation to the section 482 regulations ("a controlled taxpayer within the meaning of §1.482-1(i)(5)") than the general cross-reference that is provided in section 59A(g)(1)(C) ("any other person who is related (within the meaning of section 482) to the taxpayer").

Comments recommended that the final regulations modify the definition of "related party" to exclude related publicly traded companies or otherwise provide an exception for payments between publicly traded companies. These comments suggested that payments between related publicly traded companies do not result in base erosion. The comments explained that the boards of directors of publicly traded companies generally have fiduciary obligations to shareholders to act in the best interest of the company and are subject to regulatory oversight. On this basis, the comments asserted that a domestic corporation cannot artificially shift profits to a foreign corporation in this situation. Comments also noted that the Treasury Department and the IRS have provided relief for publicly traded companies in circumstances where there is no explicit legislative history or statutory authority to do so, such as where minority shareholders of publicly traded companies must be identified. *See* §1.367(e)-1(d)(3) and §1.382-2T(j).

The Treasury Department and the IRS have determined that it is not appropriate to modify the statutory definition of

a related party to exclude publicly traded companies because this recommendation is inconsistent with the statutory language of section 59A(g). Section 59A(g) sets forth specific limits on the definition of a "related party" that include a corporation and its 25-percent owner. Under the proposal recommended by the comments, section 59A would not apply to any less than 100 percent owned affiliate, so long as other "public" shareholders owned some interest in the corporation. The corporate laws of a state of the United States or a foreign jurisdiction may, and often do, impose certain duties on the board of directors of a company, including obligations with respect to the interests of minority shareholders. These companies are also subject to securities laws in the United States. Notwithstanding this regulatory environment, the Code includes many provisions that apply to related parties, and none of those provisions are limited to corporations that are 100 percent related.

For example, section 267(a) generally applies to transactions among greater than 50 percent controlled parties. Section 482 provides a test that can be satisfied by a quantitative measure of ownership or a qualitative test of control ("two or more organizations, trades, or businesses… owned or controlled directly or indirectly by the same interests"), that, as interpreted by regulations, can apply at well below a 100 percent relatedness standard. *See* §1.482-1(i)(5). Other sections of the Code apply based on a relatedness standard of 80 percent. *See*, *generally*, section 1504; section 351(a). In section 59A, Congress adopted, disjunctively, both the 50 percent relatedness-test from section 267(a) and the relatedness-test from section 482. Moreover, Congress also added, disjunctively, a lower objective standard for determining relatedness for a 25-percent owner.

Finally, the Treasury Department and IRS concluded that a rule that confers special status on payments to a publicly traded foreign corporation that is related (using a 25 percent or greater standard) to the payor would not be analogous to the rules in §1.367(e)-1(d)(3) or §1.382-2T(j), which provide special rules that pertain to shareholders that own less than 5 percent of publicly traded corporations, in light of challenges in determining the identity of such shareholders.

For these reasons, the final regulations do not modify the relatedness thresholds that are set forth in section 59A and the proposed regulations.

III. *Comments and Changes to Proposed §1.59A-2—Applicable Taxpayer, Aggregation Rules, Gross Receipts Test, and Base Erosion Percentage Test*

Proposed §1.59A-2 contains rules for determining whether a taxpayer is an applicable taxpayer on which the BEAT may be imposed, including rules relating to the gross receipts test, base erosion percentage test, and the determination of the aggregate group for purposes of applying these tests.

A. *Determining the gross receipts and base erosion percentage of an aggregate group that includes a RIC, a REIT, or an entity treated as a corporation by section 892*

Section 59A(e)(1)(A) excludes corporations that are (1) regulated investment companies ("RICs"), (2) real estate investment trusts ("REITs"), or (3) S corporations from the definition of an applicable taxpayer. A comment requested that the final regulations clarify that controlled RICs and REITs are similarly excluded from the aggregate group for purposes of the gross receipts test and base erosion percentage test. The comment implied that the Treasury Department and the IRS did not intend for RICs and REITs to be part of an aggregate group because RICs and REITs are not subject to the BEAT as separate taxpayers. The proposed regulations do not exclude RICs and REITs from membership in an aggregate group. A corporation is an applicable taxpayer if it is not one of the excluded categories of corporations (RIC, REIT, or S corporation), it satisfies the gross receipts test in section 59A(e)(1)(B), and it satisfies the base erosion percentage test in section 59A(e)(1)(C). The proposed regulations provide that when applying the gross receipts test and the base erosion percentage test with respect to a particular corporation for purposes of section 59A, those tests are applied on the basis of that corporation and members of that corporation's aggregate group. The proposed regulations define an aggregate group by reference to section 1563(a) in a manner consistent with section 59A(e)(3), which references section 1563(a) indirectly. The section 1563(a) definition refers to controlled groups of corporations, whether brother-sister groups or parent-subsidiary groups. Section 1563(c) provides special rules excluding certain categories of stock in a corporation from the aggregation rules in section 1563(a) (for example, certain stock held by an organization to which section 501 applies). None of those provisions exclude the stock of, or held by, a RIC or REIT. Moreover, just as the gross receipts and deductions of non-applicable taxpayers (such as partnerships) can inure to the benefit of an applicable taxpayer (such as a domestic corporation that is a partner in a partnership), so too can the gross receipts and deductions of a controlled RIC or REIT that is a member of a corporation's aggregate group inure to the benefit of that corporation. Because of these considerations, the final regulations do not adopt this recommendation.

Similarly, another comment requested that the final regulations exclude from the aggregate group foreign government owners of stock of corporations when the foreign government is treated as a corporation under section 892 and the regulations thereunder. The comment cited the exclusion from section 1563(a) of certain stock held by an organization to which section 501 applies, and suggested that a foreign government should be provided similar treatment because a foreign government, like a section 501 organization, does not have private shareholders. In addition, the comment asserted that it cannot be engaged in direct commercial activities with respect to its portfolio companies and that its investment managers consist of separate teams.

The Treasury Department and the IRS have determined that it is not appropriate to provide a regulatory exception from the aggregate group rules for entities that are commonly controlled by a foreign government shareholder and that are treated as corporations under section 892. Congress provided that the activities of an aggregate group are fully taken into account when applying the gross receipts test and the base erosion percentage test to a corpora-

tion. The fact that a common shareholder of a different chain of corporations may be more passive than other common shareholders, or that the common shareholder's investment teams are within different lines of a management structure does not change the fact the common shareholder has economic interests in the subsidiary corporation that is within the statutory aggregate group definition adopted for section 59A. Accordingly, the final regulations do not adopt this recommendation.

B. *Gross receipts from certain inventory and similar transactions*

To determine gross receipts, section 59A(e)(2)(B) provides for "rules similar to the rules" of section 448(c)(3)(B), (C), and (D). Accordingly, these final regulations provide rules that are similar to, but not necessarily the same as, the rules of section 448(c)(3) and the implementing regulations. Proposed §1.59A-1(b)(13) defines the term "gross receipts" for purposes of section 59A by reference to §1.448-1T(f)(2)(iv), which provides that gross receipts include total sales, net of returns and allowances, and all amounts received for services. Section 1.448-1T(f)(2)(iv) further provides that gross receipts are not reduced by cost of goods sold ("COGS") or reduced by the cost of property sold if such property is described in section 1221(a)(1), (3), (4), or (5) (types of property excluded from the definition of a capital asset). Separately, §1.448-1T(f)(2)(iv) provides that gross receipts from the sale of capital assets or a sale of property described in section 1221(a)(2) (relating to property used in a trade or business) are reduced by the adjusted basis of the property sold. Section 1.448-1T(f)(2)(iv) further provides that gross receipts include income from investments, but not the repayment of a loan or similar instrument.

Comments observed that, pursuant to the definition of gross receipts in the proposed regulations, banks that originate and then sell loans are required to include the gross proceeds from the sale of the loan in their gross receipts because banks generally treat loans originated in the ordinary course of business as ordinary assets under section 1221(a)(4). These comments contrasted a situation where a bank originates and holds a loan to maturity, in which case the proceeds the bank receives upon repayment are not included in gross receipts due to the express exclusion of these amounts contained in §1.448-1T(f)(2)(iv). The comments recommended that the regulations provide for a separate reduction of gross receipts from the sale of a loan for the basis in loans originated by a bank. Another comment recommended a similar exception for a bank or broker-dealer that holds stocks and bonds in inventory. This comment proposed that final regulations permit banks and broker-dealers to reduce gross receipts from ordinary course sales of stocks and bonds by the basis of these instruments. The comment also observed that the gains or losses recognized with respect to the stocks and bonds are from sales in the ordinary course and may be small relative to the cost basis in the property.

The final regulations do not adopt the approach suggested by these comments. The final regulations continue to define the term "gross receipts" by cross-referencing to §1.448-1T(f)(2)(iv), and those rules are used to determine how an item is included in gross receipts. The rules in section 59A for implementing the gross receipts test are similar to the rules described in section 448(c). *See* section 59A(e)(3) (adopting an aggregation rule similar to that in section 448(c)(2)); section 59A(e)(2)(B) (specifically cross-referencing rules similar to section 448(c)(3)(B), (C), and (D) for the treatment of short taxable years, reductions for returns and allowances, and predecessors, respectively); and section 59A(e)(2)(A) (adopting a broad concept of gross receipts, narrowed to exclude gross receipts of a foreign person that are not taken into account in determining income that is effectively connected with the conduct of a trade or business within the United States). Because of this statutory link between section 59A(e)(2) and section 448, the final regulations adopt the definition of gross receipts for purposes of section 59A that is used for section 448 purposes–that is, the definition in §1.448-1T(f)(2)(iv). Because the Act includes other new rules that cross-reference section 448, the Treasury Department and the IRS are studying section 448 generally and whether changes should be made to the regulations under section 448 to take into account the Act.

C. *Determining the Aggregate Group for Purposes of Applying the Gross Receipts Test and Base Erosion Percentage Test*

Section 59A determines the status of a corporation as an applicable taxpayer on the basis of the aggregate group rules by taking into account the gross receipts and base erosion payments of each member of the aggregate group. However, each taxpayer must compute the amount of gross receipts and base erosion payments for its aggregate group using its own taxable year and based on those corporations that are members of the aggregate group at the end of the taxable year. *See* section 59(e)(3). Therefore, members with different taxable years may have different base erosion percentages.

1. Members of an Aggregate Group with Different Taxable Years

The proposed regulations provide rules for determining whether the gross receipts test and base erosion percentage test are satisfied for purposes of section 59A with respect to a specific taxpayer when other members of its aggregate group have different taxable years. *See* proposed §1.59A-2(e)(3)(vii). In general, the proposed regulations provide that, for purposes of section 59A only, each taxpayer determines its gross receipts and base erosion percentage by reference to its own taxable year, taking into account the results of other members of its aggregate group during that taxable year. In other words, the gross receipts, base erosion tax benefits, and deductions of the aggregate group for a taxable year are determined by reference to the taxpayer's own taxable year, without regard to the taxable year of the other member. This rule applies regardless of whether the taxable year of the member begins before January 1, 2018; as a result, a taxpayer includes gross receipts, base erosion tax benefits, and deductions of the member even if that member is not subject to section 59A for that taxable year. The proposed regulations adopted this approach to reduce compliance burden through providing certainty for taxpayers and avoid the complexity of a rule that

identifies a single taxable year for an aggregate group for purposes of section 59A that may differ from a particular member of the aggregate group's taxable year. As a result, under the proposed regulations, two related taxpayers with different taxable years may compute their respective gross receipts and base erosion percentages for purposes of section 59A by reference to different periods, even though each taxpayer calculates these amounts on an aggregate group basis that takes into account other members of the controlled group. The preamble to the proposed regulations explains that taxpayers may use a reasonable method to determine the gross receipts and base erosion percentage information with regard to the taxable year of the taxpayer when members of the aggregate group of the taxpayer have a different taxable year. REG-104259-18, 83 FR 65956, 65959 (December 21, 2018).

Comments expressed concern regarding the potential administrative burdens of treating all members of a taxpayer's aggregate group as having the same taxable year as the taxpayer. These comments argued that, in many cases, companies do not maintain monthly accounting records as detailed as they do on a quarterly basis (for publicly traded companies) or an annual basis (for privately held companies). Also, comments noted that this rule does not take into account the effect of deductions that are determined on a yearly basis or subject to annual limitations, such as under section 163(j).

Comments requested that the determination of gross receipts and the base erosion percentage of a taxpayer's aggregate group be made on the basis of the taxpayer's taxable year and the taxable year of each member of its aggregate group that ends with or within the applicable taxpayer's taxable year (the "with-or-within method"). With respect to members of an aggregate group with different taxable years, the Treasury Department and the IRS appreciate the concerns raised regarding the potential administrative burden of proposed §1.59A-2(e)(3)(vii) and believe that the approach described in the comments represents a reasonable approach. The final regulations, therefore, adopt the with-or-within method, for purposes of section 59A only, to determine the gross receipts and the base erosion percentage of an aggregate group. *See* §1.59A-2(c)(3). In addition, the Treasury Department and the IRS are issuing a notice of proposed rulemaking (the "2019 proposed regulations") published in the same issue of the **Federal Register** as these final regulations that proposes rules to further address how to implement the with-or-within method, and how to take into account the changing composition of the aggregate group with respect to a particular taxpayer during the relevant periods for applying the gross receipts test and the base erosion percentage test. The final regulations do not include rules on predecessors or short taxable years. Instead, rules relating to these situations have been re-proposed in the 2019 proposed regulations. Until final rules are applicable relating to predecessors or short taxable years, taxpayers must take a reasonable approach consistent with section 59A(e)(2)(B) to determine gross receipts and base erosion benefits in these situations.

2. Time for Determining that Transactions Occurred Between Members of the Aggregate Group

The proposed regulations provide that, for purposes of section 59A, transactions that occur between members of the aggregate group that were members of the aggregate group at the time of the transaction are not taken into account for purposes of determining the gross receipts and base erosion percentage of an aggregate group. *See* proposed §1.59A-2(c). In the case of a foreign corporation that is a member of an aggregate group, only transactions that relate to income effectively connected with the conduct of a trade or business in the United States are disregarded for this purpose. The preamble to the proposed regulations explains that this limitation on the extent to which foreign corporations are included in the aggregate group is intended to prevent payments from a domestic corporation, or a foreign corporation with respect to effectively connected income, to a foreign related person, from being inappropriately excluded from the base erosion percentage test. REG-104259-18, 83 FR 65956, 65957 (December 21, 2018).

A comment requested clarity on determining whether transactions between members of an aggregate group are disregarded. Specifically, the comment requested clarity on whether a transaction is disregarded when both parties to the transaction are members of the aggregate group at the time of the transaction, or whether it is also a condition that both parties to the transaction must also be members of the aggregate group on the last day of the taxpayer's taxable year.

As requested by the comment, the final regulations clarify that a transaction between parties is disregarded for purposes of section 59A when determining the gross receipts and base erosion percentage of an aggregate group if both parties were members of the aggregate group at the time of the transaction, without regard to whether the parties were members of the aggregate group on the last day of the taxpayer's taxable year. *See* §1.59A-2(c)(1).

3. Base Erosion Tax Benefits and Deductions of a Member of an Aggregate Group with a Taxable Year Beginning Before January 1, 2018.

For purposes of determining the base erosion percentage, comments also expressed concern about including the base erosion tax benefits and deductions of a member when the taxable year of the member begins before January 1, 2018. The comments noted that this taxable year of the member is not otherwise subject to section 59A because of the effective date in section 14401(e) of the Act. However, one comment agreed with including these base erosion tax benefits and deductions in the aggregate group of a taxpayer for a taxable year of the taxpayer to which section 59A applies.

The Treasury Department and the IRS agree with comments that it is not appropriate for a taxpayer to include base erosion tax benefits and deductions attributable to a taxable year of a member of its aggregate group that begins before the effective date of section 59A when determining the base erosion percentage of the aggregate group. Accordingly, when determining the base erosion percentage of an aggregate group, the final regulations exclude the base erosion tax benefits and deductions attributable to the taxable year of a member of the aggregate group that begins before January 1, 2018. *See* §1.59A-2(c)(8). This rule avoids requiring

members of an aggregate group to calculate their hypothetical base erosion tax benefits for a year in which the base erosion tax benefit rules do not apply.

4. Other Comments Regarding the Aggregate Group Rules

Comments also addressed the following issues with respect to the aggregate group rules in the proposed regulations: (1) how to take into account transactions when a member joins or leaves an aggregate group, (2) the treatment of predecessors of a taxpayer, (3) the determination of the aggregate group of a consolidated group, and (4) the treatment of short taxable years. The Treasury Department and the IRS continue to study the recommendations provided in several comments relating to these issues. Therefore, the Treasury Department and the IRS are issuing the 2019 proposed regulations to further address aggregate group issues.

D. *Mark-to-market deductions*

To determine the base erosion percentage for the year, the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, the aggregate group) must determine the amount of base erosion tax benefits in the numerator and the total amount of certain deductions, including base erosion tax benefits, in the denominator. The proposed regulations provide rules for determining the total amount of the deductions that are included in the denominator of the base erosion percentage computation in the case of transactions that are marked to market. In determining the amount of the deduction that is used for purposes of the base erosion percentage test, the proposed regulations require the combination of all items of income, deduction, gain, or loss on each marked transaction for the year ("the BEAT Netting Rule"), such as from a payment, accrual, or mark. *See* proposed §1.59A-2(e)(3)(vi). The BEAT Netting Rule was adopted to ensure that only a single deduction is claimed with respect to each marked transaction and to prevent distortions in deductions from being included in the denominator of the base erosion percentage, including as a result of the use of an accounting method that values a position more frequently than annually.

A comment requested guidance clarifying whether the BEAT Netting Rule applies to physical securities such as stocks, bonds, repurchase agreements, and securities loans with respect to which a taxpayer applies a mark-to-market method of accounting. The comment questioned whether the BEAT Netting Rule should apply to these types of positions. The comment acknowledged that the BEAT Netting Rule produces an appropriate result with respect to derivatives by avoiding double-counting of both a current mark-to-market loss as well as a future payment to which the current loss relates. Unlike in the case of many derivatives, the comment observed that transactions involving stocks, bonds, repurchase agreements, and securities loans generally do not result in a loss of value to the holder of the relevant instrument that is subsequently realized in the form of a payment made by the holder and that effectively gives rise to an offsetting mark-up of the instrument.

To illustrate this observation, the comment provided the following example. On January 1, 2018, a dealer buys one share of stock in Company XYZ for $100. Then, during 2018, Company XYZ pays dividends of $1 with respect to the share. On December 31, 2018, the share price of Company XYZ is $90. Finally, on January 1, 2019, the dealer sells the share of Company XYZ stock for $90. The comment noted that in the absence of the BEAT Netting Rule, the amount of the dealer's deduction after marking the stock to market on December 31, 2018, would be $10. With the application of the BEAT Netting Rule, however, the comment noted that the amount of the deduction that will be included in the base erosion percentage denominator is $9. According to this comment, the BEAT Netting Rule may not be necessary to avoid the double-counting of deductions in these transactions, and could result in the netting of amounts that would not be netted under section 475 and that are not duplicative of other inclusions or deductions by the taxpayer.

Proposed §1.59A-2(e)(3)(vi) applies to any position with respect to which the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, a member of the aggregate group) applies a mark-to-market method of accounting. Therefore, the BEAT Netting Rule in the proposed regulations applies to stocks, bonds, repurchase agreements, and securities lending transactions that the taxpayer marks to market, rendering further clarification unnecessary. The Treasury Department and the IRS have determined that the applicability of the BEAT Netting Rule should not be limited in the manner suggested by the comment. In addition to avoiding the double counting that the comment acknowledged, the proposed regulations adopt the BEAT Netting Rule to enhance administrability and reduce compliance burden. That is, having a single rule apply to all transactions that are marked to market will enhance administrability, especially given the challenges in (a) distinguishing the specific financial transactions that should qualify for exclusion; (b) determining whether a distribution or payment received on an excluded instrument is duplicative of other inclusions or deductions; and (c) determining the extent to which a payment ultimately gives rise to an offsetting decline in the value of the instrument. For these reasons, the BEAT Netting Rule in the final regulations does not exclude physical securities.

Another comment recommended that the BEAT Netting Rule should not be mandatory and should instead be included in the final regulations as only a safe harbor. The comment reasoned that section 59A is generally applied on a gross basis and that requiring taxpayers to offset deductions and losses with income and gain when determining the base erosion percentage is inconsistent with a gross approach. The BEAT Netting Rule was adopted to ensure that taxpayers do not overstate the amount of deductions includible in the denominator with respect to transactions subject to a mark-to-market method of accounting. If the BEAT Netting Rule were provided as a safe harbor in the final regulations, as this comment requested, taxpayers could inappropriately inflate the denominator of the base erosion percentage by treating multiple marks as separate deductions. Therefore, the final regulations do not adopt this comment.

As discussed in Part III.D of this Summary of Comments and Explanation of Revisions, the taxpayer must also deter-

mine the amount of base erosion tax benefits in the numerator to determine the base erosion percentage for the year. Proposed §1.59A-3(b)(2)(iii) also applies the BEAT Netting Rule for purposes of determining the amount of base erosion payments that result from transactions that are marked to market. A comment expressed concern that this rule could result in mark-to-market losses being treated as base erosion payments and recommended the withdrawal of proposed §1.59A-3(b)(2)(iii), although the comment observed that if the Treasury Department and the IRS were to adopt the comment to make the qualified derivative payments ("QDP") exception available to securities loans (which is discussed in Part VII of this Summary of Comments and Explanation of Revisions), that change would make this issue moot. The Treasury Department and the IRS do not view this concern to be valid, considering that a mark-to-market loss arising from a deemed sale or disposition of a third-party security held by a taxpayer is not within the general definition of a base erosion payment because the loss is not attributable to any payment made to a foreign related party. Rather, the mark-to-market loss is attributable to a decline in the market value of the security. The Treasury Department and the IRS also note that the BEAT Netting Rule will apply primarily for purposes of determining the amount of deductions that are taken into account in the denominator of the base erosion percentage. The Treasury Department and the IRS agree with the comment that the QDP exception of §1.59A-3(b)(3)(ii) eliminates most mark-to-market transactions from characterization as a base erosion payment, including as a result of the expansion of the QDP exception to apply to the securities leg of a securities loan. See Part VII of this Summary of Comments and Explanation of Revisions for a discussion of the qualification of the securities leg of a securities loan for the QDP exception. Thus, the BEAT Netting Rule will apply only in limited circumstances such as when the taxpayer fails to properly report a QDP. The final regulations therefore continue to apply the BEAT Netting Rule for purposes of determining the amount of base erosion payments that result from transactions that are marked to market.

IV. *Comments and Changes to Proposed §1.59A-3—Base Erosion Payments and Base Erosion Tax Benefits*

Proposed §1.59A-3 contains rules for determining whether a payment or accrual gives rise to a base erosion payment and the base erosion tax benefits that arise from base erosion payments.

A. *How base erosion payments are determined in general*

Proposed §1.59A-3(b)(1) defines a base erosion payment as a payment or accrual by the taxpayer to a foreign related party that is described in one of four categories: (1) a payment with respect to which a deduction is allowable; (2) a payment made in connection with the acquisition of depreciable or amortizable property; (3) premiums or other consideration paid or accrued for reinsurance that is taken into account under section 803(a)(1)(B) or 832(b)(4)(A); or (4) a payment resulting in a reduction of the gross receipts of the taxpayer that is with respect to certain surrogate foreign corporations or related foreign persons.

The Conference Report to the Act states that base erosion payments do not include any amounts that constitute reductions to determine gross income including payments for COGS (except for reductions to determine gross income for certain surrogate foreign corporations). Conf. Rep. at 657. The proposed regulations do not contain a provision that expressly provides that amounts paid or accrued to a related foreign person that result in reductions to determine gross income are not treated as base erosion payments (except in the case of certain surrogate foreign corporations). A comment requested that, in order to provide more certainty to taxpayers, the final regulations expressly reflect that payments that result in reductions to determine gross income are not subject to section 59A. In response to this comment, §1.59A-3(b) has been modified to explicitly clarify that payments resulting in a reduction to determine gross income, including COGS, are not treated as base erosion payments within the meaning of section 59A(d)(1) or (2). *See* §1.59A-3(b)(2)(viii).

The proposed regulations do not establish any specific rules for determining whether a payment is treated as a deductible payment. However, the preamble to the proposed regulations states that, except as otherwise provided in the proposed regulations, the determination of whether a payment or accrual by the taxpayer to a foreign related party is described in one of the four categories is made under general U.S. federal income tax law. REG-104259-18, 83 FR 65956, 65959 (December 21, 2018). The preamble to the proposed regulations refers specifically to agency principles, reimbursement doctrine, case law conduit principles, and assignment of income as examples of principles of generally applicable tax law. *Id*. A comment noted the potential for ambiguity that could result by failing to reflect in the text of the proposed regulations the language contained in the preamble to the proposed regulations and requested that the final regulations provide more specific guidance on how the determination of whether a payment is a base erosion payment is made. In response to this comment, the final regulations include in the regulatory text a rule that the determination of whether a payment or accrual is a base erosion payment is made under general U.S. federal income tax law. *See* §1.59A-3(b)(2)(i).

Similarly, because existing tax law generally applies, the amounts of income and deduction for purposes of section 59A are generally determined on a gross basis under the Code and regulations. The proposed regulations generally do not permit netting of income and expense in determining amounts of base erosion payments. Comments to the proposed regulations requested guidance regarding (1) transactions involving a middle-man or a passthrough payment, (2) divisions of revenues in connection with global service arrangements, and (3) the general netting of income and expense.

1. Transactions Involving a "Middle-Man" or "Passthrough Payments"

Several comments requested additional guidance relating to transactions or arrangements in which a taxpayer serves as a so-called middle-man for a payment to a foreign related party or makes a so-called passthrough payment to a foreign related party that may frequently arise in connec-

tion with global services and similar businesses. Broadly, the comments considered situations where a domestic corporation makes a deductible payment to a foreign related party, and that foreign related party in turn makes corresponding payments to unrelated third parties. Comments that addressed this concern arose in a variety of industries and business models. In some situations, the comments observed that business exigencies require the domestic corporation to make payments to the foreign related party. For example, in a business involving the physical delivery of goods within a foreign jurisdiction, a domestic corporation may subcontract with its foreign related party to perform the foreign in-country delivery function. Another example involves global service contracts that may be entered into by a domestic corporation and a client that does business in multiple jurisdictions, and may require services in connection with the client's global operations that are also subcontracted to foreign related parties. Some more specific comments observed that this global services situation may arise in connection with U.S.-based manufacturers that sell manufactured products to unrelated global customers and simultaneously enter into contracts to provide services for the product in multiple jurisdictions in connection with the sale of equipment. The comments observed that these service contracts, like other global services contracts, frequently involve subcontracting with a foreign related party to perform the services in foreign jurisdictions.

Multiple comments requested that the final regulations provide that the definition of a base erosion payment does not include payments made pursuant to a contract when a taxpayer makes a corresponding payment to a foreign related party for third party costs. Other comments requested that the final regulations more specifically exempt the types of business models discussed in the comment letters. For example, some comments recommended that the final regulations provide an exception to the term "base erosion payment" for payments made by a taxpayer to a foreign related party with respect to services performed for an unrelated party, provided that the foreign related party performs the services outside of the United States. Other comments recommended a similar exception that would apply only to services that are performed in connection with tangible property produced or manufactured by the taxpayer (or a related party). These comments observed that Congress intended to exclude manufacturers from the BEAT because it effectively created an exception for COGS, and that this exception should be carried through to services in connection with manufacturing.

Other comments recommended an exception to the definition of base erosion payment for payments to foreign related parties that are mandated under regulatory requirements. In other situations, comments observed that regulatory considerations affect the decision by the domestic corporation to make a payment to the foreign related party. An example includes a global dealing operation where a U.S. securities dealer has a client who wants to trade its securities on a foreign securities exchange that requires a locally registered dealer; for those trades, a foreign related party of the U.S. securities dealer conducts those trades. Other examples involving regulatory considerations include U.S. life sciences companies that, in connection with obtaining food and drug approval to sell a product in a foreign market, use a foreign related party to conduct clinical trials in that market because foreign regulators require testing on local patients.

The final regulations do not adopt a general exception to the definition of a base erosion payment in situations when the foreign related payee also makes payments to unrelated persons. The BEAT statute and the legislative history contain no indication of such an exception. Moreover, this recommended exception is inconsistent with the statutory framework of the BEAT. If traced to the ultimate recipient, most expenses of a taxpayer could be linked to a payment to an unrelated party, through direct tracing or otherwise, leaving a residual of profit associated with the payment. Accordingly, adopting such an exception would have the effect of eliminating a significant portion of service payments to foreign related parties from the BEAT because it would impose the BEAT on the net rather than the gross amount of the payment. The only net income based concept included in the BEAT statute is the treatment of payments covered by the services cost method ("SCM") exception. For a further discussion of the SCM exception, see Part IV.C.1 of this Summary of Comments and Explanation of Revisions.

The final regulations also do not adopt a narrower regulatory exception for payments that arise in similar circumstances but that are also associated with manufacturing or the production of tangible property. The Treasury Department and the IRS do not view the presence or absence of manufacturing as bearing on the statutory definition of a base erosion payment for services. Further, the Treasury Department and the IRS do not view the fact that payments that reduce gross receipts, such as COGS, are not base erosion payments under section 59A(d)(1) as demonstrating Congressional intent to exclude services that do not qualify as COGS from the definition of a base erosion payment under section 59A(d)(1) if those services have a connection to manufacturing operations. Congress included a single specific exception for services – the SCM exception. For a further discussion of that exception, see Part IV.C.1 of this Summary of Comments and Explanation of Revisions.

The final regulations do not adopt a narrower exception for payments to foreign related parties that arise because of non-tax business considerations, including a non-tax foreign regulatory requirement. The Treasury Department and the IRS recognize that there may be non-tax reasons that compel a taxpayer to perform a particular global service outside the United States. For example, an international delivery service may need to engage a foreign related party in the destination country to deliver goods in a foreign jurisdiction.

The final regulations do not adopt this recommended exception because it would require rules to distinguish between the conditions under which a domestic corporation is compelled to operate through a foreign related party and the conditions under which a domestic corporation operates through a foreign related party as a result of a business choice. This distinction would be inherently subjective. For example, in a global service business that provides services to a global client that has operations around the world, the decision

to provide personnel on-site in a foreign location may or may not be compelled by the business needs of its client. Similarly, in the case of the back-office functions of a global services business, those functions may be performed in the United States or in a location outside of the United States; the location of those services may or may not be compelled by the business needs of their client. Moreover, even if there is a compelling reason to operate the activities outside the United States, a base erosion payment exists only if a taxpayer makes a payment to a foreign related party. Thus, if a foreign branch of the domestic corporation performs services in the foreign jurisdiction, there will be no payment or accrual to a foreign related party. Finally, there is no indication that Congress intended to create a broad services exception, outside of the SCM exception, even though these global services conditions are common in the modern economy.

2. Division of Revenues from Global Services

Comments requested that final regulations provide an exception from the term "base erosion payment" for revenue sharing payments or arrangements, including allocations with respect to global dealing operations. Specifically, some comments recommended that the final regulations provide that a payment is not a base erosion payment in a situation where the domestic corporation records revenue from transactions with third party customers, and in turn the domestic corporation makes payments to a foreign related party. Other comments recommended that payments by the domestic corporation to foreign related parties should not be base erosion payments if the parties have adopted a profit split as their best method of pricing the related-party transactions for purposes of section 482. Some of these comments asserted that parties to such payments could be viewed as splitting the customer revenue for purposes of section 59A. Under this view, the payments received by the foreign related party would be treated as received directly from the third-party customer, with the result that there would be no corresponding deductible payment from the domestic corporation to the foreign related party.

Other comments more specifically addressed this issue in the narrower context of a global dealing operation within the meaning of proposed §1.482-8(a)(2)(i). These comments requested that payments made pursuant to a global dealing operation not be treated as base erosion payments.

The final regulations do not adopt the recommendations to specifically exclude from the definition of a base erosion payment transactions that are priced based on the profit split or similar transfer pricing method that is used for purposes of section 482. Under section 482, the parties to a controlled transaction apply the best method to determine if the parties are compensated at arm's length. However, the use of a particular method, whether the profit split method or another method, does not change the contractual relationship between the parties. Accordingly, the final regulations do not adopt this recommendation because the proper characterization depends on the underlying facts and the relationships between the parties. *See* §1.59A-3(b)(2).

Similarly, with respect to a global dealing operation, the final regulations do not adopt the comment to provide that global dealing operations do not give rise to base erosion payments because the proper characterization depends on the underlying facts. Under general tax principles, and consistent with proposed §1.863-3(h), a global dealing operation in which participants manage a single book of assets, bear risk, and share in trading profits may be viewed as co-ownership of the trading positions or similar arrangement, with no deductible payments made by any participants for purposes of section 59A. In contrast, where non-U.S. participants are compensated for services performed, the arrangement may be more properly characterized as trading income to the U.S. participant and a deductible payment to the foreign participant for purposes of section 59A.

To the extent that an amount is treated under general U.S. federal income tax law as received by a U.S. person as an agent for, and is remitted to, a foreign related party, see also Part IV.A (How Base Erosion Payments are Determined in General) of this Summary of Comments and Explanation of Revisions, which discusses the addition of §1.59A-3(b)(2)(i) to clarify that the determination of whether a payment or accrual by the taxpayer to a foreign related party is described in one of four categories of a base erosion payment is made under general U.S. federal income tax law, including agency principles.

3. Netting of Income and Expense

Proposed §1.59A-3(b)(ii) generally states that the amount of any base erosion payment is determined on a gross basis, regardless of any contractual or legal right to make or receive payments on a net basis, except as otherwise provided in paragraph (b)(2)(iii) of that section, which addresses mark-to-market positions, or as permitted by the Code or regulations. As explained in the preamble to the proposed regulations, the BEAT statutory framework is based on including the gross amount of base erosion payments in the BEAT's expanded modified taxable income base. REG-104259-18, 83 FR 65956, 65968 (December 21, 2018).

a. In general

Numerous comments recommended that the final regulations permit netting for purposes of section 59A. Generally, netting would allow a taxpayer to determine the amount of a base erosion payment by reducing the amount of that payment by the amount of another corresponding obligation.

A comment asserted that netting should be permitted for all base erosion payments other than with respect to reinsurance payments. The comment explained that the plain language of section 59A(d)(1) provides that only amounts paid or accrued are taken into account; this comment interpreted this language to mean the net amount paid or accrued. Because section 59A(d)(3) refers to gross premiums in the reinsurance context, the comment maintained that netting is permitted for other base erosion payments. This comment also noted that netting was provided under proposed section 4491, an inbound base erosion provision included in section 4303 of the House version of H.R. 1, before the Senate amended H.R.1 to include the BEAT in place of proposed section 4491. This comment also recommended that

netting be permitted because other sections of the Code or regulations include netting concepts, such as sections 163(j), 250,and 951A, and the aggregation rule in §1.482-1T(f)(2)(i)(B).

Some comments recommended that the final regulations permit netting when the foreign related party payee has a corresponding obligation to make payments to an unrelated third party payee. Some of these comments asserted that base erosion payments arise because of commercial and regulatory efficiency and expediency, rather than because of tax planning. These comments recommended that netting be permitted in ordinary course transactions. Other comments recommended that the final regulations permit netting for deductible amounts owed by a domestic corporation to a foreign related party if the foreign related party also owes amounts to the domestic corporation and the obligations are settled on a net basis.

The Treasury Department and the IRS have determined that it is appropriate to retain the approach in the proposed regulations that the amount of a base erosion payment is determined on a gross basis, except as provided in the BEAT Netting Rule and to the extent permitted by the Code or regulations. See part III.D of this Summary of Comments and Explanation of Revisions (Mark-to-market deductions). As explained in the preamble to the proposed regulations, amounts of income and deduction are generally determined on a gross basis under the Code. REG-104259-18, 83 FR 65956, 65968 (December 21, 2018). For example, whether the amount of income or deductions with respect to financial contracts that provide for offsetting payments is taken into account on a gross or net basis is determined under generally applicable federal income tax law. Section 59A does not change that result.

The final regulations are consistent with the statutory framework of section 59A. Section 59A specifically addresses deductible payments and other statutorily defined base erosion payments, and imposes tax on an increased base of modified taxable income, but at a lower tax rate than the corporate income tax rate set forth in section 11. If regulations provided that statutorily defined base erosion payments could be reduced by offsetting amounts received, then the regulations would substantially limit the scope of section 59A. Section 11 imposes a tax on a corporation's taxable income. Taxable income is defined as gross income minus the deductions allowed by chapter 1 of the Code. Section 63. Gross income is generally defined as income from whatever source derived. Section 61. The amount of income and deductions are generally determined on a gross basis under the Code. Nothing in section 59A evidences Congressional intent to alter this framework. In fact, section 59A(c) determines modified taxable income from the starting point of taxable income as defined in section 63.

A netting rule would have the same effect as allowing a deduction from gross income because it would reduce the amount of a taxpayer's modified taxable income, and in that sense would conflict with section 59A(c)(1) (disallowing a deduction for base erosion tax benefits). Congress determined that certain deductions, namely those that are within the statutory definition of a base erosion payment, should not be allowed for purposes of the tax imposed under section 59A, and therefore, limited the availability of these deductions. Permitting netting of items of gross income and deductions to determine the amount of a base erosion payment would frustrate Congress' purpose in enacting section 59A.

In addition, the other provisions of the Code and regulations that are cited by comments are irrelevant to the analysis of section 59A and do not provide support for adopting a netting rule for purposes of section 59A. Whereas sections 163(j) and 951A refer explicitly to net amounts, section 59A explicitly refers to a deduction allowable under Chapter 1 of the Code. Section 250 provides rules for determining whether services are for "foreign use" by contemplating services provided to and from a related party that are substantially similar. This destination-based rule is entirely different from the construct of section 59A, and, moreover, section 59A contains no similar language contemplating payments to and from a related party. Proposed section 4491 would have operated through the regular income tax system and would have represented a fundamentally different approach to inbound base erosion than section 59A; therefore, that proposed revision to the Code is not relevant here. The aggregation rule in §1.482-1T(f)(2)(i)(B) does not involve the treatment of payments to foreign related parties, and thus is not relevant for purposes of analyzing the meaning of section 59A.

Some comments also cited the heading to section 59A(h) (exception for certain payments made in the ordinary course of trade or business) as support for a regulatory exception for ordinary course transactions for which a taxpayer has not adopted a mark-to-market method of accounting. Specifically, these comments suggested that Congress did not intend for section 59A(h)(2)(A)(i) to limit the QDP exception to only transactions that are marked-to-market. The citations to the heading to section 59A(h) are inconsistent with the statutory rule in section 59A(h), which provides a narrowly defined exception applicable to derivative payments under specific circumstances.

b. Hedging transactions

Another comment recommended that the final regulations permit netting in the narrow context of related-party hedging transactions. The comment observed that the QDP exception applies to related-party hedging transactions when the taxpayer uses a mark-to-market method of accounting. The comment asserted that there is no policy rationale for limiting netting relief to taxpayers that use a mark-to-market method of accounting; therefore, the comment requested that the QDP exception be expanded to also apply to taxpayers that apply the mark-to-market method for financial accounting purposes. Alternatively, the comment recommended that taxpayers engaged in related- party hedging transactions be permitted to net income items against deduction items.

The final regulations do not provide for a netting rule for related-party hedging transactions. As discussed in Part IV.A.3.a of this Summary of Comments and Explanation of Revisions, permitting netting for related-party hedging transactions would be inconsistent with the statutory framework of section 59A. Furthermore, this recommendation would eliminate or substantially modify one of the three statutory requirements for the QDP exception (that

is, use of the mark-to-market accounting method).

c. Clarification of netting under current law

Finally, some comments recommended that the final regulations clarify when netting is permitted under the Code and regulations, including confirming that netting is permitted for notional principal contracts and for cost sharing transaction payments under §1.482-7(j)(3)(i). The Treasury Department and the IRS decline to provide such specific guidance because it is beyond the scope of the final regulations; however, the Treasury Department and the IRS are cognizant that section 59A may place more significance on some sections of the Code than was the case before the Act. The Treasury Department and the IRS intend to study the effect of these provisions on the BEAT and whether changes should be made to the regulations thereunder to better take into account new considerations under the BEAT.

B. *Treatment of certain specific types of payments*

1. Losses Recognized with Respect to the Sale or Transfer of Property to a Foreign Related Party

Section 59A(d) defines a base erosion payment to include any amount paid or accrued by a taxpayer to a foreign related party with respect to which a deduction is allowable. Proposed §1.59A-3(b)(1)(i) repeats this statutory language. Proposed §1.59A-3(b)(2)(i) provides that "an amount paid or accrued" includes an amount paid or accrued using any form of consideration, including cash, property, stock, or the assumption of a liability. In explaining this provision, the preamble to the proposed regulations states that "a base erosion payment also includes a payment to a foreign related party resulting in a recognized loss; for example, a loss recognized on the transfer of property to a foreign related party." REG-104259-18, 83 FR 65956, 65960 (December 21, 2018).

This principle would apply if, for example, a taxpayer transfers to a foreign related party (a) built-in-loss property as payment for a deductible service provided by the foreign related party to the taxpayer (the latter of which may also be a base erosion payment), (b) built-in-loss property as payment for a good or service that the taxpayer is required to capitalize (for example, COGS) such that the payment is not deductible to the taxpayer (the latter of which is not a base erosion payment), or (c) depreciated nonfunctional currency as a payment for a nonfunctional currency denominated amount owed by a taxpayer.

Comments requested that the final regulations revise the definition of a base erosion payment to exclude losses recognized on the sale or exchange of property by a taxpayer to a foreign related party. According to these comments, a payment made with, or a sale of, built-in-loss property is not encompassed within the statutory definition of a base erosion payment. Comments stated that both the statutory and proposed regulations' definition contain two requirements for a payment to be a base erosion payment: there must be (i) an amount paid or accrued by the taxpayer to a foreign person that is a related party of the taxpayer; and (ii) a deduction must be allowable with respect to that amount.

Regarding the first requirement — that there must be an amount paid or accrued by the taxpayer to a foreign related party — when a U.S. taxpayer sells property to a foreign related party for cash, the comments noted that no payment or accrual has taken place by the U.S. taxpayer for purposes of section 59A; rather, the U.S. taxpayer is receiving a cash payment in exchange for the transferred property, and is not making a payment. Thus, the comments argued, the first requirement for a base erosion payment, that a payment or accrual exists, has not been met.

Regarding the second requirement — that a deduction must be allowable with respect to that amount — comments argued that even if a payment is found to have been made to the foreign related party, the deduction for the loss on the built-in-loss property is not with respect to this payment. That is, the comments argued that the loss deduction is not attributable to any "payment" made to the foreign related party (the form of consideration in the transaction); rather, the loss is attributable to the taxpayer's basis in the built-in loss property. Although that built-in-loss is recognized in connection with the transfer to a foreign related party, and thus could meet the statutory requirement as allowed "with respect to" the payment, the comments recommended a narrower interpretation that views the recognized loss as arising independently from the payment, that is viewed as merely a corollary consequence unrelated to the payment being made to the foreign related party.

The final regulations adopt the recommendation provided in these comments. The final regulations clarify the definition of a base erosion payment in §1.59A-3(b)(1)(i) and (b)(2)(ix) to provide that a loss realized from the form of consideration provided to the foreign related party is not itself a base erosion payment. For the reasons described in the comments and discussed in this Part of the Summary of Comments and Explanation of Revisions, this treatment aligns the definition of base erosion payment with the economics of the payment made by the applicable taxpayer to the foreign related party. That is, the term "base erosion payment" does not include the amount of built-in-loss because that built-in-loss is unrelated to the payment made to the foreign related party. This rule applies regardless of whether the loss realized from the form of consideration provided to the foreign related party is itself consideration for an underlying base erosion payment. To the extent that a transfer of built-in-loss property results in a deductible payment to a foreign related party that is a base erosion payment, the final regulations clarify that the amount of the base erosion payment is limited to the fair market value of that property.

2. Transfers of Property between Related Taxpayers

The proposed regulations limit the ability of a taxpayer to eliminate base erosion tax benefits by transferring depreciable or amortizable property to another member of the taxpayer's aggregate group. Specifically, proposed §1.59A-3(b)(2)(vii) provides that if a taxpayer holds depreciable or amortizable property that produces depreciation or amortization deductions that are base erosion tax benefits to the taxpayer, those depreciation or amortization deductions will continue to be treated as a base erosion tax benefit for the acquirer if

the taxpayer transfers the property to another member of its aggregate group.

The Treasury Department and the IRS are aware of similar transactions involving a domestic corporation that ordinarily acquires, from a foreign related party, property that is subject to an allowance for depreciation or amortization in the hands of the domestic corporation. In the transaction, the domestic corporation inserts into its supply chain a second domestic corporation, with a principal purpose of avoiding base erosion payments. Specifically, the second domestic corporation, a dealer in property that avails itself of the exclusion of COGS from the definition of a base erosion payment in section 59A(d)(1) and (2), acquires the property from the foreign related party and in turn resells the property to the first domestic corporation. The Treasury Department and the IRS view this type of transaction as already within the scope of the anti-abuse rule set forth in proposed §1.59A-9(b)(1) (transactions involving unrelated persons, conduits, or intermediaries), and have added an example to the final regulations clarifying the application of this anti-abuse rule to similar fact patterns.

3. Corporate Transactions

The proposed regulations provide that a payment or accrual by a taxpayer to a foreign related party may be a base erosion payment regardless of whether the payment is in cash or in any form of non-cash consideration. *See* proposed §1.59A-3(b)(2)(i). There may be situations where a taxpayer incurs a non-cash payment or accrual to a foreign related party in a transaction that meets one of the definitions of a base erosion payment, and that transaction may also qualify under certain nonrecognition provisions of the Code. Examples of these transactions include a domestic corporation's acquisition of depreciable assets from a foreign related party in an exchange described in section 351, a liquidation described in section 332, and a reorganization described in section 368.

The proposed regulations do not include any specific exceptions for these types of transactions even though (a) the transferor of the assets acquired by the domestic corporation may not recognize gain or loss, (b) the acquiring domestic corporation may take a carryover basis in the depreciable or amortizable assets, and (c) the importation of depreciable or amortizable assets into the United States in these transactions may increase the regular income tax base as compared to the non-importation of those assets. In the preamble to the proposed regulations, the Treasury Department and the IRS also note that for transactions in which a taxpayer that owns stock in a foreign related party receives depreciable property from the foreign related party as an in-kind distribution subject to section 301, there is no base erosion payment because there is no consideration provided by the taxpayer to the foreign related party in exchange for the property. REG-104259-18, 83 FR 65956, 65960 (December 21, 2018). Thus, there is no payment or accrual in that transaction.

The preamble to the proposed regulations requests comments about the treatment of payments or accruals that consist of non-cash consideration. REG-104259-18, 83 FR 65956, 65960 (December 21, 2018). Comments have suggested that corporate nonrecognition transactions or transactions in which U.S. taxpayers do not obtain a step-up in the tax basis of an acquired asset should not be treated as a base erosion payment. They argued that these nonrecognition transactions should not be treated as a payment or accrual. Based on this position, some comments argued either that the Treasury Department and the IRS do not have the authority to treat nonrecognition transactions as base erosion payments or that the better policy is to exclude nonrecognition transactions from the definition of base erosion payments. Furthermore, comments argued that nonrecognition provisions such as sections 332, 351, and 368 reflect the judgment of Congress that certain corporate transactions such as the formation and dissolution of businesses and the readjustment of continuing interests in property do not warrant the imposition of tax. They also argued that the legislative history of section 59A does not suggest that Congress intended for it to apply to nonrecognition transactions.

With regard to section 332 liquidations, comments argued that a section 332 liquidation should not be treated as a base erosion payment when a section 301 distribution is not. Furthermore, comments argued that transactions in which stock is merely deemed to be exchanged, like certain section 351 transactions or section 332 liquidations, should not be treated as base erosion payments since there is no actual transfer of shares.

Comments also argued that nonrecognition transactions are not base eroding. Comments asserted that inbound nonrecognition transactions are often used in post-acquisition restructurings, as well as in other internal restructurings to better align a multinational organization's legal structure with its commercial operations. Comments also argued that treating these transactions as base erosion payments would provide a disincentive to move intangible property and other income-producing property into the United States, contrary to the goals of the Act.

Furthermore, comments argued that amortization of a carryover tax basis of an asset acquired by a U.S. taxpayer from a related party in a nonrecognition transaction would not create the same base erosion concerns as other types of deductions. However, comments acknowledged that, if final regulations adopted a broad exception for nonrecognition transactions, taxpayers could abuse that exception by engaging in certain basis step-up transactions immediately before an inbound nonrecognition transfer. Comments suggested that augmenting the conduit anti-abuse rule of proposed §1.59A-9 may be sufficient to prevent these types of transactions. Alternatively, comments also suggested that, to delineate cases of potential abuse, a rule similar to the 5-year active trade or business rules in §1.355-3 could apply to specify instances when assets would qualify as not being "recently stepped up assets."

Comments generally supported the statement in the preamble to the proposed regulations that a section 301 distribution is not treated as a base erosion payment because there is no exchange, and requested that the exclusion be included in the final regulations as well as the preamble. Comments also requested that the definition of a base erosion payment also exclude exchanges (including section 302 and 304 transactions) that are treated as section 301 distributions pursuant to section 302(d).

Comments have generally acknowledged that the taxable transfer of depreciable or amortizable property in exchange for stock should be subject to the BEAT. For example, comments stated that the transfer of assets to a corporation that is partially taxable to the transferor pursuant to section 351(b) or 356 as a result of the receipt of "boot" by the transferor is appropriately treated as a base erosion payment. The amount of the base erosion payment could be determined based on the gain or increase in basis of the property, the amount of boot allocated to the property, or by treating all of the boot as paid for depreciable or amortizable property first, to the extent thereof. Comments also requested clarity on the treatment of the assumption of liabilities pursuant to a nonrecognition transaction. One comment requested that the assumption of liabilities in a nonrecognition transaction be excluded from the definition of a base erosion payment to the extent that the assumption is not treated as money or other property. This comment suggested that, if the Treasury Department and the IRS are concerned about abusive transactions, an anti-abuse rule could be designed to treat certain liabilities as base erosion payments.

Similarly, comments stated that the taxable transfer of assets to a domestic corporation in exchange for stock, such as in a so-called "busted section 351 transaction," should be subject to the BEAT. Comments also discussed whether a taxable distribution to a domestic corporation in a section 331 liquidation of a foreign corporation should be subject to the BEAT. These comments acknowledged that taxable transactions generally give rise to base erosion payments and did not take a view on whether section 331 liquidations should be subject to the BEAT. Accordingly, comments requested that nonrecognition transactions be excluded from the definition of a base erosion payment only to the extent that the U.S. taxpayer obtains a carryover basis in the acquired asset. Alternatively, comments have requested a safe harbor that would exclude nonrecognition transactions that are part of post-acquisition restructuring to allow taxpayers to transfer into the United States intellectual property that was recently acquired from a third party. Comments have also requested that final regulations clarify that nonrecognition transactions that occurred before the effective date of the BEAT will not be treated as base erosion payments.

Finally, comments have noted that a nonrecognition transaction involving a U.S. branch of a foreign corporation may not qualify for the ECI exception under proposed §1.59A-3(b)(3)(iii) for payments that are treated as effectively connected income in the hands of the payee, because the ECI exception under proposed §1.59A-3(b)(3)(iii) is predicated on the payment or accrual being subject to U.S. federal income taxation, which cannot occur when the transaction is not taxable.

Consistent with these comments, the final regulations generally exclude amounts transferred to, or exchanged with, a foreign related party in a transaction described in sections 332, 351, and 368 ("corporate nonrecognition transaction") from the definition of a base erosion payment. In light of the comments, the Treasury Department and the IRS have determined a limited exclusion of corporate nonrecognition transactions is consistent with the underlying anti-base erosion purpose of the BEAT, tends to reduce disincentives for taxpayers to move intangible property and other income-producing property into the United States in corporate nonrecognition treatment transactions, and is consistent with the general treatment of corporate nonrecognition transactions under other sections of the Code. However, the Treasury Department and the IRS have determined that it is not appropriate to apply this exception to the transfer of other property, or property transferred in exchange for other property, in a corporate nonrecognition transaction. Solely for purposes of determining what is a base erosion payment, "other property" has the meaning of other property or money, as used in sections 351(b), 356(a)(1)(B), and 361(b), as applicable, including liabilities described in section 357(b). However, other property does not include the sum of any money and the fair market value of any property to which section 361(b)(3) applies. Other property also includes liabilities that are assumed by the taxpayer in a corporate nonrecognition transaction, but only to the extent of the amount of gain recognized under section 357(c).

For example, if a foreign corporation transfers depreciable property to its wholly owned domestic subsidiary in a transaction to which section 351 applies, and if the foreign corporation receives subsidiary common stock and cash in exchange, the cash may be treated as a base erosion payment, while the common stock is not. Similarly, property transferred in a section 351 or 368 transaction in exchange, in whole or in part, for other property may be a base erosion payment if it otherwise meets the definition of a base erosion payment. For example, if a domestic corporation transfers property to its wholly-owned foreign subsidiary in a transaction to which section 351 applies, and if the domestic corporation receives common stock in the foreign corporation and other property consisting of depreciable property, the property transferred by the domestic corporation may be a base erosion payment. These rules apply without regard to whether or not gain or loss is recognized in the transaction.

When a taxpayer transfers other property to a foreign related party, or transfers property to a foreign related party in exchange for other property, the determination of the amount of property that is treated as received from the foreign related party in exchange for the property transferred to the foreign related party is based on U.S. federal income tax law. See, for example, Rev. Rul. 68-55, 1968-1 C.B. 140.

Consistent with concerns raised by comments, the Treasury Department and the IRS are concerned that the exclusion of nonrecognition transactions could lead to inappropriate results in certain situations. An example of an inappropriate result is the sale of depreciable property between foreign related parties shortly before a nonrecognition transaction, which could step up the taxpayer's basis in the property and increase depreciation or amortization deductions of the domestic corporation after the nonrecognition transaction relative to the alternative in which the step-up basis transactions did not occur. Accordingly, the Treasury Department and the IRS have determined that it is appropriate to specifically address these transactions with an anti-abuse rule. *See* §1.59A-9(b)(4). The anti-abuse rule applies in addition to, and in conjunction with, section

357(b). In addition, the Treasury Department and the IRS observe that, because the BEAT is applied after the application of general U.S. federal income tax law, other doctrines—including the step transaction doctrine and economic substance doctrine—also may apply.

Because the final regulations provide an exception for corporate nonrecognition transactions, it is not necessary for the final regulations to include other suggested modifications, such as (i) modifying the ECI exception for nonrecognition transactions involving U.S. branches, (ii) providing a safe harbor that would exclude nonrecognition transactions that are part of a post-acquisition restructuring, or (iii) clarifying that nonrecognition transactions that occurred before the effective date of the BEAT are not treated as base erosion payments.

The final regulations also clarify the treatment of distribution transactions, such as distributions described in section 301, and redemption transactions, such as redemptions described in section 302. A distribution with respect to stock for which there is no consideration (a "pure distribution") is not treated as an exchange. Accordingly, the final regulations provide that a pure distribution of property made by a corporation to a shareholder with respect to its stock is not an amount paid or accrued by the shareholder to the corporation. These pure distributions include distributions under section 301, without regard to the application of section 301(c) to the shareholder (addressing distributions in excess of earnings and profits). §1.59A-3(b)(2)(ii). However, unlike a pure distribution, a redemption of stock in exchange for property constitutes an exchange. Accordingly, the final regulations provide that a redemption of stock by a corporation within the meaning of section 317(b) (such as a redemption described in section 302(a) and (d) or section 306(a)(2)), or an exchange of stock described in section 304 or section 331, is an amount paid or accrued by the shareholder to the corporation (or by the acquiring corporation to the transferor in a section 304 transaction).

4. Interest Expense Allocable to a Foreign Corporation's Effectively Connected Income

a. In general

Section 59A applies to foreign corporations that have income that is subject to net income taxation as effectively connected with the conduct of a trade or business in the United States, taking into account any applicable income tax treaty of the United States. The proposed regulations generally provide that a foreign corporation that has interest expense allocable under section 882(c) to income that is effectively connected with the conduct of a trade or business within the United States will have a base erosion payment to the extent the interest expense results from a payment or accrual to a foreign related party. The amount of interest that will be treated as a base erosion payment depends on the method used under §1.882-5.

If a foreign corporation uses the three-step method described in §1.882-5(b) through (d), the proposed regulations provide that interest on direct allocations and on U.S.-booked liabilities that is paid or accrued to a foreign related party will be a base erosion payment.[1] *See* proposed §1.59A-3(b)(4)(i)(A). If U.S.-booked liabilities exceed U.S.-connected liabilities, the proposed regulations provide that a foreign corporation computing its interest expense under this method must apply the scaling ratio to all of its interest expense on a pro-rata basis to determine the amount that is a base erosion payment. The amount of interest on excess U.S.-connected liabilities that is a base erosion payment is equal to the interest on excess U.S.-connected liabilities multiplied by the foreign corporation's ratio of average foreign related-party liabilities over average total liabilities. *See* proposed §1.59A-3(b)(4)(i)(A)(*2*).

If a foreign corporation determines its interest expense under the separate currency pools method described in §1.882-5(e), the proposed regulations provide that the amount of interest expense that is a base erosion payment is equal to the sum of (1) the interest expense on direct allocations paid or accrued to a foreign related party and (2) the interest expense in each currency pool multiplied by the ratio of average foreign related-party liabilities over average total liabilities for that pool. *See* proposed §1.59A-3(b)(4)(i)(B).

Comments requested that a consistent method apply to determine the portion of interest allocated to a U.S. branch that is treated as paid to a foreign related party. The comments noted that the methods in the proposed regulations may produce meaningfully different amounts of base erosion payments depending on which method the taxpayer uses to determine its branch interest expense. Comments noted that a branch that uses the method described in §1.882-5(b) through (d) may have a lower amount of base erosion payments than a branch using the method described in §1.882-5(e) or a permanent establishment applying a U.S. tax treaty, although those differences will ultimately depend on the composition of the counterparties of the U.S.-booked liabilities and the excess U.S.-connected liabilities (as foreign related parties or not foreign related parties). See also Part IV.B.5 of this Summary of Comments and Explanation of Revisions for a discussion of interest allowed to permanent establishments applying a U.S. tax treaty. The comments argued that these differences are not supported by tax policy.

Comments generally requested a rule permitting or requiring foreign corporations to use U.S.-booked liabilities to determine the portion of U.S. branch interest expense that is treated as paid to foreign related parties, consistent with the method described in the proposed regulations for corporations that determine U.S. branch interest expense using the method described in §1.882-5(b) through (d), even if the U.S. branch uses a different method to determine its interest expense. The comments argued that U.S. assets are used to determine the amount of leverage that is properly allocable to a U.S. branch, and, as a result, U.S.-booked liabilities should determine the amount of interest treated as a base erosion payment. Specifically with

[1] For purposes of §1.882-5, direct allocations generally refer to the requirement that a allocate interest expense to income from particular assets; these circumstances generally arise with respect to (i) certain assets that are subject to qualified nonrecourse indebtedness or (ii) certain assets that are in an integrated financial transaction.

regard to banks, a comment argued that banks are highly regulated with limited or no ability to manipulate U.S.-booked liabilities, and, as a result, should be permitted to use U.S.-booked liabilities to determine the amount of U.S. branch interest expense treated as paid to foreign related parties.

The Treasury Department and the IRS agree that the rules for determining the portion of U.S. branch interest paid to foreign related parties should be consistent, regardless of whether taxpayers apply the method described in §1.882-5(b) through (d) or §1.882-5(e). For purposes of section 59A, the Treasury Department and the IRS agree that the starting point for determining the identity of the recipient should be the U.S. booked liabilities of the U.S. branch. The final regulations, therefore, provide that the amount of U.S. branch interest expense treated as paid to a foreign related party is the sum of: (1) the directly allocated interest expense that is paid or accrued to a foreign related party, (2) the interest expense on U.S.-booked liabilities that is paid or accrued to a foreign related party, and (3) the interest expense on U.S.-connected liabilities in excess of interest expense on U.S.-booked liabilities multiplied by the ratio of average foreign related-party interest over average total interest (excluding from this ratio interest expense on U.S. booked liabilities and interest expense directly allocated). *See* §1.59A-3(b)(4)(i)(A); *see also* Part IV.B.4.b.i of this Summary of Comments and Explanation of Revisions (discussing the change from a worldwide liability ratio to a worldwide interest ratio). In adopting a consistent approach, the final regulations use the same ratio to determine whether the interest expense on U.S.-connected liabilities is paid to a foreign related party regardless of whether a taxpayer applies the method described in §1.882-5(b) through (d) or §1.882-5(e). *See* §1.59A-3(b)(4)(i)(A)(3).

b. Simplifying conventions

The Treasury Department and the IRS recognize that §1.882-5 provides certain simplifying elections for determining the interest deduction of a foreign corporation. The proposed regulations request comments about similar simplifying elections for determining the portion of U.S.-connected liabilities that are paid to a foreign related party for purposes of section 59A. REG-104259-18, 83 FR 65956, 65960 (December 21, 2018).

Comments, in response to the request for comments on simplifying conventions, indicated that it may be difficult for foreign corporations to determine their worldwide ratio of liabilities owed to foreign related parties over total liabilities ("worldwide liabilities ratio"). For example, they argued that U.S. branches of foreign banks typically do not have full access to information about the bank's global operations and funding arrangements. These comments argued that even if a U.S. branch does have that information, U.S. tax law may treat some transactions as debt that non-U.S. tax law does not, or may integrate some hedging costs that are not integrated for non-U.S. tax purposes, or vice-versa. These comments further observed that if the taxpayer is using the fixed ratio election for purposes of §1.882-5, the taxpayer would not be required to obtain that information or reconcile the home office balance sheet to U.S. tax law principles for purposes of §1.882-5. Thus, the comments argued that attempting to reconstruct a global balance sheet and payments under U.S. tax principles for purposes of proposed §1.59A-3 is burdensome and should not be required.

The comments also requested various simplifying elections for determining the amount of U.S. branch interest treated as paid to foreign related parties, including (a) computing the worldwide ratio by reference to interest expense rather than worldwide liabilities ("worldwide interest ratio"), (b) using financial accounting books and records rather than U.S. tax principles to determine a worldwide ratio, or (c) providing a fixed ratio for purposes of determining the minimum amount of interest treated as paid to third parties (such as 85 percent).

i. Worldwide interest ratio

The final regulations adopt the comment recommending that taxpayers apply the worldwide ratio to determine the amount of a U.S. branch's interest expense paid to foreign related parties by reference to a worldwide ratio of interest expense, rather than a worldwide ratio of liabilities. *See* §1.59A-3(b)(4)(i)(A)(3). The final regulations adopt this approach as a rule, rather than as an election, because the Treasury Department and the IRS agree with the comments that a worldwide ratio based on interest expense, rather than liabilities, is the appropriate measurement for determining a U.S. branch's base erosion payments. Section 59A determines the amount of interest that is a base erosion payment based on the amount of interest paid or accrued to foreign related parties, rather than the amount of liabilities owed to foreign related parties. Accordingly, the final regulations determine the amount of a U.S. branch's interest expense treated as a base erosion payment based on the foreign corporation's worldwide interest ratio.

ii. Use of applicable financial statements

The Treasury Department and the IRS recognize that it may be difficult for foreign corporations to determine their worldwide interest ratio under U.S. tax principles, as indicated by the comments. Accordingly, for simplicity and to reduce the administrative burden on taxpayers, the final regulations adopt the comment to allow taxpayers to elect to determine their worldwide interest ratio using their applicable financial statements as described in section 451(b)(3). *See* §1.59A-3(b)(4)(i)(D). The final regulations also clarify that the applicable financial statement must be the applicable financial statement of the taxpayer, not a consolidated applicable financial statement, because a consolidated applicable financial statement may eliminate inter-company liabilities. The final regulations provide that a taxpayer makes this election on Form 8991 or a successor form. Until the Form 8991 is revised to incorporate the election, a taxpayer should attach a statement with that form to make this election as provided in forms and instructions.

iii. Fixed ratio or safe harbor for the worldwide interest ratio

The final regulations do not adopt a fixed ratio or safe harbor for the worldwide interest ratio as suggested in comments because the actual worldwide

interest ratio of an enterprise may vary significantly from one industry to another and from one taxpayer to another. As a result, it is not possible to establish a single safe harbor that appropriately takes into account the differing position of industries and taxpayers while protecting the interests of the government. The Treasury Department and the IRS recognize that §1.882-5 provides other safe harbors, such as the fixed ratio safe harbor for determining the ratio of liabilities to assets of 95 percent for banks and 50 percent for other taxpayers. §1.882-5(c)(4). In the context of determining the portion of a U.S. branch's interest expense that is deemed attributed to foreign related parties (versus other persons), the Treasury Department and the IRS determined that there is not a sufficient basis to establish a safe harbor because different taxpayers could have different internal capital structures.

One comment suggested that a U.S. branch of a bank should be permitted to assume that 85 percent of its funding is from unrelated lenders because regulations under section 884 provide a safe harbor assumption that 85 percent of a bank's capital can be deemed to come from deposits (and thus eligible for the bank deposit interest exemption from the tax imposed by section 881(a)). *See* §1.884-4(a)(2)(iii). The section 884 safe harbor, however, is not relevant to the determination of the ratio of funding from foreign related parties because the bank deposit exception is available for both related and unrelated depositors/lenders. Thus, this section 884 safe harbor does not reflect the expected percentage of the lenders who are not foreign related parties. *See* section 871(i)(2) and section 881(d).

c. Other coordinating rules

The final regulations also revise §1.59A-3(b)(4)(1) to take into account the expansion of the exception for certain total loss-absorbing capacity securities to include foreign issuers. See Part IV.C.5 of this Summary of Comments and Explanation of Revisions (Exception for Interest on Certain Instruments Issued by Globally Systemically Important Banking Organizations).

Finally, a comment recommended that the final regulations revise proposed §1.59A-3(b)(4)(i)(D), which provides that to the extent that a taxpayer makes an election to reduce its U.S.-connected liabilities pursuant to §1.884-1(e)(3), the reduction is treated as proportionally reducing all liabilities for purposes of determining the amount of allocable interest expense that is treated as a base erosion payment. The comment argued that §1.59A-3(b)(4)(i)(D) is inconsistent with §1.884-1(e)(3), which applies for all purposes of the Code, and which the comment asserted does not require proportionate reduction. In response to this comment, the final regulations do not include the rule in proposed §1.59A-3(b)(4)(i)(D). The Treasury Department and the IRS are considering §1.884-1(e)(3) for possible future guidance.

5. Allocations of Interest and Other Expenses Pursuant to Income Tax Treaties

The proposed regulations provide a specific rule for determining the amount of base erosion payments attributable to interest and deductions allocated to a permanent establishment under a U.S. income tax treaty. Certain U.S. income tax treaties provide alternative approaches for the allocation or attribution of business profits of an enterprise of one contracting state to its permanent establishment in the other contracting state on the basis of assets used, risks assumed, and functions performed by the permanent establishment. These treaties allow notional payments that take into account interbranch transactions and value the interbranch transactions using the most appropriate arm's length method for those transactions. A treaty-based expense allocation or attribution method does not itself create legal obligations between the U.S. permanent establishment and the rest of the enterprise. The proposed regulations reflect that under a treaty-based expense allocation or attribution method, amounts equivalent to deductible payments may be allowed in computing the business profits of an enterprise with respect to transactions between the permanent establishment and the home office or other branches of the foreign corporation ("internal dealings"). The deductions from internal dealings would not be allowed under the Code and regulations. The proposed regulations provide that deductions from internal dealings allowed in computing the business profits of the permanent establishment are base erosion payments.

The proposed regulations distinguish between the allocations of expenses and internal dealings. The allocation and apportionment of expenses of the enterprise to the branch or permanent establishment is not a base erosion payment because the allocation represents a division of the expenses of the enterprise, rather than a payment between the branch or permanent establishment and the rest of the enterprise. Internal dealings, however, are not mere divisions of enterprise expenses; rather, internal dealings are priced on the basis of assets used, risks assumed, and functions performed by the permanent establishment in a manner consistent with the arm's length principle. The proposed regulations create parity between deductions for actual regarded payments between two separate corporations (which are subject to section 482), and internal dealings (which are generally priced in a manner consistent with the applicable treaty and, if applicable, the OECD Transfer Pricing Guidelines). The proposed regulations apply only to deductions attributable to internal dealings, and not to payments to entities outside of the enterprise, which are subject to the general base erosion payment rules as provided in proposed §1.59A-3(b)(4)(v)(A).

Comments noted that internal dealings are a fiction and do not involve an actual payment or accrual under general U.S. tax principles. The comments suggested that internal dealings should be relevant only for purposes of determining the profit attributable to the permanent establishment and should not be recognized for other purposes. They noted that the OECD 2010 Report on the Attribution to Profits to Permanent Establishments ("2010 OECD Report") states that recognizing internal dealings by a permanent establishment "is relevant only for the attribution of profits" and "does not carry wider implications as regards, for example, withholding taxes." 2010 OECD Report (July 22, 2010), Part IV, C-1(iii)(f), section 166. Thus, comments suggested that internal dealings should not be relevant for BEAT purposes.

The Treasury Department and the IRS disagree that internal dealings are not rel-

evant for purposes of determining a foreign corporation's base erosion payments. Unlike the allocation of a foreign corporation's deductions to a U.S. branch under the Code and regulations, internal dealings are not a mere allocation of expenses, but rather are determined on the basis of assets used, risks assumed, and functions performed by the permanent establishment in a manner consistent with the arm's length principle. Deductions determined under internal dealings, like deductions determined under the Code and regulations, reduce the U.S. income tax base of the permanent establishment. Because internal dealings are not an allocation of expenses, the foreign corporation's worldwide ratio may not be an appropriate measure of related party payments. Instead, in the proposed regulations, the Treasury Department and the IRS determined that it is appropriate to look to the internal dealings, rather than the foreign corporation's worldwide expenses, for purposes of determining base erosion payments.

However, the Treasury Department and the IRS recognize that interest expense allowed to a permanent establishment as internal dealings often represents interest expense on back-to-back loans between (1) the permanent establishment and the home office, and (2) the home office and another entity. Furthermore, unlike other deductions that are often based on payments to the home office or to another branch for goods or services or the use of intellectual property unique to the home office or branch, money is fungible. A permanent establishment may be indifferent to whether its capital comes from the home office or a loan from another entity.

The Treasury Department and the IRS have determined that interest expense determined under §1.882-5 generally provides a reasonable estimate of the amount of interest of the foreign corporation that should be allocated to the permanent establishment based on the assets of the permanent establishment. Accordingly, it is appropriate to treat interest expense determined in accordance with a U.S. tax treaty (including interest expense determined by internal dealings) in a manner consistent with the treatment of interest expense determined under §1.882-5, to the extent it would have been allocated to the permanent establishment under §1.882-5. In effect, the internal dealing permits the permanent establishment to replace an external borrowing with an internal dealing, and this internal dealing should be treated as creating additional interest expense paid to the home office, and thus treated as a base erosion payment to a foreign payee. Accordingly, interest expense determined in accordance with a U.S. tax treaty (including interest expense determined by internal dealings) that is in excess of the amount that would have been allocated to the permanent establishment under §1.882-5 is treated as interest expense paid by the permanent establishment to the home office or another branch of the foreign corporation.

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

Accordingly, under the final regulations, a foreign corporation determines its hypothetical §1.882-5 interest expense by calculating the amount of interest that would have been allocated to effectively connected income if the foreign corporation determined its interest expense under §1.882-5. *See* §1.59A-3(b)(4)(i)(E)(2). Therefore, a foreign corporation will use the method provided in §1.59A-3(b)(4)(i)(A), as described in Part IV.B.4.a in this Summary of Comments and Explanation of Provisions, to determine its hypothetical §1.882-5 interest expense.

In this regard, the Treasury Department and the IRS observe that corporations eligible for benefits under a U.S. income tax treaty are permitted to choose whether to apply the treaty or the Code and regulations to calculate interest expense allocable to a permanent establishment or U.S. branch, and understand that many corporations eligible for treaty benefits calculate interest expense allocated to a U.S. branch or permanent establishment under both §1.882-5 and the applicable treaty to determine whether to claim treaty benefits. Additionally, the Treasury Department and the IRS also understand that corporations that determine interest expense allowed to a permanent establishment under a U.S. income tax treaty may nonetheless be required to allocate interest to the permanent establishment under §1.882-5 for state or local tax purposes.

6. Related-Party Hedging Payments

Comments requested that the final regulations provide relief from the application of the BEAT for hedging payments made by domestic corporations to foreign related parties, specifically in the context of the energy industry. The comments described a scenario in the energy industry where large multinational groups designate one or more members of their worldwide group to act as a hedging center to manage price risk associated with commodities that the group produces or sells through the execution of commodities derivatives. The comments indicated that under prevailing industry practice and applicable financial accounting standards, income, gain, loss, or expense on commodity derivatives are often accounted for as items of COGS or as a reduction to determine gross income for book accounting purposes. These items, however, are not treated as COGS or as another form of reduction to determine gross income for tax purposes; the items are deductions for tax purposes and potentially within the scope of section 59A(d)(1) and proposed §1.59A-3(b)(1)(i). The payments described in these comments are not eligible for the QDP exception in section 59A(h) and proposed §1.59A-6. The comments requested that the final regulations include a rule that related-party hedging payments are not base erosion payments.

The final regulations do not adopt this recommendation. The status of an item as a deduction is determined under U.S. federal income tax law, not industry prac-

tice or financial accounting treatment. Although the legislative history of section 59A states that base erosion payments do not include any amount that constitutes reductions to determine gross income, including payments for COGS, these statements are in the context of U.S. federal income tax law, which sets forth the tax law for deductions. In addition, section 59A(d)(1) refers to "deductions allowable under this chapter," that is, chapter 1 (normal taxes and surtaxes) of Subtitle A (income taxes) of the Code, which includes section 1 through section 1440Z-2. Congress did not indicate that the definition of a reduction to determine gross income or COGS for purposes of section 59A should be derived from financial accounting principles. In the absence of clear Congressional intent otherwise, the Treasury Department and the IRS believe that whether an amount constitutes a reduction to determine gross income or COGS must be determined under established principles of U.S. federal income tax law. Consequently, if related-party hedging payments are not properly treated as reductions to determine gross income for tax purposes, these payments are not excluded from the definition of base erosion payments. See also Part IV.A.3.b of this Summary of Comments and Explanation of Revisions (Netting of income and expense; Hedging transactions).

7. Captive Finance Subsidiaries

Comments addressed the impact of the BEAT on domestic corporate captive finance subsidiaries that purchase property (business equipment) from a foreign related party and then lease the property to unrelated third party end users. The comments requested that the final regulations permit taxpayers using this type of business model to treat the depreciation deductions attributable to the leased property as COGS for purposes of the BEAT. The comments premised this requested treatment on the theory that the cost of the leased property and its associated depreciation deductions are directly correlated with the rental income generated from leasing the property and on the unique nature of this particular business model.

The final regulations do not include an exception from the definition of base erosion payments for the transactions described in these comments. Under section 59A(d)(2), the deduction allowed for depreciation with respect to property acquired from a foreign related party is a base erosion tax benefit, notwithstanding that the property acquired by the taxpayer is used in an income-generating business in the United States, such as the leasing of the business equipment to unrelated third party lessees of the property or operating the business equipment itself as a service for unrelated third parties.

8. Capitalization and Amortization of Research and Experimental Expenditures

One comment recommended that the final regulations clarify the treatment of research and experimental ("R&E") expenditures after such costs are required to be amortized in taxable years beginning after December 31, 2021, under section 174. The comment recommended clarification that after the change to section 174 is in effect, the BEAT payment associated with R&E expenses is limited to the amount of amortization. The final regulations do not adopt this comment because the Treasury Department and the IRS view §1.59A-3(b)(1)(i) and §1.59A-3(c)(1)(i) as sufficiently clear in setting forth that a base erosion payment to a foreign related party does not result in a base erosion tax benefit until the deduction is "allowed under chapter 1 of subtitle A of the [Code]."

C. *Other exceptions from the base erosion payment definition contained in the proposed regulations*

1. Exception for Certain Amounts with Respect to Services and the Services Cost Method

Proposed §1.59A-3(b)(3)(i) provides that a base erosion payment does not result from amounts paid or accrued to a foreign related party for services that are eligible for the SCM exception described in proposed §1.59A-3(b)(3)(i)(B), but only to the extent of the total services cost of those services. Any amount paid or accrued to a foreign related party in excess of the total services cost of services eligible for the SCM exception (the mark-up component) remains a base erosion payment. Proposed §1.59A-3(b)(3)(i)(B) provides that the SCM exception applies if all of the requirements of §1.482–9(b), which describes the SCM, are satisfied, with two exceptions. First, the requirements of §1.482-9(b)(5), commonly referred to as the business judgment rule, do not apply. Second, the books and records requirement described in §1.482–9(b)(6) is replaced with the requirements of proposed §1.59A-3(b)(3)(i)(C). Section 1.482-9(b)(4) provides that certain activities, including research, development, and experimentation, are not eligible for the SCM. As a result, payments for these services do not qualify for the SCM exception described in proposed §1.59A-3(b)(3)(i)(B).

Comments supported the SCM exception and recommended that final regulations adopt this approach. The final regulations continue to provide that the SCM exception is available for the cost portion of a payment that otherwise meets the requirements for the SCM exception. A comment recommended that the final regulations provide examples or clarification as to the requirement in proposed §1.59A-3(b)(3)(i)(C) that taxpayers' books and records provide sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services in question in accordance with §1.482-9(k). The final regulations include additional detail on the documentation required to satisfy this requirement. §1.59A-3(b)(3)(i)(C).

Comments also recommended that the final regulations extend the SCM exception to the cost element of payments for other types of services that are not eligible for the SCM. Some comments suggested that an exception should be available for all services. Some comments suggested that an exception should be available for services that are excluded under §1.482-9(b)(4) (excluded activities) but that otherwise would be eligible for the SCM exception described in proposed §1.59A-3(b)(3)(i)(B). Some comments suggested that an exception should be available for research and experimentation services.

Comments suggested that applying the SCM exception to only some services will lead to inequitable results for services companies as compared to similarly situated U.S. manufacturers and distributors because the definition of base erosion pay-

ments does not include payments included in COGS, but there is not a similar rule for the costs in a services business. Comments also claimed that, relative to manufacturers or distributors, service companies are more constrained in where they operate. Comments also asserted that no base erosion could result from an expansion of the SCM exception because only the cost element of the service fee would be subject to the exception.

The comments suggesting that an exception should be available for excluded activities that otherwise would be eligible for the SCM also asserted that the list of excluded activities serves a similar purpose as the business judgment rule, which is to identify services for which total services costs can constitute an inappropriate reference point for determining profitability or that should be subject to a more robust transfer pricing analysis. Comments suggested that §1.482-9(b)(4) is essentially a list of specific activities for which the SCM is unavailable because they are deemed to contribute significantly to key competitive advantages, core capabilities, or fundamental risks of success or failure of the business. These comments suggested that when section 59A(d) states that the exception therein is based on compliance with the services cost exception in section 482 "(determined without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure)", that language was intended to disregard the list of excluded activities.

The comments requesting an expansion of the SCM exception for research and experimentation services also asserted that extending the SCM exception to these services would reduce the incentive to move intangible property offshore and would broaden the U.S. tax base by encouraging U.S. ownership and exploitation of newly created intangible property.

Section 59A(d)(5)(A) sets forth the parameters under which certain services—those that are eligible for the SCM without regard to the business judgment rule—are eligible for the SCM exception. The Treasury Department and IRS have considered the policy considerations that the comments raised for expanding the SCM exception, but have determined that the recommendation to expand the SCM exception is inconsistent with the parameters that Congress set forth in section 59A(d)(5). Further, the Treasury Department and IRS disagree with the premise in the comments that the list of excluded activities serves the same purpose as the business judgment rule. While certain services that are ineligible for the SCM as a result of being on the list of excluded activities also may be ineligible for the SCM as a result of failing the business judgment rule, the list of excluded activities from the SCM provides an objective list of categories that tend to be high margin or for which the cost of the services tends to be an inappropriate reference point for the price of those services. *See* 71 FR 44466, 44467-68 (Aug. 4, 2006). By contrast, the business judgment rule also excludes from the SCM services that tend to be low margin as a general matter, but in the context of a particular business are a core competency of the business. *See* 71 FR 44466, 44467 (Aug. 4, 2006). The parenthetical language in section 59A(d)(5)(A) indicates unambiguously that Congress intended the SCM exception to be available for all services that are typically low margin even if, in the context of a particular business, the service is a core competency of a business that may not satisfy the criteria in §1.482-9(b)(5). Accordingly, the Treasury Department and the IRS have determined that the SCM exception should continue to follow the statute, and the rule is unchanged from the proposed regulations.

2. Qualified Derivatives Payments

For a discussion of QDPs, see Part VII of this Summary of Comments and Explanation of Revisions.

3. Exception to Base Erosion Payment Status for Payments the Recipient of which is Subject to U.S. Tax

Proposed §1.59A-3(b)(3)(iii) generally provides that a base erosion payment does not result from amounts paid or accrued to a foreign related party that are subject to tax as income effectively connected with the conduct of a trade or business in the United States (ECI). Comments recommended that final regulations adopt this rule. Accordingly, this rule is unchanged in the final regulations.

Several comments recommended that final regulations include a similar exception from the definition of a base erosion payment for payments made by a domestic corporation to a controlled foreign corporation (CFC) that result in a subpart F or global intangible low tax income (GILTI) inclusion. Another comment requested that this exception be extended to apply to payments made to a passive foreign investment company (PFIC) when a U.S. person has made a qualified electing fund (QEF) election, and the payment is included in the electing U.S. person's gross income. The comments asserted that payments that give rise to a subpart F or GILTI inclusion do not erode the U.S. tax base, and accordingly, warrant a base erosion payment exception under the same policy rationale for granting this type of exception in the proposed regulations for ECI, section 988 losses, and interest paid with respect to total loss-absorbing capacity (TLAC) securities. Finally, comments noted that proposed regulations under section 267A provide an exception for certain payments that result in income inclusions under section 951 and section 951A and suggested equivalent treatment was justified in the case of the BEAT.

The final regulations do not include a subpart F, GILTI, or PFIC exception to base erosion payment status. The Treasury Department and the IRS have determined that the reasons for adopting the other exceptions cited in the comments (such as the ECI exception and the exception under section 267A) do not warrant a subpart F, GILTI, or QEF exception from base erosion payment status.

First, comments have misinterpreted the underlying policy rationale for providing an ECI exception in the proposed regulations. The proposed regulations' ECI exception was adopted in part based upon the determination that it would be appropriate in defining a base erosion payment to consider the U.S. federal tax treatment of the foreign recipient—particularly, whether a payment received by a foreign related party was subject to tax on a net basis in substantially the same manner as amounts paid to a U.S. person. In contrast to the tax directly imposed on a foreign person with respect to its ECI under sections 871(b) and 882(a), a CFC receiving a base erosion payment is not directly

subject to U.S. taxation. Rather, the U.S. shareholder is subject to tax under the subpart F or GILTI regime (or the PFIC rules). Thus, the CFC recipient (or PFIC recipient) of a payment is not itself subject to tax on a net basis in substantially the same manner as a U.S. person.

In addition, a foreign corporation that is engaged in a U.S. trade or business is itself subject to section 59A. In contrast, because neither a CFC nor a PFIC is subject to section 59A, the CFC or PFIC can make payments to a foreign related party without any BEAT consequences.

The ECI exception was also adopted to achieve symmetry with proposed §1.59A-2(c), which treats foreign corporations as outside of the controlled group, except to the extent that the foreign corporation has ECI. Because foreign corporations with ECI are treated as part of the aggregate group in determining whether a taxpayer will ultimately be subject to the BEAT, the ECI exception to base erosion payment status is necessary to ensure that the foreign corporation is treated equivalently to a domestic member of its aggregate group receiving deductible payments.

The Treasury Department and the IRS further disagree with the premise that the approaches in the proposed regulations with respect to TLAC interest and section 988 losses support an exception for subpart F or GILTI income in the final regulations. With respect to TLAC, the preamble to the proposed regulations notes that the TLAC exception is appropriate because of the special status of TLAC as part of a global system to address bank solvency and the precise limits that regulations place on the terms of TLAC securities. REG-104259-18, 83 FR 65956, 65963 (December 21, 2018).

With respect to section 988, the preamble to the proposed regulations states that the exception is based on a determination that the losses did not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party. *See* REG-104259-18, 83 FR 65956, 65963 (December 21, 2018).

The Treasury Department and the IRS also disagree with the premise that the approach in the proposed hybrid regulations under section 267A provides support for a regulatory exception. Section 267A(b)(1) expressly provides that the disqualified related-party amount does not include any payment to the extent that the payment is included in the gross income of a United States shareholder under section 951(a). Whereas Congress expressly provided an exception for subpart F in section 267A, Congress did not provide a similar exception for purposes of section 59A. The Treasury Department and the IRS have determined that the inclusion of a similar exception in another section of the Act, but not in section 59A, reflects Congressional intent to not provide a GILTI or subpart F exception for purposes of section 59A. In addition, section 59A(c)(4)(B) provides that a deduction under section 250 (providing a domestic corporation a deduction for a portion of its GILTI amount) is not included in the denominator for purposes of the base erosion percentage; this shows that Congress considered the interaction between section 59A and GILTI, but did not provide an exception from the term base erosion payment for payments subject to tax under section 951A.

Finally, with respect to the suggested GILTI exception, the Treasury Department and the IRS are concerned that a GILTI exception would be difficult to administer because it would require a determination of whether a particular payment to a CFC is included in the taxpayer's GILTI inclusion, but a taxpayer's GILTI inclusion often cannot be traced to particular payments to a CFC because a taxpayer's GILTI inclusion amount depends on multiple factors. A GILTI exception would also need to take into account differences in effective and marginal tax rates under GILTI, BEAT, and regular corporate income tax.

For the foregoing reasons, the final regulations do not provide a regulatory exception to the definition of a base erosion payment for a payment that may give rise to subpart F, GILTI, or PFIC inclusions.

4. Exchange Loss from a Section 988 Transaction

Proposed §1.59A-3(b)(3)(iv) provides that exchange losses from section 988 transactions described in §1.988-1(a)(1) are excluded from the definition of base erosion payments. Proposed §1.59A-2(e)(3)(ii)(D) provides that an exchange loss from a section 988 transaction (including with respect to transactions with persons other than foreign related parties) is not included in the denominator when calculating the base erosion percentage. The preamble to the proposed regulations requests comments on whether the denominator should exclude only section 988 losses with respect to foreign related-party transactions. REG-104259-18, 83 FR 65956, 65963 (December 21, 2018). Comments recommended that section 988 losses should not be excluded from the denominator of the base erosion percentage because excluding all section 988 losses is not consistent with the statute. Some comments, however, recommended that section 988 losses with respect to transactions with foreign related parties that are also excluded from the numerator should continue to be excluded from the denominator, and that this approach would be symmetrical with the approach in the statute for deductions for qualified derivative payments and for amounts eligible for the SCM exception. The final regulations adopt this recommendation. *See* §1.59A-2(e)(3)(ii)(D). This approach is also consistent with the treatment of amounts paid to foreign related parties with respect to TLAC securities, which are excluded from the denominator only if the deductions arise from foreign related-party transactions.

5. Exception for Interest on Certain Instruments Issued by Globally Systemically Important Banking Organizations (GSIBs)

Proposed §1.59A-3(b)(3)(v) provides that the amount paid or accrued to a foreign related party with respect to total loss-absorbing capacity ("TLAC") securities is not a base erosion payment, but only to the extent of the amount of TLAC securities required by the Board of Governors of the Federal Reserve (Federal Reserve Board) under subpart P of 12 CFR part 252. *See* proposed §1.59A-1(b)(18) and (20). Specifically, proposed §1.59A-3(b)(3)(v) provides that the amount excluded is no greater than the amount paid to foreign related parties multiplied by the scaling ratio, which is the average TLAC long-term debt required over the average TLAC security amount. The pream-

ble to the proposed regulations requests comments regarding whether the TLAC exception should also apply to similar instruments issued by foreign corporations that are required by law to issue a similar type of loss-absorbing instruments. These instruments issued by foreign corporations would be relevant for section 59A if interest expense from those instruments is deducted by the U.S. branch or permanent establishment of the foreign corporation. Comments generally supported the exception for amounts paid to a foreign related party with respect to TLAC and suggested that the final regulations expand the exception to foreign issuers.

a. TLAC issued in compliance with foreign law

Comments requested that the TLAC exception be expanded to include TLAC issued to comply with foreign laws and regulations that are similar to the TLAC requirements prescribed by the Federal Reserve Board. One comment observed that an exception for interest on TLAC that is issued to comply with foreign law and allocated to a U.S. branch or permanent establishment would provide branch parity, by excluding interest from base erosion payment status to the same extent, whether that internal TLAC debt is issued by a U.S. subsidiary or branch. See generally Rev. Proc. 2017-12, 2017-3 I.R.B. 424, for the definition of internal TLAC.

The Treasury Department and the IRS generally agree with comments that the special status of TLAC as part of the global system to address bank solvency applies equally to TLAC securities whether issued pursuant to U.S. law or foreign law. Consistent with comments, the final regulations expand the scope of the TLAC exception to include internal securities issued by GSIBs pursuant to laws of a foreign country that are comparable to the rules established by the Federal Reserve Board ("foreign TLAC"), where those securities are properly treated as indebtedness for U.S. federal income tax purposes.[2] In order to provide consistency between interest deductions on TLAC of a domestic subsidiary and a U.S. branch or permanent establishment, the final regulations limit the foreign TLAC exception to interest expense of GSIBs, and determine the limitation on the exception by reference to the specified minimum amount of TLAC debt that would be required pursuant to rules established by the Federal Reserve Board for TLAC if the branch or permanent establishment were a domestic subsidiary that is subject to Federal Reserve Board requirements. In addition, to ensure that the limitation is not greater than the amount required under foreign law, the final regulations express the limitation as the lesser of the hypothetical Federal Reserve Board limitation described in the preceding sentence and the specified minimum amount of TLAC debt that is required pursuant to bank regulatory requirements of a foreign country that are comparable to the requirements established by the Federal Reserve Board. Further, the Treasury Department and the IRS understand that in some jurisdictions, foreign TLAC may apply in a more discretionary manner than the framework established in the proposed regulations that references the specified minimum amount of TLAC debt that is required pursuant to rules established by the Federal Reserve Board for TLAC of U.S. issuers, for example, with no specified minimum amount. For that reason, if the bank regulatory requirements of a foreign country do not specify a minimum amount, the limitation is determined by reference solely to the hypothetical Federal Reserve Board limitation. The second prong serves to provide general consistency with TLAC of a domestic subsidiary, by limiting the foreign TLAC exception to no more than the amount of TLAC that would be required by the Federal Reserve Board if the branch were a subsidiary (subject to the modification for a buffer that is also discussed in this Part IV.C.5.b). These rules tend to support the systemic bank solvency goals of TLAC by reducing the tax cost of issuing such securities via foreign related parties. The Treasury Department and the IRS understand that information necessary to determine this amount is generally knowable to banks with U.S. operations. The Treasury Department and the IRS also understand that in some foreign jurisdictions, the foreign TLAC requirements may apply to organizations other than GSIBs; however, to provide general consistency with interest deductions on TLAC of a domestic subsidiary, the final regulations limit the foreign TLAC exception to only GSIBs.

b. Buffer amount above specified minimum amount

Comments also recommended that the final regulations increase the specified minimum amount of interest eligible for the TLAC exception to permit an additional "buffer" amount of TLAC that exceeds the minimum amount required to satisfy regulatory requirements (such as 115 percent of the specified minimum amount or a buffer equal to 1 to 1.5 percent of the risk-weighted assets). Comments explained that the inputs used to determine the minimum amount of TLAC needed to satisfy regulatory requirements change on a daily basis; as a result, the amount of TLAC securities needed also may change on a daily basis. The comments also noted that market issues dictate a certain lead time to issue TLAC securities. As a result, comments stated that it is the market expectation and practice that GSIBs operate with a buffer, which helps to ensure that TLAC does not fall below the minimum amount when risk-weighted assets or total leverage increase. Finally, the comments asserted that because the cost of issuing TLAC securities significantly exceeds the cost of issuing non-loss absorbing securities, banks are commercially incentivized to issue no more TLAC securities than necessary.

Because of the special status of TLAC as part of a global system to address bank solvency and the specific requirements established by the Board and other regu-

[2] While final regulations adopt the comment recommending similar treatment as between TLAC that is required under Federal Reserve Board regulations and similar foreign TLAC instruments, the final regulations do not address, and provide no inference, on whether those instruments issued pursuant to foreign law are treated as debt for U.S. federal income tax purposes. *See* Rev. Proc. 2017-12, 2017-3 I.R.B. 424 (providing generally that the IRS will treat as indebtedness internal TLAC that is issued by an intermediate holding company of a foreign GSIB pursuant to the Federal Reserve Board regulations, and that "[n]o inference should be drawn about the federal tax characterization of an instrument that is outside the scope of [Rev. Proc. 2017-12].").

lators, the Treasury Department and the IRS recognize that it is necessary and appropriate to take into account the market practices that have been adopted to prevent TLAC from falling below the specified minimum amount as required by regulations. For these reasons, the final regulations adopt the recommendation to provide a 15 percent buffer on the specified minimum amount of interest eligible for the exception. This buffer applies for both TLAC and foreign TLAC.

c. Requests to extend the TLAC exception to include other regulatory capital requirements

The Treasury Department and the IRS decline to expand the TLAC exception to cover interest payments on debt to foreign related parties that may satisfy regulatory capital requirements other than TLAC. The TLAC exception was adopted because of the unique role of TLAC securities in the global banking system for GSIBs; while other regulatory capital requirements may also serve an important role in bank regulation, the Treasury Department and the IRS are cognizant that the BEAT applies as a general matter to interest paid to foreign related parties, and have thus limited this regulatory exception to only those specific securities that are issued as part of the integrated international financial regulation and supervision system.

d. TLAC issued during transition period

Comments recommended that the final regulations increase the specified minimum amount of interest eligible for the TLAC exception to permit interest with respect to TLAC debt in place during a three-year transition period before the year in which a corporation is required to have issued TLAC. The final regulations do not extend the TLAC exception to cover TLAC issued during a pre-effective date or transition period before being required to comply with the regulations prescribed by the Federal Reserve Board, because in that situation all of the debt is discretionary rather than mandatory. Further, there is no clear objective metric to scope discretionary issuances during a pre-effective period.

e. Other operational elements of the TLAC exception

A comment recommended modifying the limitation on the exclusion for internal TLAC when a portion of the internal TLAC is held by the U.S. branch of a foreign person such that interest payments on the internal TLAC is also eligible for the ECI exception. The comment recommended that interest on the internal TLAC be first attributed to TLAC held by the U.S. branch of a foreign person, and thus excluded from the definition of a base erosion payment on the basis of the interest being ECI; and then only the incremental interest expense in excess of the amount payable to that branch would be subject to the TLAC scaling ratio limitation. The final regulations do not further expand the TLAC exception through such a rule, so as to retain the narrow scope of the TLAC exception to those securities that are required to be in place because of Federal Reserve Board requirements (taking into account the buffer described in this Part IV.C.5.b). The final regulations clarify the definition of TLAC securities amount to confirm that the TLAC scaling ratio applies without regard to whether TLAC interest is also eligible for another exclusion from base erosion payment status, and thus that the TLAC scaling ratio applies pro-rata to all internal TLAC. *See* §1.59A-1(b)(19).

Another comment recommended that the final regulations modify the definition of the "TLAC long term debt minimum amount" to reflect international standards, rather than Federal Reserve Board requirements because the comment asserted that the Federal Reserve Board may, in the future, eliminate the minimum requirement in the Federal Reserve Board regulations. Comments also recommended expanding the TLAC exception to apply to other intercompany debt that is issued to comply with other bank regulatory capital requirements. The Treasury Department and the IRS have determined that it is appropriate to limit the amount of the TLAC exception by reference to Federal Reserve Board requirements, notwithstanding comments suggesting that in the future the Federal Reserve Board may eliminate its minimum required amount. If there are meaningful changes in the total loss absorbing capacity systems in the future, the Treasury Department and the IRS would be able to reassess the section 59A regulations.

Finally, a comment recommended that the final regulations should not exclude interest on TLAC borrowing from the denominator of the base erosion percentage calculation, which is discussed in Part III of this Summary of Comments and Explanation of Revisions. The proposed regulations exclude from the denominator of the base erosion percentage amounts excluded under certain of the specific exceptions to base erosion payment status in §1.59A-3(b) for SCM, QDP, and TLAC. This is in contrast to those amounts that are not base erosion payments because they are not within the main definition of a base erosion payment, for example, a payment to an unrelated third party, which remain in the denominator. The comment suggested that interest expense that is excluded from the definition of a base erosion payment under the TLAC exception should be viewed as like a payment to an unrelated third party, that is, the interest expense should remain in the denominator of the base erosion percentage. The comment premised this position on the view that internal TLAC should be viewed as issued to the holders of external TLAC (that is, to unrelated third party investors) under a theory that the issuer of internal TLAC is an intermediary or conduit for the issuer of the external TLAC securities. Therefore, there would be no underlying base erosion payment by the U.S. borrower on the internal TLAC, and thus the internal TLAC interest expense would remain in the denominator of the base erosion percentage calculation like interest paid to unrelated third parties. The proposed regulations and the final regulations provide a regulatory exception for internal TLAC on the basis of the special status of TLAC issued by GSIBs as part of the global system to address bank solvency. That is, the rationale for the TLAC exception in the proposed regulations and final regulations is not that the internal TLAC is a conduit for the external TLAC. For this reason, the final regulations (consistent with the proposed regulations) exclude from the denominator the TLAC interest in a manner consistent with the treatment

of deductions covered by the SCM and QDP exceptions.

D. *Base erosion tax benefits*

1. Withholding Tax on Payments

The proposed regulations provide that if tax is imposed by section 871 or 881, and the tax is deducted and withheld under section 1441 or 1442 without reduction by an applicable income tax treaty on a base erosion payment, the base erosion payment is treated as having a base erosion tax benefit of zero for purposes of calculating a taxpayer's modified taxable income and base erosion percentage. If an income tax treaty reduces the amount of withholding imposed on the base erosion payment, the amount of the base erosion payment that is treated as a base erosion tax benefit is reduced in proportion to the reduction in withholding. In the regulation section pertaining to base erosion tax benefits, the final regulations include a technical correction to the fraction used to determine the amount of a base erosion payment that is treated as a base erosion tax benefit when the rate of withholding imposed on that payment is reduced by an income tax treaty. §1.59A-3(c)(3)(i). To avoid duplication, the final regulation section pertaining to the base erosion percentage replaces a similar operating rule with a cross reference to the rule for determining base erosion tax benefits. See §1.59A-2(e)(3)(iii).

Under section 884(f) and §1.884-4, a portion of interest expense allocated to income of a foreign corporation that is, or is treated as, effectively connected with the conduct of a trade or business in the United States ("excess interest") is treated as interest paid by a wholly-owned domestic corporation to the foreign corporation. The foreign corporation is subject to tax under section 881 on the excess interest and is required to report the excess interest on its income tax return, subject to the exemption provided in section 881 for bank deposit interest and reduction or elimination under applicable tax treaties. However, no withholding is required under section 1441 and 1442. *See* §1.884-4(a)(2)(iv). Because no withholding is required, excess interest is not excluded from treatment as a base erosion tax benefit under the proposed regulations.

A comment suggested that because excess interest is subject to tax under section 881(a) as if it were interest paid to a foreign corporation by a wholly-owned domestic corporation, the exclusion from base erosion tax benefits that applies to payments subject to full withholding should also apply to excess interest. The comment suggested that the exclusion from treatment as a base erosion tax benefit might apply to excess interest under the proposed regulations, but requested clarification. While excess interest would not be excluded from treatment as a base erosion tax benefit under the proposed regulations because it is not subject to withholding, the Treasury Department and the IRS have determined that it is appropriate to expand the general exclusion from base erosion tax benefits to include excess interest. Accordingly, the final regulations reduce any base erosion tax benefit attributable to interest in excess of interest on U.S.-connected liabilities by excess interest to the extent that tax is imposed on the foreign corporation with respect to the excess interest under section 884(f) and §1.884-4, and the tax is properly reported on the foreign corporation's income tax return and paid in accordance with §1.884-4(a)(2)(iv). §1.59A-3(c)(2)(ii). If an income tax treaty reduces the amount of tax imposed on the excess interest, the amount of base erosion tax benefit under this rule is reduced in proportion to the reduction in tax.

The final regulations also provide a coordination rule to clarify the interaction between the withholding tax exception and the rules determining the portion of interest expense attributable to ECI that is treated as paid to a foreign related party. As discussed in part IV.B.4. of this Summary of Comments Explanation of Revisions, interest expense attributable to ECI that is in excess of direct allocations and interest expense on U.S.-booked liabilities is treated as paid to a foreign related party in proportion to the foreign corporation's average worldwide ratio of interest expense paid to a foreign related party over total interest expense. This coordination rule provides that any interest, including branch interest under §1.884-4(b)(1), on which tax is imposed under 871 or 881 and tax has been deducted and withheld under section 1441 or 1442 but which is not attributable to direct allocations or interest expense on U.S.-booked liabilities is treated as not paid to a foreign related party for purposes of determining the foreign corporation's average worldwide ratio.

2. Rule for Classifying Interest for Which a Deduction is Allowed when Section 163(j) or Another Provision of the Code Limits Deductions

Section 59A(c)(3) provides a stacking rule in cases in which section 163(j) applies to a taxpayer, under which the reduction in the amount of deductible interest is treated as allocable first to interest paid or accrued to persons who are not related parties with respect to the taxpayer and then to related parties. The statute does not provide a rule for determining which portion of the interest treated as paid to related parties (and thus potentially treated as a base erosion payment) is treated as paid to a foreign related party as opposed to a domestic related party. Proposed §1.59A-3(c)(4) provides rules coordinating section 163(j) with the determination of the amount of base erosion tax benefits. This rule provides, consistent with section 59A(c)(3), that where section 163(j) applies to limit the amount of a taxpayer's business interest expense that is deductible in the taxable year, a taxpayer is required to treat all disallowed business interest first as interest paid or accrued to persons who are not related parties, and then as interest paid or accrued to related parties for purposes of section 59A. More specifically, with respect to interest paid to related parties, the proposed regulations provide that 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. Conversely, the amount of a disallowed business interest expense carryforward is treated first as business interest expense paid to unrelated parties, and then as business interest expense paid to related parties, proportionately between foreign and domestic related-party business interest expense.

Proposed §1.59A-3(c)(4)(i)(C) provides that business interest expense paid or ac-

crued to a foreign related party to which the ECI exception in proposed §1.59A-3(b)(3)(iii) applies is classified as domestic related business interest expense. One comment observed that the proposed regulations do not expressly provide similar rules for business interest expense paid to foreign related parties that is excluded from the definition of a base erosion payment under the TLAC exception or excluded from the definition of a base erosion tax benefit under the exception for payments subject to withholding tax. The final regulations confirm that those categories of interest expense retain their classification as payments to foreign related parties, but also that the foreign related business interest expense category is treated as consisting of interest that is eligible for these exceptions and interest that is not eligible for these exceptions, on a pro-rata basis. *See* §1.59A-3(c)(4)(i)(C)(*2*).

E. *Election to waive allowable deductions*

See the 2019 proposed regulations for a proposal to provide an election (and certain procedural safeguards) by which a taxpayer may permanently forego a deduction for all U.S. federal tax purposes, with the result that the foregone deduction will not be treated as a base erosion tax benefit.

V. *Comments and Changes to Proposed §1.59A-4—Modified Taxable Income*

Proposed §1.59A-4 contains rules relating to the determination of modified taxable income.

A. *Method of computing modified taxable income*

Section 59A(c)(1) defines modified taxable income as "the taxable income of the taxpayer computed under this chapter for the taxable year, determined without regard to – (A) any base erosion tax benefit with respect to any base erosion payment, or (B) the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year." Proposed §1.59A-4(b)(2) clarifies that modified taxable income is computed by adding back the base erosion tax benefits and base erosion percentage of any net operating loss deductions (the "add-back method"). In addition, to prevent net operating loss benefits from being duplicated, proposed §1.59A-4(b)(1) provides that taxable income may not be reduced below zero as a result of a net operating loss deduction.

Comments generally recommended one of three approaches to calculate modified taxable income: (1) the add-back method, (2) the "recomputation method," and (3) the "limited recomputation method."

1. The Add-back Method

Some comments recommended that the final regulations retain the add-back method because it would be simpler and easier to administer this method than a recomputation method. See Part V.A.2 of this Summary of Comments and Explanation of Revisions for a description of the recomputation method. Comments highlighted that the add-back method does not require attributes to be separately computed and tracked for regular income tax purposes and the BEAT. In addition, a comment asserted that this method more closely follows the statute, observing that the statutory language in section 59A(c) is substantially different from the recomputation-like language that was in section 59(a)(1)(B) relating to the foreign tax credit determination for alternative minimum tax purposes, which is now repealed for corporations. *See* section 59(a)(1)(B) (providing explicit language referencing computing the alternative minimum tax foreign tax credit as if section 904 were applied on the basis of alternative minimum taxable income instead of taxable income); *see also* the Act, §12001(a) (repealing the alternative minimum tax for corporations and rendering section 59(a)(1)(B) inapplicable to corporations). Another comment noted that the add-back method is harmonious with the language of section 59A(c)(1)(B) because that section includes the base erosion percentage of net operating loss deductions as an item included in modified taxable income as the method for determining which portion of net operating loss carryovers from prior years resulted from base erosion tax benefits. (Under a recomputation method with a net operating loss carryover that is computed on a BEAT basis, base erosion tax benefits would already be excluded from the net operating loss carryover, so it would be anomalous to also apply section 59A(c)(1)(B) to the net operating loss deduction.) In support of the add-back method, one comment asserted that applying a recomputation approach would exceed statutory authority.

2. The Recomputation Method

Some comments recommended that the final regulations determine modified taxable income by using the recomputation method that is described in the preamble to the proposed regulations whereby the taxpayer's taxable income is recomputed without the excluded items, or a variation of that method. *See* REG-104259-18, 83 F.R. 65965 (December 21, 2018) (describing a recomputation approach as requiring attributes that are limited based on taxable income to be recomputed for purposes of section 59A). For example, some comments recommended making the recomputation method elective. One comment requested a recomputation method with a special rule for net operating loss deductions, which is discussed in Part V.A.3 of this Summary of Comments and Explanation of Revisions (limited recomputation method). While comments acknowledged that the add-back method is less complex, comments asserted that the add-back method may result in greater BEAT liability. Comments claimed that the recomputation method more accurately computes the base erosion minimum tax amount ("BEMTA"). Comments also asserted that the language in section 59A(c) – specifically the clause "computed without regard to" – is more consistent with the recomputation method. Another comment noted that nothing in section 59A or its legislative history mandates the use of the add-back method and that taxpayers familiar with the prior corporate alternative minimum tax would have anticipated using the recomputation method.

Additionally, some comments requested a recomputation method with a separate tracking of attributes such as net operating loss carryovers, while others requested a recomputation method without a separate tracking of attributes. Some comments acknowledged that the recomputation method could give taxpayers a double benefit from non-base eroding deductions unless it required separate tracking of attributes for purposes of the BEAT. For example, one comment noted that the recomputation method would generally allow net operating loss carryovers to be

used more rapidly for purposes of modified taxable income than for regular tax purposes because the taxable income limitation under section 172 on net operating loss deductions would be lower for regular tax purposes. As a result, the comment noted that if net operating loss carryovers are not separately tracked for purposes of the BEAT, a taxpayer may receive a double benefit from the non-base eroding deductions because those attributes reduce modified taxable income in the loss year, but if the attributes do not reduce the taxpayer's regular tax liability, the attributes would remain available to reduce modified taxable income in a future year. In contrast, another comment asserted that attributes should not be separately tracked because section 59A requires a snapshot of relative tax attributes that are applied independently to calculate taxable income and modified taxable income.

3. The Limited Recomputation Method

Some comments recommended that the final regulations permit a taxpayer to elect to recompute its taxable income with respect to pre-2018 net operating loss carryovers (the "limited recomputation method"). Under this approach, comments generally suggested the taxpayer would use the add-back method except with respect to pre-2018 net operating loss carryovers, which would be separately used and tracked for purposes of the BEAT. One comment suggested that this approach should apply to net operating losses generally, not only pre-2018 net operating loss carryovers. Comments asserted that the proposed regulations have the effect of denying some taxpayers the economic benefit of their pre-2018 net operating loss carryovers because they do not allow pre-2018 net operating loss carryovers to offset full tax liability of taxpayers. Some comments acknowledged that using net operating loss carryovers under any of the three methods discussed in this Part V.A of the Summary of Comments and Explanation of Revisions are timing differences (rather than permanent differences that would deny economic benefit) because pre-2018 net operating loss carryovers are allowed against modified taxable income as and when those net operating loss carryovers are deducted for regular tax purposes. Comments generally asserted that limiting the utilization of net operating loss carryovers is arguably retroactive in nature because it limits the tax benefit of pre-2018 net operating loss carryovers and is unduly harsh because it may cause a taxpayer to pay tax on an amount greater than its economic income. Some comments also asserted that the limited recomputation approach is more consistent with pre-Act section 172 and the policies supporting section 59A. The comments noted that the section 172 legislative history suggests that net operating loss deductions were allowed primarily to alleviate economic losses incurred by taxpayers and asserted that absent clear statutory language and expressed legislative intent to limit the use of net operating losses, taxpayers should be able to use the net operating loss carryovers without limitation in calculating their modified taxable income. However, the comment acknowledged that an attribute tracking system is required to prevent the same net operating loss carryovers from being deducted multiple times for the BEAT.

4. Add-back Method Retained in Final Regulations

The final regulations retain the add-back method. The add-back method takes into account all the statutory language in section 59A(c)(1), which determines modified taxable income without regard to both the base erosion tax benefits and the base erosion percentage of net operating loss deductions. This approach is also consistent with the Joint Committee on Taxation's Explanation of the Act, which states that "an applicable taxpayer's modified taxable income is its taxable income for the taxable year, *increased by* (1) any base erosion tax benefit with respect to any base erosion payment and (2) the base erosion percentage of any NOL deduction allowed under section 172 for such taxable year." Joint Comm. on Tax'n, General Explanation of Pub. L. 115-97 ("Bluebook"), at 403 (emphasis added). By contrast, the recomputation method conflicts with section 59A(c)(1). If taxable income is recomputed without any base erosion tax benefits for modified taxable income, it is a necessary premise that net operating loss carryovers would also be recomputed as BEAT-basis attributes, which, under the recomputation framework, would not include the effect of any base erosion tax benefits (because the recomputation method is without regard to base erosion tax benefits). However, that framework would make the language in section 59A(c)(1)(B) superfluous or inexplicable because section 59A(c)(1)(B) addresses the percentage of base erosion tax benefits embedded in a net operating loss carryover, whereas a recomputed BEAT-basis net operating loss carryover would already exclude all base erosion tax benefits.[3]

[3] For example, assume that a domestic corporation (DC) is an applicable taxpayer that has a calendar year. In 2020, DC has gross income of $0, a deduction of $60x that is not a base erosion tax benefit, and a deduction of $40x that is a base erosion tax benefit. For regular tax purposes, DC has a net operating loss carryover within the meaning of section 172(b) of $100x. DC also has a base erosion percentage of 40 percent for the 2020 taxable year. Under the recomputation method, DC's taxable income would presumably be recomputed without regard to base erosion tax benefits, and as a result, DC would presumably have a BEAT-basis net operating loss carryover of $60x, computed as DC's excess of deductions over gross income, without regard to the $40x of deductions that are base erosion tax benefits.

Assume further that in 2021, DC has gross income of $70x, and no current year deductions. For regular tax purposes, DC is permitted a net operating loss deduction of $56x (section 172(a) limits the regular tax deduction for net operating losses that originated after the Act to 80 percent of taxable income before the net operating loss deduction), and thus DC has regular taxable income of $14x ($70x - $56x = $14x). Under the add-back method, DC's modified taxable income for 2021 would be computed as $36.4x, computed as regular taxable income of $14x, plus $0 base erosion tax benefits in 2021, plus the section 59A(c)(1)(B) base erosion percentage of the net operating loss allowed under section 172, $22.4x ($56x x 40 percent = $22.4x).

Under the recomputation method, DC would presumably need to recompute its 2021 taxable income *without regard to* its base erosion tax benefits in 2021 (there are none in the example) and also *without regard to* the base erosion percentage of the net operating loss deduction allowed under section 172 for the taxable year ($56x). Section 59A(c)(1)(B). However, the basic premise of the recomputation method is that DC has a BEAT-basis net operating loss carryover from 2020 of $60x that already excludes the 2020 base erosion tax benefits. DC's modified taxable income for 2021 might thus be computed as $14x ($70x gross income, reduced by $56x, which is the lesser of (i) the $60x BEAT-basis net operating loss carryover from 2020 or (ii) 80 percent of the taxable income ($70x) computed without regard to the section 172 deduction, or $56x). However that adaptation would render section 59A(c)(1)(B) irrelevant. If instead, section 59A(c)(1)(B) was taken into account in computing DC's modified taxable income, then DC's modified taxable income would include the erosion percentage (40 percent) of the BEAT-basis net operating loss carryover from 2020 ($60x), even though that BEAT-basis net operating loss carryover has already been stripped of any 2020 base erosion tax benefits. Thus, this adaptation that gives regard to section 59A(c)(1)(B) would seem to incongruously increase modified taxable income by $24x (40 percent of $60x = $24x). Some comments observed these anomalies, but no comments appear to provide a complete reconciliation of how the recomputation method would address the anomalies under the terms of the statute.

Further, as some comments noted, the add-back method is more consistent with the statutory framework of section 59A because the add-back method does not require additional rules regarding the treatment of separate tax attributes. The Treasury Department and the IRS have determined, and numerous comments acknowledged, that if the recomputation method were used, separate tracking of attributes would be required to avoid duplication of benefits. Unlike the alternative minimum tax that was repealed for corporations, the BEAT does not contain rules to address how a recomputation method would be implemented, including in the case of a section 381 transaction, a section 382 ownership change, or a deconsolidation. Thus, the recomputation methods would require the Treasury Department and the IRS to construct such rules by regulation. Moreover, as also identified by comments, the add-back method is simpler and easier to comply with and administer for both taxpayers and the IRS than the recomputation method or other methods (including a method by which a taxpayer could elect to apply the add-back or recomputation method) because the recomputation-based methods would require the taxpayer to calculate an entire parallel tax return and schedules to take into account iterative effects, whereas the add-back approach only requires addition, rather than iterative effects. As a result of these factors, the Treasury Department and the IRS have determined that it is not appropriate to permit the recomputation method.

These reasons for rejecting the recomputation method also apply to the limited recomputation method. Because the recomputation approach generally is not consistent with the statutory construct, it would be inappropriate to create a limited version of that approach to permit a taxpayer to use its pre-2018 net operating loss carryovers or all net operating loss carryovers. Section 59A does not provide special rules or preferences for pre-2018 net operating loss carryovers. In addition, the comments' assertions for pre-2018 net operating loss carryovers generally apply to subsequent net operating loss carryovers of certain taxpayers, and those carryovers would raise all the issues discussed.

The claim that taxpayers are losing the benefit of their net operating loss carryovers as a result of the add-back method in the proposed regulations is erroneous. Net operating loss carryovers continue to offset regular taxable income. Section 59A does not change that result, as the net operating loss deduction is allowed against modified taxable income as and when deducted for regular tax purposes. Section 172 does not provide that if a taxpayer has a net operating loss carryover then the taxpayer does not have to pay any taxes under any provision. Because the base erosion percentage of any net operating loss deduction is taken into account in determining modified taxable income, section 59A(c)(1)(B) specifically contemplates that a taxpayer may not obtain the full benefit of net operating loss carryovers even in a year in which the taxpayer uses a net operating loss deduction to fully offset taxable income for purposes of its regular tax liability.

Moreover, the statutory language in section 59A does not explicitly limit that provision to net operating loss deductions related to carryovers that originated in tax years beginning after December 31, 2017; rather, that limitation resulted from the vintage year approach adopted in proposed §1.59A-4(b)(2)(ii). Absent that provision, or if proposed §1.59A-4(b)(2)(ii) had adopted a current year base erosion percentage approach, the add-back provision in section 59A(c)(1)(B) could have also applied to net operating loss deductions related to carryovers that originated in pre-2018 tax years. See Part V.B of this Summary of Comments and Explanation of Revisions for a discussion of the comments related to proposed §1.59A-4(b)(1) and limiting the net operating loss deduction for purposes of computing modified taxable income.

B. *Amount of net operating loss deduction from net operating loss carryovers*

Under the add-back method, section 59A(c) provides that the computation of modified taxable income starts with the taxpayer's regular taxable income for the year. Section 172(a) generally provides that for regular tax purposes a deduction is allowed for the tax year in an amount equal to the net operating loss carryover to the year. For net operating loss carryovers originating after the Act, the net operating loss deduction is generally limited for regular tax purposes to 80 percent of taxable income computed without regard to the net operating loss deduction. Section 172(a). For net operating loss carryovers originating before the Act, the net operating loss carryover deduction generally is not limited for regular tax purposes. Section 13302(e)(1) of the Act. Proposed §1.59A-4(b)(1) provides that taxable income may not be reduced below zero as a result of net operating loss deductions. The preamble to the proposed regulations explains that the rule is necessary because section 172(a) could be read to provide that the same net operating loss carryover could reduce modified taxable income in multiple years. REG-104259-18, 83 F.R. 65965 (December 21, 2018).

The preamble to the proposed regulations provides an example where a taxpayer has a net operating loss carryover of $100x that arose in a taxable year beginning before January 1, 2018. REG-104259-18, 83 F.R. 65965 (December 21, 2018). In a subsequent year, the taxpayer has taxable income of $5x before taking into account the $100x net operating loss carryover. Absent the rule in proposed §1.59A-4(b)(1), the taxpayer might claim the entire $100x net operating loss carryover as a $100x deduction in that year to create a $95x taxable loss for determining modified taxable income, even though $95x of the net operating loss carryover would remain as a carryover to future years. Proposed §1.59A-4(b)(1) ensures that a net operating loss is taken into account only once in determining a taxpayer's modified taxable income.

Some comments recognized the need for proposed §1.59A-4(b)(1) consistent with the preamble to the proposed regulations. A comment acknowledged that if the net operating loss carryover deductions are not limited to the amount of taxable income, those net operating losses could reduce taxable income — and therefore the taxpayer's BEAT liability — multiple times. Another comment noted that, without proposed §1.59A-4(b)(1), allowing net operating loss carryovers to be taken into account for modified taxable income to the same extent as general taxable in-

come would give rise to certain complex questions concerning net operating loss carryovers for general tax purposes.

Other comments asserted that there is no authority in section 59A for limiting the net operating loss deduction to the amount of taxable income, that the rule in proposed §1.59A-4(b)(1) is contrary to the statute, and that the final regulations should permit taxable income to be negative as a result of net operating loss carryovers. Comments noted that modified taxable income is determined based on taxable income, which generally is gross income minus deductions allowed under chapter 1, including the net operating loss deduction. Another comment noted that with respect to the amount of net operating loss deduction in a taxable year, when Congress wants to place a floor on a number, it does so expressly; for example, section 59A(b)(1)(B) provides that regular tax liability is "reduced (but not below zero)." In contrast, there is no similar language in section 59A or section 172(a) prior to the Act for net operating loss deductions.

Comments also asserted that the limitation on the use of net operating loss carryovers as deductions in a taxable year causes taxpayers to be liable for tax pursuant to the BEAT on their base erosion tax benefits even though they are not liable for regular income tax because of their net operating loss deductions that reduced regular taxable income to zero. Comments also asserted that the proposed regulations effectively reduce the extent to which the net operating loss carryforwards may be used.

Other comments requested that the final regulations provide a transition to the proposed rule preventing taxable income to be negative as a result of a net operating loss deduction. One comment requested that final regulations provide for a deferral of the effective date of proposed §1.59A-4(b)(1) of one or two years. Another comment requested that final regulations provide that taxpayers may reduce their BEAT liability by (a) an amount equal to the pre-2018 net operating loss carryover that offset taxable income, multiplied by (b) the difference between the regular income tax rate and the BEAT rate because section 59A should not retroactively reduce the value of the pre-2018 net operating loss carryovers. These comments also highlighted a situation where a taxpayer's regular taxable income is reduced entirely by available pre-2018 net operating loss carryovers, but the taxpayer also has base erosion tax benefits that increase modified taxable income, causing a BEAT liability. The comments asserted that imposing BEAT on this modified taxable income amounts to a retroactive reduction in the value of the taxpayer's pre-2018 net operating loss carryovers, and recommended that the final regulations adopt this methodology by which pre-2018 attributes are provided a 21 percent tax rate benefit, which is similar to the limited recomputation method discussed in Part V.A of this Summary of Comments and Explanation of Revisions.

These comments are not adopted in the final regulations. First, the comments focused on a technical reading of section 172(a) as it applies to net operating loss carryovers that originated before the Act. That version of section 172(a) did not expressly limit the amount of net operating loss deduction for regular tax purposes to 100 percent of taxable income computed without regard to the net operating loss deduction. As it existed before the Act, there was no reason to limit the section 172(a) deduction in this manner because before the Act there was no consequence to claiming a net operating loss deduction greater than 100 percent of current year taxable income. For example, before the Act, a taxpayer's net operating loss carryover was only reduced by the amount of net operating loss deduction that was actually used to reduce taxable income to zero. *See* §1.172-4(a)(3).

In addition to the technical reading of section 172(a) as it applies to net operating loss carryovers that originated before the Act, the Treasury Department and the IRS continue to believe, consistent with some of the comments received, that limiting net operating loss deductions to the amount of taxable income for purposes of computing modified taxable income is necessary and appropriate to prevent net operating loss carryovers from being used multiple times to reduce modified taxable income. If the final regulations did not limit the amount of net operating loss carryover deductions for purposes of calculating modified taxable income, a taxpayer with a large pre-2018 net operating loss carryover would be able to reduce modified taxable income in multiple years with the same net operating loss carryover, without reducing the net operating loss carryover for regular income tax purposes.

The fact that taxpayers with sufficiently large pre-2018 net operating loss carryovers may be able to avoid paying regular income tax in a taxable year does not mean that those taxpayers should be permitted to offset the entire amount of their BEAT liability in that taxable year, or in other words, not be liable for tax under the BEAT. As discussed in Part V.A. of this Summary of Comments and Explanation of Revisions, the limitation on net operating loss deductions for determining modified taxable income impacts only the BEMTA. This limitation does not prevent the use of pre-2018 net operating loss carryover to reduce regular taxable income to zero. Further, to the extent a taxpayer's pre-2018 net operating loss carryovers exceed the taxpayer's taxable income, the taxpayer continues to use those remaining net operating loss carryovers in later years to offset some or all regular taxable income; and the taxpayer continues to reduce modified taxable income by the same amount in those later years.

A comment asserted that the add-back method creates an economic disparity between similarly situated taxpayers because taxpayers without pre-2018 net operating loss carryovers can make more base erosion payments than taxpayers with pre-2018 net operating loss carryovers before being subject to BEAT liability. However, taxpayers with pre-2018 net operating loss carryovers are not similarly situated to taxpayers without pre-2018 net operating loss carryovers, as the former are paying less regular income taxes than the latter, which is a factor in determining the amount of BEAT liability.

One comment questioned why current year losses can result in negative taxable income for BEAT purposes, while net operating losses that are carried to a different year cannot result in negative taxable income in that different year. Proposed §1.59A-4(b)(1) permits taxpayers that have current year losses to use that negative income amount as a starting point for computing modified taxable income because the Treasury Department and the

IRS determined that if taxpayers were not permitted to use that negative amount as a starting point for calculating modified taxable income, the base erosion tax benefits for that year could be double counted. That is, the base erosion tax benefits for that year could be included in modified taxable income for the current year and in the year the net operating loss carryover is used because of the add-back of the base erosion percentage of the net operating loss deduction in the year used. Because of this concern, the proposed regulations expressly permit current year losses to be taken into account as the starting point for computing modified taxable income. Proposed §§1.59A-4(b)(1) and (c).

Section 59A(i) provides a broad grant of regulatory authority, permitting the Secretary to prescribe regulations as may be necessary or appropriate to carry out the provisions of the section. For the reasons discussed, the Treasury Department and the IRS have determined that limiting the net operating loss deduction to taxable income in computing modified taxable income is within the grant of authority, and the final regulations do not adopt the comments requesting a different rule. The final regulations also do not adopt a rule providing a fixed 21 percent tax rate benefit for all pre-2018 net operating loss carryovers. The fact that a taxpayer may have positive modified taxable income (resulting in a positive BEAT tax liability) even if the taxpayer has a lesser amount of regular taxable income because pre-2018 net operating loss carryovers reduce taxable income is a part of the statutory framework of the BEAT; that is, imposing tax on a modified taxable income base. See also, the response to the limited recomputation method discussed in Part V.A of this Summary of Comments and Explanation of Revisions.

C. *Use of aggregate base erosion percentage for net operating loss deductions*

Proposed §1.59A-4(b)(1) generally defines modified taxable income as a taxpayer's taxable income computed under chapter 1, determined without regard to base erosion tax benefits and the base erosion percentage of any net operating loss deduction under section 172 for the taxable year. Under the proposed regulations, the base erosion percentage for the year that the net operating loss carryover arose (the "vintage year" base erosion percentage) is used to compute modified taxable income. Proposed §1.59A-4(b)(2)(ii). Although the computation of modified taxable income is made on a taxpayer-by-taxpayer basis, the proposed regulations clarify that in computing the add-back for net operating loss deductions, the relevant base erosion percentage is the base erosion percentage for the aggregate group, which is used to determine whether the taxpayer is an applicable taxpayer.

A comment noted that an aggregate base erosion percentage could potentially take into account deductions of another aggregate group member that are not otherwise included in a taxpayer's return. The comment questioned whether a more precise determination of a taxpayer's vintage year base erosion percentage is appropriate.

The Treasury Department and the IRS have determined that the base erosion percentage that is applied to net operating loss deductions when computing modified taxable income should be computed on the basis of the taxpayer and its aggregate group in the same manner as the base erosion percentage that is computed for determining whether the taxpayer is an applicable taxpayer under section 59A(e). Section 59A(e)(3) requires aggregation for purposes of computing the base erosion percentage that is used to determine whether a taxpayer is an applicable taxpayer and to determine the portion of net operating loss deductions that are included in computing modified taxable income pursuant to section 59A(c)(1)(B). Because Congress chose to determine the base erosion percentage on an aggregate basis, it follows that one aggregate group member's deductions can affect the base erosion percentage that will apply with respect to another member of the group. For these reasons, the final regulations do not revise the rules for determining the base erosion percentage that is applied to net operating loss deductions when computing modified taxable income.

D. *Operation of vintage approach for net operating losses*

Section 59A(c)(1)(B) provides that modified taxable income includes the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year. Proposed §1.59A-4(b)(2)(ii) provides that the base erosion percentage of the year in which the loss arose, or the "vintage year," is used to compute modified taxable income rather than the base erosion percentage in the year in which the taxpayer takes the net operating loss deduction.

One comment requested guidance on how the vintage year approach is applied when in the vintage year the taxpayer has both deductions that are base erosion tax benefits and deductions that are not base erosion tax benefits. The comment stated that it is not clear how to compute or order the base erosion percentage because the proposed regulations do not provide rules for determining which type of deductions were used in that vintage year to offset gross income, and which deductions were carried forward as net operating loss carryforwards. The comment provided an example in which the taxpayer in year 1 has gross income of $800x and deductions of $1000x that consist of $250x of base erosion tax benefits and $750x of non-base erosion tax benefits, resulting in a $200x net operating loss. The comment requested clarification for determining how the deductions are ordered for determining the base erosion percentage of the year 1 $200x net operating loss carryover when that carryover is deducted in a later year.

The final regulations do not revise the vintage year rule because section 59A(c)(1)(B) and the proposed regulations already provide that the base erosion percentage used with respect to the net operating loss deduction is the base erosion percentage of the taxpayer in the relevant taxable year (in this example, $250x / $1000x = 25 percent). That is, no specific ordering rule is required because the base erosion percentage calculation for the vintage year takes into account a proportionate amount of each type of deduction (or $250x divided by $1000x in the example).

Another comment suggested that in applying the vintage year approach to net operating loss deductions, a simplifying convention should be provided to address target corporations that have net operating loss carryovers and become members of a taxpayer's aggregate group

by acquisition. The comment suggested that taxpayers be permitted to elect to use their current year base erosion percentage with respect to the net operating loss deductions, rather than the vintage year base erosion percentage of the target because it may be complicated to determine the target's vintage year base erosion percentage. The comment specifically noted the difficulty in cases where the target was not an applicable taxpayer in the vintage year. The final regulations do not adopt this elective approach. Because the net operating loss carryover is an attribute of the target corporation, the target corporation is required to maintain documentation to support both the carryover amount and the other aspects of its attributes that affect the target corporation's tax liability — namely the base erosion percentage with respect to its net operating loss carryovers. Accordingly, the acquiring corporation should be able to obtain the information necessary to determine the target corporation's vintage year base erosion percentage.

VI. *Comments and Changes to Proposed §1.59A-5—BEMTA*

Proposed §1.59A-5 contains rules regarding the calculation of BEMTA and provides the base erosion and anti-abuse tax rate that applies to the taxpayer's taxable year. The proposed regulations provide that an applicable taxpayer computes its BEMTA for the taxable year to determine its liability under section 59A(a). Proposed §1.59A–5(b). Generally, the taxpayer's BEMTA equals the excess of (1) the applicable tax rate for the taxable year (''BEAT rate'') multiplied by the taxpayer's modified taxable income for the taxable year over (2) the taxpayer's adjusted regular tax liability for that year. Proposed §1.59A-5(b). In determining the taxpayer's adjusted regular tax liability for the taxable year, credits (including the foreign tax credit) are generally subtracted from the regular tax liability amount. Proposed §1.59A–5(b)(2). Consistent with section 59A(b)(1)(B), the proposed regulations provide that for taxable years beginning before January 1, 2026, the credits allowed against regular tax liability (which reduce the amount of regular tax liability for purposes of calculating BEMTA) are not reduced by the research credit determined under section 41(a) or by a portion of applicable section 38 credits.

To prevent an inappropriate understatement of a taxpayer's adjusted regular tax liability, the proposed regulations provide that credits for overpayment of taxes and for taxes withheld at source are not subtracted from the taxpayer's regular tax liability because these credits relate to U.S. federal income tax paid for the current or previous year. Proposed §1.59A-5(b)(3)(i)(C) and (ii).

A. *Applicability of aggregation rule to BEMTA*

The proposed regulations provide that the computations of modified taxable income and BEMTA are done on a taxpayer-by-taxpayer basis. That is, the aggregate group concept is used solely for determining whether a taxpayer is an applicable taxpayer, and does not apply to the computations of modified taxable income and the BEMTA. The preamble to the proposed regulations explains that if taxpayers calculated BEMTA differently depending on their differing views of the base on which the BEAT should be calculated (that is, aggregate group, consolidated group, individual company), this could lead to inequitable results across otherwise similar taxpayers. REG-104259-18, 83 F.R. 65974 (December 21, 2018).

The proposed regulations also explain that it is expected to be less costly for taxpayers to calculate BEMTA on a taxpayer-by-taxpayer basis because the statutory framework of section 59A applies in addition to the regular tax liability of a taxpayer. Calculating BEAT liability at an aggregate level, for example, would require any BEAT liability to be reallocated among the separate taxpayers.

Comments requested that electing taxpayers be permitted to apply the aggregation rules of section 59A(e)(3) to determine their modified taxable income and BEMTA. Electing taxpayers would effectively compute modified taxable income and BEMTA at the level of the aggregate group rather than at the level of the separate taxpayer.

The comments explained that aggregation would permit a group with multiple consolidated returns to be given full credit for the group's contributions to the U.S. tax base. Comments further explained that, in certain instances, business, legal, or regulatory reasons prevent groups with multiple taxpayers from forming an affiliated group of corporations within the meaning of section 1504 that can file a single consolidated return. However, the comments asserted that these groups still represent a single economic unit where they have a common parent and overall management, share services, and are generally treated as a single employer.

Comments also suggested that an election to apply the aggregation rules for BEMTA would prevent inequitable results in the application of the BEAT. For example, some comments suggested that it would be inequitable for a single consolidated group within an aggregate group that had a large amount of NOLs, minimal regular tax liability, and little to no base erosion payments to be subject to the BEAT as a result of a separate consolidated group's high base erosion percentage.

The comments suggested that an aggregate approach would result in an insignificant amount of additional complexity and little additional burden to taxpayers and the government. Comments also made suggestions regarding particular requirements of the election, such as requirements that each taxpayer joining the election have the same taxable year-end, agree to provide the IRS with all information needed to compute the aggregate BEAT liability, agree to be allocated a pro-rata share of the aggregate BEAT liability, and give consent for the statute of limitations to remain open until the audits of all group members with respect to the information used to determine that aggregate BEAT liability have closed.

The final regulations do not adopt the recommendations. The Treasury Department and the IRS recognize that, in determining whether a taxpayer is an applicable taxpayer, and for determining certain computational matters relating to modified taxable income and the BEMTA, section 59A applies by reference to the taxpayer and the members of its aggregate group. Section 59A does not explicitly extend that aggregate group treatment to the computation of a taxpayer's BEMTA or the resulting tax liability. The rules relating to the aggregate group concept

are complex, and they produce meaningful differences from the single-entity concepts in the consolidated return regulations. See Part III of this Summary of Comments and Explanation of Revisions. Section 1502 and the regulations thereunder contain detailed rules for implementing the single taxpayer elements of the consolidated return regulations. No similar rules are expressly contemplated in section 59A with respect to BEMTA. Adding similar rules to these final regulations would add significant complexity and would require the IRS to audit a parallel BEMTA computation system. Consistent with section 1502 and the regulations thereunder, aggregate groups of taxpayers that file a consolidated return must compute BEMTA on a single-entity basis under section 59A and the final regulations. *See* §1.1502-59A(b). Therefore, the final regulations continue to provide that BEMTA is calculated on a taxpayer-by-taxpayer basis.

B. *Treatment of general business credits and foreign tax credits*

A comment noted that taxpayers may have credits generated in taxable years beginning before January 1, 2018, that carry forward to be used in taxable years beginning after December 31, 2017. In the case of net operating losses 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 comment also noted that proposed §1.59A-4(b)(2)(ii) provides that those deductions are excluded from modified taxable income.

The comment requested that the final regulations exclude section 38 credits and foreign tax credits generated in pre-2018 taxable years from the definition of credits allowed under chapter 1 of the Code. As a result of this request, these credits would not be subtracted from the regular tax liability amount in determining BEMTA. Alternatively, the comment requested that the partial exclusion of section 38 credits from the calculation of BEMTA in proposed §1.59A-5(b)(3)(i)(B) be extended to foreign tax credits.

The final regulations do not adopt this comment. With respect to net operating losses that arose in taxable years beginning before January 1, 2018, the exclusion of these deductions from the calculation of modified taxable income results from two statutory elements: (i) section 59A(c)(1) provides that the starting point for modified taxable income is "taxable income of the taxpayer computed under [chapter 1 of the Code] for the taxable year …"; that is, modified taxable income starts with taxable income, as reduced for any net operating loss deduction under section 172; and (ii) section 59A(c)(1)(B) provides that modified taxable income includes, or adds back to taxable income, the base erosion percentage of any NOL deduction under section 172 for the taxable year. This statutory framework for determining modified taxable income establishes that section 59A permits the net operating loss deduction to reduce some or all of the current year's pre-NOL taxable income, but that a portion of the tax benefit from that NOL deduction is added back to taxable income. Further, §1.59A–4(b)(2)(ii) applies the base erosion percentage of the year in which the loss arose for this purpose, which effectively means that net operating losses incurred in taxable years ending on or before December 31, 2017, are entirely excluded from the calculation from modified taxable income when those deductions are used to reduce or eliminate regular taxable income. In contrast to this explicit statutory framework that addresses the lifecycle of the net operating loss carryforward, section 59A does not provide a similar rule for credits. Instead, section 59A(b)(1)(B) provides that all credits allowed under chapter 1 of the Code against regular taxable income for the taxable year are excluded from the calculation of BEMTA, except for specifically enumerated credits that are partially or fully allowed to reduce BEMTA. Because section 59A(b)(1) refers to all credits allowed to reduce taxable income during the taxable year and makes no distinction as between those credits that originated in the current taxable year or a prior taxable year, the Treasury Department and the IRS have determined that the proposed regulations are consistent with the statute, and the final regulations retain the same rules with respect to section 38 credits and foreign tax credits.

C. *Exclusion of AMT credits from credits reducing regular tax liability*

Generally, a taxpayer's BEMTA equals the excess of (1) the applicable tax rate for the year multiplied by the taxpayer's modified taxable income for the taxable year over (2) the taxpayer's adjusted regular tax liability for that year. In determining the taxpayer's adjusted regular tax liability for the taxable year, credits are generally subtracted from the regular tax liability amount. To prevent an inappropriate understatement of a taxpayer's adjusted regular tax liability, the proposed regulations provide that credits for overpayment of taxes and for taxes withheld at source are not subtracted from the taxpayer's regular tax liability because these credits relate to U.S. federal income tax paid for the current or previous year.

Historically, an alternative minimum tax ("AMT") was imposed on a corporation to the extent the corporation's tentative minimum tax exceeded its regular tax. If a corporation was subject to AMT in any year, the amount of AMT was allowed as an AMT credit in any subsequent taxable year to the extent the corporation's regular tax liability exceeded its tentative minimum tax in the subsequent year. Bluebook, pp. 92, 94.

The Act repealed the corporate AMT, and allows the corporate AMT credit to offset the entire regular tax liability of the corporation for a taxable year. In addition, the AMT credit is allowable and generally refundable for a taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) of the excess (if any) of the minimum tax credit for the taxable year over the amount of the credit allowed for the year against regular tax liability. Bluebook p. 97.

Comments requested that AMT credits be excluded from the calculation of credits that reduce adjusted regular tax liability because they represent income taxes imposed in a previous tax year and allowed as credits in a subsequent tax year. The Treasury Department and the IRS agree with these comments. Accordingly, §1.59A-5(b)(3) provides that AMT credits, like overpayment of taxes and for taxes withheld at source, do not reduce ad-

justed regular tax liability for purposes of section 59A.

D. *Rules relating to banks and registered securities dealers for purposes of computing the base erosion percentage and determining the BEAT rate for computing BEMTA*

Generally, under proposed §1.59A-2(e)(1), a taxpayer, or the aggregate group of which the taxpayer is a member, satisfies the base erosion percentage test to determine applicable taxpayer status if its base erosion percentage is at least three percent. However, section 59A(e)(1)(C) and proposed §1.59A-2(e)(2)(i) provide that a lower threshold of two percent applies if the taxpayer is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a domestic bank or registered securities dealer. Proposed §1.59A-2(e)(2)(ii) applies this two-percent threshold to the aggregate group of which a taxpayer is a member that includes a bank or registered securities dealer that is a member of an affiliated group. Proposed §1.59A-2(e)(2)(iii) provides a de minimis exception to this lower two-percent base erosion percentage threshold in the case of an aggregate group or consolidated group that has de minimis bank or registered securities dealer activities as measured by gross receipts. Specifically, proposed §1.59A-2(e)(2)(iii) provides that an aggregate group that includes a bank or a registered securities dealer that is a member of an affiliated group is not treated as including a bank or registered securities dealer for a taxable year if the total gross receipts of the aggregate group attributable to the bank or the registered securities dealer represent less than two percent of the total gross receipts of the aggregate group (or consolidated group if there is no aggregate group). Even if a taxpayer qualifies for the de minimis exception to the lower base erosion percentage test threshold, proposed §1.59A-5(c)(2) provides that the BEAT rate is increased by an additional one percent for any taxpayer that is a member of an affiliated group that includes a bank or registered securities dealer. *See* section 59A(b)(3) (requiring that the base erosion and anti-abuse tax rate in effect for the taxable year for these taxpayers must be increased by one percentage point).

A comment requested that the final regulations provide for a higher de minimis threshold of five percent and clarify that in characterizing the income of a corporation with a bank or securities dealer division for purposes of this threshold, only the gross receipts arising from the conduct of the banking or securities business would be taken into account. The Treasury Department and the IRS have determined that this modification to the de minimis threshold is not warranted because this de minimis exception in the proposed regulations was developed based on a qualitative assessment of a very small degree of activities to justify a regulatory-based exception to the statutory provision that applies to a bank or registered securities dealer. Accordingly, the final regulations retain the two-percent de minimis threshold.

Comments supported the proposed regulations' de minimis exception to the lower base erosion percentage threshold and suggested that a similar exception be created regarding the increased BEAT rate for a taxpayer that is a member of an affiliated group with de minimis gross receipts attributable to banking or securities dealer activities. In instances where the base erosion percentage exceeds three percent, the comments questioned the appropriateness of applying the BEAT rate add-on of one percent to the non-financial members of the affiliated group when the gross receipts of the financial members are insignificant relative to the non-financial members.

The final regulations adopt this comment by revising §1.59A-5(c)(2) to provide that the additional one percent add-on to the BEAT rate will not apply to a taxpayer that is part of an affiliated group with de minimis banking and securities dealer activities.

A comment recommended that an additional exception to the increased BEAT rate should be provided where the bank or securities dealer members of an affiliated group make no more than a de minimis amount of base erosion payments, measured by reference to aggregate affiliated group base erosion payments. The final regulations do not adopt this recommendation because the base erosion percentage test already operates as a statutory rule that limits the BEAT to taxpayers (without regard to any particular type of business) that have a relatively low degree of base erosion payments.

A comment requested that the final regulations include a transitory ownership exception to apply where a bank or securities dealer is a member of an affiliated group for only a short period (such as 90 days) during the taxable year. The stated purpose of this request was to allow time for a taxpayer that acquires a group that includes a bank or registered securities dealer to dispose of the bank or securities dealer member of a target affiliated group without causing the entire acquiring affiliated group to become subject to the higher BEAT rate applicable to taxpayers with bank or registered securities dealer members. The Treasury Department and the IRS decline to expand the regulatory de minimis exception to include an exception based on short-term ownership, but note that a taxpayer in this situation may be eligible for the de minimis regulatory exception if the bank and securities dealer operations are relatively small. If the operations are not sufficiently small, the statutory rules that apply to banks and registered securities dealers would no longer apply in taxable years after the disposition of the bank or securities dealer.

A comment observed that the rule in the proposed regulations extending the lower base erosion percentage threshold to the entire aggregate group that includes a bank or registered securities dealer is not supported by the language of section 59A. The comment proposed that the proper application of section 59A requires that the lower base erosion percentage should be limited to only the affiliated group that includes a bank or registered securities dealer, and not the remainder of the taxpayer's aggregate group. The final regulations do not adopt this comment. The Treasury Department and the IRS note that section 59A(e)(3) specifically requires aggregation for purposes of computing the base erosion percentage. Further, the implication of the comment is that in measuring whether a particular taxpayer has a base erosion percentage that is greater than the prescribed level in section 59A(e)(3)(C), the threshold level would be blended. That is, under the approach recommended by the comment, a taxpayer with a bank or securities dealer in its aggregate group would compute a relative weighting

of the bank/dealers (two percent threshold) vs. non-bank/dealers (three percent threshold) in order to compute a blended threshold that is used for the base erosion percentage test. There is no indication in the statutory language supporting this approach. Accordingly, no changes are made to the final regulations in this regard.

E. *Applicability of section 15 to the BEAT rate*

Section 59A(b)(1)(A) provides that the base erosion minimum tax amount of an applicable taxpayer for any taxable year is the excess of an amount equal to 10 percent (5 percent in the case of taxable years beginning in calendar year 2018) of the modified taxable income of the taxpayer for the taxable year. Proposed §1.59A-5(c) provides the base erosion and anti-abuse tax rates that apply for purposes of calculating the BEMTA. The base erosion and anti-abuse tax rate is five percent for taxable years beginning in calendar year 2018 and 10 percent for taxable years beginning after December 31, 2018, and before January 1, 2026. Proposed §1.59A-5(c)(1)(i) and (ii). Proposed §1.59A-5(c)(3) provides that section 15 does not apply to any taxable year that includes January 1, 2018, and further provides that for a taxpayer using a taxable year other than the calendar year, section 15 applies to any taxable year beginning after January 1, 2018. In the case of taxpayers that use a taxable year other than the calendar year and that includes January 1, 2019, this proposed regulation provides that section 15 applies to the change in the section 59A tax rate from 5 percent to 10 percent, based on an effective date of January 1, 2019.

Several comments asserted that final regulations should provide that section 15 applies only to the change in tax rate set forth in section 59A(b)(2) and should not apply to the change in tax rate included in section 59A(b)(1)(A) for taxable years beginning in calendar year 2018. The final regulations adopt this comment. In adopting this comment that section 15 not apply to the change in tax rate included in section 59A(b)(1)(A) for taxable years beginning in calendar year 2018, the final regulations provide no inference as to the application of section 15 to other provisions of the Code that do not set forth an explicit effective date.

VII. *Comments and Changes to Proposed §1.59A-6—Qualified Derivative Payments*

Proposed §1.59A-6 provides guidance regarding QDPs.

A. *Scope of the QDP exception*

Proposed §1.59A-6(b) defines a QDP as a payment made by a taxpayer to a foreign related party pursuant to a derivative with respect to which the taxpayer (i) recognizes gain or loss as if the derivative were sold for its fair market value on the last business day of the taxable year (and any additional times as required by the Code or the taxpayer's method of accounting); (ii) treats any recognized gain or loss as ordinary; and (iii) treats the character of all items of income, deduction, gain, or loss with respect to a payment pursuant to the derivative as ordinary. The definition in the proposed regulations adopts the statutory definition of a QDP contained in section 59A(h)(2)(A). The QDP exception under the statute and the proposed regulations is subject to further limitations that are discussed in Parts VII.B and C of this Summary of Comments and Explanation of Revisions.

A comment requested that the scope of the QDP definition be expanded. The comment requested that the final regulations extend the scope of the QDP exception so that multinational corporations that use a centralized hedging center structure can benefit from this exception from the definition of a base erosion payment with respect to their outbound related-party hedging payments. The comment stated that taxpayers in the oil and gas sector often do not adopt a mark-to-market method of tax accounting for a variety of business and tax-related reasons. The comment recommended that the final regulations adopt a distinct QDP exception that would be applicable to oil and gas hedging centers (as well as any similarly situated hedging centers). The comment requested that this QDP exception exclude related-party hedging payments from the scope of base erosion payments, without regard to whether the taxpayer satisfies the requirement in section 59A(h)(2)(A)(i) that the taxpayer accounts for the underlying commodity derivative on a mark-to-market basis. As an alternative, the comment suggested that the final regulations could interpret the mark-to-market requirement of section 59A(h)(2)(A)(i) broadly to cover taxpayers that undertake mark-to-market accounting for derivatives for either financial accounting or tax purposes.

For a derivative payment to qualify for the QDP exception, section 59A(h)(2)(A) requires that the taxpayer recognize gain or loss with respect to the derivative as if the derivative were sold for its fair market value on the last business day of the taxable year, and "such *additional times as required by this title* or the taxpayer's method of accounting" (emphasis added). The Treasury Department and the IRS, therefore, interpret section 59A as excluding a derivative from the QDP exception if the taxpayer does not adopt a mark-to-market method of tax accounting. In light of the statute's clear requirement for the QDP exception that a derivative must be treated as sold for its fair market value on the last business day of the taxable year (or more frequently, if required by the Code or the taxpayer's method of accounting), the final regulations do not adopt the comment. See § 1.475(a)-4(d).

B. *Sale-repurchase transactions and securities lending transactions*

Section 59A(h)(1) provides that a QDP is not treated as a base erosion payment. To qualify for the QDP exception, the payment must be made with respect to a derivative. A derivative is generally defined in section 59A(h)(4) as any contract the value of which, or any payment or other transfer with respect to which, is directly or indirectly determined by reference to one or more listed items, including any share of stock in a corporation or any evidence of indebtedness. A derivative does not include any of the listed items. Section 59A(h)(3) excludes from the QDP exception any payment that would be treated as a base erosion payment if it were not made pursuant to a derivative (for example, interest on a debt instrument). Section 59A(h)(3) also excludes any payment properly allocable to a nonderivative com-

ponent of a contract that contains derivative and nonderivative components.

The preamble to the proposed regulations notes that a sale-repurchase transaction satisfying certain conditions is treated as a secured loan for U.S. federal tax purposes, and therefore, is not a derivative. REG-104259-18, 83 F.R. 65962 (December 21, 2018). The preamble to the proposed regulations explains that "[b]ecause sale-repurchase transactions and securities lending transactions are economically similar to each other, the Treasury Department and the IRS have determined that these transactions should be treated similarly for purposes of section 59A(h)(4), and therefore payments on those transactions are not treated as QDPs." REG-104259-18, 83 F.R. 65963 (December 21, 2018). As a result, proposed §1.59A-6(d)(2)(iii) provides that a derivative does not include any securities lending transaction, sale-repurchase transaction, or substantially similar transaction.

Comments generally agreed that a sale-repurchase transaction that is treated as a secured loan for U.S. federal income tax purposes is not a derivative; therefore, comments acknowledged that a sale-repurchase transaction that is treated as a secured loan for U.S. federal tax purposes is not eligible for the QDP exception under section 59A, regardless of the specific exclusion language in proposed §1.59A-6(d)(2)(iii). Certain comments explained that the nominal seller of the securities in a sale-repurchase transaction is treated as transferring the securities as collateral of a loan. Comments interpret current federal income tax law to provide that the nominal seller remains the tax owner of the securities when a sale-repurchase transaction is treated as a secured loan for federal income tax purposes. Therefore, when the nominal buyer of the securities receives payments with respect to the collateral securities (for example, in the case of an equity security, the dividend payments), and passes those payments on to the nominal seller (or otherwise credits the seller for the amount of the payments), the comments asserted that the nominal seller is treated as having directly received those payments from the issuer of the securities.

In the context of section 59A, if the nominal seller in a sale-repurchase transaction that is treated as a loan is a domestic corporation and the nominal buyer is a foreign related party, any interest paid with respect to the secured loan from the domestic corporation to the foreign related party would be a base erosion payment, not a QDP. In a sale-repurchase transaction that is treated as a loan for which the nominal seller is instead a foreign related party and the nominal buyer is a domestic corporation, the payments with respect to the security held by the nominal buyer as collateral for that transaction are treated as received by the nominal buyer for the benefit of the nominal seller. Because there is no regarded "substitute payment" from the nominal buyer to the nominal seller, there cannot be a base erosion payment.

Comments asserted that securities lending transactions and sale-repurchase transactions are treated differently with respect to underlying payments or substitute payments as a result of proposed §1.59A-6(d)(2)(iii) even though the transactions are economically similar. Comments observed that in a typical fully-collateralized securities lending transaction, the securities lender transfers the securities to the securities borrower in exchange for an obligation by the borrower to make certain payments to the securities lender and return identical securities. Unlike a sale-repurchase transaction, comments remarked that this transaction results in a transfer of beneficial ownership of the securities to the securities borrower for U.S. federal income tax purposes. Comments noted that these securities lending transactions may arise in the ordinary course of business, for example, to facilitate a short sale of the underlying security. In connection with the transfer of securities, the securities borrower provides cash or other collateral to the securities lender, typically with the same or greater value as the underlying security. Comments observed that the securities lender in these transactions can be viewed as both a lender of securities to the counterparty, and as the borrower of cash from the counterparty.

Comments suggested that the final regulations should treat a collateralized securities lending transaction as consisting of two legs: (1) a loan of securities, or a "securities leg", and (2) a loan of cash, or a "cash leg." Comments stated that the cash leg is simply a cash borrowing by the security lender. Many comments conceded that the cash leg of a securities lending transaction should not be eligible for the QDP exception because the cash leg is properly treated as a loan and any payments should be treated as interest. Certain of these comments observed that the treatment of the cash leg of a securities lending transaction as debt giving rise to interest payments is consistent with the broadly symmetrical treatment of securities lending transactions and sale-repurchase transactions that are treated as secured loans for U.S. federal income tax purposes.

Comments, however, asserted that the securities leg of a securities lending transaction should be treated as a derivative that qualifies for the QDP exception. The comments argued that a securities leg meets the statutory requirement of a derivative because it represents a contract, which includes any short position, the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to any share of stock in a corporation. By treating a substitute payment in a securities lending transaction as eligible for the QDP exception, those payments would receive similar treatment for purposes of section 59A as in the case of a sale-repurchase transaction that is treated as a secured loan. That is, in the sale-repurchase transaction, the remittances on the collateral by the nominal buyer to the nominal seller are treated as a payment from the issuer of the security to the nominal seller for U.S. federal income tax purposes.

Some comments acknowledged that in certain circumstances, there is the potential to use a securities lending transaction as a financing. One comment described a scenario involving an uncollateralized securities borrowing by a domestic corporation of relatively risk-free debt, such as short-term Treasury bills, from a foreign related party. As a second step, the domestic corporation immediately sells the Treasury bills for cash; after a short period, the taxpayer buys even shorter-term Treasury bills and redelivers them to the lender. Comments acknowledged that in this situation, or in similar situations, the transaction may be viewed as economically equivalent to borrowing money, with the taxpayer exposed to the relatively small risk of changes in the value of the

security (here, U.S. government-backed Treasury bills).

Rather than excluding all securities lending transactions from QDP status, comments generally recommended that the final regulations adopt rules to address this particular risk. Some comments recommended adopting a specific operating rule to address this concern, including (i) providing that only contracts entered into in the ordinary course of the taxpayer's trade or business can qualify for the QDP exception, (ii) providing that only fully collateralized transactions can qualify for the QDP exception, or (iii) applying different rules for securities lending transactions involving relatively low-risk securities (such as Treasury bills) than for other securities that are subject to more market risk. Regarding fully collateralized securities lending transactions, some comments asserted that under certain bank regulatory regimes, other amounts outside of the actual collateral in the transaction may effectively serve as collateral due to the securities borrower's compliance with any specific regulatory regime governing securities borrowing. Some comments recommended that the final regulations adopt an anti-abuse rule rather than an operating rule to address this concern. One comment suggested an anti-abuse rule that excludes from the QDP exception transactions with specific debt-like features that make the transaction substantially similar to a financing, while another comment noted that it would be unduly burdensome to test contracts based on certain characteristics, particularly for taxpayers that engage in a high volume of these transactions in the ordinary course. This comment instead suggested that all securities lending transactions entered into for valid non-tax business purposes should be eligible for the QDP exception.

In response to these comments, the final regulations make certain revisions to §1.59A-6(d)(2)(iii). First, §1.59A-6(d)(2)(iii) has been revised to more directly provide that a derivative contract as defined in section 59A(h)(4) does not include a sale-repurchase transaction or substantially similar transaction that is treated as a secured loan for U.S. federal income tax purposes. Second, §1.59A-6(d)(2)(iii) is also revised to exclude from the definition of a derivative for purposes of section 59A(h) the cash leg of a securities lending transaction, along with cash payments pursuant to a sale-repurchase transaction, or other similar transaction. The final regulations no longer expressly exclude securities lending transactions from the definition of a derivative contract in §1.59A-6(d)(2)(iii). As a result, payments (such as a borrow fee) made with respect to the securities leg of a securities lending transaction may qualify as a QDP.

To address the concern about securities lending transactions that have a significant financing component, the final regulations adopt the recommendation from comments to provide an anti-abuse rule. *See* §1.59A-6(d)(2)(iii)(C). The anti-abuse rule in the final regulations includes criteria to limit the rule to situations that have been identified as presenting clear opportunities for abuse. The anti-abuse rule takes into account two factors: (a) whether the securities lending transaction or substantially similar transaction provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing and (b) whether the transaction is part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to the transaction as a base erosion payment. The determination of whether a securities lending transaction or substantially similar transaction provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing takes into account arrangements that effectively serve as collateral due to the taxpayer's compliance with any U.S. regulatory requirements governing such transaction. The anti-abuse rule is based on these factors because the Treasury Department and the IRS are cognizant that an objective mechanical rule based on the level of collateralization may be difficult for both taxpayers and the IRS to apply, in particular due to the high volume of transactions issued under varying conditions.

C. *QDP reporting requirements*

Section 59A(h)(2)(B) provides that no payment is a QDP for a taxable year "unless the taxpayer includes in the information required to be reported under section 6038B(b)(2)[4] [sic] with respect to such taxable year such information as is necessary to identify the payments to be so treated and such other information as the Secretary determines necessary to carry out the provisions of this subsection." Proposed §1.59A-6(b)(2)(i) clarifies that no payment is a QDP unless the taxpayer reports the information required by the Secretary in proposed §1.6038A-2(b)(7)(ix). Proposed §1.6038A-2(b)(7)(ix) identifies the specific information that a taxpayer needs to report to comply with the reporting requirement of section 59A(h)(2)(B) and proposed §1.59A-6(b)(2)(i). The proposed regulations provide that the rule for reporting QDPs applies to taxable years beginning one year after final regulations are published in the **Federal Register**. Proposed §1.6038A-2(g). Before proposed §1.6038A-2(b)(7)(ix) is applicable, a taxpayer is treated as complying with the QDP reporting requirement by reporting the aggregate amount of QDPs on Form 8991. *Id*.

1. Scope of QDP Reporting

Section 1.6038A-1(c) generally defines a reporting corporation as either a domestic corporation that is 25-percent foreign-owned, or a foreign corporation that is 25-percent foreign-owned and engaged in trade or business within the United States. A comment recommended that the final regulations clarify that a failure to comply with the Form 8991 reporting requirements by a taxpayer that is not a reporting corporation (within the meaning of §1.6038A-1(c)) does not affect the QDP status of any payments made by the taxpayer. The comment also recommended that the final regulations clarify the consequences of failing to comply with the Form 8991 QDP reporting requirements.

Section 59A(h)(2)(B) requires that all taxpayers, whether or not the taxpayer is a

[4] As enacted, section 59A(h)(2)(B) cross-references section 6038B(b)(2). This cross-reference in section 59A(h)(2)(B) is a typographical error. Section 6038B(b)(2) does not relate to section 59A. The correct cross-reference is to section 6038A(b)(2). The Act added reporting requirements for section 59A in section 6038A(b)(2). *See* Act, §14401(b).

reporting corporation within the meaning of section 6038A, report QDPs in order for the exception to apply to any particular payment. The Treasury Department and the IRS interpret the language in section 59A(h)(2)(B) referencing section 6038B(b)(2) ("the information required to be reported under section 6038B(b)(2) [sic]") as addressing the scope of information required to be reported rather than limiting the scope of taxpayers that must report in order to qualify derivatives as QDPs under section 59A(h). The final regulations, therefore, clarify that §1.59A-6(b)(2)(i) applies to all taxpayers (whether or not a taxpayer is a reporting corporation as defined in §1.6038A-1(c)) and that all taxpayers must report the information required by §1.6038A-2(b)(7)(ix) for a payment to be eligible for QDP status.

Comments also requested additional guidance regarding the consequences when a taxpayer fails to comply with the QDP reporting requirements with respect to a particular payment. The proposed regulations provide that a failure by a taxpayer to report a particular payment as a QDP disqualifies only that payment and does not affect the taxpayer's properly reported payments. The final regulations retain that rule. In addition, §1.59A-6(b)(2)(i) provides that a taxpayer satisfies the reporting requirement by including a QDP in the aggregate amount of all QDPs (rather than the aggregate amount as determined by type of derivative contract as provided in proposed §1.6038A-2(b)(7)(ix)(A)) on Form 8991 or a successor form.

Another comment requested a reasonable cause exception to the QDP reporting requirements because treating a payment as a base erosion payment solely when a taxpayer failed to report the payments as a QDP would unfairly penalize a taxpayer for making an error. The Treasury Department and the IRS have determined that a reasonable cause exception is inappropriate because section 59A(h)(2)(B) provides that a taxpayer must identify all base erosion payments. A taxpayer must determine that a payment is eligible for the QDP exception and, therefore, properly excluded from the base erosion percentage calculation. Similarly, a taxpayer must determine that a payment is properly characterized as a QDP to properly determine modified taxable income for purposes of section 59A. In addition, a reasonable cause exception would make it more difficult for the IRS to administer section 59A. However, as discussed in Part VII.C.3 of this Summary of Comments and Explanation of Revisions, the final regulations provide a good faith standard that applies during the QDP transition period before the reporting set forth in §1.6038A-2(b)(7)(ix) is required. In addition, in response to comments, the transition period has been extended to 18 months.

2. Determining the Amount of QDP Payment

A comment recommended that the final regulations clarify that taxpayers may use the net amount with respect to each derivative transaction to arrive at the aggregate QDP amount that must be reported on Form 8991. The comment noted that this approach would be consistent with the BEAT Netting Rule for mark-to-market transactions. See Part III.D of Summary of Comments and Explanation of Revisions. Generally, the Treasury Department and the IRS have adopted this comment. *See* §1.59A-6(b)(2)(iii). A taxpayer, however, must exclude from the net amount of a QDP any payment made with respect to a derivative that is either excluded from QDP status pursuant to section 59A9(h)(3) or otherwise treated as a type of payment that is not a derivative payment. *See* §1.59A-6(b)(3)(ii).

Another comment requested excluding from QDP reporting requirements any payments with respect to securities lending transactions and sale-repurchase transactions that are not regarded under generally accepted accounting principles (GAAP). The final regulations do not adopt this recommendation. Reporting QDPs is a statutory requirement to provide the IRS with data about transactions that have been excluded under the QDP exception, and the financial accounting for these transactions is not relevant to QDP status. Furthermore, the Treasury Department and the IRS have determined that the deferred applicability date and transition period, described in Part VII.C.3 of Summary of Comments and Explanation of Revisions, will provide taxpayers with adequate time to develop systems to track the information that may not have been previously maintained in accounting systems.

3. Applicability Date and Transition Period for QDP Reporting

Comments asserted that taxpayers needed additional time before the final regulations regarding QDP reporting are applicable. Comments noted that before the enactment of section 59A, taxpayers generally were not required to separately track or account for certain transactions with foreign related parties. The Treasury Department and the IRS recognize that section 59A will require taxpayers to develop new systems to properly report QDPs; therefore, the final regulations extend the transition period for meeting the complete QDP reporting requirements until taxable years beginning on or after June 7, 2021.

Another comment requested additional guidance regarding the QDP reporting requirements that apply before the applicability date of the final regulations for these rules (the "QDP transition period"). Specifically, comments interpreted the QDP transition period as applying only to a reporting corporation as defined in §1.6038A-1(c). They recommended that all taxpayers be permitted to report QDPs on an aggregate basis during the QDP transition period and that the good faith effort standard for reporting QDPs during the transition period should apply to all taxpayers. The final regulations adopt these comments by clarifying that §1.6038A-2(b)(7)(ix) applies to a taxpayer whether or not the taxpayer is a reporting corporation as defined in §6038A-1(c). *See* §1.59A-6(b)(2)(i). In addition, the final regulations eliminate the rule in the proposed regulations requiring a taxpayer to report the aggregate amount of QDPs as determined by type of derivative contract, the identity of each counterparty, and the aggregate amount of QDPs made to each counterparty. The Treasury Department and the IRS anticipate that the aggregate amount of QDPs provides adequate information to allow the IRS to administer the QDP rules.

VIII. *Comments and Changes to Proposed §1.59A-7—Application of BEAT to Partnerships*

Proposed §1.59A-7 provides rules regarding how partnerships and their partners are treated for purposes of the BEAT. The proposed regulations generally apply

an aggregate approach in addressing the treatment of payments made by a partnership or received by a partnership for purposes of section 59A.

A. *Partnership contributions and distributions*

1. Request for Contribution Exception

The proposed regulations treat a contribution to a partnership as a transaction between the partners that may result in a base erosion payment, including when a partnership with a domestic corporate partner receives a contribution of depreciable property from a foreign related party. Several comments requested a change to the approach taken in the proposed regulations. One comment asserted that the issuance of a partnership interest in exchange for a contribution to a partnership was not intended to be a base erosion payment covered by section 59A(d)(2) and that subjecting inbound nonrecognition transactions to the BEAT seems contrary to the purpose of the Act, which the comment stated was to encourage taxpayers to relocate business functions and assets to the United States and expand business activities in the United States. The comment noted that if Congress intended to subject nonrecognition transactions to the BEAT, it would have done so more explicitly.

Other comments generally asserted that nonrecognition transactions should not be subject to the BEAT. Some of these comments specifically addressed section 721 transactions and recommended that the same exception for section 351 transactions that is discussed in Part IV.B.3 of this Summary of Comments and Explanation of Revisions apply to section 721(a) transactions.

In contrast, a comment noted that applying an aggregate approach to partnerships for purposes of the BEAT was consistent with the purposes of the statute. The comment asserted that treating a contribution of property in exchange for a partnership interest as a potential base erosion payment is consistent with the concept of treating a partnership as an aggregate of its partners and with the purposes of section 59A. The comment explained that to the extent there is a base eroding transaction when property (such as depreciable property) is contributed to a partnership under section 721, it is the acquisition of a proportionate share of new property by the existing partners from a contributing partner (assuming that partner is a foreign related party). The comment also explained that the existing partners would have paid for the new property with a proportionate share of the existing assets of the partnership. In addition, the comment noted that a contributing partner (such as a domestic corporation) could be acquiring a proportionate share of the partnership's existing assets (where one or more partners of the partnership are foreign related parties).

The final regulations do not adopt the comments requesting an exception for nonrecognition transactions involving partnerships. The general premise of the aggregate approach to transactions involving partners and partnerships in both the proposed regulations and the final regulations is to treat partners as engaging in transactions directly with each other, not as engaging in transactions with the partnership as a separate entity (solely for purposes of section 59A). See §1.59A-7(b) and (c); proposed §1.59A-7(b)(1)-(3); REG-104259-18, 83 F.R. 65965 (December 21, 2018). The Treasury Department and the IRS acknowledge that the final regulations include an exception for specified corporate nonrecognition transactions that is discussed in Part IV.B.3 of the Summary of Comments and Explanation of Revisions, which presents some similarity with the types of transactions contemplated by this comment. For example, if a domestic corporation and a foreign related party each contribute depreciable property to a new domestic corporation in exchange for stock of the new domestic corporation in a transaction that qualifies under section 351(a), the new domestic corporation generally will not be treated as making a base erosion payment in exchange for the depreciable property pursuant to the new exception in the final regulations for specified corporate nonrecognition transactions that is discussed in Part IV.B.3 of the Summary of Comments and Explanation of Revisions. In contrast, if the same domestic corporation and a foreign related party each contribute depreciable property to a new partnership in exchange for interests in the partnership in a transaction that qualifies under section 721(a), the transaction is treated as a partner-to-partner exchange that may result in a base erosion payment solely for purposes of section 59A, with no specific exception adopted in the final regulations.

The final regulations do not extend the exception for specified corporate nonrecognition transactions to partnership transactions because that treatment would be generally inconsistent with the approach of treating partners in a partnership as engaging in transactions with each other. The preamble to the proposed regulations states that the Treasury Department and the IRS determined that a rule that applies the aggregate principle consistently is necessary to align the treatment of economically similar transactions. REG-104259-18, 83 FR 65956, 65967 (Dec. 21, 2018).

The adoption of a section 721(a) exception to the BEAT could permit related parties to use a partnership to avoid a transaction that would be a base erosion payment if that transaction occurred directly among the partners. The Treasury Department and the IRS acknowledge that in some respects, a similar argument could be made against adopting the exception for specified corporate nonrecognition transactions that applies to the section 351(a) example that is described in this Part VIII.A.1; however, the general tax rules that apply to corporations under subchapter C are fundamentally different from the general tax rules that apply to partnerships under subchapter K. In particular, when property is distributed by a partnership back to the partner, nonrecognition by the partnership and the partner is the general rule under subchapter K; however, when property is distributed by a corporation back to its shareholder, recognition and income by the corporation and the shareholder is the general rule under subchapter C. Compare sections 731(b) and (a) with sections 311(b) and 301(c). For these reasons, the final regulations do not extend the exception that is provided to specified corporate nonrecognition transactions to partnership nonrecognition transactions, such as contributions.

2. Amounts Paid or Accrued

Proposed §1.59A-3(b)(2)(i) confirms that an amount "paid or accrued," as those terms are used for purposes of determin-

ing whether there is a base erosion payment, includes an amount paid or accrued using any form of consideration.

A comment asserted that subchapter K of the Code contains well-developed provisions to distinguish between a sale or exchange, as opposed to a contribution, and that there should only be a "payment or accrual" for purposes of section 59A(d) to the extent a partner is treated as receiving proceeds from the partnership pursuant to a sale (for example, under the disguised sale rules of section 707). Similarly, a comment recommended that a distribution by a partnership described in section 731 generally not be treated as an amount paid or accrued for purposes of section 59A, except to the extent that the transaction would be treated as a deemed sale of property by the partnership.

In addition, one comment recommended that if the final regulations continue to treat certain partnership contributions and distributions as "payments" that could be base erosion payments, the applicability date of the provisions relating to this treatment should be modified to take into account that taxpayers have engaged in contributions to (or distributions by) partnerships between December 31, 2017, and December 21, 2018, without guidance that these transactions could be treated as base erosion payments. The comment also recommended a special rule to exclude pro-rata contributions (contributions made by each partner of the partnership in proportion to its interest in the partnership) from the definition of "an amount paid or accrued."

The final regulations continue to treat contributions to and distributions from partnerships as "payments" that could be base erosion payments under the aggregate approach. Section 59A does not contain an explicit restriction on the type of consideration that constitutes a payment. Proposed §1.59A-3(b)(2)(i) confirms that "an amount paid or accrued includes an amount paid or accrued using any form of consideration, including cash, property, stock, or the assumption of a liability." The final regulations include the same language. The Treasury Department and the IRS have determined that it is not appropriate to change the operating rule describing payment consideration or delay its application. However, in response to comments, the final regulations add partnership interests to the non-exclusive list of examples of consideration in §1.59A-3(b)(2)(ii) to reaffirm this result.

The final regulations do not exclude pro-rata contributions from the definition of "an amount paid or accrued" and therefore, they are not excluded from the definition of a base erosion payment. If pro-rata contributions are made by each partner, each transaction must be separately considered, consistent with the general rule in section 59A that assesses transactions on a gross, rather than net, basis. A pro-rata contribution exclusion would be inconsistent with the aggregate approach taken in these final regulations. For example, if there was an exception, a domestic corporation could contribute cash to a new partnership and its foreign parent could contribute depreciable property, each in proportion to their interest in the partnership, and under the exception, the transaction would not be subject to section 59A even though, under the aggregate approach, the domestic corporation effectively acquired its proportionate share of the contributed depreciable property from a foreign related party in exchange for cash. *See also* Part VIII.B of this Summary of Comments and Explanation of Revisions (Netting). To clarify this point, §1.59A-7(c)(5)(iv) provides that when both parties to a transaction use non-cash consideration, each party must separately determine its base erosion payment with respect to each property, and §1.59A-7(d)(1) provides that base erosion tax benefits are calculated separately for each payment or accrual on a property-by-property basis and are not netted.

Consistent with the approach taken for contributions to a partnership, the Treasury Department and the IRS determined that no special rule should be provided for distributions by a partnership. The approach suggested by a comment — only treating distributions subject to the disguised sales rules as potential base erosion payments — would be inconsistent with the aggregate approach to partnerships for the reasons discussed in the context of partnership contributions.

3. Request for ECI Exception

A comment recommended that contributions of depreciable (or amortizable) property by a foreign related party to a partnership (in which an applicable taxpayer is a partner) or distributions of depreciable or amortizable property by a partnership (in which a foreign related party is a partner) to an applicable taxpayer be excluded from the definition of a base erosion payment to the extent that the foreign related party would receive (or would be expected to receive) allocations of income from that partnership interest that would be taxable to the foreign related party as effectively connected income. The final regulations do not include rules relating to these comments. In the 2019 proposed regulations, however, the Treasury Department and the IRS request comments regarding how to address a contribution by a foreign person to a partnership engaged in a U.S. trade or business, transfers of partnership interests by a foreign person, and transfers of property by the partnership with a foreign person as a partner to a related U.S. person. See Part VI.B of the Explanation of Provisions of the preamble to the 2019 proposed regulations in which the Treasury Department and the IRS request comments regarding transactions involving partners and partnerships that have effectively connected income.

B. *Netting*

Proposed §1.59A-3(b)(2)(iii) provides that the amount of any base erosion payment is determined on a gross basis unless the transaction is subject to a special mark-to-market rule or the Code or regulations otherwise provide. A comment requested that a special netting rule be provided for partnerships when the base erosion tax benefits allocated by a partnership are reduced by deductions foregone as a result of the partner contributing property to the partnership.

The Treasury Department and the IRS have determined that this suggestion is inconsistent with the gross basis regime generally. See Part IV.A.3 of this Summary of Comments and Explanation of Revisions (Netting). The result addressed in the comment is the same result that would arise if the transactions had occurred outside of a partnership. For example, a taxpayer that acquired one depreciable asset from a foreign related party and sold an-

other asset would be in a similar position: the taxpayer would treat the depreciation with respect to the acquired asset as a base erosion tax benefit and there would be no offset for deductions from the asset the taxpayer sold (even if those "foregone" deductions would not have been base erosion tax benefits). Section 1.59A-7(d)(1) clarifies that base erosion tax benefits are determined separately for each asset, payment, or accrual, as applicable, and are not netted with other items.

C. *Aggregate approach to ownership of partnership assets*

Proposed §1.59A-7(b)(5)(i) provides that (subject to the small partner exception), for purposes of section 59A, each partner is treated as owning its share of the partnership items determined under section 704, including the assets of the partnership, using a reasonable method with respect to the assets. A comment proposed either removing the phrase "including the assets of the partnership" from this rule or including examples that clarify the purposes of section 59A for which the aggregate approach to the ownership of partnership assets is relevant.

In response to this comment, the final regulations remove this language from §1.59A-7(b)(5)(i). Instead, when it is necessary for a person to determine what assets were transferred from or to a partner in a partnership, the relevant provision refers to the partner's proportionate share of the assets, as determined based on all of the facts and circumstances. *See* §1.59A-7(c)(2), (3), and (4).

D. *Determining the base erosion payment*

Proposed §1.59A-7(b) generally provides that section 59A is applied at the partner level and that amounts paid or accrued by (or to) a partnership are treated as paid or accrued by (or to) the partners based on their distributive shares.

A number of comments requested clarification with respect to the aggregate approach taken in the proposed regulations. For example, a comment indicated that the proposed regulations do not address how to determine each partner's share of a payment received by a partnership if the payment results in no income or gain or results in a deduction or loss (for example, where a partnership sells depreciable or amortizable property to an applicable taxpayer and the amount realized is equal to or less than the partnership's adjusted basis in the property). The comment recommended that the final regulations provide rules for determining the extent to which a partner is treated as receiving a payment received by a partnership where the payment results in no income or a deduction or loss. The comment suggested that taxpayers be permitted to use a reasonable method to determine each partner's share of a payment received by the partnership if the payment results in no income and that, in circumstances where a payment results in a deduction or loss, the partner's share of the payment be determined by the partner's share of the deduction or loss. Additionally, the comment suggested that the final regulations permit taxpayers to use a reasonable method to determine each partner's share of the payment received by the partnership where the income or gain is recognized over multiple taxable years (such as in an installment sale).

Comments also requested that the final regulations clarify that depreciation deductions allocated to a taxpayer by a partnership that are attributable to property contributed to the partnership by a foreign related party are not treated as base erosion tax benefits if the property was contributed before the effective date of the BEAT.

One comment requested clarification regarding a scenario described in the preamble in which a foreign related party and a taxpayer form a partnership, and the foreign related party contributes depreciable property to the partnership. The preamble concludes that deductions for depreciation of the property contributed generally are base erosion tax benefits because the partnership is treated as acquiring the property in exchange for an interest in the partnership under section 721(a). REG-104259-18, 83 FR 65956, 65967 (Dec. 21, 2018). The comment requested that the final regulations clarify whether, in the scenario described in the preamble, each partner is treated as making its share of the payment (in the form of an interest in the partnership) to the foreign related party contributing the depreciable property under proposed §1.59A-7(b)(2) in determining if there is a base erosion payment. The language in the preamble to the proposed regulations that the comment discussed was in error. Consistent with the aggregate approach, the language should have stated that the deductions for depreciation of the property contributed generally are base erosion tax benefits because the *other partners* are treated as acquiring the property in exchange for a portion of their interest in the partnership assets, and this is clarified in the final regulations. *See* §1.59A-7(c)(3).

In response to the comments, the final regulations provide a more detailed explanation of how the aggregate approach set forth in the proposed regulations operates, including the treatment of partnership contributions and transfers of partnership interests (including issuances). In addition, §1.59A-7(g) includes examples illustrating the application of the rules.

The final regulations clarify that if property described in §1.59A-3(b)(1)(ii) or (iv) (depreciable or amortizable property or property that results in reductions to determine gross income) is transferred to a partnership, each partner is treated as receiving its proportionate share of the property for purposes of determining if it has a base erosion payment. Similarly, if the partnership transfers property described in §1.59A-3(b)(1)(ii) or (iv), each partner is treated as transferring its proportionate share of the property for purposes of determining if the recipient has a base erosion payment. *See* §1.59A-7(c)(2). If a partnership interest is transferred (other than by a partnership), the transferor generally is treated as transferring its proportionate share of the partnership's assets. When a partnership interest is transferred by a partnership, each partner whose proportionate share of assets is reduced is treated as transferring the amount of the reduction. *See* §1.59A-7(c)(3).

In keeping with this construct, if a taxpayer was a partner in a partnership and a foreign related party contributed depreciable property to the partnership before January 1, 2018, there would be no base erosion payment. However, also consistent with this construct, if a taxpayer acquires an interest (including an increased interest) in any partnership asset (including pursuant to a transfer of a partnership interest either by the partnership or by an-

other person) on or after January 1, 2018, from a partnership that holds depreciable property and has a foreign related party as a partner whose interest in the asset is reduced, with or without a section 754 election by the partnership, that transaction will be a base erosion payment because the property will be treated as acquired on or after January 1, 2018. *See* §1.59A-7(c).

The final regulations also clarify that the amount of deduction resulting from a payment is not impacted by the gain or loss arising from the consideration used to make the payment. Therefore, if the partnership makes a payment, that payment from the partnership may result in a deduction even if the partnership incurs a gain on the transfer under general tax principles because the partnership used built-in gain property as consideration. Similarly, if the partnership receives a payment as consideration for the sale of built-in loss property, that payment to the partnership will result in income. *See* §1.59A-3(b)(2)(ix) and §1.59A-7(c)(5)(iv) and (d)(1).

If a series of payments or accruals with respect to a transaction occurs over time, whether there is a base erosion payment is determined each time there is a payment or accrual. If, instead, there is a single payment that results in base erosion tax benefits being allocated by a partnership over multiple years, the portion of the payment that is a base erosion payment must be determined at the time of the payment, but the amount of the base erosion tax benefits will be determined based on the allocations by the partnership that occur each year. For example, if a partnership, whose partners are a domestic corporation and an unrelated person, acquires depreciable property from a foreign related party of the domestic corporation, then the entire amount is a base erosion payment with respect to the domestic corporation and any allocations by the partnership of depreciation to the domestic corporation are base erosion tax benefits.

The final regulations clarify that if a distribution of property from a partnership to a partner causes an increase in the tax basis of property that either continues to be held by the partnership or is distributed from the partnership to a partner, such as under section 732(b) or 734(b), the increase in tax basis for the benefit of a taxpayer that is attributable to a foreign related party is treated as if it was newly purchased property by the taxpayer from the foreign related party that is placed in service when the distribution occurs for purposes of determining if a taxpayer has a base erosion payment. *See* §1.59A-7(c)(4).

The final regulations also include certain additional operating rules to clarify how §1.59A-7 applies. For example, §1.59A-7(c)(5)(ii) clarifies the order in which the base erosion payment rules apply, and §1.59A-7(c)(5)(iv) reaffirms that if both parties to a transaction use non-cash consideration, each transfer of property must be separately analyzed to determine if there is a base erosion payment.

The final regulations also clarify that if a transaction is not specifically described in §1.59A-7, whether it gives rise to a base erosion payment or base erosion tax benefit will be determined in accordance with the principles of §1.59A-7 and the purposes of section 59A. *See* §1.59A-7(b). Further, the final regulations clarify that the aggregate approach under §1.59A-7 does not override the treatment of any partnership item under any Code section other than section 59A. *See* §1.59A-7(a). That clarification is consistent with the principle that a rule of general applicability applies unless explicitly replaced or turned off by another rule. Thus, for example, section 482 continues to apply to controlled transactions involving partnerships (such as transfers of property or provisions of services, contributions, and distributions), as it applies to all controlled transactions, and is taken into account in determining the arm's length consideration for such transactions (such as the pricing of transferred property or services, and the valuation of contributions and distributions) and in determining whether partnership transactions (including partnership allocations) otherwise clearly reflect income. *See*, for example, §§ 1.482-1(f)(1)(iii) and (i)(7) and (8) and 1.704-1(b)(1)(iii) and (5)(Ex. 28); Notice 2015-54, 2015-34 I.R.B. 210, §§ 2.03 and 2.04.

Given the absence in the statute of a provision describing the specific treatment of partnerships and partners, the Act's legislative history, and the overall significance of the proper functioning of the BEAT regime, the Treasury Department and the IRS have determined that, in addition to section 59A, certain authorities in subchapter K provide support for the treatment of partners and partnerships under these final regulations. The 1954 legislative history to subchapter K makes clear that this determination of aggregate versus entity should be based on the policies of the provision at issue, in this case, section 59A. See H.R. Rep. No. 83-2543, at 59 (1954). Under the rules of subchapter K, an aggregate approach applies if it is appropriate to carry out the purpose of a provision of the Code, unless an entity approach is specifically prescribed and clearly contemplated by the relevant statute. *See*, for example, §1.701-2(e). The BEAT regime does not prescribe the treatment of a partnership as an entity and the treatment of a partnership as an aggregate is appropriate with respect to payments made to or received by it.

E. Determining a partner's base erosion tax benefit

For purposes of determining whether a payment or accrual by a partnership is a base erosion payment, proposed §1.59A-7(b)(2) provides that (subject to the small partner exception) any amount paid or accrued by a partnership is treated as paid or accrued by each partner based on the partner's distributive share of items of deduction (or other amounts that could be base erosion tax benefits) with respect to that amount (as determined under section 704). A comment noted that proposed §1.59A-7(b)(2) does not indicate how a partner's base erosion tax benefits would be determined if a partner's distributive share of the partnership item that produces the base erosion tax benefits changed from one taxable year to another taxable year. The comment concluded that the amount of a partner's distributive share of deductions with respect to property acquired by the partner's base erosion payment that is treated as a base erosion tax benefit may not correspond to the amount of the partner's initial base erosion payment with respect to that property. The comment recommended that the final regulations clarify whether any amount of the partner's distributive share of deductions with respect to property acquired by a base erosion payment (in any amount) that is treated as made by the partner would be

a base erosion tax benefit, subject to the small partner exception.

Another comment requested that the final regulations provide that when depreciable property is contributed to a partnership that adopts the remedial method under §1.704-3(d) with respect to that property, the remedial items of depreciation (which may be allocated to a partner that is an applicable taxpayer) should not be treated as base erosion tax benefits. The comment further asserted that treating remedial items as base erosion tax benefits would penalize applicable taxpayers that are U.S. transferors in section 721(c) partnerships for which the gain deferral method is applied. *See generally* §1.721(c)-1T.

As recommended by a comment, §1.59A-7(d)(1) clarifies that the base erosion tax benefits are not dependent on the amount of the base erosion payment, and provides that a partner's base erosion tax benefits are the partner's distributive share of any deductions described in §1.59A-3(c)(1)(i) or (ii) or reductions to determine gross income described in §1.59A-3(c)(1)(iii) or (iv) attributable to the base erosion payment.

The final regulations also clarify that a taxpayer's base erosion tax benefits resulting from a base erosion payment include the partner's distributive share of any deduction or reduction to determine gross income attributable to the base erosion payment, including as a result of section 704(c), section 734(b), section 743(b) or certain other sections. *See* §1.59A-7(d)(1). As a result, if a taxpayer is allocated depreciation or amortization deductions from property acquired pursuant to a base erosion payment, those deductions are base erosion tax benefits. If the partner obtains depreciation deductions in excess of the partner's proportionate share of the depreciable property, those deductions still arise from the acquisition of the property pursuant to a base erosion payment, and the Treasury Department and the IRS have determined that it would not be appropriate to exclude those deductions from base erosion tax benefit treatment.

F. *Small partner exception*

The proposed regulations provide that partners with certain small ownership interests are excluded from the aggregate approach for purposes of determining base erosion tax benefits from the partnership. This small partner exception generally applies to partnership interests that: (i) represent less than ten percent of the capital and profits of the partnership; (ii) represent less than ten percent of each item of income, gain, loss, deduction, and credit; and (iii) have a fair market value of less than $25 million.

Comments recommended expanding the thresholds for the small partner exception for partnership interests and items to 25 percent, and eliminating the fair market value limitation. The comments suggested that the compliance burden associated with the thresholds in the proposed regulations would be substantial and that minority partners may have little or no ability to obtain the necessary information from the partnership.

The final regulations do not adopt these recommendations. In determining the appropriate threshold for a small ownership interest in the proposed regulations, the Treasury Department and the IRS considered the treatment of small ownership interests in partnerships in analogous situations in other Treasury regulations. Further, the fair market value threshold addresses a concern that while a partner may have a relatively small interest in a partnership, the partnership itself could have significant value such that partnership items should not be excluded from the BEAT base when an analogous payment made outside of the partnership context is not similarly excluded from the BEAT base. The $25 million fair market value threshold was developed after qualitative consideration of these factors.

Comments also recommended that the small partner exception apply to payments made to a partnership. The final regulations do not adopt this recommendation. The proposed regulations included the small partner interest exception for payments by a partnership in part because the Treasury Department and the IRS were cognizant that small partners in a partnership may not always have sufficient information about the amounts of payments made by the partnership and the identity of the payee. The Treasury Department and the IRS were also cognizant that this type of information is not currently reportable by the partnership to its partners on a Form K-1; that is, without information provided by the partnership to the taxpayer partner, that partner may not be able to determine whether it is treated as having made a base erosion payment through the partnership pursuant to proposed §1.59A-7. The Treasury Department and the IRS considered these factors, and reached a qualitative conclusion that at or below the threshold level set forth in the proposed regulations, the administrability considerations outweighed the competing consideration of ensuring that base erosion payments through a partnership are properly taken into account by taxpayer partners in the partnership.

In a situation where a taxpayer makes a payment to a partnership (that is, a payment that may be a base erosion payment under proposed §1.59A-7 because a partner in the partnership is a foreign related party with respect to the payor), the administrability concerns that factored into the small partner exception for payments by a partnership are less pronounced. That is, the taxpayer (payor) will generally have information to determine whether it has made a payment to a partnership in which any foreign related party is a partner without needing to obtain significant information from the partnership. Based on these factors, the Treasury Department and the IRS reached a qualitative conclusion that the administrability aspects of accounting for payments by a taxpayer to a partnership are not outweighed by the competing consideration of ensuring that base erosion payments to a partnership are properly taken into account by taxpayer payors.

IX. *Comments and Changes to Proposed §1.59A-9—Anti-Abuse and Recharacterization Rules*

Proposed §1.59A-9 contains anti-abuse rules that recharacterize certain transactions in accordance with their substance for purposes of carrying out the provisions of section 59A. The proposed anti-abuse rules address the following types of transactions: (a) transactions involving intermediaries acting as a conduit if there is a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment); (b) transactions with a principal purpose of increasing the

deductions taken into account in the denominator of the base erosion percentage; and (c) transactions among related parties entered into with a principal purpose of avoiding the application of rules applicable to banks and registered securities dealers (for example, causing a bank or registered securities dealer to disaffiliate from an affiliated group so as to avoid the requirement th at it be a member of such a group).

Comments generally requested more guidance on when a transaction has "a principal purpose" of avoiding a provision of section 59A. Comments expressed a concern that any transaction that would result in a lower BEAT liability could be viewed as having "a principal purpose" of avoiding a provision of the section 59A regulations. Comments also expressed a concern that the anti-abuse rules could be interpreted as applying to transactions undertaken in the ordinary course of a taxpayer's business. One comment requested that the Treasury Department and the IRS consider whether existing anti-abuse rules and judicial doctrines, including section 7701(o), are sufficient to address abuse of section 59A.

Consistent with the grant of authority in section 59A(i), the Treasury Department and the IRS believe that anti-abuse rules specific to section 59A are needed. The final regulations address the requests for clarity regarding the "principal purpose" standard in the final regulations by adding new examples that illustrate the differences between transactions that the Treasury Department and the IRS find to be abusive or non-abusive. *See* §1.59A-9(c)(5), (7), (8), (9).

A comment requested that the anti-abuse rule for transactions involving intermediaries acting as a conduit be modified so that it would not apply to transactions where taxpayers restructure their operations in a way that reduces their base erosion payments because they have moved operations to the United States. The comment asserted that proposed §1.59A-9(b)(1) should not apply where taxpayers restructure their operations for business reasons even if, under the resulting structure, payments are made to a foreign related party through an intermediary. As an example, the comment suggested that taxpayers might restructure their business so that a domestic related party performs functions previously performed by a foreign related party. However, if the foreign related party continues to perform some functions that benefit the taxpayer, and payments for those functions are made through the domestic related party, the comment suggested that proposed §1.59A-9(b)(1) could apply to the transaction. The determination of whether proposed §1.59A-9(b)(1) will apply to a transaction is dependent, in part, on whether the transaction has a principal purpose of avoiding a base erosion payment or reducing the amount of a base erosion payment. The requested exception could lead to inappropriate results where the change in the taxpayer's operations is insignificant compared to the impact of reducing the taxpayer's base erosion payments. Accordingly, the final regulations do not include the requested exception.

Another comment requested clarification on when the anti-abuse rule in proposed §1.59A-9(b)(1) could apply to a "corresponding payment" to an intermediary that would have been a base erosion payment if made to a foreign related party. The final regulations do not modify this rule because the rule is already clear that it applies to a corresponding payment that is part of a transaction, plan, or arrangement that has a principal purpose of avoiding a base erosion payment, and the final regulations include examples of transactions with such a purpose. Another similar comment requested clarification on when the anti-abuse rule in proposed §1.59A-9(b)(1) could apply to an "indirect" corresponding payment. The final regulations do not modify this rule because it is already clear that transactions involving conduits and intermediaries can include transactions involving multiple intermediaries, for example, multiple intermediary lenders in a fact pattern similar to that in proposed §1.59A-9(c)(4) (Example 4), and thus expanding that example to involve another intermediary would be redundant.

Other comments asked for a clarification that the anti-abuse rule for transactions designed to inflate the denominator of the base erosion percentage applies only to non-economic deductions such as those described in the example in proposed §1.59A-9(c)(5) (Example 5). One comment recommended that the rule be limited to deductions and losses incurred for "the" principal purpose of increasing the denominator. The comment expressed a concern that the rule could be interpreted as applying to deductions and losses on transactions undertaken in the ordinary course of a taxpayer's business. The final regulations do not change the standard for determining whether transactions that increase the denominator of the base erosion percentage are abusive. Narrowing the rule to apply only to transactions where the single principal purpose is to increase the denominator of the base erosion percentage would make it difficult to administer in all but the most egregious cases. Further, it is a common formulation for anti-abuse rules to apply when "a principal purpose" or "one of the principal purposes" of a transaction is to avoid a particular provision. *See*, for example, section 954(h)(7)(A), (C), and (D); section 965(c)(3)(F); *see also* 60 FR 46500, 46501 (rejecting comments requesting that an anti-avoidance rule of §1.954-1(b)(4) apply only if a purpose of first importance, rather than a principal purpose, was to avoid the de minimis test of §1.954-1(b)(1)(i) because the suggested standard would be "significantly more subjective" than the test adopted and therefore inadministrable). However, the final regulations address the requests for clarity regarding the treatment of transactions entered into in the ordinary course of a taxpayer's business by adding a new example of the application of §1.59A-9(b)(2). *See* §1.59A-9(c)(7).

One comment requested that the anti-abuse rule with respect to the disaffiliation of banks and registered securities dealers be removed. The comment expressed a concern that proposed §1.59A-9(b)(3) could effectively prevent taxpayers from disaffiliating a bank or registered securities dealer, notwithstanding the fact that disaffiliation could have other non-tax effects. The comment suggested that if a disaffiliation made sense from a business perspective and is permissible under applicable banking and securities rules, the Treasury Department and the IRS should not treat disaffiliation as abusive. The Treasury Department and the IRS have determined that disaffiliation of a bank or registered securities dealer could be

abusive in certain circumstances, such as the interposition of entities other than "includible corporations" (as defined in section 1504(b)) with a principal purpose of avoiding the rules applicable to banks and registered securities dealers. Moreover, in developing guidance under various Code provisions, the Treasury Department and IRS often consider that disaffiliation could potentially avoid the purposes of a provision. See, for example, §1.904(i)-1, which similarly limits the use of deconsolidation to avoid foreign tax credit limitations. *See* 59 FR 25584. Therefore, the final regulations retain §1.59A-9(b)(3). However, the final regulations address the concern raised by the comment by providing examples to clarify the types of transactions that the Treasury Department and the IRS consider to be abusive. *See* §1.59A-9(c)(8) and (9).

Finally, a comment recommended excluding from the anti-abuse rule transactions entered into, or pursuant to a binding commitment that was in effect, before the date of public announcement of certain provisions in section 59A. The final regulations do not adopt this recommendation. The anti-abuse rule in §1.59A-9 is based on the specific grant of authority in section 59A(i), and the Treasury Department and the IRS decline to adopt a grandfathering rule when no such rule was adopted by statute.

X. *Rules Relating to Insurance Companies*

Section 59A(d)(3) provides that the term "base erosion payment" includes any premium or other consideration paid or accrued by a taxpayer to a foreign related party for any reinsurance payments that are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A). The preamble to the proposed regulations requests comments regarding several issues relating to insurance companies. Specifically, the preamble to the proposed regulations requests comments regarding certain reinsurance agreements and other commercial agreements with reciprocal payments that are settled on a net basis. REG-104259-18, 83 F.R. 65968 (December 21, 2018).

Comments were also requested with respect to whether claims payments for losses incurred and other deductible payments made by a domestic reinsurance company to a foreign related insurance company are base erosion payments within the scope of section 59A(d)(1). REG-104259-18, 83 F.R. 65968 (December 21, 2018). The proposed regulations, however, did not provide any exceptions specific to the insurance industry.

Comments received generally addressed whether (1) claims payments for losses incurred (claims payments) under reinsurance contracts should be treated as base erosion payments, and (2) certain payments made pursuant to reinsurance contracts should be netted. For a discussion of comments relating to life/non-life consolidated returns, see Part XI of this Summary of Comments and Explanation of Revisions**.**

A. *Reinsurance claims payments to a related foreign insurance company*

The proposed regulations do not provide specific rules for payments by a domestic reinsurance company to a related foreign insurance company. The preamble to the proposed regulations notes the treatment of claims payments for purposes of section 59A may be different for life insurance companies and non-life insurance companies. REG-104259-18, 83 F.R. 65968 (December 21, 2018). For a life insurance company, payments for claims or losses incurred are deductible pursuant to sections 805(a)(1); therefore, these payments are potentially within the scope of section 59A(d)(1). With respect to non-life insurance companies, however, the preamble to the proposed regulations notes that certain claims payments for losses incurred may be treated as reductions in gross income under section 832(b)(3), rather than deductions under section 832(c). To the extent not covered by section 59A(d)(3), these payments treated as reductions in gross income may not be within scope of section 59A.

Generally, comments requested that the final regulations provide an exception to the term "base erosion payment" for claims payments made by a domestic reinsurance company to a related foreign insurance company. Some comments recommended that the exception should apply only to claims payments with respect to reinsurance that ultimately relates to the risk of unrelated third parties. Comments also stated that there was no apparent policy reason for treating life and non-life insurance claims payments differently for purposes of section 59A, although one comment noted that this distinction between life and non-life insurance claims payments results from the different approaches taken in drafting section 801(b) and section 832(b)(3), and that the Code sometimes provides disparate results.

Comments explained that an exception for claims payments by a domestic reinsurance company to a related foreign insurance company would provide symmetrical treatment for life insurance companies and non-life insurance companies. In addition, comments noted that reinsurance transactions with respect to which outbound claims payments are made do not base erode because they result from insurance business that is moved into the United States; therefore, it is appropriate to provide an exception similar to the TLAC exception and the exception for foreign currency losses. As noted, several comments requested an exception for reinsurance claims payments only to the extent that the claims payments are with respect to policies ultimately insuring third-party risks. Comments stated that because the reinsurance claims payments are payable only when an unrelated third party makes a claim under an insurance policy that the domestic insurance company has reinsured (and the nature of those claims payments are non-routine and often large and unpredictable), the timing and amount of the claims payment are not controlled by the related parties. Finally, comments noted that foreign regulatory requirements generally require that a local entity provide insurance to its residents; as a result of these regulatory requirements, domestic companies that want to provide insurance in many jurisdictions must do so by reinsuring a subsidiary established in the local jurisdiction.

Comments also addressed how an exception for claims payments should impact the base erosion percentage calculation. Generally, comments recommended that claims payments be excluded from the numerator, but included in the denominator. If claims payments were eliminated from the denominator, comments noted that a significant amount of business expenses

would be removed from the base erosion percentage calculation. Several comments acknowledged that the final regulations may adopt an exception that applies to both the numerator and the denominator; in that case, comments recommended that claims payments should be eliminated from the denominator of the base erosion percentage only to the extent that the payments are made to a foreign related party. Comments also indicated that the ambiguity regarding whether a claims payment is a deduction or a reduction in gross income for non-life insurance companies could result in taxpayers taking inconsistent positions and may lead to controversy regarding the calculation of the denominator for the base erosion percentage.

Finally, several comments noted that certain self-help remedies with respect to claims payments are not available for insurance companies. First, because insurance companies are per se corporations under §301.7701-2(b)(4), an election under §301.7701-3 to treat a related foreign insurance company as a disregarded entity for U.S. tax purposes is unavailable. In addition, comments stated that regulators in some jurisdictions would prohibit a local insurance company from making an election to be treated as a U.S. taxpayer pursuant to section 953(d) if the election would result in U.S. withholding tax with respect to payments to policyholders.

Section 1.59A-3(b)(3)(ix) adopts the recommendation from these comments and provides a specific exception for deductible amounts for losses incurred (as defined in section 832(b)(5)) and claims and benefits under section 805(a) ("claims payments") paid pursuant to reinsurance contracts that would otherwise be within the definition of section 59A(d)(1), to the extent that the amounts paid or accrued to the related foreign insurance company are properly allocable to amounts required to be paid by such company (or indirectly through another regulated foreign insurance company), pursuant to an insurance, annuity, or reinsurance contract, to a person other than a related party. The final regulations also clarify that all claims payments are included in the denominator of the base erosion percentage, except to the extent excepted from the definition of a base erosion payment under §1.59A-3(b)(3)(ix). This treatment in the denominator is consistent with the treatment in the final regulations of derivatives and QDPs (discussed in Part VII of this Summary of Comments and Explanation of Revisions), section 988 foreign exchange losses (discussed in Part IV.C.4 of this Summary of Comments and Explanation of Revisions), and deductions for services eligible for the SCM exception (discussed in Part IV.C.1 of this Summary of Comments and Explanation of Revisions).

B. *Netting with respect to insurance contracts*

As discussed in Part IV.A.2 of this Summary of Comments and Explanation of Revisions, the amount of any base erosion payment is generally determined on a gross basis, regardless of any contractual or legal right to make or receive payments on a net basis. The proposed regulations do not provide an exception to this general rule with respect to reinsurance agreements.

Several comments recommended that the final regulations permit netting with respect to reinsurance contracts to better reflect the economics of the transactions. One comment suggested that the final regulations permit netting with respect to a single economic transaction where the parties exchange net value in the form of a single payment, which would include many reinsurance transactions. Other comments identified specific types of reinsurance transactions for which netting should or should not be permitted. For quota share reinsurance arrangements, comments noted that the proposed regulations provide that the gross amount of reinsurance premium is a base erosion payment without considering any inbound payments such as reserve adjustments, ceding commissions, and claims payments. Other comments suggested that the amount of base erosion payments with respect to modified coinsurance ("modco") and funds withheld reinsurance be determined on a net basis (particularly when settlement is on a net basis) in the final regulations to be consistent with the norm of paying tax on a net basis.

As background, reinsurance is the transfer from an insurer (referred to as the "ceding" company) to a reinsurer of all or part of the risk assumed under a policy or a group of policies. A traditional reinsurance agreement typically requires the ceding company to pay a reinsurance premium to the reinsurance company and the reinsurance company to pay a ceding commission to the ceding company. The reinsurance premium compensates the reinsurer for acquiring the reinsured obligations. The ceding commission compensates the ceding company for its expenses incurred in acquiring and managing the reinsured policies, and may include a profit margin. When the risks are transferred, the ceding company may reduce its reserves for the reinsured obligations, and the reinsurance company establishes its own reserves for the reinsured obligations. In terms of payment flows, it is common for the ceding commission owed under the reinsurance agreement to be netted against the reinsurance premium owed, such that the ceding company remits the reinsurance premium net of the ceding commission amount. However, both flows are typically separately identified in the contract and in any case represent reciprocal economic obligations. When losses are paid under the reinsured policies, depending on the terms of the reinsurance agreement, the reinsurer will have corresponding obligations to make payments to the ceding company (for example, the agreement may require the reinsurer to reimburse a percentage of total losses, or losses above a certain dollar threshold).

Under modco and similar funds-withheld reinsurance agreements, the ceding company retains the assets with respect to the policies reinsured and generally does not transmit an initial premium payment to the reinsurer under the agreement. The reinsuring company in a modco agreement is entitled to premiums and a share of investment earnings on certain assets, and the ceding company is entitled to expense allowances (similar to ceding commissions) and reimbursement for losses paid under the reinsured policies, but the parties make net settlement payments based on each party's overall entitlement under the agreement on a periodic basis. Comments noted that in this respect, the arrangement is similar to making settlement payments under a derivative contract. In both the modco and traditional reinsurance context, comments asserted that imposing tax on one leg of a reinsurance

transaction (the premium payment) is not equitable and does not reflect the economics of the transaction.

A comment recommended that the final regulations exclude ceding commissions paid by a domestic insurance company to a foreign affiliate in exchange for the domestic insurance company's reinsurance of foreign risk from the definition of a base erosion payment. The comment suggested that this exception would be similar to the exception for section 988 foreign currency losses and for TLAC securities because an insurance group should not have a base erosion payment when insurance regulators dictate the structure of reinsurance agreements. The comments noted that reinsurance involves substantial payments in both directions, including premiums, ceding commissions, and claims. The comment explained that a ceding commission compensates the reinsured for its policy acquisition costs plus a small profit component and noted that a substantial amount of the commissions are reimbursements for third party expenses for many lines of business. For most reinsurance contracts, a comment noted that ceding commissions and premiums are separately stated in the reinsurance contract, but not separately paid. Instead, premiums are paid to the reinsurer net of the ceding commission.

Several comments expressed strong support for the determination in the proposed regulations that netting is not permitted with respect to reinsurance arrangements. Comments indicated that the result from the proposed regulations is appropriate under current law and necessary to achieve the legislative goals for the BEAT. Before the enactment of the BEAT, comments explained that foreign insurance groups had a significant competitive advantage over U.S.-based insurance companies because foreign groups were allowed to shift their U.S. earnings into low-tax jurisdictions using affiliated reinsurance payments. Comments asserted that section 59A identified reinsurance as a base erosion payment to close the loophole. Comments also noted that using gross amounts is consistent with the statutory annual statement that is the basis for determining taxable income under subchapter L. Comments explained that the use of gross reinsurance premium, rather than net, is consistent with the excise tax imposed under section 4371, which computes the excise tax as a percentage of gross reinsurance payments, even for a funds-withheld or modco contract (where only net amounts are transferred between the contracting insurance companies). Finally, comments noted that when Congress determines that netting is appropriate with respect to insurance, it specifically permits netting. *See* sections 848(d)(1), 72(u)(2)(B), and 834(e); *see also* sections 803(a) and 832.

Some comments asserted that the statutory language of section 59A(d)(3), which provides that base erosion payments include consideration paid or accrued "for any reinsurance payments which are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A)," requires treating only the net amounts paid by a domestic company under a modco-type reinsurance contract as base erosion payments. For example, in the life insurance context, section 803(a)(1) defines "premiums" as:

(A) The gross amount of premiums and other consideration on insurance and annuity contracts, less

(B) return premiums, and premiums and other consideration arising out of indemnity reinsurance.

Further, section 59A(c)(2)(A)(iii)(I) closely tracks section 803(a)(1) in its definition of base erosion tax benefit in the life insurance context as the amount by which "gross premiums and other consideration on insurance and annuity contracts" are reduced by "premiums and other consideration arising out of indemnity reinsurance." These comments suggested that the phrase "consideration arising out of indemnity reinsurance" suggests a broader view of the transaction than just reinsurance premiums and is best interpreted as referring to the net cash settlement payments under a modco-type reinsurance contract, rather than the gross amount identified in the contract as reinsurance premium.

Other comments disagreed with this characterization and noted that section 59A(d)(3) is describing consideration paid or accrued for reinsurance—that is, payments moving in one direction from the taxpayer to foreign related party—without describing offsetting or reciprocal payments. The comments noted that the phrase "arising out of indemnity reinsurance" was merely lifted from preexisting section 803(a)(1)(B), rather than being selected deliberately by Congress to account for both inflows and outflows under a reinsurance contract. They noted further that section 803(a)(1)(B) and its non-life counterpart, section 832(b)(4), use parallel structures for measuring the amount of premiums included in insurance company gross income, starting with total premiums received, and reducing that total by premiums paid for reinsurance and by return premiums (that is, premium amounts refunded to the policyholder). The two provisions do not provide for additional offsets based on obligations flowing in the other direction, such as ceding commissions or reinsurance claim payments owed.

Some comments asserted that foreign insurers may decide to reduce their capacity, discontinue lines of business, or increase pricing as a result of section 59A. Those comments acknowledged that domestic reinsurers may pick up the increased capacity, but warned that the shift to domestic reinsurers would concentrate the insured risk in the United States rather than spreading it globally, resulting in less risk diversification (a key element of insurance risk management). Other comments disagreed with this contention, noting that global reinsurance capacity has remained strong and that premium increases have been negligible since the enactment of section 59A.

In contrast, a comment asserted in the context of reinsurance that it was clear that the law applies on a gross basis, both based on the plain language of the statute and the intent of Congress, and that relevant policy considerations weigh heavily in favor of applying the BEAT on a gross basis. The comment explained that because the reinsurance transactions at issue are between related parties, they are not necessarily at arm's length. Further, according to the comment, the legislative purpose of section 59A was to level the playing field between U.S. and foreign-owned companies, which can only be advanced if section 59A is applied on a gross basis.

The final regulations do not adopt the recommendations that payments made under a reinsurance contract be netted

for purposes of determining the amount of a base erosion payment, unless netting would otherwise be permitted for U.S. federal income tax purposes. Section 59A's requirements are best interpreted in the context of the existing body of tax law and regulations. As discussed in Part IV.A.3 of this Summary of Comments and Explanation of Revisions, amounts of income and deduction are generally determined on a gross basis under the Code, and unless a rule permits netting (so that there is no deduction or the deduction is a reduced amount, as opposed to a deduction offset by an item of income), no netting is permitted.

Although comments asserted that section 59A(d)(3) (defining a base erosion payment as including certain reinsurance payments) requires the netting of ceding commissions and other payments from the related foreign reinsurance company against reinsurance premiums, the Treasury Department and IRS are not persuaded by arguments that the language of section 59A(d)(3) mandates that result. Whether payments under particular types of reinsurance contracts (for example, modco) may be netted for purposes of section 59A is determined based on the existing rules in the Code and regulations regarding netting. The subchapter L provisions cited in section 59A(d)(3) (section 803(a)(1)(B) for life insurance companies and section 832(b)(4)(A) for non-life insurance companies) do not provide for netting of ceding commissions, claims payments or other expenses against premiums.

With respect to the comment that modco and other reinsurance contracts that are periodically settled on a net basis are substantially similar to derivative contracts, the Treasury Department and IRS note that Congress specified in section 59A(h)(4)(C) that the term "derivative" does not include insurance contracts. This indicates that Congress did not intend for agreements with derivative-like characteristics that are also insurance contracts to be treated as derivatives for purposes of section 59A.

With respect to comments that ceding commissions should be broken down into components and not treated as base erosion payments to the extent that they reimburse amounts paid to third parties, this scenario is not materially different from those described in comments received from taxpayers in other industries and discussed in Part IV.A.1 of this Summary of Comments and Explanation of Revisions. These other comments described various scenarios in which a domestic corporation makes a deductible payment to a foreign related party, and that foreign related party in turn makes deductible payments to unrelated third parties. Therefore, the final regulations do not adopt a narrower regulatory exception for payments to foreign related insurance companies that arise in connection with a regulatory requirement.

XI. *Comments and Changes to §1.1502-59A*

A. *In general*

Proposed § 1.1502-59A provides rules regarding the application of section 59A and the regulations thereunder to consolidated groups. Under these rules, all members of a consolidated group are treated as a single taxpayer for purposes of determining whether the group is an applicable taxpayer and the amount of tax due under section 59A. For example, items resulting from intercompany transactions (as defined in §1.1502-13(b)(1)(i)) are disregarded for purposes of making the required computations.

Some comments requested clarification on what it means for intercompany transactions to be "disregarded" in making the required computations under section 59A. Generally, intercompany transactions should not change the consolidated taxable income or consolidated tax liability of a consolidated group. For example, where one member (S) sells depreciable property to another member (B) at a gain, S's gain on the sale is deferred. Every year, as B depreciates the property, S recognizes a portion of its deferred gain. As a result, the depreciation expense deducted by B that exceeds the depreciation expense the group would have deducted if S and B were divisions of a single entity ("additional depreciation") is offset by the amount of gain S recognizes each year, and the intercompany sale does not change the consolidated taxable income.

However, the base erosion percentage is generally computed based solely on deductions; income items are not relevant. Therefore, under the foregoing example, B's depreciation deduction would include the additional depreciation amount, but S's offsetting gain inclusion would be excluded from the base erosion percentage computation.

To make clear that intercompany transactions may not impact the BEAT consequences of a consolidated group, these final regulations clarify in §1.1502-59A(b)(1) that items resulting from intercompany transactions are not taken into account in computing the group's base erosion percentage and BEMTA. Consequently, in the foregoing example, B's additional depreciation is not taken into account in computing the group's base erosion percentage.

In addition, some comments raised concerns that the proposed section 59A regulations and proposed §1.1502-59A may be incompatible with the rules and framework of §1.1502-47 for life-nonlife consolidated groups. The Treasury Department and the IRS are analyzing these concerns and expect to address the issues in future proposed regulations, and thus reserve on this matter in the final regulations.

B. *New rules under §1.1502-59A(c) when a member deconsolidates from a consolidated group with a section 163(j) carryforward*

Proposed section 1.1502-59A(c)(3) provides rules to determine whether a consolidated group's business interest deduction permitted under section 163(j) is a base erosion tax benefit. Due to the fungibility of money, these rules generally treat the consolidated group as a single entity and aggregate all members' current-year business interest expense paid to nonmembers. The current-year business interest expense deducted by members is then classified as an amount paid or accrued to a domestic related party, foreign related party, or unrelated party based on specified allocation ratios, which are based on the entire group's business interest expense paid. If members cannot fully deduct their current-year business interest expense, then the members' section 163(j) carryforwards are allocated a status as a domestic related carryforward, foreign

related carryforward, or unrelated carryforward based on specified allocation ratios. Such status is taken into account for BEAT purposes in future years when the member deducts its section 163(j) disallowed business interest expense carryforward, whether the member remains in the group or deconsolidates.

A comment requested a special rule under §1.1502-59A(c)(3) for certain situations in which a member (T) deconsolidates from a consolidated group (the original group) that was not an applicable taxpayer under section 59A and joins an unrelated consolidated group. Assume that, during the time T was a member of the original group, T incurred business interest expense that could not be fully deducted and has a section 163(j) disallowed business interest expense carryforward. T then deconsolidates from the original group and joins the new group, which is an applicable taxpayer under section 59A. The comment recommended allowing T to use the special allocation ratios under §1.1502-59A(c)(3) of the new group for the taxable year of the acquisition (rather than the allocation ratios of the original group). The comment posited that the original group would not have determined or maintained information pertaining to the allocation ratios because the original group was not an applicable taxpayer.

The final regulations do not adopt this special rule. Whether a business interest expense deducted by members of a consolidated group is a base erosion tax benefit is determined on a single-entity basis, without regard to which member actually incurred the payment to the domestic related, foreign related, or unrelated party. Therefore, in the foregoing example, whether T's deduction of its section 163(j) disallowed business interest expense carryforward is a base erosion tax benefit must be determined by reference to the original group, not the new group.

Furthermore, to determine whether a consolidated group is an applicable taxpayer, the group generally must determine its base erosion percentage for the year. In order to do so, the group must apply the classification rule under §1.1502-59A(c)(3) to its aggregate current-year business interest expense that was deducted. Therefore, the original group should have the information relevant to the classification rule under §1.1502-59A(c)(3), regardless of whether it was an applicable taxpayer. Consequently, the final regulations do not adopt the rule recommended by the comment.

However, the final regulations provide two rules for situations in which a member deconsolidates from the original consolidated group with a section 163(j) carryforward. The first rule is an exception that applies if the original group was not an applicable taxpayer because it did not meet the gross receipts test in the year the business interest expense at issue was incurred. Under these circumstances, application of the classification rule under §1.1502-59A(c)(3) would have been unnecessary within the original consolidated group with regard to the year in which the interest was paid or accrued. This special rule permits the deconsolidating member (and any acquiring consolidated group) to apply the classification rule on a separate-entity basis to determine the status of the deconsolidating member's section 163(j) disallowed business interest expense carryforward as a payment or accrual to a domestic related, foreign related, or unrelated party. The second rule applies if the deconsolidating member (or its acquiring consolidated group) fails to substantiate the status of its section 163(j) disallowed business interest expense carryforward from the original group. In that case, the section 163(j) disallowed business interest expense carryforward is treated as a payment or accrual to a foreign related party.

Applicability Dates

Pursuant to section 7805(b)(1)(B), these final regulations (other than the reporting requirements for QDPs in §1.6038A-2(b)(7), §1.1502-2, and §1.1502-59A) apply to taxable years ending on or after December 17, 2018. However, taxpayers may apply these final regulations in their entirety for taxable years ending before December 17, 2018. Taxpayers may also apply provisions matching §§1.59A-1 through 1.59A-9 from the Internal Revenue Bulletin (IRB) 2019-02 (https://www.irs.gov/pub/irs-irbs/irb19-02.pdf) in their entirety for all taxable years ending on or before December 6, 2019. Taxpayers choosing to apply the proposed regulations must apply them consistently and cannot selectively choose which particular provisions to apply.

Section 1.6038A-2(b)(7)(ix) applies to taxable years beginning on or after June 7, 2021. No penalty under sections 6038A(d) or 6038C(c) will apply to a failure solely under §1.6038A-2(a)(3), (b)(6), or (b)(7) that is corrected by March 6, 2020.

Pursuant to sections 1503(a) and 7805(b)(1)(A), §1.1502-2 and §1.1502-59A apply to taxable years for which the original consolidated Federal income tax return is due (without extensions) after December 6, 2019. However, taxpayers may apply §1.1502-2 and §1.1502-59A in their entirety for taxable years for which such a return is due (without extensions) before December 6, 2019.

Statement of Availability of IRS Documents

IRS revenue procedures, revenue rulings, notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. For purposes of Executive Order 13771, this rule is regulatory.

These final regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB)

regarding review of tax regulations. The Office of Information and Regulatory Affairs has designated these regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these regulations.

A. *Background*

The Tax Cuts and Jobs Act of 2017 (the "Act") added new section 59A, which applies to large corporations that have the ability to reduce U.S. tax liabilities by making deductible payments to foreign related parties. The Base Erosion and Anti-Abuse Tax ("BEAT") is generally levied on certain large corporations that have deductions paid or accrued to foreign related parties that are greater than three percent of their total deductions (two percent in the case of certain banks or registered securities dealers), a determination referred to as the base erosion percentage test. Large corporations are those with gross receipts of $500 million or more, as calculated under the rules of section 59A, a determination referred to as the gross receipts test. By taxing these corporations' base erosion tax benefits, the BEAT "aims to level the playing field between U.S. and foreign-owned multinational corporations in an administrable way." Senate Committee on Finance, Explanation of the Bill, S. Prt. 115-20, at 391 (November 22, 2017). The BEAT operates as a minimum tax, so a taxpayer is only subject to additional tax under the BEAT if the BEAT tax rate multiplied by the taxpayer's modified taxable income exceeds the taxpayer's regular tax liability adjusted for certain credits.

B. *Need for the final regulations*

Section 59A is largely self-executing, which means that it is binding on taxpayers and the IRS without any regulatory action. Although it is self-executing, the Treasury Department and the IRS recognize that section 59A provides interpretive latitude for taxpayers and the IRS which could create uncertainty and prompt a variety of taxpayer responses without further guidance. The final regulations are needed to address questions regarding the application of section 59A and to reduce compliance burden and economic inefficiency that would be caused by uncertainty about how to calculate tax liability.

C. *Overview of the final regulations*

These final regulations provide guidance under section 59A regarding the determination of the tax with respect to base erosion payments for certain taxpayers with substantial gross receipts. They provide guidance for applicable taxpayers to determine the amount of BEAT liability and how to compute the components of the tax calculation.

Regulations under section 59A (§§1.59A-1 through 1.59A-10) provide details for taxpayers regarding whether a taxpayer is an applicable taxpayer and the computation of certain components of the base erosion minimum tax amount, including the amount of base erosion payments, the amount of base erosion payments that are treated as base erosion tax benefits, and modified taxable income. The regulations also provide specific guidance for banks, registered securities dealers, and insurance companies, and provide guidance in applying section 59A to amounts paid by and to partnerships. These regulations also establish anti-abuse rules to prevent taxpayers from taking measures to inappropriately circumvent section 59A.

Regulations under sections 383, 1502 and 6038A (§§1.383-1, 1.1502-2, 1.1502-59A, 1.6038A-1, 1.6038A-2, and 1.6038-4) provide rules for the application of section 59A with respect to limitations on certain capital losses and excess credits, consolidated groups and their members, and reporting requirements, which include submitting, in certain cases, new Form 8991, Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts.

D. *Economic Analysis*

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of these final regulations compared to a no-action baseline that reflects anticipated Federal income tax-related behavior in the absence of these final regulations.

2. Summary of Economic Effects

These final regulations provide certainty and clarity to taxpayers regarding the meaning of terms and calculations they are required to apply under the BEAT provisions of the Act. In the absence of the enhanced specificity provided by these regulations, similarly situated taxpayers might interpret the statutory rules of section 59A differently, potentially resulting in inefficient patterns of economic activity. For example, two otherwise similar taxpayers might structure an income-generating activity differently based solely on different assumptions about whether that activity will involve payments that are subject to the BEAT. If this tax-driven difference in business structures confers a competitive advantage on the less profitable enterprise, U.S. economic performance may suffer. This final regulatory guidance thus provides value by helping to ensure that economic agents face similar tax incentives, a tenet of economic efficiency.

The Treasury Department and the IRS project that under these final regulations, 3,500-4,500 taxpayers may be applicable taxpayers under the BEAT because those taxpayers (1) are U.S. shareholders of a foreign corporation, 25 percent foreign-owned corporations, or foreign corporations engaged in a trade or business within the United States and (2) have gross receipts of $500 million or more without taking into account the gross receipts of members of its aggregate group. As many as 100,000-110,000 additional taxpayers may be applicable taxpayers as a result of being members of an aggregate group.[5]

The Treasury Department and the IRS recognize that in response to these final regulations, these businesses may alter the way they transact with related versus unrelated parties. They may make changes to financial arrangements, supply chain arrangements, or the locations of business activity, each in ways that increase or reduce the volume of payments made to a foreign affiliate that qualify as base ero-

[5] These estimates are based on current tax filings for taxable year 2017 and do not yet include the BEAT. At this time, the Treasury Department and the IRS do not have readily available data to determine whether a taxpayer that is a member of an aggregate group will meet all tests to be an applicable taxpayer for purposes of the BEAT.

sion payments, relative to the decisions they would make under alternative regulatory approaches, including the no-action baseline. These differences in business activities may have economic effects beyond their effects on taxpayers' tax liability.

The Treasury Department and the IRS have not attempted to quantify the economic effects of any changes in business activity stemming from these final regulations. The Treasury Department and the IRS do not have readily available data or models that predict with reasonable precision the decisions that businesses would make under the final regulations versus alternative regulatory approaches. Nor do they have readily available data or models that would measure with reasonable precision the loss or gain in economic surplus resulting from these business decisions relative to the business decisions that would be made under an alternative regulatory approach. Such estimates would be necessary to quantify the economic effects of the final regulations versus alternative approaches.

Within these limitations, part I.D.3 of these Special Analyses (and the Summary of Comments and Explanation of Revisions) explains the rationale behind the final regulations and provides a qualitative assessment of the economic effects of the final regulations relative to the alternative regulatory approaches that were considered.

The Treasury Department and the IRS welcome comments on these conclusions and on the economic effects of the provisions described in the following sections.

3. Economic Effects of Provisions Substantially Revised from the Proposed Regulations

a. *Securities lending transactions*

Section 59A(h) includes an exception to base erosion payment status for certain payments by a corporation to a foreign related party pursuant to certain derivative contracts (qualified derivative payments, or QDPs). The statute further provides that the QDP exception does not apply to a payment pursuant to a derivative contract that would be treated as a base erosion payment if the payment was not made pursuant to a derivative contract. The final regulations specify how the QDP exception applies to securities lending transactions, a particular form of financial transaction. In this regard, the final regulations generally provide parity in the treatment of securities lending transactions and sale-repurchase transactions, a similar, alternative form of financial transaction. This part I.D.3.a discusses the treatment of securities lending transactions and sale-repurchase transactions under the final regulations. For a further description of securities lending transactions and sale-repurchase transactions, see Part VII.B of the Summary of Comments and Explanation of Revisions.

In general, a sale-repurchase transaction is an agreement under which a person transfers a security in exchange for cash and simultaneously agrees to receive substantially identical securities from the transferee in the future in exchange for cash. Certain sale-repurchase transactions are treated as secured debt for federal tax purposes; that is, the nominal seller of the securities in the sale-repurchase transaction is treated as transferring securities as collateral for a loan from the nominal buyer to the nominal seller. The fee paid by the nominal seller to the nominal buyer pursuant to this type of sale-repurchase contract is one example of a payment that does not qualify for the QDP exception.

In this type of sale-repurchase transaction, the nominal seller remains the beneficial owner of the securities for federal income tax purposes and is treated as a cash borrower from the nominal buyer. Because the nominal seller remains the beneficial owner of the securities for federal income tax purposes, when the nominal buyer receives any payments with respect to the securities and passes those payments through to the nominal seller (known as substitute payments), such as interest or dividends, the nominal seller is treated as receiving that payment directly from the issuer of the security for federal income tax purposes. Thus, the substitute payment is not considered a payment between the nominal seller and the nominal buyer for federal tax purposes. Consequently, even if the nominal buyer is a U.S. person and the nominal seller is a foreign related party, the substitute payments on the sale-repurchase agreement that is treated as a loan for federal tax purposes generally are not base erosion payments for the BEAT.

Certain securities lending transactions are economically similar to sale-repurchase transactions but are treated differently for federal income tax purposes. In some securities lending transactions, a securities lender also transfers securities to a securities borrower in exchange for an obligation that the securities borrower make certain payments to the securities lender and also return identical (though not necessarily the same) securities to the securities lender. In connection with the transfer of securities in this type of transaction, the securities borrower may also provide cash or other form of collateral to the securities lender, often with the same or greater value as the lent security. Economically, the securities lender in these transactions can be viewed as both a lender of securities to the counterparty, and a borrower of cash from the counterparty. In these respects, the securities lending transaction is economically similar to a sale-repurchase transaction.

However, in these securities lending transactions, the securities lender is no longer treated as the beneficial owner of the securities for federal income tax purposes. As a result, when the securities borrower makes substitute payments (with respect to the securities) in the securities lending transaction, those substitute payments may be base erosion payments (without regard for the QDP exception) if the securities lender is a foreign related party because the substitute payments are treated as payments from the securities borrower to the securities lender for federal income tax purposes.

The proposed regulations state that sale-repurchase transactions are not eligible for the QDP exception. The proposed regulations further provide that securities lending transactions are not eligible for the QDP exception because the securities lending transactions are economically similar to sale-repurchase transactions. However, as discussed in this part I.D.3.a, substitute payments on a sale-repurchase transaction are not a base erosion payment because the nominal seller of the securities is treated as remaining the beneficial owner of the securities for federal income tax purposes. Comments observed that the proposed regulations thus failed to take

into account the disparate tax treatment of substitute payments for sale-repurchase transactions and securities lending transactions for purposes of the BEAT.

To take into account the disparate treatment of the substitute payments in securities lending transactions, the final regulations remove the per se exclusion of securities lending transactions from the QDP exception. Instead, the final regulations more narrowly exclude the borrowing of cash pursuant to a securities lending transaction ("cash leg") from the QDP exception. This change provides symmetry with the treatment of a sale-repurchase transaction that is treated as a secured loan for federal income tax purposes. Under the final regulations, both a sale-repurchase transaction and the cash leg of a securities lending transaction are excluded from the QDP exception to the extent that they are treated as financings, and thus may be base erosion payments.

The final regulations no longer exclude payments attributable to the borrowing of securities pursuant to a securities lending transaction from qualifying for the QDP exception; as a result, substitute payments on the security may qualify for the QDP exception. This change in the final regulations provides general symmetry in the treatment of substitute payments made pursuant to sale-repurchase transactions and securities lending transactions for purposes of the BEAT.

The final regulations also provide an anti-abuse rule to address a potentially abusive transaction characterized by an uncollateralized borrowing of securities that can be liquidated for cash in a multiple-step transaction that is economically similar to an uncollateralized cash loan.

Specifically, the Treasury Department and the IRS adopted an anti-abuse rule that takes into account two factors: (a) whether the securities lending transaction or substantially similar transaction provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing and (b) whether the transaction is part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to the transaction as a base erosion payment.

The Treasury Department and the IRS considered an alternative anti-abuse rule that would have applied solely on the basis of the securities loan being undercollateralized. The Treasury Department and the IRS did not adopt this alternative in the final regulations because the Treasury Department and the IRS are cognizant that an objective mechanical rule based solely on the level of collateralization may be difficult for both taxpayers and the IRS to apply, in particular due to the high volume of transactions issued under varying conditions. Accordingly, the final regulations further provide that for the anti-abuse rule to apply, the transactions must also be part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to the transaction as a base erosion payment. See §§1.59A-6(d)(2)(iii)(C); 1.59A-6(e)(2)(Example 2).

The Treasury Department and the IRS recognize that in response to these final regulations, businesses may increase the volume of certain securities lending transactions relative to the volume that would occur under alternative anti-abuse rules. The Treasury Department and the IRS project, however, that taxpayer response to these rules, and the relative economic effects of adoption of the final rule, will be minor given the wide range of financial transactions that applicable taxpayers currently engage in, the various roles that securities lending transactions play, and the relatively small difference in regulatory treatment between the final regulations and alternative anti-abuse rules.

The Treasury Department and the IRS have not attempted to provide a quantitative prediction of the change in the volume of securities lending transactions nor to quantify the economic effects of this potential shift that may result from the final regulations, relative to alternative regulatory approaches. The Treasury Department and the IRS do not have readily available data or models that predict with reasonable precision the types of intercompany arrangements that businesses would adopt under the final regulations versus alternative regulatory approaches. Nor do they have readily available data or models that would measure with reasonable precision the difference in returns or risk that would occur as a result of this shift in the volume of securities lending transactions relative to the alternative regulatory approach. Such estimates would be necessary to quantify the economic effects of these final regulations over the treatment of securities lending transactions versus alternative regulatory approaches.

Profile of affected taxpayers. The taxpayers affected by these provisions of the final regulations are domestic banks and broker-dealers that engage in securities lending transactions with a foreign related party where the domestic bank or broker-dealer is the securities borrower that makes substitute payments to the foreign related party. The taxpayers affected are also foreign banks and broker-dealers that engage in these securities lending transactions with a foreign related party as part of their conduct of a U.S. trade or business.

To provide an estimate of taxpayers affected by the change to the QDP rule, the Treasury Department and the IRS used current tax filings for taxable year 2017 and examined the set of filers who marked-to-market securities and were (1) U.S. shareholders of a foreign corporation as indicated by the filing of Form 5471 or (2) otherwise potentially applicable taxpayers as indicated by the filing of Form 5472. This marked-to-market proxy is reasonable because the QDP exception applies only if a taxpayer recognizes gain or loss as if the derivative were sold for fair market value on the last day of the taxable year and treats that gain or loss as ordinary. Based on these tax data, the number of taxpayers estimated to be affected by these provisions of the final regulations is 900, based on counts of the forms shown in the accompanying table.

Taxpayers affected by §1.59A (estimate based on current tax filings for taxable year 2017)	
	Estimated Impacted Filer Counts
Form 1120 with mark-to-market on Form M3 and Form 5471 and/or 5472	750
Form 1120F who completed line u of the Additional Information and Form 5471 and/or 5472	150

b. *Section 988 losses in the denominator of the base erosion percentage*

Under section 59A, a taxpayer is subject to the BEAT only if the taxpayer meets the statutory tests to be an applicable taxpayer, including the base erosion percentage test. 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, that aggregate group) has a base erosion percentage of three percent or more. A lower threshold of two percent generally applies if the taxpayer, or a member of the taxpayer's aggregate group, is a member of an affiliated group that includes a domestic bank or registered securities dealer. The final regulations specify how losses from certain currency exchange transactions should be included in the base erosion percentage test.

Proposed §1.59A-3(b)(3)(iv) provides that exchange losses from section 988 transactions described in §1.988-1(a)(1) are excluded from the definition of base erosion payments. Section 988 transactions are generally transactions in which the amount that the taxpayer is entitled to receive (or required to pay) is denominated in terms of a nonfunctional currency or is determined by reference to one or more nonfunctional currencies. In the proposed regulations, the Treasury Department and the IRS determined that this section 988 exception from the definition of a base erosion payment is appropriate because those losses do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party. Because exchange losses from section 988 transactions are excluded from the definition of base erosion payments in the proposed regulations, those losses are not included in the numerator of the base erosion percentage under the proposed regulations. The final regulations retain the exclusion of section 988 losses from the definition of base erosion payments and from the numerator of the base erosion percentage.

Proposed §1.59A-2(e)(3)(ii)(D) also provides that exchange losses from section 988 transactions (including with respect to transactions with persons other than foreign related parties) are not included in the denominator when calculating the base erosion percentage for purposes of the base erosion percentage test. In response to comments, the final regulations restore the section 988 losses to the denominator when calculating the base erosion percentage, except to the extent of the amount of section 988 losses from transactions with foreign related parties that is also excluded from the numerator of the base erosion percentage.

As an alternative, the Treasury Department and the IRS considered removing all section 988 losses from the denominator of the base erosion percentage test. However, the Treasury Department and the IRS determined that it was appropriate to exclude from the denominator only the amounts that are excluded from the numerator because that is how other statutory exceptions from the BEAT are addressed in the base erosion percentage calculations. Specifically, for the QDP exception (discussed in Part I.D.3.a of this Special Analysis) and the services cost method exception (discussed in Part IV.C.1 of the Summary of Comments and Explanation of Revisions) the amounts in the denominator of the base erosion percentage are also accounted for in this manner. That is, the denominator does include the amount of QDP deductions or services cost method deductions that are also excluded from the numerator of the base erosion percentage because of those exceptions.

The Treasury Department and the IRS project that under these final regulations, fewer taxpayers would be expected to satisfy the base erosion percentage test and therefore fewer would be liable for the BEAT, relative to the alternative regulatory approach as specified in the proposed regulations. These final regulations include in the denominator of the base erosion percentage section 988 losses arising from foreign currency transactions with unrelated parties. Inclusion of such losses in the denominator, all else equal, reduces the base erosion percentage, and may increase the likelihood that businesses engage in incremental section 988 transactions with unrelated parties to reduce the base erosion percentage, relative to the proposed regulations. However, regulations under §1.59A-9(b)(2) (anti-abuse rule addressing transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation) are expected to limit this behavior.

The Treasury Department and the IRS have not attempted to provide a quantitative prediction of the change in the volume of section 988 transactions nor to quantify the economic effects of this change resulting from the final regulations, relative to the alternative regulatory approach. The Treasury Department and the IRS do not have readily available data or models that predict with reasonable precision the volume of section 988 transactions that businesses might engage in under the final regulations versus the alternative regulatory approach because of the complex role that currency exchange plays for these businesses. The Treasury Department and the IRS further do not have readily available data or models that would measure with reasonable precision the difference in economic returns or volatility that these businesses would experience as a result of this shift in section 988 transactions relative to the alternative regulatory approach, again because of the complex role that currency exchange plays for these businesses. Such estimates would be necessary to quantify the economic effects of these final regulations over the treatment of section 988 transactions versus the alternative regulatory approach.

Profile of affected taxpayers. The taxpayers affected by these provisions of the final regulations generally are those taxpayers that engage in foreign currency transactions with unrelated parties and have section 988 losses that will be included in the denominator of the base erosion percentage under the final regulations.

The Treasury Department and the IRS have not estimated the number of these taxpayers because the Form 1120 series does not separately break out gains or losses from section 988 transactions. The sole form that breaks out section 988 gain and loss is Form 5471, which is filed by U.S. shareholders of a CFC. Information from Form 5471 is unlikely to be informative because a CFC is unlikely to be an applicable taxpayer.

4. Economic Effects of Provisions Not Substantially Revised from the Proposed Regulations

a. *Applicable Taxpayer for Aggregate Groups*

A taxpayer is liable for the BEAT only if the taxpayer is an applicable taxpayer. In general, an applicable taxpayer is a corporation, other than a RIC, REIT, or an S corporation, that satisfies the gross receipts test and the base erosion percentage test. For purposes of these tests, members of a group of corporations related by certain specified percentages of stock ownership are aggregated. Section 59A(e)(3) refers to aggregation on the basis of persons treated as a single taxpayer under section 52(a) (controlled group of corporations), which includes both domestic and foreign persons. In the proposed regulations, the Treasury Department and the IRS determined that to implement the provisions of section 59A, it was necessary to treat foreign corporations as outside of the controlled group for purposes of applying the aggregation rules, except to the extent that the foreign corporation is subject to net income tax under section 882(a) (tax on income of foreign corporations connected with U.S. business). The final regulations also adopt this position.

Upon aggregation of domestic and foreign controlled groups of corporations, intra-aggregate group transactions are eliminated for purposes of the gross receipts test and base erosion percentage test. If aggregation were defined to include both domestic and all related foreign persons (i.e., a "single employer" under section 52(a)), regardless of whether the foreign person was subject to tax in the United States, this would eliminate most base erosion payments, which are defined by section 59A(d)(1) as "any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowed under this chapter." Without these base erosion payments, virtually no taxpayer or aggregate group would satisfy the base erosion percentage test; thus substantially all taxpayers (or the aggregate group of which the taxpayer was a member) would be excluded from the requirement to pay a tax equal to the base erosion minimum tax amount (BEMTA).

In the proposed regulations, the Treasury Department and the IRS considered an alternative of not providing guidance on the aggregation rule in the statute. Absent the proposed regulations, there would be uncertainty among taxpayers as to whether the tax equal to the BEMTA would apply to them. Without guidance, different taxpayers would likely take different positions regarding the determination of their status as an applicable taxpayer, which would result in inefficient decision-making and inconsistent application of the statute as taxpayers engage in corporate restructurings, or adjust investment and spending policies based on tax planning strategies to manage BEAT liability. No substantive comments objected to the general approach set forth in the proposed regulations.

b. *Service Cost Method exception*

Section 59A(d)(5) provides an exception from the definition of a base erosion payment for an amount paid or accrued by a taxpayer for services if the services are eligible for the services cost method under section 482 (without regard to certain requirements under the section 482 regulations) and the amount constitutes the total services cost with no markup component. The statute is ambiguous as to whether the SCM exception (1) does not apply to a payment or accrual that includes a markup component, or (2) does apply to such a payment or accrual that includes a markup component, but only to the extent of the total services costs. The proposed regulations follow the latter approach. See REG-104259-18, 83 F.R. 65961 (December 21, 2018). The final regulations retain the same approach. See part IV.C.1 of the Summary of Comments and Explanation of Revisions.

Alternatives would have been to disallow the SCM exception for the entire amount of any payment that includes a markup component, or to not provide any guidance at all regarding the SCM exception. The Treasury Department and the IRS rejected the former approach. The section 482 regulations mandate intercompany pricing under an "arm's length standard." Under specific circumstances, the section 482 regulations provide that intercompany payments for services can be set by a taxpayer at the cost of providing the service with no profit markup. However, the section 482 regulations prohibit use of this cost-only SCM approach for services "that contribute significantly to fundamental risks of business success or failure" (the "business judgment rule"). See §1.482-9(b)(5). At arm's length, such services generally would be priced to include a profit element to satisfy the market's demand for, and supply of, services among recipients and providers. Section 59A(d)(5)(A) explicitly allows an exception from the BEAT for services that would be eligible for the SCM, "determined without regard to [the business judgment rule]." By allowing an exception from the BEAT for intercompany service payments that do not include a profit markup (i.e., under the SCM transfer pricing method), but also for intercompany service payments that must apply a different transfer pricing method, and therefore generally would include a profit markup at arm's length (i.e., those subject to the business judgment rule), the statute creates ambiguity about the SCM exception's application with respect to the portion of intercompany prices paid for services reflecting the cost of providing the services, when there is also a mark-up component. Thus, the proposed regulations provide that the SCM exception is available if there is a profit markup (provided that other requirements are satisfied), but the portion of any payment exceeding cost is not eligible for the SCM exception.

The Treasury Department and the IRS also rejected the option of not providing any guidance at all regarding the SCM exception because if taxpayers relied on statutory language alone, taxpayers would adopt different approaches due to ambiguity in the statute, leaving it open to differing statutory interpretations and an inconsistent application of the statute. Comments supported the SCM exception and recommended that final regulations adopt the approach from the proposed regulations.

c. *Effectively Connected Income*

The final regulations provide an exception from the definition of base erosion

payment for payments to the U.S. branch of a foreign related person to the extent that the payments are treated as effectively connected income.

Under section 59A, whether a deductible payment is a base erosion payment is determined based on whether the recipient is a foreign person (as defined in section 6038A(c)(3)) and a related party. See section 59A(f). A foreign person means any person who is not a United States person. However, the Treasury Department and the IRS determined in the proposed regulations that establishing whether a payment is a base erosion payment based solely on the status of the recipient as a foreign person is inconsistent with the statute's intent of eliminating base erosion. As a result, deductible payments to a foreign person that are treated as effectively connected income are subject to tax under section 871(b) and 882(a) in substantially the same manner as payments to a U.S. citizen or resident, or a domestic corporation, and, thus, such payments do not result in base erosion. Thus, such payments are treated as income to the recipient and subject to U.S. tax, substantially similar to any payment between related U.S. corporations. Further, treatment of effectively connected income payments to a foreign related party would produce different tax results for two similarly situated U.S. taxpayers. That is, if the taxpayer were to make a payment to a related U.S. corporation, the payment generally would not be subject to the BEAT, but if a taxpayer were to make a payment to a foreign person with respect to its effectively connected income, it would give rise to BEAT liability, despite the fact that in both cases the recipients include the payment in U.S. taxable income. The final regulations retain the same approach as the proposed regulations. See §1.59A-3(b)(3)(iii). This approach provides consistency with the approach in the regulations to determining the applicable taxpayer for aggregate groups, which is discussed in part I.D.4.a of this Special Analysis, because this provision excludes from the definition of a base erosion payment those payments to members of the aggregate group that are also excluded from the base erosion percentage because the payments are also within the aggregate group.

The Treasury Department and the IRS considered an alternative of not providing this exception to the definition of a base erosion payment, but determined that it would be inconsistent to exclude a payment to the U.S. branch of a foreign related person from the base erosion percentage (a condition to the application of the BEAT) but not also exclude the same payment from the amount of base erosion payments (a factor in determining the amount of BEAT tax liability).

d. *Modified Taxable Income*

Modified taxable income is a taxpayer's taxable income for the year calculated without regard to any base erosion tax benefit or the base erosion percentage of any allowable net operating loss deductions under section 172 (net operating loss deduction). As discussed in Part V.A. of the Summary of Comments and Explanation of Revisions, the proposed regulations provide that modified taxable income is computed under the add-back method of adding back to taxable income the base erosion tax benefits and base erosion percentage of any net operating loss deductions. The regulations do not provide for computing modified taxable income by recomputing the tax base without base erosion tax benefits under an approach similar to the alternative minimum tax, which the Act repealed for corporations. Applying the recomputation method would require taxpayers to maintain records for separate carryforward balances for attributes, such as net operating loss deductions and business interest expense carryovers. These items are limited based on taxable income, so under the recomputation or alternative minimum tax-approach, there would most likely be different annual limitations and other computational differences for regular tax purposes and section 59A purposes. The final regulations retain the same approach as the proposed regulations. This add-back approach is expected to be less costly for taxpayers to apply than the recomputation approach because under the add-back approach, where amounts are only added to taxable income, taxpayers will not have to recompute their entire tax return on a different basis or maintain separate sets of records to track annual limitations on attributes such as net operating loss carryforwards or business interest expense carryforwards (and the IRS will not have to administer such a system). See Part V.A. of the Summary of Comments and Explanation of Revisions for a detailed discussion of the comments that were not adopted.

e. *Payments to or from partnerships*

As discussed in Part VIII of the Summary of Comments and Explanation of Revisions section, these final regulations apply the "aggregate" approach to base erosion payments involving partnerships, which is to say that the regulations generally treat the partnership as an aggregation of its partners, with the partners viewed as entering into transactions. This aggregate approach is in contrast to the alternative "entity" approach that treats the partnership as an entity that engages in transactions. Because partnerships are passthrough entities that are not themselves subject to U.S. income tax and because the income of the partnership is taxable to the partners in the partnership, these final regulations apply the aggregate approach and provide that payments by a corporation to a partnership, and payments by a partnership to a corporation, are treated in the first instance as payments to the partners in the partnership and in second instance as payments by the partners in the partnership. Under the alternative entity approach that assesses the partnership as a separate entity, a payment by an applicable taxpayer (corporation) to a related foreign partnership could be a base erosion payment even if all of the partners in the partnership are domestic persons.

Under the aggregate approach adopted in these final regulations, the applicable taxpayer (corporation) that makes a payment to a related foreign partnership with a partner or partners that are related foreign parties will determine whether it has made a base erosion payment by treating the amount as having been paid to each partner of the partnership. Conversely, also in the absence of this aggregate approach, a payment by an applicable taxpayer (corporation) to a related domestic partnership would not be a base erosion payment even if some or all of the partners in the partnership are foreign related parties. As with a payment to a related for-

eign partnership, under the aggregate approach adopted in these final regulations, the applicable taxpayer (corporation) that makes a payment to a related domestic partnership with a partner or partners that are related foreign parties will determine whether it has made a base erosion payment by treating the amount as having being paid to each partner of the partnership. This approach is thus neutral in both preventing potential abuse and preventing potential over-breadth.

The final regulations retain the same general approach that was provided in the proposed regulations. See Part VIII of the Summary of Comments and Explanation of Revisions. The Treasury Department and the IRS considered an alternative of not providing guidance on transactions involving partnerships; however, as discussed in this part I.D.4.e, these final regulations eliminate the distortion that would otherwise be present if determination of whether a payment is a base erosion payment is made by reference to the partnership, rather than by reference to the partners. For example, in the absence of these final regulations, taxpayers might be incentivized to route payments through a domestic partnership that is formed by foreign persons as an intermediary to avoid the BEAT. Conversely, in the absence of the final regulations, taxpayers would be incentivized to restructure to avoid making any payments to a foreign partnership that has partners that are solely domestic because such payment could be inappropriately classified as a base erosion payment.

f. *Anti-abuse and Reporting Requirements*

Section 59A(i) provides the Secretary authority to issue regulations and other guidance including for the purposes of preventing the avoidance of the purposes of section 59A. Pursuant to this specific grant of regulatory authority, §1.59A-9 provides rules recharacterizing certain specified transactions as necessary to prevent the avoidance of section 59A, and provides examples. The Treasury Department and the IRS have determined that any compliance burdens or other economic costs created by the anti-abuse provisions are necessary to further the purposes of section 59A.

These final regulations also provide reporting requirements necessary to properly administer and enforce section 59A. In particular, the Treasury Department and the IRS have identified certain types of information from taxpayers who are applicable taxpayers for purposes of section 59A that will be required to be reported on Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code), and a new Form 8991, Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts. The regulations increase record keeping requirements for taxpayers relative to the baseline because additional information is to be reported on Form 5472 and Form 8991. The requirements added by the proposed regulations, however, derive directly from statutory changes that require information from applicable taxpayers and are necessary for the effective administration of section 59A.

II. *Paperwork Reduction Act*

1. *Collections of Information – Forms 8991, 5471, 5472, and 8858*

The collections of information in the final regulations with respect to section 59A are in §§1.59A-3(b)(3)(i)(C),1.59A-3(b)(4)(i)(D), and 1.6038A-2. In response to comments addressing the notice of proposed rulemaking preceding the final regulations, the Treasury Department and the IRS have revised the collection of information with respect to section 6038A. The revised collection of information with respect to sections 59A and 6038A is in §1.6038A-2(b)(7)(ix).

The collection of information in §1.59A-6(b)(2)(i) and §1.6038A-2(b)(7)(ix) requires an applicable taxpayer that makes qualified derivative payments to report information regarding its qualified derivative payments on Form 8991 in order for the QDP exception from base erosion payment status to apply to any particular payment. In response to comments, §1.59A-6(b)(2)(i) provides that a taxpayer satisfies the reporting requirement by reporting the aggregate amount of all QDPs (rather than the aggregate amount as determined by type of derivative contract as provided in proposed §1.6038A-2(b)(7)(ix)(A)) on Form 8991 or its successor form. To comply with these reporting requirements, taxpayers will need to develop systems to collect and report the relevant information. To separately determine the aggregate amount of QDPs by each specific type of derivative contract would add to the complexity of those systems. That additional complexity and compliance burden outweighs the utility to the IRS of receiving that information for each specific type of derivative contract. Section 1.59A-6(b)(2)(iv) also provides that during the transition period before §1.59A-6(b)(2)(i) is applicable, taxpayers will not be deemed to have failed to satisfy the reporting requirement if the taxpayer reports the aggregate amount of qualified derivative payments in good faith. For purposes of the PRA, the reporting burden associated with §1.59A-3(b)(4)(i)(D), §1.59A-6(b)(2)(i) and §1.6038A-2(b)(7)(ix) will be reflected in the PRA submission associated with the Form 8991 series (see chart at the end of this Part II of the Special Analysis section for the status of the PRA submission for this form).

Tax Form Impacted		
Collection of information	Number of respondents (estimated)	Forms to which the information may be attached
§1.59A-3(b)(4)(i)(D) election to use-applicable financial statements	105,600	Form 8991 series
§1.59A-6(b)(2)(i) and §1.6038A-2(b)(7)(ix) requirement to report qualified derivative payments	105,600	Form 8991 series

CDW

The information collection requirements pursuant to §1.59A-3(b)(3)(i)(C) are discussed further below. The collections of information pursuant to section 59A, except with respect to information collected under §1.59A-3(b)(3)(i)(C), will be conducted by way of the following:

- Form 8991, Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts;
- Schedule G to the Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations;
- Part VIII of the updated Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business;
- Revised Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities.

For purposes of the Paperwork Reduction Act, the reporting burden associated with the collections of information with respect to section 59A, other than with respect to §1.59A-3(b)(3)(i)(C), will be reflected in the IRS Forms 14029 Paperwork Reduction Act Submission, associated with Forms 5471 (OMB control numbers 1545-0123, and 1545-0074), 5472 (OMB control number 1545-0123), 8858 (OMB control numbers 1545-0123, 1545-0074, and 1545-1910), and 8991 (OMB control number 1545-0123).

The current status of the Paperwork Reduction Act submissions related to BEAT is provided in the following table. The BEAT provisions are included in aggregated burden estimates for the OMB control numbers listed below which, in the case of 1545-0123, represents a total estimated burden time, including all other related forms and schedules for corporations, of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017) and, in the case of 1545-0074, a total estimated burden time, including all other related forms and schedules for individuals, of 1.784 billion hours and total estimated monetized costs of $31.764 billion ($2017). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the BEAT requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions imposed prior to the Act. No burden estimates specific to the final regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the final regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the final regulations. The Treasury Department and the IRS request comment on all aspects of information collection burdens related to the final regulations. In addition, when available, drafts of IRS forms are posted for comment at https://apps.irs.gov/app/picklist/list/draftTaxForms.htm.

Form	Type of Filer	OMB Number(s)	Status
Form 5471 (including Schedule G)	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18.
	Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd		
	Individual (NEW Model)	1545-0074	Limited Scope submission (1040 only) on 10/11/18 at OIRA for review. Full ICR submission for all forms in 3/2019. 60 Day Federal Register notice not published yet for full collection.
	Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201808-1545-031		
Form 5472 (including Part VIII)	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/11/18. Public Comment period closed on 12/10/18.
	Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd		
Form 8858	All other Filers (mainly trusts and estates) (Legacy system)	1545-1910	Published in the Federal Register on 10/30/18. Public Comment period closed on11/30/18. ICR in process by the Treasury Department as of 9/6/18.
	Link: https://www.federalregister.gov/documents/2018/10/30/2018-23644/agency-information-collection-activities-submission-for-omb-review-comment-request-multiple-irs		
	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/8/18. Public Comment period closed on 12/10/18.
	Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd		

Form	Type of Filer	OMB Number(s)	Status
	Individual (NEW Model)	1545-0074	Limited Scope submission (1040 only) on 10/11/18 at OIRA for review. Full ICR submission for all forms in 3-2019. 60 Day Federal Register notice not published yet for full collection.
	Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201808-1545-031		
Form 8991	Business (NEW Model)	1545-0123	Published in the Federal Register on 10/11/18. Public Comment period closed on 12/10/18.
	Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd		

Related New or Revised Tax Forms

	New	Revision of existing form	Number of respondents (2018, estimated)
Form 8991	Y		3,500 – 4,500
Form 5471, Schedule G		Y	15,000 – 25,000
Form 5472, Part VIII	Y		80,000 – 100,000
Form 8858		Y	15,000 – 25,000

The numbers of respondents in the Related New or Revised Tax Forms table were estimated by Treasury's Office of Tax Analysis based on data from IRS Compliance Planning and Analytics using tax return data for tax years 2015 and 2016. Data for Form 8991 represent preliminary estimates of the total number of taxpayers which may be required to file the new Form 8991. Only certain large corporate taxpayers with gross receipts of at least $500 million are expected to file this form. Data for each of the Forms 5471, 5472, and 8858 represent preliminary estimates of the total number of taxpayers that are expected to file these information returns regardless of whether that taxpayer must also file Form 8991.

The Treasury Department and the IRS project that 3,500 – 4,500 taxpayers may be applicable taxpayers under the BEAT. This estimate is based on the number of filers that (1) filed the Form 1120 series of tax returns (except for the Form 1120-S), (2) filed a Form 5471 or Form 5472, and (3) reported gross receipts of at least $500 million. Because an applicable taxpayer is defined under section 59A(e)(1)(A) as a corporation other than a regulated investment company, a real estate investment trust, or an S corporation, the Treasury Department and the IRS have determined that taxpayers who filed the Form 1120 series of tax returns will be most likely to be affected by these proposed regulations. Additionally, the Treasury Department and the IRS estimated the number of filers likely to make payments to a foreign related party based on filers of the Form 1120 series of tax returns who also filed a Form 5471 or Form 5472 to determine the number of respondents. Finally, because an applicable taxpayer is defined under section 59A(e)(1)(B) as a taxpayer with average annual gross receipts of at least $500 million for the 3-taxable-year period ending with the preceding taxable year, the Treasury Department and the IRS estimated the scope of respondents based on the amount of gross receipts reported by taxpayers filing the Form 1120 series of tax returns.

These projections are based solely on data with respect to the taxpayer, without taking into account any members of the taxpayer's aggregate group. As many as 105,600 additional taxpayers may be applicable taxpayers as a result of being members of an aggregate group.[6] This estimate is based on the number of taxpayers who filed a Form 1120 and also filed a Form 5471 or a Form 5472, but without regard to the gross receipts test.

2. Collection of Information – §1.59A-3(b)(3)(i)(C)

The information collection requirements pursuant to §1.59A-3(b)(3)(i)(C) will be satisfied by the taxpayer maintaining permanent books and records that are adequate to verify the amount charged for the services and the total services costs incurred by the renderer, including a description of the services in question, identification of the renderer and the recipient of the services, calculation of the amount of profit mark-up (if any) paid for the services, and sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services.

The collection of information in §1.59A-3(b)(3)(i)(C) is mandatory for taxpayers seeking to exclude certain amounts paid or accrued to a foreign related party for services from treatment as base erosion payments for purposes of section 59A (the "SCM exception to the BEAT"). Taxpayers seeking to rely on the SCM exception to the BEAT are aggregate groups of corporations with average annual gross receipts of at least $500 million and that make payments to foreign related parties. The information required to be

[6] These estimates are based on current tax filings for taxable year 2017 and do not yet include the BEAT. At this time, the Treasury Department and the IRS do not have readily available data to determine whether a taxpayer that is a member of an aggregate group will meet all tests to be an applicable taxpayer for purposes of the BEAT.

maintained will be used by the IRS for tax compliance purposes.

Estimated total annual reporting burden: 5,000 hours.

Estimated average annual burden hours per respondent: 2.5 hours.

Estimated average cost per respondent ($2017): $238.00.

Estimated number of respondents: 2,000. This estimate is based on the assumption that only a portion of taxpayers will qualify for the SCM exception to the BEAT, multiplied by the number of respondents shown above.

Estimated annual frequency of responses: Once.

Based on these estimates, the annual three-year reporting burden for those electing the SCM exemption is $0.16 mn/yr ($2017) ($238 x 2000/3, converted to millions).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

III. *Regulatory Flexibility Act*

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). This certification is based on the fact that these regulations will primarily affect aggregate groups of corporations with average annual gross receipts of at least $500 million and that make payments to foreign related parties. Generally only large businesses both have substantial gross receipts and make payments to foreign related parties.

Pursuant to section 7805(f), the proposed regulations preceding these final regulations (REG-104259-18) were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

IV. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately $154 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

VI. *Congressional Review Act*

The Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget has determined that this is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et. seq.) ("CRA"). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the Federal Register. Notwithstanding this requirement, section 808(2) of the CRA allows agencies to dispense with the requirements of 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule determines.

Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest. The Treasury Department and the IRS have determined that the rules in this Treasury decision (other than the reporting requirements for QDPs in §1.6038A-2(b)(7), §1.1502-2(a)(9), and §1.1502-59A) shall take effect for taxable years ending on or after December 17, 2018. Section 14401(e) of the Act provides that section 59A applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017. This means that the statute is currently effective, and taxpayers may be required to make payments under section 59A on a U.S. federal income tax return for 2018 tax years. These final regulations provide crucial guidance for taxpayers on how to apply the rules of section 59A, correctly calculate their liability under section 59A, and accurately file their U.S. federal income tax returns. Because the statute already requires taxpayers to comply with section 59A, a 60-day delay in the effective date is unnecessary and contrary to the public interest.

Drafting Information

The principal authors of these final regulations are Azeka J. Abramoff, Sheila Ramaswamy, and Karen Walny of the Office of Associate Chief Counsel (International) and Julie Wang and John P. Stemwedel of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for §1.6038A-2 and adding entries for §§1.59A-0, 1.59A-1, 1.59A-2, 1.59A-3, 1.59A-4, 1.59A-5, 1.59A-6, 1.59A-7,

1.59A-8, 1.59A-9, 1.59A-10, 1.1502-59A, and 1.1502-100 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

§1.59A-0 also issued under 26 U.S.C. 59A(i).

§1.59A-1 also issued under 26 U.S.C. 59A(i).

§1.59A-2 also issued under 26 U.S.C. 59A(i).

§1.59A-3 also issued under 26 U.S.C. 59A(i).

§1.59A-4 also issued under 26 U.S.C. 59A(i).

§1.59A-5 also issued under 26 U.S.C. 59A(i).

§1.59A-6 also issued under 26 U.S.C. 59A(i).

§1.59A-7 also issued under 26 U.S.C. 59A(i).

§1.59A-8 also issued under 26 U.S.C. 59A(i).

§1.59A-9 also issued under 26 U.S.C. 59A(i).

§1.59A-10 also issued under 26 U.S.C. 59A(i).

* * * * *

§1.1502-59A also issued under 26 U.S.C. 1502.

* * * * *

§1.1502-100 also issued under 26 U.S.C. 1502.

* * * * *

§1.6038A-2 also issued under 26 U.S.C. 6001, 6038A, and 6038C.

* * * * *

Par. 2. Sections 1.59A-0 through 1.59A-10 are added to read as follows:

* * * * *

Sec.

1.59A-0 Table of contents.

1.59A-1 Base erosion and anti-abuse tax.

1.59A-2 Applicable taxpayer.

1.59A-3 Base erosion payments and base erosion tax benefits.

1.59A-4 Modified taxable income.

1.59A-5 Base erosion minimum tax amount.

1.59A-6 Qualified derivative payment.

1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

1.59A-8 [Reserved].

1.59A-9 Anti-abuse and recharacterization rules.

1.59A-10 Applicability date.

* * * * *

§1.59A-0 Table of contents.

This section contains a listing of the headings for §§1.59A-1, 1.59A-2, 1.59A-3, 1.59A-4, 1.59A-5, 1.59A-6, 1.59A-7, 1.59A-8, 1.59A-9, 1.59A-10.

§1.59A-1 Base erosion and anti-abuse tax.

(a) Purpose.

(b) Definitions.

(1) Aggregate group.

(2) *Applicable section 38 credits.*

(3) Applicable taxpayer.

(4) Bank.

(5) Base erosion and anti-abuse tax rate.

(6) Business interest expense.

(7) Deduction.

(8) Disallowed business interest expense carryforward.

(9) Domestic related business interest expense.

(10) Foreign person.

(11) Foreign related business interest expense.

(12) Foreign related party.

(13) Gross receipts.

(14) Member of an aggregate group.

(15) Registered securities dealer.

(16) Regular tax liability.

(17) Related party.

(i) In general.

(ii) 25-percent owner.

(iii) Application of section 318.

(18) TLAC long-term debt required amount.

(19) TLAC securities amount.

(20) TLAC security.

(21) Unrelated business interest expense.

§1.59A-2 Applicable taxpayer.

(a) Scope.

(b) Applicable taxpayer.

(c) Aggregation rules.

(1) In general.

(2) Aggregate group determined with respect to each taxpayer.

(i) In general.

(ii) Reserved.

(3) Taxable year of members of an aggregate group.

(4) Reserved.

(5) Reserved.

(6) Reserved.

(7) Partnerships.

(8) Transition rule for aggregate group members with different taxable years.

(d) Gross receipts test.

(1) Amount of gross receipts.

(2) Taxpayer not in existence for entire three-year period.

(3) Gross receipts of foreign corporations.

(4) Gross receipts of an insurance company.

(5) Reductions in gross receipts.

(6) Gross receipts of consolidated groups.

(e) Base erosion percentage test.

(1) In general.

(2) Base erosion percentage test for banks and registered securities dealers.

(i) In general.

(ii) Aggregate groups.

(iii) De minimis exception for banking and registered securities dealer activities.

(3) Computation of base erosion percentage.

(i) In general.

(ii) Certain items not taken into account in denominator.

(iii) Effect of treaties on base erosion percentage determination.

(iv) Amounts paid or accrued between members of a consolidated group.

(v) Deductions and base erosion tax benefits from partnerships.

(vi) Mark-to-market positions.

(vii) Reinsurance losses incurred and claims payments.

(viii) Certain payments that qualify for the effectively connected income exception and another base erosion payment exception.

(f) Examples.

(1) Mark-to-market.

(i) Facts.

(ii) Analysis.

(2) [Reserved].

§1.59A-3 Base erosion payments and base erosion tax benefits.

(a) Scope.

(b) Base erosion payments.

(1) In general.

(2) Operating rules.

(i) In general.

(ii) Amounts paid or accrued in cash and other consideration.

(iii) Transactions providing for net payments.

(iv) Amounts paid or accrued with respect to mark-to-market position.

(v) Coordination among categories of base erosion payments.

(vi) Certain domestic passthrough entities.

(A) In general.

(B) Amount of base erosion payment.

(C) Specified domestic passthrough.

(D) Specified foreign related party.

(vii) Transfers of property to related taxpayers.

(viii) Reductions to determine gross income.

(ix) Losses recognized on the sale or transfer of property.

(3) Exceptions to base erosion payment.

(i) Certain services cost method amounts.

(A) In general.

(B) Eligibility for the services cost method exception.

(C) Adequate books and records.

(D) Total services cost.

(ii) Qualified derivative payments.

(iii) Effectively connected income.

(A) In general.

(B) Application to certain treaty residents.

(iv) Exchange loss on a section 988 transaction.

(v) Amounts paid or accrued with respect to TLAC securities and foreign TLAC securities.

(A) In general.

(B) Limitation on exclusion for TLAC securities.

(C) Scaling ratio.

(D) Average domestic TLAC securities amount.

(E) Average TLAC long-term debt required amount.

(F) Limitation on exclusion for foreign TLAC securities.

(*1*) In general.

(*2*) Foreign TLAC long-term debt required amount.

(3) No specified minimum provided by local law.

(4) Foreign TLAC security.

(vi) Amounts paid or accrued in taxable years beginning before January 1, 2018.

(vii) Business interest carried forward from taxable years beginning before January 1, 2018.

(viii) Specified nonrecognition transactions.

(A) In general.

(B) Other property transferred to a foreign related party in a specified nonrecognition transaction.

(C) Other property received from a foreign related party in certain specified nonrecognition transactions.

(D) Definition of other property

(E) Allocation of other property.

(ix) Reinsurance losses incurred and claims payments.

(A) In general.

(B) Regulated foreign insurance company.

(4) Rules for determining the amount of certain base erosion payments.

(i) Interest expense allocable to a foreign corporation's effectively connected income.

(A) Methods described in §1.882-5.

(B) U.S.-booked liabilities determination.

(C) U.S.-booked liabilities in excess of U.S.-connected liabilities.

(D) Election to use financial statements.

(E) Coordination with certain tax treaties.

(*1*) In general.

(*2*) Hypothetical §1.882-5 interest expense defined.

(*3*) Consistency requirement.

(F) Coordination with exception for foreign TLAC securities.

(ii) Other deductions allowed with respect to effectively connected income.

(iii) Depreciable property.

(iv) Coordination with ECI exception.

(v) Coordination with certain tax treaties.

(A) Allocable expenses.

(B) Internal dealings under certain income tax treaties.

(vi) Business interest expense arising in taxable years beginning after December 31, 2017.

(c) Base erosion tax benefit.

(1) In general.

(2) Exception to base erosion tax benefit.

(i) In general.

(ii) Branch-level interest tax.

(3) Effect of treaty on base erosion tax benefit.

(4) Application of section 163(j) to base erosion payments.

(i) Classification of payments or accruals of business interest expense based on the payee.

(A) Classification of payments or accruals of business interest expense of a corporation.

(B) Classification of payments or accruals of business interest expense by a partnership.

(C) Classification of payments or accruals of business interest expense paid or accrued to a foreign related party that is subject to an exception.

(*1*) ECI exception.

(*2*) TLAC interest and interest subject to withholding tax.

(ii) Ordering rules for business interest expense that is limited under section 163(j)(1) to determine which classifications of business interest expense are deducted and which classifications of business interest expense are carried forward.

(A) In general.

(B) Ordering rules for treating business interest expense deduction and disallowed business interest expense carryforwards as foreign related business interest expense, domestic related business interest expense, and unrelated business interest expense. (*1*) General ordering rule for allocating business interest expense deduction between classifications.

(*2*) Ordering of business interest expense incurred by a corporation.

(*3*) Ordering of business interest expense incurred by a partnership and allocated to a corporate partner.

(d) Examples.

(1) Example 1: Determining a base erosion payment.

(i) Facts.

(ii) Analysis.

(2) Example 2: Interest allocable under §1.882-5.

(i) Facts.

(ii) Analysis.

(3) Example 3: Interaction with section 163(j).

(i) Facts.

(ii) Analysis.

(A) Classification of business interest.

(B) Ordering rules for disallowed business interest expense carryforward.

(4) Example 4: Interaction with section 163(j); carryforward.

(i) Facts.
(ii) Analysis.
(A) Classification of business interest.
(B) Ordering rules for disallowed business interest expense carryforward.
(5) Example 5: Interaction with section 163(j); carryforward.
(i) Facts.
(ii) Analysis.
(6) Example 6: Interaction with section 163(j); partnership.
(i) Facts.
(ii) Partnership level analysis.
(iii) Partner level allocations analysis.
(iv) Partner level allocations for determining base erosion tax benefits.
(v) Computation of modified taxable income.
(7) Example 7: Transfers of property to related taxpayers.
(i) Facts.
(ii) Analysis.
(A) Year 1.
(B) Year 2.

§1.59A-4 Modified taxable income.

(a) Scope.
(b) Computation of modified taxable income.
(1) In general.
(2) Modifications to taxable income.
(i) Base erosion tax benefits.
(ii) Certain net operating loss deductions.
(3) Rule for holders of a residual interest in a REMIC.
(c) Examples.
(1) Example 1: Current year loss.
(i) Facts.
(ii) Analysis.
(2) Example 2: Net operating loss deduction.
(i) Facts.
(ii) Analysis.

§1.59A-5 Base erosion minimum tax amount.

(a) Scope.
(b) Base erosion minimum tax amount.
(1) In general.
(2) Calculation of base erosion minimum tax amount.
(3) Credits that do not reduce regular tax liability.
(i) Taxable years beginning on or before December 31, 2025.
(ii) Taxable years beginning after December 31, 2025.
(c) Base erosion and anti-abuse tax rate.
(1) In general.
(i) Calendar year 2018.
(ii) Calendar years 2019 through 2025.
(iii) Calendar years after 2025.
(2) Increased rate for banks and registered securities dealers.
(i) In general.
(ii) De minimis exception to increased rate for banks and registered securities dealers.
(3) Application of section 15 to tax rates in section 59A.
(i) New tax.
(ii) Change in tax rate pursuant to section 59A(b)(1)(A).
(iii) Change in rate pursuant to section 59A(b)(2).

§1.59A-6 Qualified derivative payment.

(a) Scope.
(b) Qualified derivative payment.
(1) In general.
(2) Reporting requirements.
(i) In general.
(ii) Failure to satisfy the reporting requirement.
(iii) Reporting of aggregate amount of qualified derivative payments.
(iv) Transition period for qualified derivative payment reporting.
(3) Amount of any qualified derivative payment.
(i) In general.
(ii) Net qualified derivative payment that includes a payment that is a base erosion payment.
(c) Exceptions for payments otherwise treated as base erosion payments.
(d) Derivative defined.
(1) In general.
(2) Exceptions.
(i) Direct interest.
(ii) Insurance contracts.
(iii) Securities lending and sale-repurchase transactions.
(A) Multi-step transactions treated as financing.
(B) Special rule for payments associated with the cash collateral provided in a securities lending transaction or substantially similar transaction.
(C) Anti-abuse exception for certain transactions that are the economic equivalent of substantially unsecured cash borrowing.
(3) American depository receipts.
(e) Examples.
(1) Example 1: Notional principal contract as QDP.
(i) Facts.
(ii) Analysis.
(2) Example 2: Securities lending anti-abuse rule.
(i) Facts.
(ii) Analysis.

§1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

(a) Scope.
(b) Application of section 59A to partnerships.
(c) Base erosion payment.
(1) Payments made by or to a partnership.
(2) Transfers of certain property.
(3) Transfers of a partnership interest.
(i) In general.
(ii) Transfers of a partnership interest by a partner.
(iii) Certain issuances of a partnership interest by a partnership.
(iv) Partnership interest transfers defined.
(4) Increased basis from a distribution.
(5) Operating rules applicable to base erosion payments.
(i) Single payment characterized as separate transactions.
(ii) Ordering rule with respect to transfers of a partnership interest.
(iii) Consideration for base erosion payment or property resulting in base erosion tax benefits.
(iv) Non-cash consideration.
(d) Base erosion tax benefit for partners.
(1) In general.
(2) Exception for base erosion tax benefits of certain small partners.
(i) In general.
(ii) Attribution.
(e) Other rules for applying section 59A to partnerships.
(1) Partner's distributive share.

(2) Gross receipts.
(i) In general.
(ii) Foreign corporation.
(3) Registered securities dealers.
(4) Application of sections 163(j) and 59A(c)(3) to partners.
(5) Tiered partnerships.
(f) Foreign related party.
(g) Examples.
(1) Facts.
(2) Examples.
(i) Example 1: Contributions to a partnership on partnership formation.
(A) Facts.
(B) Analysis.
(ii) Example 2: Section 704(c) and remedial allocations.
(A) Facts.
(B) Analysis.
(iii) Example 3: Sale of a partnership interest without a section 754 election.
(A) Facts.
(B) Analysis.
(iv) Example 4: Sale of a partnership interest with section 754 election.
(A) Facts.
(B) Analysis.
(v) Example 5: Purchase of depreciable property from a partnership.
(A) Facts.
(B) Analysis.
(vi) Example 6: Sale of a partnership interest to a second partnership.
(A) Facts.
(B) Analysis.
(vii) Example 7: Distribution of cash by a partnership to a foreign related party.
(A) Facts.
(B) Analysis.
(viii) Example 8: Distribution of property by a partnership to a taxpayer.
(A) Facts.
(B) Analysis.
(ix) Example 9: Distribution of property by a partnership in liquidation of a foreign related party's interest.
(A) Facts.
(B) Analysis.

§1.59A-8 [Reserved].

§1.59A-9 Anti-abuse and recharacterization rules.

(a) Scope.
(b) Anti-abuse rules.
(1) Transactions involving unrelated persons, conduits, or intermediaries.
(2) Transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.
(3) Transactions to avoid the application of rules applicable to banks and registered securities dealers.
(4) Nonrecognition transactions.
(c) Examples.
(1) Facts.
(2) Example 1: Substitution of payments that are not base erosion payments for payments that otherwise would be base erosion payments through a conduit or intermediary.
(i) Facts.
(ii) Analysis.
(3) Example 2: Alternative transaction to base erosion payment.
(i) Facts.
(ii) Analysis.
(4) Example 3: Alternative financing source.
(i) Facts.
(ii) Analysis.
(5) Example 4: Alternative financing source that is a conduit.
(i) Facts.
(ii) Analysis.
(6) Example 5: Intermediary acquisition.
(i) Facts.
(ii) Analysis.
(7) Example 6: Offsetting transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.
(i) Facts.
(ii) Analysis.
(8) Example 7: Ordinary course transactions that increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.
(i) Facts.
(ii) Analysis.
(9) Example 8: Transactions to avoid the application of rules applicable to banks and registered securities dealers.
(i) Facts.
(ii) Analysis.
(10) Example 9: Transactions that do not avoid the application of rules applicable to banks and registered securities dealers.
(i) Facts.
(ii) Analysis.
(11) Example 10: Acquisition of depreciable property in a nonrecognition transaction.
(i) Facts.
(ii) Analysis.
(12) Example 11: Transactions between related parties with a principal purpose of increasing the adjusted basis of property.
(i) Facts.
(ii) Analysis.

§1.59A-10 Applicability date.

§1.59A-1 Base erosion and anti-abuse tax.

(a) *Purpose*. This section and §§1.59A-2 through 1.59A-10 (collectively, the "section 59A regulations") provide rules under section 59A to determine the amount of the base erosion and anti-abuse tax. Paragraph (b) of this section provides definitions applicable to the section 59A regulations. Section 1.59A-2 provides rules regarding how to determine whether a taxpayer is an applicable taxpayer. Section 1.59A-3 provides rules regarding base erosion payments and base erosion tax benefits. Section 1.59A-4 provides rules for calculating modified taxable income. Section 1.59A-5 provides rules for calculating the base erosion minimum tax amount. Section 1.59A-6 provides rules relating to qualified derivative payments. Section 1.59A-7 provides rules regarding the application of section 59A to partnerships. Section 1.59A-8 is reserved for rules regarding the application of section 59A to certain expatriated entities. Section 1.59A-9 provides anti-abuse rules to prevent avoidance of section 59A. Finally, §1.59A-10 provides the applicability date for the section 59A regulations.

(b) *Definitions*. For purposes of this section and §§1.59A-2 through 1.59A-10, the following terms have the meanings provided in this paragraph (b).

(1) *Aggregate group.* The term *aggregate group* means the group of corporations determined by—

(i) Identifying a controlled group of corporations as defined in section 1563(a), except that the phrase "more than 50 percent" is substituted for "at least 80 percent" each place it appears in section 1563(a)(1) and the determination is made

without regard to sections 1563(a)(4) and (e)(3)(C), and

(ii) Once the controlled group of corporations is determined, excluding foreign corporations except with regard to income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations published under 26 CFR chapter I. Notwithstanding the foregoing, if a foreign corporation is subject to tax on a net basis pursuant to an applicable income tax treaty of the United States, it is excluded from the controlled group of corporations except with regard to income taken into account in determining its net taxable income.

(2) *Applicable section 38 credits*. The term *applicable section 38 credits* means the credits allowed under section 38 for the taxable year that are properly allocable to—

(i) The low-income housing credit determined under section 42(a),

(ii) The renewable electricity production credit determined under section 45(a), and

(iii) The investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.

(3) *Applicable taxpayer.* The term *applicable taxpayer* means a taxpayer that meets the requirements set forth in §1.59A-2(b).

(4) *Bank*. The term *bank* has the meaning provided in section 581.

(5) *Base erosion and anti-abuse tax rate*. The term *base erosion and anti-abuse tax rate* means the percentage that the taxpayer applies to its modified taxable income for the taxable year to calculate its base erosion minimum tax amount. See §1.59A-5(c) for the base erosion and anti-abuse tax rate applicable for the relevant taxable year.

(6) *Business interest expense*. The term *business interest expense*, with respect to a taxpayer and a taxable year, has the meaning provided in §1.163(j)-1(b)(2).

(7) *Deduction*. The term *deduction* means any deduction allowable under chapter 1 of subtitle A of the Internal Revenue Code.

(8) *Disallowed business interest expense carryforward*. The term *disallowed business interest expense carryforward* has the meaning provided in §1.163(j)-1(b)(9).

(9) *Domestic related business interest expense*. The term *domestic related business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a related party that is not a foreign related party.

(10) *Foreign person*. The term *foreign person* means any person who is not a United States person. For purposes of the preceding sentence, a United States person has the meaning provided in section 7701(a)(30), except that any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States is not a United States person. See §1.59A-7(b) for rules applicable to partnerships.

(11) *Foreign related business interest expense*. The term *foreign related business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a foreign related party.

(12) *Foreign related party.* The term *foreign related party* means a foreign person, as defined in paragraph (b)(10) of this section, that is a related party, as defined in paragraph (b)(17) of this section, with respect to the taxpayer. In addition, for purposes of §1.59A-3(b)(4)(v)(B) (relating to internal dealings under certain income tax treaties), a foreign related party also includes the foreign corporation's home office or a foreign branch of the foreign corporation. See §1.59A-7(b), (c), and (f) for rules applicable to partnerships.

(13) *Gross receipts.* The term *gross receipts* has the meaning provided in §1.448-1T(f)(2)(iv).

(14) Member of an aggregate group. The term *member of an aggregate group* means a corporation that is included in an aggregate group, as defined in paragraph (b)(1) of this section.

(15) *Registered securities dealer.* The term *registered securities dealer* means any dealer as defined in section 3(a)(5) of the Securities Exchange Act of 1934 that is registered, or required to be registered, under section 15 of the Securities Exchange Act of 1934.

(16) *Regular tax liability.* The term *regular tax liability* has the meaning provided in section 26(b).

(17) *Related party*—(i) *In general*. A *related party*, with respect to an applicable taxpayer, is—

(A) Any 25-percent owner of the taxpayer;

(B) Any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer; or

(C) A controlled taxpayer within the meaning of §1.482-1(i)(5) together with, or with respect to, the taxpayer.

(ii) *25-percent owner*. With respect to any corporation, a *25-percent owner* means any person who owns at least 25 percent of—

(A) The total voting power of all classes of stock of the corporation entitled to vote; or

(B) The total value of all classes of stock of the corporation.

(iii) *Application of section 318*. Section 318 applies for purposes of paragraphs (b)(17)(i) and (ii) of this section, except that—

(A) "10 percent" is substituted for "50 percent" in section 318(a)(2)(C); and

(B) Section 318(a)(3)(A) through (C) are not applied so as to consider a United States person as owning stock that is owned by a person who is not a United States person.

(18) TLAC long-term debt required amount. The term *TLAC long-term debt required amount* means the specified minimum amount of debt that is required pursuant to 12 CFR 252.162(a).

(19) TLAC securities amount. The term *TLAC securities amount* is the sum of the adjusted issue prices (as determined for purposes of §1.1275-1(b)) of all TLAC securities issued and outstanding by the taxpayer, without regard to whether interest thereunder would be a base erosion payment absent §1.59A-3(b)(3)(v).

(20) TLAC security. The term *TLAC security* means an eligible internal debt security, as defined in 12 CFR 252.161.

(21) *Unrelated business interest expense*. The term *unrelated business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a party that is not a related party.

§1.59A-2 Applicable taxpayer.

(a) *Scope*. This section provides rules for determining whether a taxpayer is an applicable taxpayer. Paragraph (b) of this section defines an applicable taxpayer. Paragraph (c) of this section provides rules for determining whether a taxpayer is an applicable taxpayer by reference to the aggregate group of which the taxpayer is a member. Paragraph (d) of this section provides rules regarding the gross receipts test. Paragraph (e) of this section provides rules regarding the base erosion percentage test. Paragraph (f) of this section provides examples illustrating the rules of this section.

(b) *Applicable taxpayer*. For purposes of section 59A, a taxpayer is an applicable taxpayer with respect to any taxable year if the taxpayer—

(1) Is a corporation, but not a regulated investment company, a real estate investment trust, or an S corporation;

(2) Satisfies the gross receipts test of paragraph (d) of this section; and

(3) Satisfies the base erosion percentage test of paragraph (e) of this section.

(c) *Aggregation rules*—(1) *In general*. Solely for purposes of this section and §1.59A-4, a taxpayer that is a member of an aggregate group determines its gross receipts and its base erosion percentage on the basis of the aggregate group. For these purposes, transactions that occur between members of the taxpayer's aggregate group that were members of the aggregate group as of the time of the transaction are not taken into account. In the case of a foreign corporation that is a member of an aggregate group, only transactions that occur between members of the aggregate group and that relate to income effectively connected with, or treated as effectively connected with, the conduct of a trade or business in the United States are not taken into account for this purpose. In the case of a foreign corporation that is a member of an aggregate group and that is subject to tax on a net basis pursuant to an applicable income tax treaty of the United States, only transactions that occur between members of the aggregate group and that relate to income that is taken into account in determining its net taxable income are not taken into account for this purpose.

(2) *Aggregate group determined with respect to each taxpayer*—(i) *In general*. Solely for purposes of this section, an aggregate group is determined with respect to each taxpayer. As a result, the aggregate group of one taxpayer may be different than the aggregate group of another member of the taxpayer's aggregate group.

(ii) [Reserved].

(3) *Taxable year of members of an aggregate group*. Solely for purposes of this section, a taxpayer that is a member of an aggregate group measures the gross receipts and base erosion percentage of the aggregate group for a taxable year by reference to the taxpayer's gross receipts, base erosion tax benefits, and deductions for the taxable year and the gross receipts, base erosion tax benefits, and deductions of each member of the aggregate group for the taxable year of the member that ends with or within the taxpayer's taxable year.

(4) through (6) [Reserved].

(7) *Partnerships*. For the treatment of partnerships for purposes of determining gross receipts and base erosion tax benefits, see §1.59A-7(e)(2) and (d), respectively.

(8) *Transition rule for aggregate group members with different taxable years*. If the taxpayer has a different taxable year than another member of the taxpayer's aggregate group (other member), and the other member is eligible for the exception in §1.59A-3(b)(3)(vi) (amounts paid or accrued in taxable years beginning before January 1, 2018) with respect to a taxable year ending with or within the taxpayer's taxable year ("excepted taxable year"), the excepted taxable year of the other member is not taken into account for purposes of paragraph (e) of this section. This rule applies solely for purposes of determining whether a taxpayer is an applicable taxpayer under this section.

(d) *Gross receipts test*—(1) *Amount of gross receipts*. A taxpayer, or the aggregate group of which the taxpayer is a member, satisfies the gross receipts test of this section if it has average annual gross receipts of at least $500,000,000 for the three-taxable-year period ending with the preceding taxable year.

(2) Taxpayer not in existence for entire three-year period. If a taxpayer was not in existence for the entire three-year period referred to in paragraph (d)(1) of this section, the taxpayer determines a gross receipts average for the period that it was in existence (which includes gross receipts in the current year).

(3) *Gross receipts of foreign corporations*. With respect to any foreign corporation, only gross receipts that are taken into account in determining income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States are taken into account for purposes of paragraph (d)(1) of this section. In the case of a foreign corporation that is a member of an aggregate group and that is subject to tax on a net basis pursuant to an applicable income tax treaty of the United States, the foreign corporation includes only gross receipts that are attributable to transactions taken into account in determining its net taxable income.

(4) *Gross receipts of an insurance company*. Solely for purposes of this section, for any corporation that is subject to tax under subchapter L or any corporation that would be subject to tax under subchapter L if that corporation were a domestic corporation, gross receipts are reduced by return premiums (within the meaning of section 803(a)(1)(B) and section 832(b)(4)(A)), but are not reduced by any reinsurance premiums paid or accrued.

(5) *Reductions in gross receipts*. For purposes of this section, gross receipts for any taxable year are reduced by returns and allowances made during that taxable year.

(6) *Gross receipts of consolidated groups*. For purposes of this section, the gross receipts of a consolidated group are determined by aggregating the gross receipts of all of the members of the consolidated group. See §1.1502-59A(b).

(e) *Base erosion percentage test*—(1) *In general*. A taxpayer, or the aggregate group of which the taxpayer is a member, satisfies the base erosion percentage test if its base erosion percentage is three percent or higher.

(2) *Base erosion percentage test for banks and registered securities dealers*—(i) *In general*. A taxpayer that is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a bank (as defined in §1.59A-1(b)(4)) or a registered securities dealer (as defined in section §1.59A-1(b)(15)) satisfies the base ero-

sion percentage test if its base erosion percentage is two percent or higher.

(ii) *Aggregate groups*. An aggregate group of which a taxpayer is a member and that includes a bank or a registered securities dealer that is a member of an affiliated group (as defined in section 1504(a)(1)) is subject to the base erosion percentage threshold described in paragraph (e)(2)(i) of this section.

(iii) *De minimis exception for banking and registered securities dealer activities*. An aggregate group that includes a bank or a registered securities dealer that is a member of an affiliated group (as defined in section 1504(a)(1)) is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section for a taxable year, if, for that taxable year, the total gross receipts of the aggregate group attributable to the bank or the registered securities dealer (or attributable to all of the banks and registered securities dealers in the group, if more than one) represent less than two percent of the total gross receipts of the aggregate group, as determined under paragraph (d) of this section. When there is no aggregate group, a consolidated group that includes a bank or a registered securities dealer is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section for a taxable year, if, for that taxable year, the total gross receipts of the consolidated group attributable to the bank or the registered securities dealer (or attributable to all of the banks or registered securities dealers in the group, if more than one) represent less than two percent of the total gross receipts of the consolidated group, as determined under paragraph (d) of this section.

(3) *Computation of base erosion percentage*—(i) *In general*. The taxpayer's base erosion percentage for any taxable year is determined by dividing—

(A) The aggregate amount of the taxpayer's (or in the case of a taxpayer that is a member of an aggregate group, the aggregate group's) base erosion tax benefits (as defined in §1.59A-3(c)(1)) for the taxable year, by

(B) The sum of—

(*1*) The aggregate amount of the deductions (including deductions for base erosion tax benefits described in §1.59A-3(c)(1)(i) and base erosion tax benefits described in §1.59A-3(c)(1)(ii)) allowable to the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) under chapter 1 of Subtitle A for the taxable year;

(*2*) The base erosion tax benefits described in §1.59A-3(c)(1)(iii) with respect to any premiums or other consideration paid or accrued by the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) to a foreign related party for any reinsurance payment taken into account under sections 803(a)(1)(B) or 832(b)(4)(A) for the taxable year; and

(*3*) Any amount paid or accrued by the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) resulting in a reduction of gross receipts described in §1.59A-3(c)(1)(iv) for the taxable year.

(ii) *Certain items not taken into account in denominator*. Except as provided in paragraph (e)(3)(viii) of this section, the amount under paragraph (e)(3)(i)(B) of this section is determined by not taking into account—

(A) Any deduction allowed under section 172, 245A, or 250 for the taxable year;

(B) Any deduction for amounts paid or accrued for services to which the exception described in §1.59A-3(b)(3)(i) applies;

(C) Any deduction for qualified derivative payments that are not treated as base erosion payments by reason of §1.59A-3(b)(3)(ii);

(D) Any exchange loss within the meaning of §1.988-2 from a section 988 transaction as described in §1.988-1(a)(1) that is not treated as a base erosion payment by reason of §1.59A-3(b)(3)(iv);

(E) Any deduction for amounts paid or accrued to foreign related parties with respect to TLAC securities and foreign TLAC securities that are not treated as base erosion payments by reason of §1.59A-3(b)(3)(v);

(F) Any reinsurance losses incurred and claims payments described in §1.59A-3(b)(3)(ix); and

(G) Any deduction not allowed in determining taxable income for the taxable year.

(iii) *Effect of treaties on base erosion percentage determination*. See §1.59A-3(c)(2) and (3).

(iv) *Amounts paid or accrued between members of a consolidated group*. See §1.1502-59A(b).

(v) *Deductions and base erosion tax benefits from partnerships*. See §1.59A-7(b), (d), and (e).

(vi) *Mark-to-market positions.* For any position with respect to which the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, a member of the aggregate group) applies a mark-to-market method of accounting for U.S. federal income tax purposes, the taxpayer must determine its gain or loss with respect to that position for any taxable year by combining all items of income, gain, loss, or deduction arising with respect to the position during the taxable year, regardless of how each item arises (including from a payment, accrual, or mark) for purposes of paragraph (e)(3) of this section. See paragraph (f)(1) of this section (*Example 1*) for an illustration of this rule. For purposes of section 59A, a taxpayer computes its losses resulting from positions subject to a mark-to-market regime under the Internal Revenue Code based on a single mark for the taxable year on the earlier of the last business day of the taxpayer's taxable year and the disposition (whether by sale, offset, exercise, termination, expiration, maturity, or other means) of the position, regardless of how frequently a taxpayer marks to market for other purposes. See §1.59A-3(b)(2)(iii) for the application of this rule for purposes of determining the amount of base erosion payments.

(vii) *Reinsurance losses incurred and claims payments*. Except as provided in paragraph (e)(3)(ii)(F) of this section, amounts paid for losses incurred (as defined in section 832(b)(5)) and claims and benefits under section 805(a)(1) are taken into account for purposes of paragraph (e)(3)(i)(B)(*1*) of this section.

(viii) *Certain payments that qualify for the effectively connected income exception and another base erosion payment exception*. Subject to paragraph (c) of this section (transactions that occur between members of the taxpayer's aggregate group), a payment that qualifies for the effectively connected income

exception described in §1.59A-3(b)(3)(iii) and either the service cost method exception described in §1.59A-3(b)(3)(i), the qualified derivative payment exception described in §1.59A-3(b)(3)(ii), or the TLAC exception described in §1.59A-3(b)(3)(v) is not subject to paragraph (e)(3)(ii)(B), (C), or (E) of this section and those amounts are included in the denominator of the base erosion percentage if the foreign related party who received the payment is not a member of the aggregate group.

(f) *Examples*. The following examples illustrate the rules of this section.

(1) *Mark-to-market*—(i) *Facts*. (A) Foreign Parent (FP) is a foreign corporation that owns all of the stock of domestic corporation (DC). FP is a foreign related party of DC under §1.59A-1(b)(12). DC is a registered securities dealer that does not hold any securities for investment. On January 1 of year 1, DC enters into two interest rate swaps for a term of two years, one with unrelated Customer A as the counterparty (position A) and one with unrelated Customer B as the counterparty (position B). Each of the swaps provides for semiannual periodic payments to be made or received on June 30 and December 31. No party makes any payment to any other party upon initiation of either of the swaps (that is, they are entered into at-the-money). DC is required to mark-to-market positions A and B for U.S. federal income tax purposes. DC is a calendar year taxpayer.

(B) For position A in year 1, DC makes a payment of $150x on June 30, and receives a payment of $50x on December 31. There are no other payments in year 1. On December 31, position A has a value to DC of $110x (that is, position A is in-the-money by $110x).

(C) For position B in year 1, DC receives a payment of $120x on June 30, and makes a payment of $30x on December 31. There are no other payments in year 1. On December 31, position B has a value to DC of ($130x) (that is, position B is out-of-the-money by $130x).

(ii) *Analysis*. (A) With respect to position A, based on the total amount of payments made and received in year 1, DC has a net deduction of $100x. In addition, DC has a mark-to-market gain of $110x. As described in paragraph (e)(3)(vi) of this section, the mark-to-market gain of $110x is combined with the net deduction of $100x resulting from the payments. Therefore, with respect to position A, DC has a gain of $10x, and thus has no deduction in year 1 for purposes of section 59A.

(B) With respect to position B, based on the total amount of payments made and received in year 1, DC has net income of $90x. In addition, DC has a mark-to-market loss of $130x. As described in paragraph (e)(3)(vi) of this section, the mark-to-market loss of $130x is combined with the net income of $90x resulting from the payments. Therefore, with respect to position B, DC has a loss of $40x, and thus has a $40x deduction in year 1 for purposes of section 59A.

(2) [Reserved]

§1.59A-3 Base erosion payments and base erosion tax benefits.

(a) *Scope*. This section provides definitions and related rules regarding base erosion payments and base erosion tax benefits. Paragraph (b) of this section provides definitions and rules regarding base erosion payments. Paragraph (c) of this section provides rules for determining the amount of base erosion tax benefits. Paragraph (d) of this section provides examples illustrating the rules described in this section.

(b) *Base erosion payments*—(1) *In general*. Except as provided in paragraph (b)(3) of this section, a *base erosion payment* means—

(i) Any amount paid or accrued by the taxpayer to a foreign related party of the taxpayer and with respect to which a deduction is allowable under chapter 1 of subtitle A of the Internal Revenue Code;

(ii) Any amount paid or accrued by the taxpayer to a foreign related party of the taxpayer in connection with the acquisition of property by the taxpayer from the foreign related party if the character of the property is subject to the allowance for depreciation (or amortization in lieu of depreciation);

(iii) Any premium or other consideration paid or accrued by the taxpayer to a foreign related party of the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A); or

(iv) Any amount paid or accrued by the taxpayer that results in a reduction of the gross receipts of the taxpayer if the amount paid or accrued is with respect to—

(A) A surrogate foreign corporation, as defined in section 59A(d)(4)(C)(i), that is a related party of the taxpayer (but only if the corporation first became a surrogate foreign corporation after November 9, 2017); or

(B) A foreign person that is a member of the same expanded affiliated group, as defined in section 59A(d)(4)(C)(ii), as the surrogate foreign corporation.

(2) *Operating rules*—(i) *In general*. The determination of the amount paid or accrued, and the identity of the payor and recipient of any amount paid or accrued, is made under general U.S. federal income tax law.

(ii) *Amounts paid or accrued in cash and other consideration*. For purposes of paragraph (b)(1) of this section, an amount paid or accrued includes an amount paid or accrued using any form of consideration, including cash, property, stock, a partnership interest, or the assumption of a liability, including any exchange transaction. A distribution of property that is not part of an exchange (such as a distribution under section 301, without regard to whether section 301(c)(1), (c)(2), or (c)(3) applies), is not received with respect to an amount paid or accrued and does not give rise to a base erosion payment. In contrast, a redemption of stock by a corporation within the meaning of section 317(b) (such as a redemption described in section 302(a) or (d) or section 306(a)(2)), or a transaction in which there is an exchange for stock (such as a section 304 or section 331 transaction), is an amount paid or accrued by the shareholder to the corporation (or by the acquiring corporation to the transferor in a section 304 transaction), without regard to the treatment of such transaction for U.S. federal income tax purposes. See paragraph (b)(3)(viii) of this section for an exception for specified nonrecognition transactions (as defined in paragraph (b)(3)(viii)(A) of this section).

(iii) *Transactions providing for net payments*. Except as otherwise provided in paragraph (b)(2)(iv) of this section or as permitted by the Internal Revenue Code or the regulations, the amount of any base erosion payment is determined on a gross

basis, regardless of any contractual or legal right to make or receive payments on a net basis. For this purpose, a right to make or receive payments on a net basis permits the parties to a transaction or series of transactions to settle obligations by offsetting any amounts to be paid by one party against amounts owed by that party to the other party. For example, any premium or other consideration paid or accrued by a taxpayer to a foreign related party for any reinsurance payments is not reduced by or netted against other amounts owed to the taxpayer from the foreign related party or by reserve adjustments or other returns.

(iv) *Amounts paid or accrued with respect to mark-to-market position*. For any transaction with respect to which the taxpayer applies the mark-to-market method of accounting for U.S. federal income tax purposes, the rules set forth in §1.59A-2(e)(3)(vi) apply to determine the amount of the base erosion payment.

(v) *Coordination among categories of base erosion payments*. A payment that does not satisfy the criteria of one category of base erosion payment may be a base erosion payment described in one of the other categories.

(vi) *Certain domestic passthrough entities*—(A) *In general*. If a taxpayer pays or accrues an amount that would be a base erosion payment except for the fact that the payment is made to a specified domestic passthrough, then the taxpayer will be treated as making a base erosion payment to each specified foreign related party for purposes of section 59A and §§1.59A-2 through 1.59A-10. This rule has no effect on the taxation of the specified domestic passthrough under subchapter J or subchapter M of the Code (as applicable).

(B) *Amount of base erosion payment*. The amount of the base erosion payment is equal to the lesser of the amount paid or accrued by the taxpayer to or for the benefit of the specified domestic passthrough and the amount of the deduction allowed under section 561, 651, or 661 to the specified domestic passthrough with respect to amounts paid, credited, distributed, deemed distributed, or required to be distributed to a specified foreign related party.

(C) *Specified domestic passthrough*. For purposes of this paragraph (b)(2)(vi), specified domestic passthrough means:

(*1*) A domestic trust that is not a grantor trust under subpart E of subchapter J of chapter 1 of the Code ("domestic trust") and which domestic trust is allowed a deduction under section 651 or section 661 with respect to amounts paid, credited, or required to be distributed to a specified foreign related party;

(*2*) A real estate investment trust (as defined in §1.856-1(a)) that pays, or is deemed to pay, a dividend to a specified foreign related party for which a deduction is allowed under section 561; or

(*3*) A regulated investment company (as defined in §1.851-1(a)) that pays, or is deemed to pay, a dividend to a specified foreign related party for which a deduction is allowed under section 561.

(D) *Specified foreign related party*. For purposes of this paragraph (b)(2)(vi), specified foreign related party means, with respect to a specified domestic passthrough, any foreign related party of a taxpayer that is a direct or indirect beneficiary or shareholder of the specified domestic passthrough.

(vii) *Transfers of property to related taxpayers*. If a taxpayer owns property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation) with respect to which paragraph (c)(1)(ii) of this section applies, 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 (taking into account §1.59A-7), any deduction for depreciation (or amortization in lieu of depreciation) by the transferee taxpayer remains subject to paragraph (c)(1)(ii) of this section to the same extent the amounts would have been so subject in the hands of the transferor. See paragraph (d)(7) of this section (*Example 7*) for an illustration of this rule.

(viii) *Reductions to determine gross income*. For purposes of paragraphs (b)(1)(i) and (ii) of this section, any amount resulting in a reduction to determine gross income under section 61, including an amount properly treated as cost of goods sold under the Code, is not a base erosion payment.

(ix) *Losses recognized on the sale or transfer of property*. If a taxpayer recognizes a loss on a sale or transfer of property to a foreign related party, the loss recognized with respect to the sale or transfer is not a deduction that would cause the payment to be treated as a base erosion payment under paragraph (b)(1)(i) of this section. However, if a taxpayer uses property to make a payment to a foreign related party and the payment otherwise meets the requirements of paragraph (b)(1) of this section, the amount of the payment that is treated as a base erosion payment equals the fair market value of the property at the time of the transfer.

(3) *Exceptions to base erosion payment*. Paragraph (b)(1) of this section does not apply to the types of payments or accruals described in paragraphs (b)(3)(i) through (ix) of this section.

(i) *Certain services cost method amounts*—(A) *In general*. Amounts paid or accrued by a taxpayer to a foreign related party for services that meet the requirements in paragraph (b)(3)(i)(B) of this section, but only to the extent of the total services cost of those services. Thus, any amount paid or accrued to a foreign related party in excess of the total services cost of services eligible for the services cost method exception (the mark-up component) remains a base erosion payment. For this purpose, services are an activity as defined in §1.482-9(l)(2) performed by a foreign related party (the renderer) that provides a benefit as defined in §1.482-9(l)(3) to the taxpayer (the recipient).

(B) *Eligibility for the services cost method exception*. To be eligible for the services cost method exception, all of the requirements of §1.482-9(b) must be satisfied, except that:

(*1*) The requirements of §1.482-9(b)(5) do not apply for purposes of determining eligibility for the service cost method exception in this section; and

(*2*) Adequate books and records must be maintained as described in paragraph (b)(3)(i)(C) of this section, instead of as described in §1.482-9(b)(6).

(C) *Adequate books and records*. Permanent books of account and records must be maintained for as long as the costs with respect to the services are incurred by the renderer. The books and records must be adequate to permit verification by the Commissioner of the amount charged for the services and the total services costs incurred by the renderer, including a description of the services

in question, identification of the renderer and the recipient of the services, calculation of the amount of profit mark-up (if any) paid for the services, and sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services in question in accordance with §1.482-9(k). For example, where a renderer incurs costs that are attributable to performing a service for the taxpayer that includes services eligible for the services cost method exception under this section (regardless of whether the taxpayer determined its payments for those services based on the services cost method) and another service that is not eligible for the services cost method exception, books and records must be maintained that show, among other things: the total amount of costs that are attributable to each of those services, the method chosen under §1.482-9(k) to apportion the costs between the service eligible for the services cost method under this section and the other service, and the application of that method in calculating the amount eligible for the services cost method exception. This paragraph (b)(3)(i)(C) does not affect the recordkeeping requirements imposed by any other provision, including §1.6001-1.

(D) *Total services cost*. For purposes of this section, total services cost has the same meaning as total services costs in §1.482-9(j).

(ii) *Qualified derivative payments*. Any qualified derivative payment as described in §1.59A-6.

(iii) *Effectively connected income*—(A) *In general*. Except as provided in paragraph (b)(3)(iii)(B) of this section, amounts paid or accrued to a foreign related party that are subject to U.S. federal income taxation as income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations. Paragraph (b)(3)(iii) of this section applies only if the taxpayer receives a withholding certificate on which the foreign related party claims an exemption from withholding under section 1441 or 1442 because the amounts are effectively connected income.

(B) *Application to certain treaty residents*. If a foreign related party determines its taxable income pursuant to the business profits provisions of an applicable income tax treaty, amounts paid or accrued to the foreign related party that are taken into account in determining its taxable income.

(iv) *Exchange loss on a section 988 transaction*. Any exchange loss within the meaning of §1.988-2 from a section 988 transaction described in §1.988-1(a)(1) that is an allowable deduction and that results from a payment or accrual by the taxpayer to a foreign related party.

(v) *Amounts paid or accrued with respect to TLAC securities and foreign TLAC securities*—(A) *In general*. Except as provided in paragraph (b)(3)(v)(B) and (F) of this section, amounts paid or accrued to foreign related parties with respect to TLAC securities and foreign TLAC securities.

(B) *Limitation on exclusion for TLAC securities*. The amount excluded under paragraph (b)(3)(v)(A) of this section is no greater than the product of the scaling ratio and amounts paid or accrued to foreign related parties with respect to TLAC securities for which a deduction is allowed.

(C) *Scaling ratio*. For purposes of this paragraph (b)(3)(v), the scaling ratio for a taxable year of a taxpayer is a fraction the numerator of which is 115 percent of the average TLAC long-term debt required amount and the denominator of which is the average TLAC securities amount. The scaling ratio may in no event be greater than one.

(D) *Average TLAC securities amount*. The average TLAC securities amount for a taxable year is the average of the TLAC securities amounts for the year, computed at regular time intervals in accordance with this paragraph. The TLAC securities amount used in calculating the average TLAC securities amount is computed on a monthly basis.

(E) *Average TLAC long-term debt required amount*. The average TLAC long-term debt required amount for a taxable year is the average of the TLAC long-term debt required amounts, computed on a monthly basis.

(F) *Limitation on exclusion for foreign TLAC securities*—(*1*) *In general*. The amount excluded under paragraph (b)(3)(v)(A) of this section for foreign TLAC securities is limited to the extent that interest deducted by a U.S. trade or business or permanent establishment with respect to foreign TLAC securities exceeds the interest expense associated with the foreign TLAC long-term debt required amount, applying the scaling ratio principles set forth under paragraphs (b)(3)(v)(B) through (E) of this section.

(*2*) Foreign TLAC long-term debt required amount. For purposes of paragraph (b)(3)(v) of this section, the term *foreign TLAC long-term debt required amount* means in the case of a trade or business or a permanent establishment in the United States, the lesser of—

(*i*) The specified minimum amount of debt, if any, required pursuant to a bank regulatory requirement imposed under the laws or regulations of a foreign country that are comparable to 12 CFR 252.160-167; or

(*ii*) The specified minimum amount of debt, if any, that would be required pursuant to 12 CFR 252.162(a) if the trade or business or permanent establishment were a U.S. person (as determined under Federal Reserve regulations).

(*3*) *No specified minimum provided by local law*. For purposes of paragraph (b)(3)(v)(F)(*2*)(*ii*) of this section, if the bank regulatory requirements imposed under the laws or regulations of a foreign country do not specify a minimum amount, the limitation for purposes of paragraph (b)(3)(v)(F)(*2*) of this section is determined by reference solely to paragraph (b)(3)(v)(F)(*2*)(*ii*) of this section.

(*4*) Foreign TLAC security. For purposes of paragraph (b)(3)(v) of this section, the term *foreign TLAC security* means an internal debt security issued under a bank regulatory requirement imposed under the laws or regulations of a foreign country that is comparable to 12 CFR 252.160-167. The laws or regulations of a foreign country are comparable to 12 CFR 252.160-167 if the requirement is imposed by a Financial Stability Board member state and those laws or regulations are substantially consistent with TLAC standards of the Financial Stability Board.

(vi) *Amounts paid or accrued in taxable years beginning before January 1, 2018*. Any amount paid or accrued in taxable years beginning before January 1, 2018.

(vii) *Business interest carried forward from taxable years beginning before January 1, 2018*. Any disallowed business interest described in section 163(j)(2) that is carried forward from a taxable year beginning before January 1, 2018.

(viii) *Specified nonrecognition transactions*—(A) *In general*. Subject to paragraph (b)(3)(viii)(B) and (C) of this section, any amount transferred to, or exchanged with, a foreign related party pursuant to a transaction to which sections 332, 351, 355, or 368 apply ("specified nonrecognition transaction"). See §1.59A-9(b)(4) for anti-abuse rules.

(B) *Other property transferred to a foreign related party in a specified nonrecognition transaction*. If a taxpayer transfers other property (as defined in paragraph (b)(3)(viii)(D) of this section) to a foreign related party pursuant to a specified nonrecognition transaction, the other property is treated as an amount paid or accrued to which paragraph (b)(3) of this section does not apply, regardless of whether gain is recognized on the transaction.

(C) *Other property received from a foreign related party in certain specified nonrecognition transactions*. If, in a transaction described in section 351, 355, or 368, the taxpayer transfers property and receives other property (as defined in paragraph (b)(3)(viii)(D) of this section) from a foreign related party, the property transferred by the taxpayer is treated as an amount paid or accrued to which paragraph (b)(3) of this section does not apply, regardless of whether gain is recognized on the transaction.

(D) *Definition of other property*. Solely for purposes of this paragraph (b)(3)(viii), the term *other property* has the meaning of the phrase "other property or money" as used in section 351(b), with respect to a transaction to which section 351 applies, and as used in sections 356(a)(1)(B) and 361(b), with respect to a transaction to which sections 355 or 368 apply, as applicable, including liabilities treated as money under section 357(b). However, the term *other property* does not include the sum of any money and the fair market value of any other property to which section 361(b)(3) applies. The term *other property* also includes liabilities that are assumed by the taxpayer in the specified nonrecognition transaction, but only to the extent of the amount of gain recognized under section 357(c).

(E) *Allocation of other property*. Other property is treated as exchanged for property in a specified nonrecognition transaction in a manner consistent with U.S. federal income tax law. For purposes making the allocation under this paragraph (b)(3)(viii)(E), liabilities described in paragraph (b)(3)(viii)(D) of this section are treated as money received.

(ix) *Reinsurance losses incurred and claims payments*—(A) *In general*. Any amounts paid by a taxpayer subject to tax under subchapter L to a foreign related party that is a regulated insurance company under a reinsurance contract between the taxpayer and the regulated foreign insurance company for losses incurred (as defined in section 832(b)(5)) and claims and benefits under section 805(a)(1), to the extent that the amounts paid or accrued are properly allocable to amounts required to be paid by the regulated foreign insurance company (or indirectly through another regulated foreign insurance company), pursuant to an insurance, annuity, or reinsurance contract, to a person other than a related party. For purposes of this paragraph (b)(3)(ix), the determination of whether a contract is an insurance contract or an annuity contract is made without regard to sections 72(s), 101(f), 817(h), and 7702, provided that the contract is regulated as a life insurance or annuity contract in its jurisdiction of issuance and no policyholder, insured, annuitant or beneficiary with respect to the contract is a United States person.

(B) *Regulated foreign insurance company*. The term regulated foreign insurance company means any foreign corporation which –

(*1*) Is subject to regulation as an insurance (or reinsurance) company by the country in which the corporation is created, organized, or maintains its registered office, and is licensed, authorized, or regulated by the applicable insurance regulatory body for that country to sell insurance, annuity, or reinsurance contracts to persons other than related parties in that country, and

(*2*) Would be subject to tax under subchapter L if it were a domestic corporation.

(4) *Rules for determining the amount of certain base erosion payments*. The following rules apply in determining the amount that is a base erosion payment.

(i) *Interest expense allocable to a foreign corporation's effectively connected income*—(A) *Methods described in §1.882-5*. A foreign corporation that has interest expense allocable under section 882(c) to income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States applying the method described in §1.882-5(b) through (d) or the method described in §1.882-5(e) has base erosion payments under paragraph (b)(1)(i) of this section for the taxable year equal to the sum of—

(*1*) The interest expense on a liability described in §1.882-5(a)(1)(ii)(A) or (B) (direct allocations) that is paid or accrued by the foreign corporation to a foreign related party;

(*2*) The interest expense on U.S.-booked liabilities, as described in §1.882-5(d)(2), determined by taking into account paragraph (b)(4)(i)(B) of this section, that is paid or accrued by the foreign corporation to a foreign related party; and

(*3*) The interest expense on U.S.-connected liabilities, as described in §1.882-5(d) or 1.882-5(e), in excess of interest expense on U.S.-booked liabilities as described in §1.882-5(d)(2), if any (hereafter, excess U.S.-connected liabilities), multiplied by a fraction, the numerator of which is the foreign corporation's average worldwide interest expense due to a foreign related party, and the denominator of which is the foreign corporation's average total worldwide interest expense. The numerator and denominator of this fraction are determined by translating interest expense into the functional currency of the foreign corporation using any reasonable method, consistently applied. Any interest expense that is interest expense on a U.S.-booked liability or is subject to a direct allocation is excluded from both the numerator and the denominator of the fraction.

(B) *U.S.-booked liabilities determination*. For purposes of paragraph (b)(4)(i)(A) of this section, the determination of the interest expense on U.S.-booked liabilities, as described in §1.882-5(d)(2), is made without regard to whether the foreign corporation applies the method de-

scribed in §1.882-5(b) through (d) or the method described in §1.882-5(e) for purposes of determining interest expense.

(C) *U.S.-booked liabilities in excess of U.S.-connected liabilities*. For purposes of paragraph (b)(4)(i)(A)(*2*) of this section, if a foreign corporation has U.S.-booked liabilities, as described in §1.882-5(d)(2), in excess of U.S.-connected liabilities, as described in §1.882-5(d) or §1.882-5(e), the foreign corporation applies the scaling ratio pro-rata to all interest expense on U.S.-booked liabilities consistent with §1.882-5(d)(4) for purposes of determining the amount of allocable interest expense on U.S.-booked liabilities that is a base erosion payment. This paragraph (b)(4)(i)(C) applies without regard to whether the foreign corporation applies the method described in §1.882-5(b) through (d) or the method described in §1.882-5(e) for purposes of determining its interest expense.

(D) *Election to use financial statements*. A foreign corporation may elect to calculate the fraction described in paragraph (b)(4)(i)(A)(*3*) of this section on the basis of its applicable financial statement rather than U.S. tax principles. For purposes of this section, an applicable financial statement has the meaning provided in section 451(b)(3). The applicable financial statement must be the applicable financial statement of the foreign corporation, not a consolidated applicable financial statement. A foreign corporation makes this election in accordance with the requirements of Form 8991 (or successor).

(E) *Coordination with certain tax treaties*—(*1*) *In general*. If a foreign corporation elects to determine its taxable income pursuant to business profits provisions of an income tax treaty rather than provisions of the Internal Revenue Code, or the regulations published under 26 CFR chapter I, for determining effectively connected income, and the foreign corporation does not apply §1.882-5 to allocate interest expense to a permanent establishment, then paragraph (b)(4)(i)(A) through (D) of this section applies to determine the amount of hypothetical §1.882-5 interest expense that is a base erosion payment under paragraph (b)(1) of this section. Interest expense allowed to the permanent establishment in excess of the hypothetical §1.882-5 interest expense, if any, is treated as an amount paid or accrued by the permanent establishment to the foreign corporation's home office or to another branch of the foreign corporation and is a base erosion payment to the extent that the payment or accrual is described under paragraph (b)(1) of this section.

(*2*) *Hypothetical §1.882-5 interest expense defined*. The hypothetical §1.882-5 interest expense is equal to the amount of interest expense that would have been allocable under section 882(c) to income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States if the foreign corporation determined interest expense in accordance with section §1.882-5. However, the hypothetical §1.882-5 interest expense shall not exceed the amount of interest expense allowed to the permanent establishment.

(*3*) *Consistency requirement*. For purposes of determining the amount described in paragraph (b)(4)(i)(E)(*2*) of this section and applying paragraph (b)(4)(i)(A) through (D) of this section, the elections of §1.882-5 must be applied consistently and are subject to the rules and limitations of §1.882-5, including limitations on the time period in which an election may be made or revoked. If a foreign corporation otherwise meets the requirements for making or revoking an election under §1.882-5, then solely for purposes of this section, the foreign corporation is treated as making or revoking the election in accordance with the requirements of Form 8991 (or successor) and its instructions.

(F) *Coordination with exception for foreign TLAC securities*. For purposes of paragraph (b)(4)(i)(A) of this section, amounts paid or accrued to a foreign related party with respect to securities that are eligible for the foreign TLAC exception in paragraph (b)(3)(v) of this section are not treated as paid to a foreign related party.

(ii) *Other deductions allowed with respect to effectively connected income*. A deduction allowed under §1.882-4 for an amount paid or accrued by a foreign corporation to a foreign related party (including a deduction for an amount apportioned in part to effectively connected income and in part to income that is not effectively connected income) is a base erosion payment under paragraph (b)(1) of this section.

(iii) *Depreciable property*. Any amount paid or accrued by a foreign corporation to a foreign related party of the taxpayer in connection with the acquisition of property by the foreign corporation from the foreign related party if the character of the property is subject to the allowance for depreciation (or amortization in lieu of depreciation) is a base erosion payment to the extent the property so acquired is used, or held for use, in the conduct of a trade or business within the United States.

(iv) *Coordination with ECI exception*. For purposes of paragraph (b)(4) of this section, amounts paid or accrued to a foreign related party treated as effectively connected income (or, in the case of a foreign related party that determines taxable income pursuant to the business profits provisions of an applicable income tax treaty, such amounts that are taken into account in determining taxable income) are not treated as paid to a foreign related party.

(v) *Coordination with certain tax treaties*—(A) *Allocable expenses*. Except as provided in paragraph (b)(4)(i)(E) of this section with respect to interest, if a foreign corporation determines its taxable income on a net basis pursuant to an applicable income tax treaty rather than provisions of the Internal Revenue Code, or the regulations published under 26 CFR chapter I, for determining effectively connected income, then the foreign corporation must determine whether each allowable deduction is a base erosion payment under paragraph (b)(1) of this section.

(B) *Internal dealings under certain income tax treaties*. Except as provided in paragraph (b)(4)(i)(E) of this section with respect to interest, if, pursuant to the terms of an applicable income tax treaty, a foreign corporation determines the profits attributable to a permanent establishment based on the assets used, risks assumed, and functions performed by the permanent establishment, then any deduction attributable to any amount paid or accrued (or treated as paid or accrued) by the permanent establishment to the foreign corporation's home office or to another branch of the foreign corporation (an "internal dealing") is a base erosion payment to the extent that the payment or accrual is described under paragraph (b)(1) of this section.

(vi) *Business interest expense arising in taxable years beginning after December 31, 2017*. Any disallowed business interest expense described in section 163(j)(2) that resulted from a payment or accrual to a foreign related party that first arose in a taxable year beginning after December 31, 2017, is treated as a base erosion payment under paragraph (b)(1)(i) of this section in the year that the business interest expense initially arose. See paragraph (c)(4) of this section for rules that apply when business interest expense is limited under section 163(j)(1) in order to determine whether the disallowed business interest is attributed to business interest expense paid to a person that is not a related party, a foreign related party, or a domestic related party.

(c) *Base erosion tax benefit*—(1) *In general*. Except as provided in paragraph (c)(2) of this section, a base erosion tax benefit means:

(i) In the case of a base erosion payment described in paragraph (b)(1)(i) of this section, any deduction that is allowed under chapter 1 of subtitle A of the Internal Revenue Code for the taxable year with respect to that base erosion payment;

(ii) In the case of a base erosion payment described in paragraph (b)(1)(ii) of this section, any deduction allowed under chapter 1 of subtitle A of the Internal Revenue Code for the taxable year for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with that payment;

(iii) In the case of a base erosion payment described in paragraph (b)(1)(iii) of this section, any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity reinsurance, or any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance; or

(iv) In the case of a base erosion payment described in paragraph (b)(1)(iv) of this section, any reduction in gross receipts with respect to the payment in computing gross income of the taxpayer for the taxable year for purposes of chapter 1 of subtitle A of the Internal Revenue Code.

(2) *Exception to base erosion tax benefit*—(i) *In general*. Except as provided in paragraph (c)(3) of this section, any base erosion tax benefit attributable to any base erosion payment is not taken into account as a base erosion tax benefit if tax is imposed on that payment under section 871 or 881, and the tax has been deducted and withheld under section 1441 or 1442. If a payment is taken into account for purposes of the fraction described in paragraph (b)(4)(i)(A)(*3*) of this section, and tax is imposed on the payment under section 871 or 881, and the tax has been deducted and withheld under section 1441 or 1442, the payment is treated as not paid or accrued to a foreign related party.

(ii) *Branch-level interest tax*. Except as provided in paragraph (c)(3) of this section, any base erosion tax benefit of a foreign corporation attributable to any base erosion payment determined under paragraph (b)(4)(i)(A)(*3*) of this section or attributable to interest expense in excess of the hypothetical section 1.882-5 interest expense determined under paragraph (b)(4)(i)(E)(*1*) of this section is not taken into account as a base erosion tax benefit to the extent of the amount of excess interest, as defined in §1.884-4(a)(2), if any, on which tax is imposed on the foreign corporation under section 884(f) and §1.884-4, if the tax is properly reported on the foreign corporation's income tax return and paid in accordance with §1.884-4(a)(2)(iv).

(3) *Effect of treaty on base erosion tax benefit*. If any treaty between the United States and any foreign country reduces the rate of tax imposed by section 871 or 881, the amount of base erosion tax benefit that is not taken into account under paragraph (c)(2) of this section is equal to the amount of the base erosion tax benefit before the application of paragraph (c)(2) of this section multiplied by a fraction of—

(i) The rate of tax imposed under the treaty; over

(ii) The rate of tax imposed without regard to the treaty.

(4) *Application of section 163(j) to base erosion payments*—(i) *Classification of payments or accruals of business interest expense based on the payee*. The following rules apply for corporations and partnerships:

(A) *Classification of payments or accruals of business interest expense of a corporation*. For purposes of this section, in the year that business interest expense of a corporation is paid or accrued the business interest expense is classified as foreign related business interest expense, domestic related business interest expense, or unrelated business interest expense.

(B) *Classification of payments or accruals of business interest expense by a partnership*. For purposes of this section, in the year that business interest expense of a partnership is paid or accrued, the business interest expense that is allocated to a partner is classified separately with respect to each partner in the partnership as foreign related business interest expense, domestic related business interest expense, or unrelated business interest expense.

(C) *Classification of payments or accruals of business interest expense paid or accrued to a foreign related party that is subject to an exception*—(*1*) *ECI exception*. For purposes of paragraph (c)(4)(i)(A) and (B) of this section, business interest expense paid or accrued to a foreign related party to which the exception in paragraph (b)(3)(iii) of this section (effectively connected income) applies is classified as domestic related business interest expense.

(*2*) *TLAC interest and interest subject to withholding tax*. For purposes of paragraph (c)(4)(i)(A) and (B) of this section, if the exception in paragraph (b)(3)(v) of this section (TLAC securities) or paragraph (c)(2) or (3) of this section (withholding tax) applies to business interest expense paid or accrued to a foreign related party, that business interest expense remains classified as foreign related business interest expense, and retains its classification as eligible for those exceptions, on a pro-rata basis with other foreign related business interest expense.

(ii) *Ordering rules for business interest expense that is limited under section 163(j)(1) to determine which classifications of business interest expense are deducted and which classifications of business interest expense are carried forward*—(A) *In general*. Section 163(j) and the regulations published under 26 CFR chapter I provide a limitation on the amount of business interest expense allowed as a deduction in a taxable year by a corporation

or a partner in a partnership. In the case of a corporation with a disallowed business interest expense carryforward, the regulations under section 163(j) determine the ordering of the business interest expense deduction that is allowed on a year-by-year basis by reference first to business interest expense incurred in the current taxable year and then to disallowed business interest expense carryforwards from prior years. To determine the amount of base erosion tax benefit under paragraph (c)(1) of this section, this paragraph (c)(4)(ii) sets forth ordering rules that determine the amount of the deduction of business interest expense allowed under section 163(j) that is classified as paid or accrued to a foreign related party for purposes of paragraph (c)(1)(i) of this section. This paragraph (c)(4)(ii) also sets forth similar ordering rules that apply to disallowed business interest expense carryforwards for which a deduction is permitted under section 163(j) in a later year.

(B) *Ordering rules for treating business interest expense deduction and disallowed business interest expense carryforwards as foreign related business interest expense, domestic related business interest expense, and unrelated business interest expense*—(*1*) *General ordering rule for allocating business interest expense deduction between classifications*. For purposes of paragraph (c)(1) of this section, if a deduction for business interest expense is not subject to the limitation under section 163(j)(1) in a taxable year, the deduction is treated first as foreign related business interest expense and domestic related business interest expense (on a pro-rata basis), and second as unrelated business interest expense. The same principle applies to business interest expense of a partnership that is deductible at the partner level under §1.163(j)-6(f).

(*2*) *Ordering of business interest expense incurred by a corporation*. If a corporation's business interest expense deduction allowed for any taxable year is attributable to business interest expense paid or accrued in that taxable year and to disallowed business interest expense carryforwards from prior taxable years, the ordering of business interest expense deduction provided in paragraph (c)(4)(ii)(B)(*1*) of this section among the classifications described therein applies separately for the carryforward amount from each taxable year, following the ordering set forth in §1.163(j)-5(b)(2). Corresponding adjustments to the classification of disallowed business interest expense carryforwards are made consistent with this year-by-year approach. For purposes of section 59A and this section, an acquiring corporation in a transaction described in section 381(a) will succeed to and take into account the classification of any disallowed business interest expense carryforward. See §1.381(c)(20)-1.

(*3*) *Ordering of business interest expense incurred by a partnership and allocated to a corporate partner*. For a corporate partner in a partnership that is allocated a business interest expense deduction under §1.163(j)-6(f), the ordering rule provided in paragraph (c)(4)(ii)(B)(*1*) of this section applies separately to the corporate partner's allocated business interest expense deduction from the partnership; that deduction is not comingled with the business interest expense deduction addressed in paragraph (c)(4)(ii)(B)(*1*) or (*2*) of this section or the corporate partner's items from any other partnership. Similarly, when a corporate partner in a partnership is allocated excess business interest expense from a partnership under the rules set forth in §1.163(j)-6(f) and the excess interest expense becomes deductible to the corporate partner, that partner applies the ordering rule provided in paragraph (c)(4)(ii)(B)(*1*) of this section separately to that excess interest expense on a year-by-year basis. Corresponding adjustments to the classification of disallowed business interest expense carryforwards are made consistent with this year-by-year and partnership-by-partnership approach.

(d) *Examples*. The following examples illustrate the application of this section. For purposes of all the examples, assume that the taxpayer is an applicable taxpayer and all payments apply to a taxable year beginning after December 31, 2017.

(1) *Example 1: Determining a base erosion payment*—(i) *Facts*. FP is a foreign corporation that owns all of the stock of FC, a foreign corporation, and DC, a domestic corporation. FP has a trade or business in the United States with effectively connected income (USTB). DC owns FDE, a foreign disregarded entity. DC pays interest to FDE and FC. FDE pays interest to USTB. All interest paid by DC to FC and by FDE to USTB is deductible by DC in the current year for regular income tax purposes. FDE also acquires depreciable property from FP during the taxable year. FP's income from the sale of the depreciable property is not effectively connected with the conduct of FP's trade or business in the United States. DC and FP (based only on the activities of USTB) are applicable taxpayers under §1.59A-2(b).

(ii) *Analysis*. The payment of interest by DC to FC is a base erosion payment under paragraph (b)(1)(i) of this section because the payment is made to a foreign related party and the interest payment is deductible. The payment of interest by DC to FDE is not a base erosion payment because the transaction is not a payment to a foreign person and the transaction is not a deductible payment. With respect to the payment of interest by FDE to USTB, if FP's USTB treats the payment of interest by FDE to USTB as income that is effectively connected with the conduct of a trade or business in the United States pursuant to section 864 or as profits attributable to a U.S. permanent establishment of a tax treaty resident, and if DC receives a withholding certificate from FP with respect to the payment, then the exception in paragraph (b)(3)(iii) of this section applies. Accordingly, the payment from DC, through FDE, to USTB is not a base erosion payment even though the payment is to the USTB of FP, a foreign related party. The acquisition of depreciable property by DC, through FDE, from FP is a base erosion payment under paragraph (b)(1)(ii) of this section because there is a payment to a foreign related party in connection with the acquisition by the taxpayer of property of a character subject to the allowance for depreciation and the exception in paragraph (b)(3)(iii) of this section does not apply because FP's income from the sale of the depreciable property is not effectively connected with the conduct of FP's trade or business in the United States. See §1.59A-2 for the application of the aggregation rule with respect to DC and FP's USTB.

(2) *Example 2: Interest allocable under §1.882-5*—(i) *Facts*. FC, a foreign corporation, has income that is effectively connected with the conduct of a trade or business within the United States. FC determines its interest expense under the three-step process described in §1.882-5(b) through (d) with a total interest expense of $125x. The total interest expense is comprised of interest expense of $100x on U.S.- booked liabilities ($60x paid to a foreign related party and $40x paid to unrelated persons) and $25x of interest on excess U.S.-connected liabilities. FC has average worldwide interest expense (not including interest expense on U.S.-booked liabilities) of $500x, of which $100x is interest expense paid to a foreign related party. FC is an applicable taxpayer with respect to its effectively connected income. Assume all of the interest expense is deductible in the current taxable year and that none of the interest is subject to the effectively connected income exception in paragraph (b)(3)(iii) of this section.

(ii) *Analysis*. Under paragraph (b)(4)(i) of this section, the total amount of interest expense determined under §1.882-5 that is a base erosion payment is $65x ($60x + 5x). FC has $60x of interest on U.S.-booked liabilities that is paid to a foreign related party and that is treated as a base erosion payment under paragraph (b)(4)(i)(A)(*2*) of this section. Additionally, $5x of the $25x of interest expense on excess U.S.-connected liabilities is treated as a base erosion payment under paragraph (b)(4)(i)(A)(*3*) of this section ($25x * ($100x / $500x)).

(3) *Example 3: Interaction with section 163(j)*—(i) *Facts*. Foreign Parent (FP) is a foreign corporation that owns all of the stock of DC, a domestic corporation that is an applicable taxpayer. DC does not conduct a utility trade or business as described in section 163(j)(7)(A)(iv), an electing real property trade or business as described in section 163(j)(7)(B), or an electing farming business as described in section 163(j)(7)(C). In Year 1, DC has adjusted taxable income, as defined in section 163(j)(8), of $1000x and pays the following amounts of business interest expense: $420x that is paid to unrelated Bank, and $360x that is paid to FP. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 1. None of the exceptions in paragraph (b)(3) of this section apply, and the interest is not subject to withholding.

(ii) *Analysis*—(A) *Classification of business interest*. In Year 1, DC is permitted to deduct only $300x of business interest expense under section 163(j)(1) ($1000x x 30%). Paragraph (c)(4)(ii)(B) of this section provides that for purposes of paragraph (c)(1) of this section the deduction is treated first as foreign related business interest expense and domestic related business interest expense (here, only FP); and second as unrelated business interest expense (Bank). As a result, the $300x of business interest expense that is permitted under section 163(j)(1) is treated entirely as the business interest paid to the related foreign party, FP. All of DC's $300x deductible interest is treated as an add-back to modified taxable income in the Year 1 taxable year for purposes of §1.59A-4(b)(2)(i).

(B) *Ordering rules for disallowed business interest expense carryforward*. Under section 163(j)(2), the $480x of disallowed business interest ($420x + $360x - $300x) is carried forward to the subsequent year. Under paragraph (c)(4)(ii)(B)(*1*) and (*2*) of this section, the disallowed business interest carryforward is correspondingly treated first as unrelated business interest expense, and second pro-rata as foreign related business interest expense and domestic related business interest expense. As a result, $420x of the $480x disallowed business interest expense carryforward is treated first as business interest expense paid to Bank and the remaining $60x of the $480x disallowed business interest expense carryforward is treated as interest paid to FP and as an add-back to modified taxable income.

(4) *Example 4: Interaction with section 163(j); carryforward*—(i) *Facts*. The facts are the same as in paragraph (d)(3) of this section (the facts in *Example 3*), except that in addition, in Year 2, DC has adjusted taxable income of $250x, and pays the following amounts of business interest expense: $50x that is paid to unrelated Bank, and $45x that is paid to FP. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 2. None of the exceptions in paragraph (b)(3) of this section apply.

(ii) *Analysis*—(A) *Classification of business interest*. In Year 2, for purposes of section 163(j)(1), DC is treated as having paid or accrued total business interest expense of $575x, consisting of $95x business interest expense actually paid in Year 2 and $480x of business interest expense that is carried forward from Year 1. DC is permitted to deduct $75x of business interest expense in Year 2 under the limitation in section 163(j)(1) ($250x x 30%). Section 1.163(j)-5(b)(2) provides that, for purposes of section 163(j), the allowable business interest expense is first attributed to amounts paid or accrued in the current year, and then attributed to amounts carried over from earlier years on a first-in-first-out basis from the earliest year. Accordingly, the $75x of deductible business interest expense is deducted entirely from the $95x business interest expense incurred in Year 2 for section 163(j) purposes. Because DC's business interest expense deduction is limited under section 163(j)(1) and because DC's total business interest expense is attributable to more than one taxable year, paragraph (c)(4)(ii)(B)(*2*) of this section provides that the ordering rule in paragraph (c)(4)(ii)(B)(*1*) of this section is applied separately to each annual amount of section 163(j) disallowed business interest expense carryforward. With respect to the Year 2 layer, which is deducted first, paragraph (c)(4)(ii)(B) of this section provides that, for purposes of paragraph (c)(1) of this section, the Year 2 $75x deduction is treated first as foreign related business interest expense and domestic related business interest expense (here, only FP, $45x); and second as unrelated business interest expense (Bank, $30x). Consequentially, all of the $45x deduction of business interest expense that was paid to FP in Year 2 is treated as a base erosion tax benefit and an add-back to modified taxable income for the Year 2 taxable year for purposes of §1.59A-4(b)(2)(i).

(B) *Ordering rules for disallowed business interest expense carryforward*. The disallowed business interest expense carryforward of $20x from Year 2 is correspondingly treated first as business interest expense paid to Bank under paragraph (c)(4)(i) of this section. The disallowed business interest expense carryforward of $480x from the Year 1 layer that is also not allowed as a deduction in Year 2 remains treated as $420x paid to Bank and $60 paid to FP.

(5) *Example 5: Interaction with section 163(j); carryforward*—(i) *Facts*. The facts are the same as in paragraph (d)(4) of this section (the facts in *Example 4*), except that in addition, in Year 3, DC has adjusted taxable income of $4000x and pays no business interest expense. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 3.

(ii) *Analysis*. In Year 3, DC is treated as having paid or accrued total business interest expense of $500x, consisting of $480x of business interest expense that is carried forward from Year 1 and $20x of business interest expense that is carried forward from Year 2 for purposes of section 163(j)(1). DC is permitted to deduct $1200x of business interest expense in Year 3 under the limitation in section 163(j)(1) ($4000x x 30%). For purposes of section 163(j), DC is treated as first deducting the business interest expense from Year 1 then the business interest expense from Year 2. See §1.163(j)-5(b)(2). Because none of DC's $500x business interest expense is limited under section 163(j), the stacking rule in paragraph (c)(4)(ii) of this section for allowed and disallowed business interest expense does not apply. For purposes of §1.59A-4(b)(2)(i), DC's add-back to modified taxable income is $60x determined by the classifications in paragraph (c)(4)(i)(A) of this section ($60x treated as paid to FP from Year 1).

(6) *Example 6: Interaction with section 163(j); partnership*—(i) *Facts*. The facts are the same as in paragraph (d)(4) of this section (the facts in *Example 4*), except that in addition, in Year 2, DC forms a domestic partnership (PRS) with Y, a domestic corporation that is not related to DC within the meaning of §1.59A-1(b)(17). PRS does not conduct a utility trade or business as described in section 163(j)(7)(A)(iv), an electing real property trade or business as described in section 163(j)(7)(B) or an electing farming business as described in section 163(j)(7)(C) subject to section 163(j). PRS is not a small business described in section 163(j)(3). DC and Y are equal partners in partnership PRS. In Year 2, PRS has ATI of $100x and $48x of business interest expense. $12x of PRS's business interest expense is paid to Bank, and $36x of PRS's business interest expense is paid to FP. PRS allocates the items comprising its $100x of ATI $50x to DC and $50x to Y. PRS allocates its $48x of business interest expense $24x to DC and $24x to Y. DC classifies its $24x of business interest expense as $6x unrelated business interest expense (Bank) and $18x as foreign related business interest expense (FP) under paragraph (c)(4)(i)(B) of this section. Y classifies its $24x of business interest expense as entirely unrelated business interest expense of Y (Bank and FP) under paragraph (c)(4)(i)(B) of this section. None of the exceptions in paragraph (b)(3) of this section apply.

(ii) *Partnership level analysis*. In Year 2, PRS's section 163(j) limit is 30 percent of its ATI, or $30x ($100x x 30 percent). Thus, PRS has $30x of deductible business interest expense and $18x of excess business interest expense ($48x - $30x). The $30x of deductible business interest expense is includible in PRS's non-separately stated income or loss, and is not subject to further limitation under section 163(j) at the partners' level.

(iii) *Partner level allocations analysis*. Pursuant to §1.163(j)-6(f)(2), DC and Y are each allocated $15x of deductible business interest expense and $9x of excess business interest expense. At the end of Year 2, DC and Y each have $9x of excess business interest expense from PRS, which under §1.163(j)-6 is not treated as paid or accrued by the partner until such partner is allocated excess taxable income or excess business interest income from PRS in a succeeding year. Pursuant to §1.163(j)-6(e), DC and Y, in computing their limit under section 163(j), do not increase any of their section 163(j) items by any of PRS's section 163(j) items.

(iv) *Partner level allocations for determining base erosion tax benefits*. The $15x of deductible business interest expense allocated to DC is treated first as foreign related business interest expense (FP) under paragraph (c)(4)(ii)(B) of this section. DC's excess business interest expense from PRS of $9x is classified first as the unrelated business interest expense with respect to Bank ($6x) and then as the remaining portion of the business interest expense paid to FP ($3x, or $18x - $15x). Under paragraph (c)(4)(ii)(B)(*3*) of this section, these classifications of the PRS items apply irrespective of the classifications of DC's own interest expense as set forth in paragraph (d)(4) of this section (*Example 4*).

(v) *Computation of modified taxable income*. For Year 2, DC is treated as having incurred base erosion tax benefits of $60x, consisting of the $15x base ero-

sion tax benefit with respect to its interest in PRS that is computed in paragraph (d)(6)(iii) of this section (*Example 6*) and $45x that is computed in paragraph (d)(4) of this section (*Example 4*).

(7) *Example 7: Transfers of property to related taxpayers*—(i) *Facts*. FP is a foreign corporation that owns all of the stock of DC1 and DC2, both domestic corporations. DC1 and DC2 are both members of the same aggregate group but are not members of the same consolidated tax group under section 1502. In Year 1, FP sells depreciable property to DC1. On the first day of the Year 2 tax year, DC1 sells the depreciable property to DC2.

(ii) *Analysis*—(A) *Year 1*. The acquisition of depreciable property by DC1 from FP is a base erosion payment under paragraph (b)(1)(ii) of this section because there is a payment to a foreign related party in connection with the acquisition by the taxpayer of property of a character subject to the allowance for depreciation.

(B) *Year 2*. The acquisition of the depreciable property in Year 2 by DC2 is not itself a base erosion payment because DC2 did not acquire the property from a foreign related party. However, under paragraph (b)(2)(viii) of this section any depreciation expense taken by DC2 on the property acquired from DC1 is a base erosion payment and a base erosion tax benefit under paragraph (c)(1)(ii) of this section because the acquisition of the depreciable property was a base erosion payment by DC1 and the property was sold to a member of the aggregate group; therefore, the depreciation expense continues as a base erosion tax benefit to DC2 as it would have been to DC1 if it continued to own the property.

§1.59A-4 Modified taxable income.

(a) *Scope*. Paragraph (b)(1) of this section provides rules for computing modified taxable income. Paragraph (b)(2) of this section provides rules addressing how base erosion tax benefits and net operating losses affect modified taxable income. Paragraph (b)(3) of this section provides a rule for a holder of a residual interest in a REMIC. Paragraph (c) of this section provides examples illustrating the rules described in this section.

(b) *Computation of modified taxable income*—(1) *In general*. The term *modified taxable income* means a taxpayer's taxable income, as defined in section 63(a), determined with the additions described in paragraph (b)(2) of this section. Notwithstanding the foregoing, the taxpayer's taxable income may not be reduced to an amount less than zero as a result of a net operating loss deduction allowed under section 172. See paragraphs (c)(1) and (2) of this section (*Examples 1* and *2*).

(2) *Modifications to taxable income*. The amounts described in this paragraph (b)(2) are added back to a taxpayer's taxable income to determine its modified taxable income.

(i) *Base erosion tax benefits*. The amount of any base erosion tax benefit as defined in §1.59A-3(c)(1).

(ii) *Certain net operating loss deductions*. The base erosion percentage, as described in §1.59A-2(e)(3), of any net operating loss deduction allowed to the taxpayer under section 172 for the taxable year. For purposes of determining modified taxable income, the net operating loss deduction allowed does not exceed taxable income before taking into account the net operating loss deduction. See paragraph (c)(1) and (2) of this section (*Examples 1* and *2*). The base erosion percentage for the taxable year that the net operating loss arose is used to determine the addition under this paragraph (b)(2)(ii). For a net operating loss that arose in a taxable year beginning before January 1, 2018, the base erosion percentage for the taxable year is zero.

(3) *Rule for holders of a residual interest in a REMIC*. For purposes of paragraph (b)(1) of this section, the limitation in section 860E(a)(1) is not taken into account in determining the taxable income amount that is used to compute modified taxable income for the taxable year.

(c) *Examples*. The following examples illustrate the rules of paragraph (b) of this section.

(1) *Example 1: Current year loss*—(i) *Facts*. A domestic corporation (DC) is an applicable taxpayer that has a calendar 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 a net operating loss carryforward to 2020 of $400x that arose in 2016.

(ii) *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 paragraph (b)(2)(ii) of this section, DC's starting point for computing modified taxable income does not take into account the $400x net operating loss carryforward because the allowable deductions for 2020, not counting the NOL deduction, exceed the gross income for 2020. DC's modified taxable income for 2020 is $20x, computed as $(50x) + $70x base erosion tax benefit.

(2) *Example 2: Net operating loss deduction*—(i) *Facts*. The facts are the same as in paragraph (c)(1)(i) of this section (the facts in *Example 1*), except that DC's gross income in 2020 is $500x.

(ii) *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 a net operating loss deduction of $350x (which is the amount of taxable income before taking into account the net operating loss deduction, as provided in paragraph (b)(2)(ii) of this section ($500x - $150x)). DC's modified taxable income for 2020 is $70x, computed as $0x + $70x base erosion tax benefit. DC's modified taxable income is not increased as a result of the $350x net operating loss deduction in 2020 because the base erosion percentage of the net operating loss that arose in 2016 is zero under paragraph (b)(2)(ii) of this section.

§1.59A-5 Base erosion minimum tax amount.

(a) *Scope*. Paragraph (b) of this section provides rules regarding the calculation of the base erosion minimum tax amount. Paragraph (c) of this section describes the base erosion and anti-abuse tax rate applicable to the taxable year.

(b) *Base erosion minimum tax amount*—(1) *In general*. For each taxable year, an applicable taxpayer must determine its base erosion minimum tax amount.

(2) *Calculation of base erosion minimum tax amount*. With respect to any applicable taxpayer, the base erosion minimum tax amount for any taxable year is, the excess (if any) of—

(i) An amount equal to the base erosion and anti-abuse tax rate multiplied by the modified taxable income of the taxpayer for the taxable year, over

(ii) An amount equal to the regular tax liability as defined in §1.59A-1(b)(16) of the taxpayer for the taxable year, reduced (but not below zero) by the excess (if any) of-

(A) The credits allowed under chapter 1 of subtitle A of the Code against regular tax liability over

(B) The sum of the credits described in paragraph (b)(3) of this section.

(3) *Credits that do not reduce regular tax liability*. The sum of the following credits are used in paragraph (b)(2)(ii)(B) of this section to limit the amount by which the credits allowed under chapter 1 of subtitle A of the Internal Revenue Code reduce regular tax liability—

(i) *Taxable years beginning on or before December 31, 2025*. For any taxable

year beginning on or before December 31, 2025—

(A) The credit allowed under section 38 for the taxable year that is properly allocable to the research credit determined under section 41(a);

(B) The portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of those applicable section 38 credits or the base erosion minimum tax amount (determined without regard to this paragraph (b)(3)(i)(B)); and

(C) Any credits allowed under sections 33, 37, and 53.

(ii) *Taxable years beginning after December 31, 2025*. For any taxable year beginning after December 31, 2025, any credits allowed under sections 33, 37, and 53.

(c) *Base erosion and anti-abuse tax rate*—(1) *In general*. For purposes of calculating the base erosion minimum tax amount, the base erosion and anti-abuse tax rate is—

(i) *Calendar year 2018*. For taxable years beginning in calendar year 2018, five percent.

(ii) *Calendar years 2019 through 2025*. For taxable years beginning after December 31, 2018, through taxable years beginning before January 1, 2026, 10 percent.

(iii) *Calendar years after 2025*. For taxable years beginning after December 31, 2025, 12.5 percent.

(2) *Increased rate for banks and registered securities dealers*—(i) *In general*. In the case of a taxpayer that is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a bank or a registered securities dealer, the percentage otherwise in effect under paragraph (c)(1) of this section is increased by one percentage point.

(ii) *De minimis exception to increased rate for banks and registered securities dealers*. Paragraph (c)(2)(i) of this section does not apply to a taxpayer that is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a bank or registered securities dealer if, in that taxable year, the total gross receipts of the affiliated group attributable to the bank or the registered securities dealer (or attributable to all of the banks and registered securities dealers in the group, if more than one) represent less than two percent of the total gross receipts of the affiliated group, as determined under §1.59A-2(d).

(3) *Application of section 15 to tax rates in section 59A*—(i) *New tax*. Section 15 does not apply to any taxable year that includes January 1, 2018.

(ii) *Change in tax rate pursuant to section 59A(b)(1)(A)*. Section 15 does not apply to any taxable year that includes January 1, 2019.

(iii) *Change in rate pursuant to section 59A(b)(2)*. Section 15 applies to the change in tax rate pursuant to section 59A(b)(2)(A).

§1.59A-6 Qualified derivative payment.

(a) *Scope*. This section provides additional guidance regarding qualified derivative payments. Paragraph (b) of this section defines the term qualified derivative payment. Paragraph (c) of this section provides guidance on certain payments that are not treated as qualified derivative payments. Paragraph (d) defines the term derivative for purposes of section 59A. Paragraph (e) of this section provides examples illustrating the rules of this section.

(b) *Qualified derivative payment*—(1) *In general*. A *qualified derivative payment* means any payment made by a taxpayer to a foreign related party pursuant to a derivative with respect to which the taxpayer—

(i) Recognizes gain or loss as if the derivative were sold for its fair market value on the last business day of the taxable year (and any additional times as required by the Internal Revenue Code or the taxpayer's method of accounting);

(ii) Treats any gain or loss so recognized as ordinary; and

(iii) Treats the character of all items of income, deduction, gain, or loss with respect to a payment pursuant to the derivative as ordinary.

(2) *Reporting requirements*—(i) *In general*. No payment is a qualified derivative payment under paragraph (b)(1) of this section for any taxable year unless the taxpayer (whether or not the taxpayer is a reporting corporation as defined in §1.6038A-1(c)) reports the information required in §1.6038A-2(b)(7)(ix) for the taxable year. To report its qualified derivative payments, a taxpayer must include the payment in the aggregate amount of qualified derivative payments on Form 8991 (or successor).

(ii) *Failure to satisfy the reporting requirement*. If a taxpayer fails to satisfy the reporting requirement described in paragraph (b)(2)(i) of this section with respect to any payments, those payments are not eligible for the qualified derivative payment exception described in §1.59A-3(b)(3)(ii) and are base erosion payments unless an exception in §1.59A-3(b)(3) otherwise applies. A taxpayer's failure to report a payment as a qualified derivative payment does not impact the eligibility of any other payment which the taxpayer properly reported under paragraph (b)(2)(i) of this section from being a qualified derivative payment.

(iii) *Reporting of aggregate amount of qualified derivative payments*. The aggregate amount of qualified derivative payments is the sum of the amount described in paragraph (b)(3) of this section for each derivative. To the extent that the taxpayer is treated as receiving a payment, as determined in §1.59A-2(e)(3)(vi), for the taxable year with respect to a derivative, the payment is not included in the aggregate qualified derivative payments.

(iv) *Transition period for qualified derivative payment reporting*. Before paragraph (b)(2)(i) of this section is applicable, a taxpayer will be treated as satisfying the reporting requirement described section 59A(h)(2)(B) to the extent that the taxpayer reports the aggregate amount of qualified derivative payments on Form 8991 (or successor). *See* §1.6038A-2(g) (applicability date for §1.6038A-2(b)(7)(ix)). Until paragraph (b)(2)(i) of this section is applicable, paragraph (b)(2)(ii) of this section will not apply to a taxpayer who reports the aggregate amount of qualified derivative payments in good faith.

(3) *Amount of any qualified derivative payment*—(i) *In general*. The amount of any qualified derivative payment excluded from the denominator of the base erosion percentage as provided in §1.59A-2(e)(3)(ii)(C) is determined as provided in §1.59A-2(e)(3)(vi).

(ii) *Net qualified derivative payment that includes a payment that is a base erosion payment*. Any net amount determined in paragraph (b)(3)(i) of this section must

be reduced by any gross items that are treated as a base erosion payment pursuant to paragraph (c) of this section.

(c) *Exceptions for payments otherwise treated as base erosion payments*. A payment does not constitute a qualified derivative payment if—

(1) The payment would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment; or

(2) In the case of a contract that has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

(d) *Derivative defined*—(1) *In general*. For purposes of this section, the term *derivative* means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following:

(i) Any share of stock in a corporation;

(ii) Any evidence of indebtedness;

(iii) Any commodity that is actively traded;

(iv) Any currency; or

(v) Any rate, price, amount, index, formula, or algorithm.

(2) *Exceptions*. The following contracts are not treated as derivatives for purposes of section 59A.

(i) *Direct interest*. A derivative contract does not include a direct interest in any item described in paragraph (d)(1)(i) through (v) of this section.

(ii) *Insurance contracts*. A derivative contract does not include any insurance, annuity, or endowment contract issued by an insurance company to which subchapter L applies (or issued by any foreign corporation to which the subchapter would apply if the foreign corporation were a domestic corporation).

(iii) *Securities lending and sale-repurchase transactions*—(A) *Multi-step transactions treated as financing*. For purposes of paragraph (d)(1) of this section, a derivative does not include any securities lending transaction, sale-repurchase transaction, or substantially similar transaction that is treated as a secured loan for federal tax purposes. Securities lending transaction and sale-repurchase transaction have the meanings provided in §1.861-2(a)(7).

(B) *Special rule for payments associated with the cash collateral provided in a securities lending transaction or substantially similar transaction*. For purposes of paragraph (d)(1) of this section, a derivative does not include the cash collateral component of a securities lending transaction (or the cash payments pursuant to a sale-repurchase transaction, or similar payments pursuant to a substantially similar transaction).

(C) *Anti-abuse exception for certain transactions that are the economic equivalent of substantially unsecured cash borrowing*. For purposes of paragraph (d)(1) of this section, a derivative does not include any securities lending transaction or substantially similar transaction that is part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to that transaction as a base erosion payment and that provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing. The determination of whether the securities lending transaction or substantially similar transaction provides the taxpayer with the economic equivalent of a substantially unsecured cash borrowing takes into account arrangements that effectively serve as collateral due to the taxpayer's compliance with any U.S. regulatory requirements governing such transaction.

(3) *American depository receipts*. For purposes of section 59A, American depository receipts (or any similar instruments) with respect to shares of stock in a foreign corporation are treated as shares of stock in that foreign corporation.

(e) *Examples*. The following examples illustrate the rules of this section.

(1) *Example 1: Notional principal contract as QDP*—(i) *Facts*. Domestic Corporation (DC) is a dealer in securities within the meaning of section 475. On February 1, 2019, DC enters into a contract (Interest Rate Swap) with Foreign Parent (FP), a foreign related party, for a term of five years. Under the Interest Rate Swap, DC is obligated to make a payment to FP each month, beginning March 1, 2019, in an amount equal to a variable rate determined by reference to the prime rate, as determined on the first business day of the immediately preceding month, multiplied by a notional principal amount of $50x. Under the Interest Rate Swap, FP is obligated to make a payment to DC each month, beginning March 1, 2019, in an amount equal to 5% multiplied by the same notional principal amount. The Interest Rate Swap satisfies the definition of a notional principal contract under §1.446-3(c). DC recognizes gain or loss on the Interest Rate Swap pursuant to section 475. DC reports the information required to be reported for the taxable year under §1.6038A-2(b)(7)(ix).

(ii) *Analysis*. The Interest Rate Swap is a derivative as described in paragraph (d) of this section because it is a contract that references the prime rate and a fixed rate for determining the amount of payments. The exceptions described in paragraph (c) of this section do not apply to the Interest Rate Swap. Because DC recognizes ordinary gain or loss on the Interest Rate Swap pursuant to section 475(d)(3), it satisfies the condition in paragraph (b)(1)(ii) of this section. Because DC satisfies the requirement relating to the information required to be reported under paragraph (b)(2) of this section, any payment to FP with respect to the Interest Rate Swap will be a qualified derivative payment. Therefore, under §1.59A-3(b)(3)(ii), the payments to FP are not base erosion payments.

(2) *Example 2: Securities lending anti-abuse rule*—(i) *Facts*. (A) Foreign Parent (FP) is a foreign corporation that owns all of the stock of domestic corporation (DC) and foreign corporation (FC). FP and FC are foreign related parties of DC under §1.59A-1(b)(12) but not members of DC's aggregate group. On January 1 of year 1, with a principal purpose of providing financing to DC without DC making a base erosion payment to FC, FC lends 100x U.S. Treasury bills with a remaining maturity of 11 months (Securities A) to DC (Securities Lending Transaction 1) for a period of six months. Pursuant to the terms of Securities Lending Transaction 1, DC is obligated to make substitute payments to FC corresponding to the interest payments on Securities A. DC does not post cash collateral with respect to Securities Lending Transaction 1, and no other arrangements of FC or DC effectively serve as collateral under any U.S. regulatory requirements governing the transaction. Immediately thereafter, DC sells Securities A for cash.

(B) On June 30 of year 1, FC lends 100x U.S. Treasury bills with a remaining maturity of 11 months (Securities B) to DC (Securities Lending Transaction 2) for a period of six months. Pursuant to the terms of Securities Lending Transaction 2, DC is obligated to make substitute payments to FC corresponding to the interest payments on Securities B. Immediately thereafter, DC sells Securities B for cash and uses the cash to purchase U.S. Treasury bills with a remaining maturity equal to the Securities A bills that DC then transfers to FC in repayment of Securities Lending Transaction 1.

(ii) *Analysis*. Securities Lending Transaction 1 and Securities Lending Transaction 2 are not treated as derivatives for purposes of paragraph (d)(1) of this section because the transactions are part of an arrangement that has been entered into with a principal purpose of avoiding the treatment of any payment with respect to Securities Lending Transaction 1 and Securities Lending Transaction 2 as a base erosion payment and provides DC with the economic equivalent of a substantially unsecured cash borrowing by DC. As a result, pursuant to paragraph (d)(2)(iii)(C) of this section, the substitute payments made by DC to FC with respect to Securities A and Securities B are not eligible for the exception in §1.59A-3(b)(3)(ii) (qualified derivative payment).

§1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

(a) *Scope*. This section provides rules regarding how partnerships and their partners are treated for purposes of making certain determinations under section 59A, including whether there is a base erosion payment or base erosion tax benefit. All references to partnerships in this section include domestic and foreign partnerships. This section applies to payments to a partnership and payments from a partnership as well as transfers of partnership interests (as defined in paragraph (c)(3)(iv) of this section). The aggregate principle described in this section does not override the treatment of partnership items under any Code section other than section 59A. The aggregate principles provided in this section apply without regard to any tax avoidance purpose relating to a particular partnership. See §1.701-2(e). Paragraph (b) of this section describes how the aggregate approach to partnerships applies for purposes of certain section 59A determinations. Paragraph (c) of this section provides rules for determining whether there is a base erosion payment with respect to a payment to or from a partnership. Paragraph (d) of this section provides rules for determining the base erosion tax benefits of a partner. Paragraph (e) of this section provides additional rules relating to the application of section 59A to partnerships. Paragraph (f) of this section provides a rule for determining whether a person is a foreign related party. Paragraph (g) of this section provides examples that illustrate the application of the rules of this section.

(b) *Application of section 59A to partnerships*. The purpose of this section is to provide a set of operating rules for the application of section 59A to partnerships and partners in a manner consistent with the purposes of section 59A. Except for purposes of determining a partner's base erosion tax benefits under paragraph (d)(1) of this section and whether a taxpayer is a registered securities dealer under paragraph (e)(3) of this section, section 59A determinations are made at the partner level in the manner described in this section. The provisions of section 59A must be interpreted in a manner consistent with this approach. If a transaction is not specifically described in this section, whether the transaction gives rise to a base erosion payment or base erosion tax benefit is determined in accordance with the principles of this section and the purposes of section 59A.

(c) *Base erosion payment*. For purposes of determining whether a taxpayer has made a base erosion payment as described in §1.59A-3(b), the taxpayer must treat a payment to or from a partnership as made to or from each partner and the assets and liabilities of the partnership as assets and liabilities of each partner. This paragraph (c) provides specific rules for determining whether a partner has made or received a payment, including as a result of a partnership interest transfer (as defined in paragraph (c)(3)(iv) of this section).

(1) *Payments made by or to a partnership*. For purposes of determining whether a payment or accrual by a partnership is a base erosion payment described in §1.59A-3(b)(1)(i), any amount paid or accrued by the partnership (including any guaranteed payment described in section 707(c)) is treated as paid or accrued by each partner based on the partner's distributive share of the item of deduction with respect to that amount. For purposes of determining whether a payment or accrual to a partnership is a base erosion payment described in §1.59A-3(b)(1)(i) or (iii), any amount paid or accrued to the partnership (including any guaranteed payment described in section 707(c)) is treated as paid or accrued to each partner based on the partner's distributive share of the item of income with respect to that amount. See paragraph (e)(1) of this section to determine the partner's distributive share.

(2) *Transfers of certain property*. When a partnership transfers property, each partner is treated as transferring its proportionate share of the property transferred for purposes of determining whether there is a base erosion payment described in §1.59A-3(b)(1)(ii) or (iv). When a partnership acquires property, each partner is treated as acquiring its proportionate share of the property acquired for purposes of determining whether there is a base erosion payment described in §1.59A-3(b)(1)(ii) or (iv). For purposes of this paragraph (c)(2), a transfer of property does not include a transfer of a partnership interest (as defined in paragraph (c)(3)(iv) of this section). See paragraph (c)(3) of this section for rules applicable to transfers of partnership interests. See paragraphs (g)(2)(v) and (vi) of this section (*Example 5* and *Example 6*) for examples illustrating the application of this paragraph (c)(2).

(3) *Transfers of a partnership interest*—(i) *In general*. A transfer of a partnership interest (as defined in paragraph (c)(3)(iv) of this section) is generally treated as a transfer by each partner in the partnership of its proportionate share of the partnership's assets to the extent of any change in its proportionate share of any partnership asset, as well as any assumption of associated liabilities by the partner. Paragraphs (c)(3)(ii) and (iii) of this section provide rules for applying the general rule to transfers of a partnership interest by a partner and issuances of a partnership interest by the partnership for contributed property, respectively. See paragraph (g)(2)(vii) of this section (*Example 7*) for an example illustrating the application of this paragraph (c)(3)(i).

(ii) *Transfers of a partnership interest by a partner*. A transfer of a partnership interest (as defined in paragraph (c)(3)(iv) of this section) by a partner is treated as a transfer by the transferor to the recipient of the transferor's proportionate share of each of the partnership assets and an assumption by the recipient of the transferor's proportionate share of the partnership liabilities. If the partner's entire partnership interest is not transferred, only the proportionate share of each of the partnership assets and liabilities associated with the transferred partnership interest is treated as transferred and assumed. See paragraphs (g)(2)(iii), (iv), and (vi) of this section (*Example 3*, *Example 4*, and *Example 6*) for examples illustrating the application of this paragraph (c)(3)(ii).

(iii) *Certain issuances of a partnership interest by a partnership*. If a partnership issues an interest in the partnership in exchange for a contribution of property to the partnership, the contributing partner is treated as exchanging a portion of the contributed property and assuming any liabilities associated with the transferred partnership interest for a portion of the partners' pre-contribution interests in the partnership's assets and the partners' assumption of any liabilities transferred to the partnership. For purposes of this paragraph (c)(3)(iii), a reference to the "part-

nership's assets" includes the assets contributed by the contributing partner and any other assets that are contributed to the partnership at the same time. Each partner whose proportionate share in a partnership asset (including the assets contributed to the partnership as part of the transaction) is reduced as a result of the transaction is treated as transferring the asset to the extent of the reduction, and each person who receives a proportionate share or an increased proportionate share in an asset as a result of the transaction is treated as receiving an asset to the extent of the increase, proportionately from the partners' reduced interests. For example, if a person contributes property to a partnership in which each of two existing partners has a 50 percent pro-rata interest in the partnership in exchange for a one-third pro-rata partnership interest, each of the pre-contribution partners is treated as transferring a one-third interest in their share of existing partnership assets to the contributing partner, and the contributing partner is treated as transferring a one-third interest in the contributed assets to each of the original partners. See paragraphs (g)(2)(i) and (ii) of this section (*Example 1* and *Example 2*) for additional examples illustrating the application of this paragraph (c)(3)(iii).

(iv) *Partnership interest transfers defined*. For purposes of paragraphs (c)(3) and (4) of this section, a transfer of a partnership interest includes any issuance of a partnership interest by a partnership; any sale of a partnership interest; any increase or decrease in a partner's proportionate share of any partnership asset as a result of a contribution of property or services to a partnership, a distribution, or a redemption; or any other transfer of a proportionate share of any partnership asset (other than a transfer of a partnership asset that is not a partnership interest by the partnership to a person not acting in a partner capacity), whether by a partner or the partnership (including as a result of a deemed or actual sale or a capital shift).

(4) *Increased basis from a distribution*. If a distribution of property from a partnership to a partner results in an increase in the tax basis of either the distributed property or other partnership property, such as under section 732(b) or 734(b), the increase in tax basis attributable to a foreign related party is treated as if it was newly purchased property acquired by the taxpayer (to the extent of its proportionate share) from the foreign related party that is placed in service when the distribution occurs. See §1.734-1(e). This increased basis treated as newly purchased property is treated as acquired with a base erosion payment, unless an exception in §1.59A-3(b) applies. For this purpose, in the case of a distribution to a foreign related party, the increased basis in the remaining partnership property that is treated as newly purchased property is entirely attributable to the foreign related party. In the case of a distribution to a taxpayer, the increased basis in the distributed property that is treated as newly purchased property is attributable to each foreign related party in proportion to the foreign related party's proportionate share of the asset immediately before the distribution. If the distribution is to a person other than a taxpayer or a foreign related party, there is no base erosion payment caused by the distribution under this paragraph (c)(4). See paragraphs (g)(2)(vii), (viii), and (ix) of this section (*Example 7*, *Example 8*, and *Example 9*) for examples illustrating the application of this paragraph (c)(4).

(5) *Operating rules applicable to base erosion payments*—(i) *Single payment characterized as separate transactions*. If a single transaction is partially characterized in one manner and partially characterized in another manner, each part of the transaction is separately analyzed. For example, if a contribution of property to a partnership is partially treated as a contribution and partially treated as a disguised sale, the contribution and sale are separately analyzed under paragraph (c) of this section.

(ii) *Ordering rule with respect to transfers of a partnership interest*. If a partnership interest is transferred (within the meaning of paragraph (c)(3)(iv) of this section), paragraph (c)(3) of this section first applies to determine the assets deemed transferred by the transferor(s) to the transferee(s) and liabilities deemed assumed by the parties. Then, to the extent applicable (such as where a partnership makes a contribution in exchange for an interest in another partnership or when a partnership receives an interest in another partnership as a contribution to it), paragraph (c)(2) of this section applies for purposes of determining the proportionate share of the property received by the partners in a partnership. See paragraph (g)(2)(vi) of this section (*Example 6*) for an illustration of this rule.

(iii) *Consideration for base erosion payment or property resulting in base erosion tax benefits*. When a partnership pays or receives property, services, or other consideration, each partner is deemed to pay or receive the property, services, or other consideration paid or received by the partnership for purposes of determining if there is a base erosion payment, except as otherwise provided in paragraph (c) of this section. See paragraphs (g)(2)(v) and (vi) of this section (*Example 5* and *Example 6*) for illustrations of this rule.

(iv) *Non-cash consideration*. When both parties to a transaction use non-cash consideration, each party must separately apply paragraph (c) of this section to determine its base erosion payment with respect to each property. For example, if two partnerships, each with a domestic corporation and a foreign corporation as partners, all of whom are related, exchange depreciable property, each transfer of property would be separately analyzed to determine whether it is a base erosion payment.

(d) *Base erosion tax benefit for partners*—(1) *In general*. A partner's distributive share of any deduction or reduction in gross receipts attributable to a base erosion payment (including as a result of sections 704(b) and (c), 707(a) and (c), 732(b) and (d), 734(b) and (d), 737, 743(b) and (d), and 751(b)) is the partner's base erosion tax benefit, subject to the exceptions in §1.59A-3(c)(2). See paragraph (e)(1) of this section to determine the partner's distributive share for purposes of section 59A. A partner's base erosion tax benefit may be more than the partner's base erosion payment. For example, if a partnership makes a payment to a foreign related party of its domestic partner to acquire a depreciable asset, and the partnership specially allocates more depreciation deductions to a partner than its proportionate share of the asset, the partner's base erosion tax benefit includes the specially allocated depreciation deduction even if the total allocated deduction exceeds the partner's share of the base erosion payment made to acquire the asset. Base erosion

tax benefits are determined separately for each asset, payment, or accrual, as applicable, and are not netted with other items. A taxpayer determines its base erosion tax benefits for non-partnership items pursuant to §1.59A-3(c).

(2) *Exception for base erosion tax benefits of certain small partners*—(i) *In general*. For purposes of determining a partner's amount of base erosion tax benefits attributable to a base erosion payment made by a partnership, a partner does not take into account its distributive share of any base erosion tax benefits from the partnership for the taxable year if –

(A) The partner's interest in the partnership represents less than ten percent of the capital and profits of the partnership at all times during the taxable year;

(B) The partner is allocated less than ten percent of each partnership item of income, gain, loss, deduction, and credit for the taxable year; and

(C) The partner's interest in the partnership has a fair market value of less than $25 million on the last day of the partner's taxable year, determined using a reasonable method.

(ii) *Attribution*. For purposes of paragraph (d)(2)(i) of this section, a partner's interest in a partnership or partnership item is determined by adding the interests of the partner and any related party of the partner (as determined under section 59A), taking into account any interest owned directly, indirectly, or through constructive ownership (applying the section 318 rules as modified by section 59A (except section 318(a)(3)(A) through (C) will also apply so as to consider a United States person as owning stock that is owned by a person who is not a United States person), but excluding any interest to the extent already taken into account).

(e) *Other rules for applying section 59A to partnerships*—(1) *Partner's distributive share*. For purposes of section 59A, each partner's distributive share of an item of income or deduction of the partnership is determined under sections 704(b) and (c) and takes into account amounts determined under other provisions of the Code, including but not limited to sections 707(a) and (c), 732(b) and (d), 734(b) and (d), 737, 743(b) and (d), and 751(b). *See* §1.704-1(b)(1)(iii) regarding the application of section 482. These amounts are calculated separately for each payment or accrual on a property-by-property basis, including for purposes of section 704(c), and are not netted. For purposes of section 59A, a partner's distributive share of a reduction to determine gross income is equal to a proportionate amount of the partnership's reduction to determine gross income corresponding to the partner's share of the partnership gross receipts (as determined under paragraph (e)(2)(i) of this section) related to that reduction.

(2) *Gross receipts*—(i) *In general*. For purposes of section 59A, each partner in the partnership includes a share of partnership gross receipts in proportion to the partner's distributive share (as determined under sections 704(b) and (c)) of items of gross income that were taken into account by the partnership under section 703 or 704(c) (such as remedial or curative items under §1.704-3(c) or (d)).

(ii) *Foreign corporation*. See §1.59A-2(d)(2) for gross receipts of foreign corporations.

(3) *Registered securities dealers*. If a partnership, or a branch of the partnership, is a registered securities dealer, each partner is treated as a registered securities dealer unless the partner's interest in the registered securities dealer would satisfy the criteria for the exception in paragraph (d)(2) of this section. For purposes of applying the de minimis exception in §1.59A-2(e)(2)(iii), a partner takes into account its distributive share of the relevant partnership items.

(4) *Application of sections 163(j) and 59A(c)(3) to partners*. See §1.59A-3(c)(4).

(5) *Tiered partnerships*. In the case of one or more partnerships owning an interest in another partnership (or partnerships), the rules of this section apply successively to each partnership and its partners in the chain of ownership. Paragraphs (d)(2) and (f) of this section and the small partner exception in paragraph (e)(3) of this section apply only to a partner that is not itself a partnership.

(f) *Foreign related party*. With respect to any person that owns an interest in a partnership, the related party determination in section 59A(g) applies at the partner level.

(g) *Examples*. The following examples illustrate the application of this section.

(1) *Facts*. The following facts are assumed for purposes of the examples.

(i) DC is a domestic corporation that is an applicable taxpayer for purposes section 59A.

(ii) FC is a foreign corporation that is a foreign related party with respect to DC.

(iii) UC is a domestic corporation that is not related to DC and FC.

(iv) Neither FC nor any partnership in the examples is (or is treated as) engaged in a U.S. trade or business or has a permanent establishment in the United States.

(v) All payments apply to a taxable year beginning after December 31, 2017.

(vi) Unless otherwise stated, all allocations are pro-rata and satisfy the requirements of section 704(b) and all the partners have equal interests in the partnership.

(vii) Unless otherwise stated, depreciable property acquired and placed in service by the partnership has a remaining recovery period of five years and is depreciated under the alternative depreciation system of section 168(g) using the straight line method. Solely for purposes of simplifying the calculations in these examples, assume the applicable convention rules in section 168(d) do not apply.

(viii) No exception under §1.59A-3(b) or (c) applies to any amount paid or accrued.

(2) *Examples*—(i) *Example 1: Contributions to a partnership on partnership formation*—(A) *Facts*. DC and FC form partnership PRS, with each contributing depreciable property that has a fair market value and tax basis of $100x, Property A and Property B, respectively. Therefore, the property contributed by FC, Property B, will generate $20x of annual section 704(b) and tax depreciation deductions for five years. The depreciation deductions will be allocated $10x to each of DC and FC each year. Before the transactions, for purposes of section 59A, DC is treated as owning a 100 percent interest in Property A and a zero percent interest in Property B, and FC is treated as owning a 100 percent interest in Property B and a zero percent interest in Property A. After the formation of PRS, for purposes of section 59A, DC and FC are each treated as owning a 50 percent proportionate share of each of Property A and Property B.

(B) *Analysis*. The treatment of contributions of property in exchange for an interest in a partnership is described in paragraph (c)(3)(iii) of this section. Under paragraph (c)(3)(iii) of this section, DC is treated as exchanging a 50 percent interest in Property A for a 50 percent proportionate share of Property B. Under §1.59A-3(b)(1)(ii), the payment to acquire depreciable property, Property B, from FC is a base erosion payment. The base erosion tax benefit is the amount of depreciation allocated to DC with respect to Property B ($10x per year) and is not netted with any other partnership item pursuant to paragraph (d)(1) of this section.

(ii) *Example 2: Section 704(c) and remedial allocations*—(A) *Facts*. The facts are the same as in paragraph (g)(2)(i)(A) of this section (the facts in *Example 1*), except that Property B has a tax basis of $40x and PRS adopts the remedial method under §1.704-3(d).

(B) *Analysis*. The analysis and results are the same as in paragraph (g)(2)(i)(B) of this section (the analysis in *Example 1*), except that annual tax depreciation is $8x ($40x/5) and annual remedial tax deduction allocation to DC is $2x (with $2x of remedial income to FC) for five years. Both the tax depreciation and the remedial tax allocation to DC are base erosion tax benefits to DC under paragraph (d)(1) of this section.

(iii) *Example 3: Sale of a partnership interest without a section 754 election*—(A) *Facts*. UC and FC are equal partners in partnership PRS, the only asset of which is Property A, a depreciable property with a fair market value of $200x and a tax basis of $120x. PRS does not have any section 704(c) assets. DC purchases 50 percent of FC's interest in PRS for $50x. Prior to the sale, for section 59A purposes, FC is treated as owning a 50 percent proportionate share of Property A and DC is treated as owning no interest in Property A. Following the sale, for section 59A purposes, DC is treated as owning a 25 percent proportionate share of Property A, all of which is treated as acquired from FC. The partnership does not have an election under section 754 in effect. Property A will generate $24x of annual tax and section 704(b) depreciation deductions for five years. The depreciation deductions will be allocated $12x to UC and $6x to both FC and DC each year.

(B) *Analysis*. The sale of a partnership interest by a partner is analyzed under paragraph (c)(3)(ii) of this section. Under section (c)(3)(ii) of this section, FC is treated as selling to DC 25 percent of Property A. Under §1.59A-3(b)(1)(ii), the payment to acquire depreciable property is a base erosion payment. Under paragraph (d)(1) of this section, the base erosion tax benefit is the amount of depreciation allocated to DC with respect to the base erosion payment, which would be the depreciation deductions allocated to DC with respect to Property A. DC's annual $6x depreciation deduction is its base erosion tax benefit with respect to the base erosion payment.

(iv) *Example 4: Sale of a partnership interest with section 754 election*—(A) *Facts*. The facts are the same as in paragraph (g)(2)(iii)(A) of this section (the facts in *Example 3*), except that the partnership has an election under section 754 in effect. As a result of the sale, there is a $20x positive adjustment to the tax basis in Property A with respect to DC under section 743(b) (DC's $50x basis in the PRS interest less DC's $30x share of PRS's tax basis in Property A). The section 743(b) step-up in tax basis is recovered over a depreciable recovery period of five years. Therefore, DC will be allocated a total of $10x in annual depreciation deductions for five years, comprised of $6x with respect to DC's proportionate share of PRS's common tax basis in Property A ($30x over 5 years) and $4x with respect to the section 743(b) adjustment ($20x over 5 years).

(B) *Analysis*. The analysis is the same as in paragraph (g)(2)(iii)(B) of this section (the analysis in *Example 3*); however, because section 743(b) increases the basis in Property A for DC by $20x, DC is allocated additional depreciation deductions of $4x per year as a result of the section 743(b) adjustment and has an annual base erosion tax benefit of $10x ($6x plus $4x) for five years under paragraph (d)(1) of this section.

(v) *Example 5: Purchase of depreciable property from a partnership*—(A) *Facts*. The facts are the same as in paragraph (d)(2)(iii)(A) of this section (the facts in *Example 3*), except that instead of DC purchasing an interest in the partnership, DC purchases Property A from the partnership for $200x.

(B) *Analysis*. DC must analyze whether the purchase of the depreciable property from the partnership is a base erosion payment under paragraph (c)(2) of this section. Under paragraph (c)(2) of this section, DC is treated as acquiring FC's proportionate share of Property A from FC. Because DC paid the partnership for the partnership's interest in Property A, under paragraph (c)(5)(iii) of this section, DC is treated as paying FC for FC's proportionate share of Property A. Under §1.59A-3(b)(1)(ii), the payment to FC to acquire depreciable property is a base erosion payment. DC's base erosion tax benefit is the amount of depreciation allocated to DC with respect to the base erosion payment, which in this case is the amount of depreciation deductions with respect to the property acquired with a base erosion payment, or the depreciation deductions from FC's (but not UC's) proportionate share of the asset. See §1.59A-7(d)(1).

(vi) *Example 6: Sale of a partnership interest to a second partnership*—(A) *Facts*. FC, UC1, and UC2 are equal partners in partnership PRS1. DC and UC3 are equal partners in partnership PRS2. UC1, UC2, and UC3 are not related to DC or FC. PRS1's sole asset is Property A, which is depreciable property with a fair market value and tax basis of $300x. FC sells its entire interest in PRS1 to PRS2 for $100. For section 59A purposes, FC's proportionate share of Property A prior to the sale is one-third. Following the sale, for section 59A purposes, PRS2's proportionate share of Property A is one-third and DC's proportionate share of Property A (through PRS2) is one-sixth (50 percent of one-third).

(B) *Analysis*. Under paragraph (c)(5)(ii) of this section (the ordering rule), FC's transfer of its interest in PRS1 is first analyzed under paragraph (c)(3) of this section to determine how the transfer of the partnership interest is treated. Then, paragraph (c)(2) of this section applies to analyze how the acquisition of property by PRS2 is treated. Under paragraph (c)(3)(ii) of this section, FC is deemed to transfer its proportionate share of PRS1's assets, which is one-third of Property A. Then, under paragraph (c)(2) of this section, DC is treated as acquiring its proportionate share of PRS2's proportionate share of Property A from FC, which is one-sixth (50 percent of one-third). Under paragraph (c)(5)(iii) of this section, DC is treated as paying for the property it is treated as acquiring from FC. Therefore, DC's deemed payment to FC to acquire depreciable property is a base erosion payment under §1.59A-3(b)(1)(ii). DC's base erosion tax benefit is equal to DC's distributive share of depreciation deductions that PRS2 allocates to DC attributable to Property A. See §1.59A-7(d)(1).

(vii) *Example 7: Distribution of cash by a partnership to a foreign related party*—(A) *Facts*. DC, FC, and UC are equal partners in a partnership, PRS, the assets of which consist of cash of $90x and a depreciable asset (Property A) with a fair market value of $180x and a tax basis of $60x. Each partner's interest in PRS has a fair market value of $90x ($270x/3) and a tax basis of $50x. Assume that all non-depreciable assets are capital assets, all depreciable assets are nonresidential real property under section 168, and that no depreciation has been claimed prior to the transaction below. PRS has an election under section 754 in effect. PRS distributes the $90x of cash to FC in complete liquidation of its interest, resulting in gain to FC of $40x ($90x minus its tax basis in PRS of $50x) under section 731(a)(1) and an increase to the tax basis of Property A under section 734(b) of $40x. Prior to the distribution, for section 59A purposes, each partner had a one-third proportionate share of Property A. After the distribution, for section 59A purposes, the remaining partners each have a 50 percent proportionate share of Property A. Each partner's pro-rata allocation of depreciation deductions with respect to Property A is in proportion to each partner's proportionate share of Property A both before and after the distribution. Half of the depreciation deductions attributable to the $40x section 734(b) step-up will be allocated to DC. In addition, DC's proportionate share of Property A increased from one-third to one-half and therefore DC will be allocated depreciation deductions with respect to half of the original basis of $60x (or $30x) instead of one-third of $60x (or $20x).

(B) *Analysis*. Distributions of property that cause an increase in the tax basis of property that continues to be held by the partnership are analyzed under paragraph (c)(4) of this section. The $40x increase in the tax basis of Property A as a result of the distribution of cash to FC is treated as newly purchased property acquired from FC under paragraph (c)(4) of this section and therefore acquired with a base erosion payment under §1.59A-3(b)(1)(ii) to DC to the extent of DC's proportionate share. DC's base erosion tax benefit is the amount of DC's depreciation deductions attributable to that base erosion payment, which is DC's distributive share of the depreciation deductions with respect to the $40x increase in the tax basis of Property A. See §1.59A-7(d)(1). In addition, FC transferred a partnership interest to DC (as defined in paragraph (c)(3)(iv) of this section), which is analyzed under paragraph (c)(3)(i) of this section. Under paragraph (c)(3)(i) of this section, DC is deemed to acquire a one-sixth interest in Property A from FC (the increase in DC's proportionate share from one-third to one-half). DC's base erosion tax benefit from this additional one-sixth interest in Property A is the amount of DC's depreciation deductions attributable to this interest.

(viii) *Example 8: Distribution of property by a partnership to a taxpayer*—(A) *Facts*. The facts are the same as paragraph (g)(2)(vii)(A) of this section (the facts of *Example 7*), except that PRS's depreciable property consists of two assets, Property A having a fair market value of $90x and a tax basis of $60x and Property B having a fair market value of $90x and a tax basis of zero. Instead of distributing cash to FC, PRS distributes Property B to DC in liquidation of its interest, resulting in an increase in the basis of the distributed Property B to DC of $50x (from zero to $50x) under section 732(b) because DC's tax basis in the PRS interest was $50x. For section 59A purposes, prior to the distribution, each partner had a one-third proportionate share of Property B and after the distribution, the property is wholly owned by DC.

(B) *Analysis*. Distributions of property that cause an increase in the tax basis of property that is distributed to a taxpayer are analyzed under paragraph (c)(4) of this section. Under paragraph (c)(4) of this section, the $50x increase in tax basis is treated as newly purchased property that was acquired with a base erosion payment to the extent that the increase in tax basis is attributable to FC. Under paragraph (c)(4) of this section, the portion of the increase that is attributable to FC is the proportionate share of the Property B immediately before the distribution that was treated as owned by FC. Immediately before the distribution, FC had a one-third proportionate share of Property B. Accordingly, one-third of the $50x increase in the tax basis of Property B is treated as if it was newly purchased property acquired by DC from FC with a base erosion payment under §1.59A-3(b)(1)(ii). DC's base erosion tax benefit is the amount of DC's depreciation deductions with respect to the base erosion payment, which in this case is the depreciation deductions with respect to the one-third interest in the increased basis treated as newly purchased property deemed acquired from FC. See §1.59A-3(c)(1). In addition, PRS transferred Property B to DC, which is analyzed under paragraph (c)(2) of this section. Prior to the distribution, DC, FC, and UC each owned one-third of Property B. After the distribution, DC entirely owned Property B. Therefore, under paragraph (c)(2) of this section, DC is treated as acquiring one-third of Property B from FC. DC's depreciation deductions with respect to the one-third of Property B acquired from FC (without regard to the basis increase) is also a base erosion tax benefit.

(ix) *Example 9: Distribution of property by a partnership in liquidation of a foreign related party's interest*—(A) *Facts*. The facts are the same as paragraph (g)(2)(viii)(A) (the facts of *Example 8*), except that Property B is not distributed to DC and, instead, Property A is distributed to FC in liquidation of its interest, resulting in a tax basis in Property A of $50x in FC's hands under section 732(b) and a section 734(b) step-up in Property B of $10x (because Property A's tax basis was reduced from $60x to $50x), allocable to DC and UC. For section 59A purposes, prior to the distribution, each partner had a one-third proportionate share of Property B and after the distribution, DC and UC each have a one-half proportionate share of Property B.

(B) *Analysis*. Distributions of property that cause an increase in the tax basis of property that continues to be held by the partnership are analyzed under paragraph (c)(4) of this section. Under paragraph (c)(4) of this section, because the distribution of Property A to FC from PRS caused an increase in the tax basis of Property B, the entire $10x increase in tax basis is treated as newly purchased property that was acquired with a base erosion payment under §1.59A-3(b)(1)(ii). DC's base erosion tax benefit is the amount of DC's depreciation deductions attributable to the base erosion payment, which is DC's distributive share of the depreciation deductions with respect to the $10x increase in the tax basis of Property B. See §1.59A-7(d)(1). In addition, under paragraph (c)(3)(i) of this section, DC is deemed to acquire a one-sixth interest in Property B from FC (the increase in DC's proportionate share from one-third to one-half). While this increase is a base erosion payment under §1.59A-3(b)(1)(ii), there is no base erosion tax benefit from this additional one-sixth interest in Property B because the tax basis in Property B (without regard to the basis) is zero and therefore the increase in DC's proportionate share does not result in any additional depreciation deductions.

§1.59A-8 [Reserved].

§1.59A-9 Anti-abuse and recharacterization rules.

(a) *Scope*. This section provides rules for recharacterizing certain transactions according to their substance for purposes of applying section 59A and the section 59A regulations. Paragraph (b) of this section provides specific anti-abuse rules. Paragraph (c) of this section provides examples illustrating the rules of paragraph (b) of this section.

(b) *Anti-abuse rules*—(1) *Transactions involving unrelated persons, conduits, or intermediaries*. If a taxpayer pays or accrues an amount to one or more intermediaries (including an intermediary unrelated to the taxpayer) that would have been a base erosion payment if paid or accrued to a foreign related party, and one or more of the intermediaries makes (directly or indirectly) corresponding payments to or for the benefit of a foreign related party as part of a transaction (or series of transactions), plan or arrangement that has as a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment), the role of the intermediary or intermediaries is disregarded as a conduit, or the amount paid or accrued to the intermediary is treated as a base erosion payment, as appropriate.

(2) *Transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation*. A transaction (or component of a transaction or series of transactions), plan or arrangement that has a principal purpose of increasing the deductions taken into account for purposes of §1.59A-2(e)(3)(i)(B) (the denominator of the base erosion percentage computation) is disregarded for purposes of §1.59A-2(e)(3).

(3) *Transactions to avoid the application of rules applicable to banks and registered securities dealers*. A transaction (or series of transactions), plan or arrangement that occurs among related parties that has a principal purpose of avoiding the rules applicable to certain banks and registered securities dealers in §1.59A-2(e)(2) (base erosion percentage test for banks and registered securities dealers) or §1.59A-5(c)(2) (increased base erosion and anti-abuse tax rate for banks and registered securities dealers) is not taken into account for purposes of §1.59A-2(e)(2) or §1.59A-5(c)(2).

(4) *Nonrecognition transactions*. If a transaction (or series of transactions), plan or arrangement, has a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a specified nonrecognition transaction, then §1.59A-3(b)(3)(viii)(A) will not apply to the specified nonrecognition transaction. For purposes of this paragraph (b)(4), if a transaction (or series of transactions), plan or arrangement between related parties increases the adjusted basis of property within the six month period before the taxpayer acquires the property in a specified nonrecognition transaction, the transaction (or series of transactions), plan or arrangement is deemed to have a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a nonrecognition transaction.

(c) *Examples*. The following examples illustrate the application of this section.

(1) *Facts.* The following facts are assumed for purposes of the examples.

(i) DC is a domestic corporation that is an applicable taxpayer for purposes section 59A.

(ii) FP is a foreign corporation that owns all the stock of DC.

(iii) None of the foreign corporations have income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations thereunder.

(iv) All payments occur in a taxable year beginning after December 31, 2017.

(2) *Example 1: Substitution of payments that are not base erosion payments for payments that otherwise would be base erosion payments through a conduit or intermediary*—(i) *Facts*. FP owns Property 1 with a fair market value of $95x, which FP intends to transfer to DC. A payment from DC to FP for Property 1 would be a base erosion payment. Corp A is a domestic corporation that is not a related party with respect to DC. As part of a plan with a principal purpose of avoiding a base erosion payment, FP enters into an arrangement with Corp A to transfer Property 1 to Corp A in exchange for $95x. Pursuant to the same plan, Corp A transfers Property 1 to DC in exchange for $100x. Property 1 is subject to the allowance for depreciation (or amortization in lieu of depreciation) in the hands of DC.

(ii) *Analysis*. The arrangement between FP, DC, and Corp A is deemed to result in a $95x base erosion payment under paragraph (b)(1) of this section because DC's payment to Corp A would have been a base erosion payment if paid to a foreign related party, and Corp A makes a corresponding payment to FP as part of the series of transactions that has as a principal purpose of avoiding a base erosion payment.

(3) *Example 2: Alternative transaction to base erosion payment*—(i) *Facts*. The facts are the same as in paragraph (c)(2)(i) of this section (the facts in *Example 1*), except that DC does not purchase Property 1 from FP or Corp A. Instead, DC purchases Property 2 from Corp B, a domestic corporation that is not a related party with respect to DC and that originally produced or acquired Property 2 for Corp B's own account. Property 2 is substantially similar to Property 1, and DC uses Property 2 in substantially the same manner that DC would have used Property 1.

(ii) *Analysis*. Paragraph (b)(1) of this section does not apply to the transaction between DC and Corp B because Corp B does not make a corresponding payment to or for the benefit of FP as part of a transaction, plan or arrangement.

(4) *Example 3: Alternative financing source*—(i) *Facts*. On Date 1, FP loaned $200x to DC in exchange for Note A. DC pays or accrues interest annually on Note A, and the payment or accrual is a base erosion payment within the meaning of §1.59A-3(b)(1)(i). On Date 2, DC borrows $200x from Bank, a corporation that is not a related party with respect to DC, in exchange for Note B. The terms of Note B are substantially similar to the terms of Note A. DC uses the proceeds from Note B to repay Note A.

(ii) *Analysis*. Paragraph (b)(1) of this section does not apply to the transaction between DC and Bank because Bank does not make a corresponding payment to or for the benefit of FP as part of the series of transactions.

(5) *Example 4: Alternative financing source that is a conduit*—(i) *Facts*. The facts are the same as in paragraph (c)(4)(i) of this section (the facts in *Example 3*) except that in addition, as part of the same plan or arrangement as the Note B transaction and with a principal purpose of avoiding a base erosion payment, FP deposits $250x with Bank. The difference between the interest rate paid by Bank to FP on FP's deposit and the interest rate paid by DC to Bank is less than one percentage point. The interest rate charged by Bank to DC would have differed absent the deposit by FP.

(ii) *Analysis*. The transactions between FP, DC, and Bank are deemed to result in a base erosion payment under paragraph (b)(1) of this section because DC's payment to Bank would have been a base erosion payment if paid to a foreign related party, and Bank makes a corresponding payment to FP as part of the series of transactions that has as a principal purpose of avoiding a base erosion payment. See Rev. Rul. 87-89, 1987-2 C.B. 195, Situation 3.

(6) *Example 5: Intermediary acquisition*—(i) *Facts*. FP owns all of the stock of DC1 and DC2, each domestic corporations. FP is a manufacturer of lawn equipment. DC1 is in the trade or business of renting equipment to unrelated third parties. DC2 is a dealer in property that capitalizes its purchases into inventory and recovers the amount through cost of goods sold. Before Date 1, in the ordinary course of DC1's business, DC1 acquired depreciable property from FP that DC1 in turn rented to unrelated third parties. DC1's purchases from FP were base erosion payments within the meaning of §1.59A-3(b)(1)(ii). On Date 1, with a principal purpose of avoiding a base erosion payment, FP and DC2 reorganized their operations so that DC2 acquires the lawn equipment from FP and immediately thereafter, DC2 resells the lawn equipment to DC1.

(ii) *Analysis*. The transactions between FP, DC1, and DC2 are deemed to result in a base erosion payment under paragraph (b)(1) of this section because DC1's payment to DC2 would have been a base erosion payment if paid directly to FP, and DC2 makes a corresponding payment to FP as part of a series of transactions, plan, or arrangement that has a principal purpose of avoiding a base erosion payment from DC1 to FP.

(7) *Example 6: Offsetting transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation*—(i) *Facts*. With a principal purpose of increasing the deductions taken into account by DC for purposes of §1.59A-2(e)(3)(i)(B), DC enters into a long position with respect to Asset with Financial Institution 1 and simultaneously enters into a short position with respect to Asset with Financial Institution 2. Financial Institution 1 and Financial Institution 2 are not related to DC and are not related to each other.

(ii) *Analysis*. Paragraph (b)(2) of this section applies to the transactions between DC and Financial Institution 1 and DC and Financial Institution 2. These transactions are not taken into account for purposes of §1.59A-2(e)(3)(i)(B) because the transactions have a principal purpose of increasing the deductions taken into account for purposes of §1.59A-2(e)(3)(i)(B).

(8) *Example 7: Ordinary course transactions that increase the amount of deductions taken into account in the denominator of the base erosion percentage computation*—(i) *Facts*. DC, a financial institution, enters into a long position with respect to stock in Corporation with Person 1 and later on the same day enters into a short position with respect to stock in Corporation with Person 2. Person 1 and Person 2 are not related to DC and are not related to each other. DC entered into the positions in the ordinary course of its business and did not have a principal purpose of increasing the deductions taken into account by DC for purposes of §1.59A-2(e)(3)(i)(B).

(ii) *Analysis*. Paragraph (b)(2) of this section does not apply because the transactions between DC and Person 1 and Person 2 were not entered into with a principal purpose of increasing the deductions taken into account by DC for purposes of §1.59A-2(e)(3)(i)(B).

(9) *Example 8: Transactions to avoid the application of rules applicable to banks and registered securities dealers*—(i) *Facts*. DC owns all of the stock of DC1 and Bank (an entity defined in section 581). DC, DC1, and Bank are members of an affiliated group of corporations within the meaning of section 1504(a) that elect to file a consolidated U.S. federal income tax return. With a principal purpose of avoiding the rules of §1.59A-2(e)(2) or §1.59A-5(c)(2), DC and DC1 form a new partnership (PRS). DC contributes all of its stock of Bank, and DC1 contributes cash, to PRS. DC, DC1, and Bank do not materially change their business operations following the formation of PRS.

(ii) *Analysis*. Paragraph (b)(3) of this section applies to transactions with respect to Bank because the transactions with respect to PRS were entered into with a principal purpose of avoiding the rules of §1.59A-2(e)(2) or §1.59A-5(c)(2). The contribution of Bank to a PRS is not taken into account, and Bank will be deemed to be part of the affiliated group including DC and DC1 for purposes of §1.59A-2(e)(2) and §1.59A-5(c)(2).

(10) *Example 9: Transactions that do not avoid the application of rules applicable to banks and registered securities dealers*—(i) *Facts*. The facts are the same as the facts of paragraph (c)(9)(i) of this section (the facts of Example 8), except that DC sells 90 percent of the stock of Bank to an unrelated party in exchange for cash.

(ii) *Analysis*. Paragraph (b)(3) of this section does not apply to DC's sale of the stock of Bank because the sale was not made with a principal purpose of avoiding the rules of §1.59A-2(e)(2) or §1.59A-5(c)(2). Bank will not be treated as part of the affiliated group including DC and DC1 for purposes of §1.59A-2(e)(2) and §1.59A-5(c)(2).

(11) *Example 10: Acquisition of depreciable property in a nonrecognition transaction*—(i) *Facts*. U, which is not a related party with respect to FP or DC, owns Property 1 with an adjusted basis of $50x and a fair market value of $100x. On Date 1, FP purchases property, including Property 1, from U in exchange for cash, and then FP contributes Property 1 to DC in an exchange described in section 351. Following the exchange, DC's basis in Property 1 is $100x.

(ii) *Analysis*. Paragraph (b)(4) of this section does not apply to DC's acquisition of Property 1 because the purchase of Property 1 from U (along with the purchase of other property from U that FP did not contribute to DC) did not have a principal purpose of increasing the adjusted basis of property that was subsequently transferred to DC. The transaction is economically equivalent to an alternative transaction under which FP contributed $100x to DC and then DC purchased Property 1 from U. Further, the second sentence of paragraph (b)(4) of this section (providing that certain transactions are deemed to have a principal purpose of increas-

ing the adjusted basis of property that a taxpayer acquires in a nonrecognition transaction) does not apply because FP purchased Property 1 from an unrelated party.

(12) *Example 11: Transactions between related parties with a principal purpose of increasing the adjusted basis of property*—(i) *Facts*. The facts are the same as paragraph (c)(11)(i) of this section (the facts in *Example 10*), except that U is related to FP and DC.

(ii) *Analysis*. Paragraph (b)(4) of this section applies to DC's acquisition of Property 1 because the transaction that increased the adjusted basis of Property 1 (the purchase of Property 1 from U) was between related parties, and within six months DC acquired Property 1 from FP in a specified nonrecognition transaction. Accordingly, the purchase of property from U is deemed to have a principal purpose of increasing the adjusted basis of Property 1, the exception in §1.59A-3(b)(3)(viii)(A) for specified nonrecognition transactions will not apply to the contribution of Property 1 to DC, and DC's depreciation deductions with respect to Property 1 will be base erosion tax benefits.

§1.59A-10 Applicability date.

Sections 1.59A-1 through 1.59A-9 apply to taxable years ending on or after December 17, 2018. However, taxpayers may apply these final regulations in their entirety for taxable years beginning after December 31, 2017, and ending before December 17, 2018. In lieu of applying these final regulations, taxpayers may apply the provisions matching §§1.59A-1 through 1.59A-9 from the Internal Revenue Bulletin (IRB) 2019-02 (https://www.irs.gov/pub/irs-irbs/irb19-02.pdf) in their entirety for all taxable years ending on or before December 6, 2019.

Par. 3. Section 1.383-1 is amended by adding two sentences at the end of paragraph (d)(3)(i) to read as follows:

§1.383-1 Special limitations on certain capital losses and excess credits.

* * * * *

(d) * * *

(3) * * *

(i) * * * The application of section 59A is not a limitation contained in subtitle A for purposes of this paragraph (d)(3)(i). Therefore, the treatment of pre-change losses and pre-change credits in the computation of the base erosion minimum tax amount will not affect whether such losses or credits result in absorption of the section 382 limitation and the section 383 credit limitation.

* * * * *

Par. 4. Section 1.1502-2 is revised to read as follows:

§1.1502-2 Computation of tax liability.

(a) *Taxes imposed*. The tax liability of a group for a consolidated return year is determined by adding together—

(1) The tax imposed by section 11(a) in the amount described in section 11(b)

on the consolidated taxable income for the year (reduced by the taxable income of a member described in paragraphs (a)(5) through (8) of this section);

(2) The tax imposed by section 541 on the consolidated undistributed personal holding company income;

(3) If paragraph (a)(2) of this section does not apply, the aggregate of the taxes imposed by section 541 on the separate undistributed personal holding company income of the members which are personal holding companies;

(4) If neither paragraph (a)(2) nor (3) of this section apply, the tax imposed by section 531 on the consolidated accumulated taxable income (see §1.1502–43);

(5) The tax imposed by section 594(a) in lieu of the taxes imposed by section 11 on the taxable income of a life insurance department of the common parent of a group which is a mutual savings bank;

(6) The tax imposed by section 801 on consolidated life insurance company taxable income;

(7) The tax imposed by section 831(a) on consolidated insurance company taxable income of the members which are subject to such tax;

(8) Any increase in tax described in section 1351(d)(1) (relating to recoveries of foreign expropriation losses); and

(9) The tax imposed by section 59A on base erosion payments of taxpayers with substantial gross receipts.

(b) *Credits*. A group is allowed as a credit against the taxes described in paragraph (a) of this section (except for paragraph (a)(9) of this section) of this section: the general business credit under section 38 (see §1.1502–3), the foreign tax credit under section 27 (see §1.1502–4), and any other applicable credits provided under the Internal Revenue Code. Any increase in tax due to the recapture of a tax credit will be taken into account. See section 59A and the regulations thereunder for credits allowed against the tax described in paragraph (a)(9) of this section.

(c) *Allocation of dollar amounts*. For purposes of this section, if a member or members of the consolidated group are also members of a controlled group that includes corporations that are not members of the consolidated group, any dollar amount described in any section of the Internal Revenue Code is apportioned among all members of the controlled group in accordance with the provisions of the applicable section and the regulations thereunder.

(d) *Applicability date*—This section applies to taxable years for which the original consolidated Federal income tax return is due (without extension) after December 6, 2019.

Par. 5. Section 1.1502-4 is amended by revising paragraph (d)(3) to read as follows:

§1.1502-4 Consolidated foreign tax credit.

* * * * *

(d) * * *

(3) *Computation of tax against which credit is taken*. The tax against which the limiting fraction under section 904(a) is applied will be the consolidated tax liability of the group determined under §1.1502-2, but without regard to paragraphs (a)(2), (3), (4), (8), and (9) of that section, and without regard to any credit against such liability.

* * * * *

Par. 6. Section 1.1502-43 is amended by revising paragraph (b)(2)(i)(A) to read as follows:

§1.1502-43 Consolidated accumulated earnings tax.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(A) The consolidated liability for tax determined without §1.1502-2(a)(2) through (4), and without the foreign tax credit provided by section 27, over

* * * * *

Par. 7. Section 1.1502-47 is amended by revising paragraph (f)(7)(iii) to read as follows.

§1.1502-47 Consolidated returns by life-nonlife groups.

* * * * *

(f) * * *

(7) * * *

(iii) Any taxes described in §1.1502-2 (other than by paragraphs (a)(1) and (6) of that section).

* * * * *

Par. 8. Section 1.1502-59A is added to read as follows:

§1.1502-59A Application of section 59A to consolidated groups.

(a) *Scope*. This section provides rules for the application of section 59A and the regulations thereunder (the *section 59A regulations*) to consolidated groups and their members (as defined in §1.1502-1(h) and (b), respectively). Rules in the section 59A regulations apply to consolidated groups except as modified in this section. Paragraph (b) of this section provides rules treating a consolidated group (rather than each member of the group) as a single taxpayer, and a single applicable taxpayer, as relevant, for certain purposes. Paragraph (c) of this section coordinates the application of the business interest stacking rule under §1.59A-3(c)(4) to consolidated groups. Paragraph (d) of this section addresses how the base erosion minimum tax amount is allocated among members of the consolidated group. Paragraph (e) of this section coordinates the application of this section and §1.1502-47. Paragraph (f) of this section sets forth definitions. Paragraph (g) of this section provides examples. Paragraph (h) of this section provides the applicability date.

(b) *Consolidated group as the applicable taxpayer*—(1) *In general*. For purposes of determining whether the consolidated group is an applicable taxpayer (within the meaning of §1.59A-2(b)) and the amount of tax due pursuant to section 59A(a), all members of a consolidated group are treated as a single taxpayer. Thus, for example, members' deductions are aggregated in making the required computations under section 59A. In addition, to ensure that intercompany transactions (as defined in §1.1502-13(b)(1)(i)) do not affect the consolidated group's base erosion percentage or base erosion minimum tax amount, items resulting from intercompany transactions are not taken into account in making such computations under section 59A. For example, additional depreciation deductions resulting from intercompany asset sales are not taken into account for purposes of applying the base erosion percentage test under §1.59A-2(e).

(2) *Consolidated group as member of the aggregate group*. The consolidated group is treated as a single member of an aggregate group for purposes of §1.59A-2(c).

(3) *Related party determination*. For purposes of section 59A and the section 59A regulations, if a person is a related party with respect to any member of a consolidated group, that person is a related party of the group and of each of its members.

(c) *Coordination of section 59A(c)(3) and section 163(j) in a consolidated group*—(1) *Overview*. This paragraph (c) provides rules regarding the application of §1.59A-3(c)(4) to a consolidated group's section 163(j) interest deduction. The classification rule in paragraph (c)(3) of this section addresses how to determine if, and to what extent, the group's section 163(j) interest deduction is a base erosion tax benefit. These regulations contain 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. Paragraph (c)(3) of this section classifies the group's aggregate current year BIE deduction, in conformity with §1.59A-3(c)(4), as constituting domestic related current year BIE deduction, foreign related current year BIE deduction, or unrelated current year BIE deduction. The allocation rules in paragraph (c)(4) of this section then 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. Any member's current year BIE that is carried forward to the succeeding taxable year as a disallowed BIE carryforward is allocated a status as domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward under paragraph (c)(5) of this section. 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 paragraph (c)(3) of this section, based on the status allocated to the member's disallowed BIE carryforward under paragraph (c)(5) of this section. This paragraph (c) also provides rules regarding the consequences of the deconsolidation of a corporation that has been allocated a domestic related BIE carryforward status, a foreign related BIE carryforward status, or an unrelated BIE carryforward status; and the consolidation of a corporation with a disallowed BIE carryforward classified as from payments to a domestic related party, foreign related party, or unrelated party.

(2) *Absorption rule for the group's business interest expense*. To determine the amount of the group's section 163(j) interest deduction, and to determine the year in which the member's business interest expense giving rise to the deduction was incurred or accrued, see §§1.163(j)-4(d) and 1.163(j)-5(b)(3).

(3) *Classification of the group's section 163(j) interest deduction*—(i) *In general*. Consistent with §1.59A-3(c)(4)(i) and paragraph (b) of this section, the classification rule of this paragraph (c)(3) determines whether the consolidated group's section 163(j) interest deduction is a base erosion tax benefit. To the extent the consolidated group's business interest expense is permitted as a deduction under section 163(j)(1) in a taxable year, the deduction is classified first as from business interest expense paid or accrued to a foreign related party and business interest expense paid or accrued to a domestic related party (on a pro-rata basis); any remaining deduction is treated as from business interest expense paid or accrued to an unrelated party.

(ii) *Year-by-year application of the classification rule*. If the consolidated group's section 163(j) interest deduction in any taxable year is attributable to business interest expense paid or accrued in more than one taxable year (for example, the group deducts the group's aggregate current year BIE, the group's disallowed BIE carryforward from year 1, and the group's disallowed BIE carryforward from year 2), the classification rule in paragraph (c)(3)(i) of this section applies

separately to each of those years, pursuant to paragraphs (c)(3)(iii) and (iv) of this section.

(iii) *Classification of current year BIE deductions*. Current year BIE deductions are classified under the section 59A regulations and this paragraph (c) as if the consolidated group were a single taxpayer that had paid or accrued the group's aggregate current year BIE to domestic related parties, foreign related parties, and unrelated parties. The rules of paragraph (c)(4) of this section apply for allocating current year BIE deductions among members of the consolidated group. To the extent the consolidated group's aggregate current year BIE exceeds its section 163(j) limitation, the rules of paragraph (c)(5) of this section apply.

(iv) *Classification of deductions of disallowed BIE carryforwards*. Each member of the group applies the classification rule in this paragraph (c)(3) to its deduction of any part of a disallowed BIE carryforward from a year, after the group applies paragraph (c)(5) of this section to the consolidated group's disallowed BIE carryforward from that year. Therefore, disallowed BIE carryforward that is actually deducted by a member is classified based on the status of the components of that carryforward, assigned pursuant to paragraph (c)(5) of this section.

(4) *Allocation of domestic related current year BIE deduction status and foreign related current year BIE deduction status among members of the consolidated group*—(i) *In general*. This paragraph (c)(4) applies if the group has domestic related current year BIE deductions, foreign related current year BIE deductions, or both, as a result of the application of the classification rule in paragraph (c)(3) of this section. Under this paragraph (c)(4), the domestic related current year BIE, foreign related current year BIE, or both, that is treated as deducted in the current year are deemed to have been incurred pro-rata by all members that have current year BIE deduction in that year, regardless of which member or members actually incurred the current year BIE to a domestic related party or a foreign related party.

(ii) *Domestic related current year BIE deduction*—(A) *Amount of domestic related current year BIE deduction status allocable to a member*. The amount of domestic related current year BIE deduction status that is allocated to a member is determined by multiplying the group's domestic related current year BIE deduction (determined pursuant to paragraph (c)(3) of this section) by the percentage of current year BIE deduction allocable to such member in that year.

(B) *Percentage of current year BIE deduction allocable to a member*. The percentage of current year BIE deduction allocable to a member is equal to the amount of the member's current year BIE deduction divided by the amount of the group's aggregate current year BIE deduction.

(iii) *Amount of foreign related current year BIE deduction status allocable to a member*. The amount of foreign related current year BIE deduction status that is allocated to a member is determined by multiplying the group's foreign related current year BIE deduction (determined pursuant to paragraph (c)(3) of this section) by the percentage of current year BIE deduction allocable to such member (defined in paragraph (c)(4)(ii)(B) of this section).

(iv) *Treatment of amounts as having unrelated current year BIE deduction status*. To the extent the amount of a member's current year BIE that is absorbed under paragraph (c)(2) of this section exceeds the domestic related current year BIE deduction status and foreign related current year BIE deduction status allocated to the member under paragraph (c)(4)(ii) and (iii) of this section, such excess amount is treated as from payments or accruals to an unrelated party.

(5) *Allocation of domestic related BIE carryforward status and foreign related BIE carryforward status to members of the group*—(i) *In general*. This paragraph (c)(5) applies in any year the consolidated group's aggregate current year BIE exceeds its section 163(j) limitation. After the application of paragraph (c)(4) of this section, any remaining domestic related current year BIE, foreign related current year BIE, and unrelated current year BIE is deemed to have been incurred pro-rata by members of the group pursuant to the rules in paragraph (c)(5)(ii), (iii), and (iv) of this section, regardless of which member or members actually incurred the business interest expense to a domestic related party, foreign related party, or unrelated party.

(ii) *Domestic related BIE carryforward*—(A) *Amount of domestic related BIE carryforward status allocable to a member*. The amount of domestic related BIE carryforward status that is allocated to a member equals the group's domestic related BIE carryforward from that year multiplied by the percentage of disallowed BIE carryforward allocable to the member.

(B) *Percentage of disallowed BIE carryforward allocable to a member*. The percentage of disallowed BIE carryforward allocable to a member for a taxable year equals the member's disallowed BIE carryforward from that year divided by the consolidated group's disallowed BIE carryforwards from that year.

(iii) *Amount of foreign related BIE carryforward status allocable to a member*. The amount of foreign related BIE carryforward status that is allocated to a member equals the group's foreign related BIE carryforward from that year multiplied by the percentage of disallowed BIE carryforward allocable to the member (as defined in paragraph (c)(5)(ii)(B) of this section).

(iv) *Treatment of amounts as having unrelated BIE carryforward status*. If a member's disallowed BIE carryforward for a year exceeds the amount of domestic related BIE carryforward status and foreign related BIE carryforward status that is allocated to the member pursuant to paragraphs (c)(5)(ii) and (iii) of this section, respectively, the excess carryforward amount is treated as from payments or accruals to an unrelated party.

(v) *Coordination with section 381*. If a disallowed BIE carryforward is allocated a status as a domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward under the allocation rule of paragraph (c)(5) of this section, the acquiring corporation in a transaction described in section 381(a) will succeed to and take into account the allocated status of the carryforward for purposes of section 59A. See §1.381(c)(20)-1.

(6) *Member deconsolidates from a consolidated group*—(i) *General rule*. When a member deconsolidates from a group (the original group), the member's disal-

lowed BIE carryforwards retain their allocated status, pursuant to paragraph (c)(5) of this section, as a domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward (as applicable). Following the member's deconsolidation, the status of the disallowed BIE carryforwards of the remaining members is not redetermined.

(ii) *Gross receipts exception*. This paragraph (c)(6)(ii) applies if the original group had insufficient gross receipts to satisfy the gross receipts test under §1.59A-2(d) and thus was not an applicable taxpayer in the year in which the deconsolidating member's disallowed BIE carryforward was incurred. If this paragraph (c)(6)(ii) applies, the deconsolidating member may determine the status of its disallowed BIE carryforward from that year by applying the classification rule of §1.59A-3(c)(4) solely to the interest payments or accruals of the deconsolidating member, rather than by applying §1.1502-59A(c)(3).

(iii) *Failure to substantiate*. If the deconsolidating member fails to substantiate a disallowed BIE carryforward as a domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward, then the disallowed BIE carryforward is treated as a foreign related BIE carryforward.

(7) *Corporation joins a consolidated group*. If a corporation joins a consolidated group (the acquiring group), and that corporation was allocated a domestic related BIE carryforward status, foreign related BIE carryforward status, or unrelated BIE carryforward status pursuant to paragraph (c)(5) of this section from another consolidated group (the original group), 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 is taken into account in determining the acquiring group's base erosion tax benefit when the corporation's disallowed BIE carryforward is absorbed.

(d) *Allocation of the base erosion minimum tax amount to members of the consolidated group*. For rules regarding the allocation of the base erosion minimum tax amount, see section 1552. Allocations under section 1552 take into account the classification and allocation provisions of paragraphs (c)(3) through (5) of this section.

(e) [Reserved].

(f) *Definitions*. The following definitions apply for purposes of this section –

(1) *Aggregate current year BIE*. The consolidated group's *aggregate current year BIE* is the aggregate of all members' current year BIE.

(2) *Aggregate current year BIE deduction*. The consolidated group's *aggregate current year BIE deduction* is the aggregate of all members' current year BIE deductions.

(3) *Applicable taxpayer*. The term *applicable taxpayer* has the meaning provided in §1.59A-2(b).

(4) *Base erosion minimum tax amount*. The consolidated group's *base erosion minimum tax amount* is the tax imposed under section 59A.

(5) *Base erosion tax benefit*. The term *base erosion tax benefit* has the meaning provided in §1.59A-3(c)(1).

(6) *Business interest expense*. The term *business interest expense*, with respect to a member and a taxable year, has the meaning provided in §1.163(j)-1(b)(2), and with respect to a consolidated group and a taxable year, has the meaning provided in §1.163(j)-4(d)(2)(iii).

(7) *Consolidated group's disallowed BIE carryforwards*. The term *consolidated group's disallowed BIE carryforwards* has the meaning provided in §1.163(j)-5(b)(3)(i).

(8) *Current year BIE*. A member's *current year BIE* is the member's business interest expense that would be deductible in the current taxable year without regard to section 163(j) and that is not a disallowed business interest expense carryforward from a prior taxable year.

(9) *Current year BIE deduction*. A member's *current year BIE deduction* is the member's current year BIE that is permitted as a deduction in the taxable year.

(10) *Domestic related BIE carryforward*. The consolidated group's *domestic related BIE carryforward* for any taxable year is the excess of the group's domestic related current year BIE over the group's domestic related current year BIE deduction (if any).

(11) *Domestic related current year BIE*. The consolidated group's *domestic related current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to a domestic related party.

(12) *Domestic related current year BIE deduction*. The consolidated group's *domestic related current year BIE deduction* for any taxable year is the portion of the group's aggregate current year BIE deduction classified as from interest paid or accrued to a domestic related party under paragraph (c)(3) of this section.

(13) *Domestic related party*. A *domestic related party* is a related party that is not a foreign related party and is not a member of the same consolidated group.

(14) *Disallowed BIE carryforward*. The term *disallowed BIE carryforward* has the meaning provided in §1.163(j)-1(b)(9).

(15) *Foreign related BIE carryforward*. The consolidated group's *foreign related BIE carryforward* for any taxable year, is the excess of the group's foreign related current year BIE over the group's foreign related current year BIE deduction (if any).

(16) *Foreign related current year BIE*. The consolidated group's *foreign related current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to a foreign related party.

(17) *Foreign related current year BIE deduction*. The consolidated group's *foreign related current year BIE deduction* for any taxable year is the portion of the consolidated group's aggregate current year BIE deduction classified as from interest paid or accrued to a foreign related party under paragraph (c)(3) of this section.

(18) *Foreign related party*. A *foreign related party* has the meaning provided in §1.59A-1(b)(12).

(19) *Related party*. The term *related party* has the meaning provided in §1.59A-1(b)(17), but excludes members of the same consolidated group.

(20) *Section 163(j) interest deduction*. The term *section 163(j) interest deduction* means, with respect to a taxable year, the amount of the consolidated group's business interest expense permitted as a deduction pursuant to §1.163(j)-5(b)(3) in the taxable year.

(21) *Section 163(j) limitation*. The term *section 163(j) limitation* has the meaning provided in §1.163(j)-1(b)(31).

(22) *Unrelated BIE carryforward*. The consolidated group's *unrelated BIE carryforward* for any taxable year is the excess of the group's unrelated current year BIE over the group's unrelated current year BIE deduction.

(23) *Unrelated current year BIE*. The consolidated group's *unrelated current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to an unrelated party.

(24) *Unrelated current year BIE deduction*. The consolidated group's *unrelated current year BIE deduction* for any taxable year is the portion of the group's aggregate current year BIE deduction classified as from interest paid or accrued to an unrelated party under paragraph (c)(3) of this section.

(25) *Unrelated party*. An *unrelated party* is a party that is not a related party.

(g) *Examples*. The following examples illustrate the general application of this section. For purposes of the examples, a foreign corporation (FP) wholly owns domestic corporation (P), which in turn wholly owns S1 and S2. P, S1, and S2 are members of a consolidated group. The consolidated group is a calendar year taxpayer.

(1) *Example 1: Computation of the consolidated group's base erosion minimum tax amount*. (i) *The consolidated group is the applicable taxpayer*—(A) *Facts*. The members have never engaged in intercompany transactions. For the 2019 taxable year, P, S1, and S2 were permitted the following amounts of deductions (within the meaning of section 59A(c)(4)), $2,400x, $1,000x, and $2,600x; those deductions include base erosion tax benefits of $180x, $370x, and $230x. The group's consolidated taxable income for the year is $150x. In addition, the group satisfies the gross receipts test in §1.59A-2(d).

(B) *Analysis*. Pursuant to paragraph (b) of this section, 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% (($180x + $370x + $230x)/($2,400x + $1,000x + $2,600x)). The consolidated group is an applicable taxpayer under §1.59A-2(b) because the group satisfies the gross receipts test and the group's base erosion percentage (13%) is higher than 3%. The consolidated group's modified taxable income is computed by adding back the members' base erosion tax benefits (and, when the consolidated group has consolidated net operating loss available for deduction, the consolidated net operating loss allowed multiplied by the base erosion percentage) to the consolidated taxable income, $930x ($150x + $180x + $370x + $230x). The group's base erosion minimum tax amount is then computed as 10 percent of the modified taxable income less the regular tax liability, $61.5x ($930x × 10% - $150x × 21%).

(ii) *The consolidated group engages in intercompany transactions*—(A) *Facts*. The facts are the same as in paragraph (g)(1)(i)(A) of this section (the facts in *Example 1*(i)), 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.

(B) *Analysis*. The result is the same as paragraph (g)(1)(i)(A) of this section (the facts in *Example 1*(i)). Pursuant to paragraph (b)(2) of this section, items resulting from the intercompany sale (for example, gross receipts, depreciation deductions) are not taken into account in computing the group's gross receipts under §1.59A-2(d) and base erosion percentage under §1.59A-2(e)(3).

(2) *Example 2: Business interest expense subject to section 163(j) and the group's domestic related current year BIE and foreign related current year BIE for the year equals its section 163(j) limitation*—(i) *Facts*. During the current year (Year 1), P incurred $150x of business interest expense to domestic related parties; S1 incurred $150x of business interest expense to foreign related parties; and S2 incurred $150x of business interest expense to unrelated parties. The group's section 163(j) limitation for the year is $300x. After applying the rules in §1.163(j)-5(b)(3), the group deducts $150x of P's Year 1 business interest expense, and $75x each of S1 and S2's Year 1 business interest expense. Assume the group is an applicable taxpayer for purposes of section 59A.

(ii) *Analysis*—(A) *Application of the absorption rule in paragraph (c)(2) of this section*. Following the rules in section 163(j), the group's section 163(j) interest deduction for Year 1 is $300x, and the entire amount is from members' Year 1 business interest expense.

(B) *Application of the classification rule in paragraph (c)(3) of this section*. Under paragraph (c)(3) of this section, the 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 group has $150x of domestic related current year BIE and $150x of foreign related current year BIE, and the group's aggregate current year BIE deduction will be classified equally among the related party expenses. Therefore, $150x of the group's deduction is classified as domestic related current year BIE deduction and $150x is classified as a foreign related current year BIE deduction.

(C) *Application of the allocation rule in paragraph (c)(4) of this section*. After the application of the classification rule in paragraph (c)(3) of this section, the 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 will be allocated to P, S1, and S2 based on each member's deduction of its Year 1 business interest expense.

(*1*) *Allocations to P*. The percentage of current year BIE deduction attributable to P is 50% (P's deduction of its Year 1 current year BIE, $150x, divided by the 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 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 group's foreign related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to P, 50%).

(*2*) *Allocations to S1 and S2*. The percentage of current year BIE deduction attributable to S1 is 25% (S1's deduction of its Year 1 current year BIE, $75x, divided by the group's aggregate current year BIE deduction for Year 1, $300x). Thus, the amount of domestic related current year BIE deduction status allocated to S1 is $37.5x (the 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 $37.5x (the group's foreign related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to S1, 25%). 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 under this paragraph (f)(2)(ii)(C)(*2*).

(D) *Application of the allocation rule in paragraph (c)(5) of this section*. Although the group will have disallowed BIE carryforwards after Year 1 (the 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 paragraph (c)(3) of this section. Thus, under paragraph (c)(5)(iv) of this section, each member's disallowed BIE carryforward is treated as from payments or accruals to unrelated parties.

(3) *Example 3: Business interest expense subject to section 163(j)*—(i) *The group's domestic related current year BIE and foreign related current year BIE for the year exceeds its section 163(j) limitation*. (A) *Facts*. During the current year (Year 1), P incurred $60x of business interest expense to domestic related parties; S1 incurred $40x of business interest expense to foreign related parties; and S2 incurred $80x of business interest expense to unrelated parties. The group's section 163(j) limitation for the year is $60x. After applying the rules in §1.163(j)-5(b)(3), the group deducts $20x each of P, S1, and S2's current year business interest expense. Assume the group is an applicable taxpayer for purposes of section 59A.

(B) *Analysis*—(*1*) *Application of the absorption rule in paragraph (c)(2) of this section*. Following the rules in section 163(j), the group's section 163(j) interest deduction is $60x, and the entire amount is from members' Year 1 business interest expense.

(*2*) *Application of the classification rule in paragraph (c)(3) of this section*. Under paragraph (c)(3) of this section, the group's $60x of aggregate current year BIE deduction 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 from unrelated parties. The group's total related party interest expense in Year 1, $100x (sum of the group's Year 1 domestic related current year BIE, $60x, and the group's Year 1 foreign related current year BIE, $40x), exceeds the group's aggregate current year BIE deduction of $60x. Thus, the group's aggregate current year BIE deduction will be classified, pro-rata, as from payments or accruals to domestic related parties and foreign related parties. Of the group's aggregate current year BIE deduction in Year 1, $36x is classified as a domestic related current year BIE deduction (the group's aggregate current year BIE deduction, $60x, multiplied by the ratio of domestic related current year BIE over the group's total Year 1 related party interest expense ($60x / ($60x+$40x))); and $24x of the group's aggregate current year BIE deduction is classified as a foreign related current year BIE deduction (the group's section 163(j) interest deduction, $60x, multiplied by the ratio of foreign related current year BIE over the group's total Year 1 related party interest expense ($40x / ($60x+$40x))).

(*3*) *Application of the allocation rule in paragraph (c)(4) of this section*. After the application of the classification rule in paragraph (c)(3) of this section, the group has $36x of domestic related current year BIE deduction and $24x of 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 will be allocated to P, S1, and S2 based on each member's current year BIE deduction in Year 1.

(*i*) *Allocation of the group's domestic related current year BIE deduction status*. Because each member is deducting $20x of its Year 1 business interest expense, all three members have the same percentage of current year BIE deduction attributable to them. The percentage of current year BIE deduction attributable to each of P, S1, and S2 is 33.33% (each member's current year BIE deduction in Year 1, $20x, divided by the group's aggregate current year BIE deduction for Year 1, $60x). Thus, the amount of domestic related current year BIE deduction status allocable to each member is $12x (the group's domestic related current year BIE deduction, $36x, multiplied by the percentage of current year BIE deduction allocable to each member, 33.33%).

(*ii*) *Allocations of the group's foreign related current year BIE deduction status*. The amount of foreign related current year BIE deduction status allocable to each member is $8x (the group's foreign related current year BIE deduction, $24x, multiplied by the percentage of current year BIE deduction allocable to each member, 33.33%, as computed earlier in paragraph (f)(3) of this section (*Example 3*).

(*4*) *Application of the allocation rule in paragraph (c)(5) of this section*. In Year 1 the group has $60x of domestic related current year BIE, of which $36x is deducted in the year (by operation of the classification rule). Therefore, the group has $24x of domestic related BIE carryforward. Similarly, the group has $40x of foreign related current year BIE in Year 1, of which $24x is deducted in the year. Therefore, the group has $16x of foreign related BIE carryforward. The $24x domestic related BIE carryforward status and $16x foreign related BIE carryforward status will be allocated to P, S1, and S2 in proportion to the amount of each member's disallowed BIE carryforward.

(*i*) *Allocation to P*. The percentage of disallowed BIE carryforward allocable to P is 33.33% (P's Year 1 disallowed BIE carryforward, $40x ($60x - $20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x + $40x + 80x - $60x)). Thus, the amount of domestic related BIE carryforward status allocated to P is $8x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to P, 33.33%); and the amount of foreign related BIE carryforward status allocated to P is $5.33x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to P, 33.33%). Under paragraph (c)(5)(iv) of this section, P's disallowed BIE carryforward that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $26.67x ($40x P's disallowed BIE carryforward - $8x domestic related BIE carryforward status allocated to P - $5.33x foreign related BIE carryforward status allocated to P) is treated as interest paid or accrued to an unrelated party.

(*ii*) *Allocation to S1*. The percentage of disallowed BIE carryforward allocable to S1 is 16.67% (S1's Year 1 disallowed BIE carryforward, $20x ($40x - $20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x + $40x + 80x - $60x). Thus, the amount of domestic related BIE carryforward status allocated to S1 is $4x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to S1, 16.67%); and the amount of foreign related BIE carryforward status allocated to S1 is $2.67x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to S1, 16.67%). Under paragraph (c)(5)(iv) of this section, S1's disallowed BIE that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $13.33x ($20x S1's disallowed BIE carryforward - $4x domestic related BIE carryforward status allocated to S1 - $2.67x foreign related BIE carryforward status allocated to S1) is treated as interest paid or accrued to an unrelated party.

(*iii*) *Allocation to S2*. The percentage of disallowed BIE carryforward allocable to S2 is 50% (S2's Year 1 disallowed BIE carryforward, $60x ($80x-$20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x+$40x-+80x-$60x). Thus, the amount of domestic related BIE carryforward status allocated to S2 is $12x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to S2, 50%); and the amount of foreign related BIE carryforward status allocated to S2 is $8x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to S2, 50%). Under paragraph (c)(5)(iv) of this section, S2's disallowed BIE that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $40x ($60x S2's disallowed BIE carryforward - $12x domestic related BIE carryforward status allocated to S2 - $8x foreign related BIE carryforward status allocated to S2) is treated as interest paid or accrued to an unrelated party.

(ii) *The group deducting its disallowed BIE carryforwards*—(A) *Facts*. The facts are the same as in paragraph (g)(3)(i)(A) of this section (the facts in *Example 3*(i)), and in addition, none of the members incurs any business interest expense in Year 2. The group's section 163(j) limitation for Year 2 is $30x.

(B) *Analysis*—(*1*) *Application of the absorption rule in paragraph (c)(2) of this section*. Following the rules in section 163(j), each member of the group is deducting $10x of its disallowed BIE carryforward from Year 1. Therefore, the group's section 163(j) deduction for Year 2 is $30x.

(*2*) *Application of the classification rule in paragraph (c)(3) of this section*. Under paragraph (c)(3)(iv) of this section, to the extent members are deducting their Year 1 disallowed BIE carryforward in Year 2, the classification rule will apply to the deduction in Year 2 after the allocation rule in paragraph (c)(5) of this section has allocated the related and unrelated party status to the member's disallowed BIE carryforward in Year 1. The allocation required under paragraph (c)(5) of this section is described in paragraph (f)(3)(i)(B)(*4*) of this section.

(*i*) *Use of P's allocated domestic related BIE carryforward status and foreign related BIE carryforward status*. P has $40x of Year 1 disallowed BIE carryforward, and P was allocated $8x of domestic related BIE carryforward status and $5.33x of foreign related BIE carryforward status. In Year 2, P deducts $10x of its Year 1 disallowed BIE carryforward. Under the classification rule of paragraph (c)(3) of this section, P is treated as deducting pro-rata from its allocated status of domestic related BIE carryforward and foreign related BIE carryforward. Therefore, P is treated as deducting $6x of its allocated domestic related BIE carryforward ($10x × $8x / ($8x + $5.33x)), and $4x of its allocated foreign related BIE carryforward ($10x × $5.33x / $8x + $5.33x)). After Year 2, P has remaining $30x of Year 1 disallowed BIE carryforward, of which $2x has a status of domestic related BIE carryforward, $1.33x has the status of foreign related BIE carryforward, and $26.67x of interest treated as paid or accrued to unrelated parties.

(*ii*) *Use of S1's allocated domestic related BIE carryforward status and foreign related BIE carryforward status*. S1 has $20x of Year 1 disallowed BIE carryforward, and S1 was allocated $4x of domestic related BIE carryforward status and $2.67x of foreign related BIE carryforward status. In Year 2, S2 deducts $10x of its Year 1 disallowed BIE carryforward. Because S2's deduction of its Year 1 disallowed BIE carryforward, $10x, exceeds its allocated domestic related BIE carryforward status ($4x) and foreign related BIE carryforward status ($2.67x), all of the allocated related party status are used up. After Year 2, all of S1's Year 1 disallowed BIE carryforward, $10x, is treated as interest paid or accrued to an unrelated party.

(*iii*) *Use of S2's allocated domestic related BIE carryforward status and foreign related BIE carryforward status*. S2 has $60x of Year 1 disallowed BIE carryforward, and S2 was allocated $12x of domestic related BIE carryforward status and $8x of foreign related BIE carryforward status. In Year 2, S2 deducts $10x of its Year 1 disallowed BIE carryforward. Under the classification rule of paragraph (c)(3) of this section, S2 is treated as deducting $6x of its allocated domestic related BIE carryforward ($10x × $12x / ($12x + $8x)), and $4x of its allocated foreign related BIE carryforward ($10x × $8x / $8x + $12x)). After Year 2, P has remaining $50x of Year 1 disallowed BIE carryforward, of which $6x has a status of domestic related BIE carryforward, $4x has the status of foreign related BIE carryforward, and $40x of interest treated as paid or accrued to unrelated parties.

(h) *Applicability date*. This section applies to taxable years for which the original consolidated Federal income tax return is due (without extensions) after December 6, 2019.

Par. 9. Section 1.1502-100 is amended by revising paragraph (b) to read as follows:

§1.1502-100 Corporations exempt from tax.

* * * * *

(b) The tax liability for a consolidated return year of an exempt group is the tax imposed by section 511(a) on the consolidated unrelated taxable income for the year (determined under paragraph (c) of this section), and by allowing the credits provided in §1.1502-2(b).

* * * * *

Par. 10. Section 1.6038A-1 is amended by

1. Re-designating paragraph (n)(2) as paragraph (n)(2)(i) and adding a subject heading for newly re-designated paragraph (n)(2)(i).
2. Adding a sentence to the end of newly re-designated paragraph (n)(2)(i).
3. Adding paragraph (n)(2)(ii).
4. Revising the last sentence of paragraph (n)(3).

The additions and revision read as follows:

§1.6038A-1 General requirements and definitions.

* * * * *

(n) * * *

(2) *Section 1.6038A-2*—(i) *In general*. * * * Section 1.6038A-2(a)(3), (b)(6), and (b)(7) apply to taxable years ending on or after December 17, 2018. However, taxpayers may apply these final regulations in their entirety for taxable years ending before December 17, 2018.

(ii) *Transition rule*. No penalty under sections 6038A(d) or 6038C(c) will apply to a failure solely under §1.6038A-2(a)(3), (b)(6), or (b)(7) that is corrected by December 6, 2019.

(3) * * * For taxable years ending on or before December 31, 2017, see §1.6038A-4 as contained in 26 CFR part 1 revised as of April 1, 2018.

* * * * *

Par. 11. Section 1.6038A-2 is amended by

1. Revising the subject headings for paragraphs (a) and (a)(1).
2. Revising paragraph (a)(2).
3. Adding paragraph (a)(3).
4. Revising paragraphs (b)(1)(ii), (b)(2)(iv), and the second sentence of paragraph (b)(3).
5. Redesignating paragraphs (b)(6) through (9) as paragraphs (b)(8) through (11).
6. Adding new paragraphs (b)(6) and (7).
7. Revising paragraph (c) and the first sentence of paragraph (d).
8. Removing the language "Paragraph (b)(8)" from the second sentence of paragraph (g) and adding the language "Paragraph (b)(10)" in its place.
9. Adding three sentences to the end of paragraph (g).

The revisions and additions read as follows:

§1.6038A-2 Requirement of return.

(a) *Forms required*—(1) *Form 5472*. * * *

(2) *Reportable transaction*. A reportable transaction is any transaction of the types listed in paragraphs (b)(3) and (4) of this section, and, in the case of a reporting corporation that is an applicable taxpayer, as defined under §1.59A-2(b), any other arrangement that, to prevent avoidance of the purposes of section 59A, is identified on Form 5472 as a reportable transaction. However, except as the Secretary may prescribe otherwise for an applicable taxpayer, the transaction is not a reportable transaction if neither party to the transaction is a United States person as defined in section 7701(a)(30) (which, for purposes of section 6038A, includes an entity that is a reporting corporation as a result of being treated as a corporation under §301.7701-2(c)(2)(vi) of this chapter) and the transaction—

(i) Will not generate in any taxable year gross income from sources within the United States or income effectively connected, or treated as effectively connected, with the conduct of a trade or business within the United States, and

(ii) Will not generate in any taxable year any expense, loss, or other deduction that is allocable or apportionable to such income.

(3) *Form 8991*. Each reporting corporation that is an applicable taxpayer, as defined under §1.59A-2(b), must make an annual information return on Form 8991. The obligation of an applicable taxpayer to report on Form 8991 does not depend on applicability of tax under section 59A or obligation to file Form 5472.

(b) * * *

(1) * * *

(ii) The name, address, and U.S. taxpayer identification number, if applicable, of all its direct and indirect foreign shareholders (for an indirect 25-percent foreign shareholder, explain the attribution of ownership); whether any 25-percent foreign shareholder is a surrogate foreign corporation under section 7874(a)(2)(B) or a member of an expanded affiliated group as defined in section 7874(c)(1); each country in which each 25-percent foreign shareholder files an income tax return as a resident under the tax laws of that country; the places where each 25-percent shareholder conducts its business; and the country or countries of organization, citizenship, and incorporation of each 25-percent foreign shareholder.

* * * * *

(2) * * *

(iv) The relationship of the reporting corporation to the related party (including, to the extent the form may prescribe, any intermediate relationships).

(3) * * * The total amount of such transactions, as well as the separate amounts for each type of transaction described below, and, to the extent the form may prescribe, any further description, categorization, or listing of trans-

actions within these types, must be reported on Form 5472, in the manner the form or its instructions may prescribe. * * *

* * * * *

(6) *Compilation of reportable transactions across multiple related parties*. A reporting corporation must, to the extent and in the manner Form 5472 or its instructions may prescribe, include a schedule tabulating information with respect to related parties for which the reporting corporation is required to file Forms 5472. The schedule will not require information (beyond totaling) that is not required for the individual Forms 5472. The schedule may include the following:

(i) The identity and status of the related parties;

(ii) The reporting corporation's relationship to the related parties;

(iii) The reporting corporation's reportable transactions with the related parties; and

(iv) Other items required to be reported on Form 5472.

(7) *Information on Form 5472 and Form 8991 regarding base erosion payments*. If any reporting corporation is an applicable taxpayer, as defined under §1.59A-2(b), it must report the information required by Form 8991 and by any Form 5472 it is required to file (including the information required by their accompanying instructions), regarding:

(i) Determination of whether a taxpayer is an applicable taxpayer;

(ii) Computation of base erosion minimum tax amount, including computation of regular tax liability as adjusted for purposes of computing base erosion minimum tax amount;

(iii) Computation of modified taxable income;

(iv) Base erosion tax benefits;

(v) Base erosion percentage calculation;

(vi) Base erosion payments;

(vii) Amounts with respect to services as described in §1.59A-3(b)(3)(i), including a breakdown of the amount of the total services cost and any mark-up component;

(viii) Arrangements or transactions described in §1.59A-9;

(ix) Any qualified derivative payment, including:

(A) The aggregate amount of qualified derivative payments for the taxable year; and

(B) A representation that all payments satisfy the requirements of §1.59A-6(b)(2); and

(x) Any other information necessary to carry out section 59A.

* * * * *

(c) *Method of reporting*. All statements required on or with the Form 5472 or Form 8991 under this section and §1.6038A-5 must be in the English language. All amounts required to be reported under paragraph (b) of this section must be expressed in United States currency, with a statement of the exchange rates used, and, to the extent the forms may require, must indicate the method by which the amount of a reportable transaction or item was determined.

(d) * * * A Form 5472 and Form 8991 required under this section must be filed with the reporting corporation's income tax return for the taxable year by the due date (including extensions) of that return. * * *

* * * * *

(g) * * * Paragraph (b)(7)(ix) of this section applies to taxable years beginning on or after June 7, 2021. Before these final regulations are applicable, a taxpayer will be treated as satisfying the reporting requirement described in §1.59A-6(b)(2) only to the extent that it reports the aggregate amount of qualified derivative payments on Form 8991. *See* §1.59A-6(b)(2)(iv) (transition period for qualified derivative payment reporting).

§1.6038A-4 [Amended].

Par. 12. For each paragraph listed in the table, remove the language in the "Remove" column from wherever it appears and add in its place the language in the "Add" column as set forth below and in paragraph (f), designate Examples 1 and 2 as paragraphs (f)(1) and (2), respectively.

Paragraph	Remove	Add
(a)(1)	$10,000	$25,000
(a)(3)	$10,000	$25,000
(d)(1)	$10,000	$25,000
(d)(4)	$10,000	$25,000
(f)	$10,000	$25,000
(f)	$30,000	$75,000
(f)	$90,000	$225,000

§1.6655-5 [Amended].

Par. 13. Section 1.6655-5 is amended in paragraph (e) by designating Examples 1 through 13 as paragraphs (e)(1) through (13), respectively, and by removing the language "§1.1502-2(h)" in newly designated paragraph (e)(10) and adding the language"§1.1502-1(h)" in its place.

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

Approved: November 13, 2019.

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on December 2, 2019, 4:15 p.m., and published in the issue of the Federal Register for December 6, 2019, 84 F.R. 66968)

Part III

2019 Required Amendments List for Qualified Retirement Plans and § 403(b) Retirement Plans

Notice 2019-64

I. PURPOSE

This notice sets forth the 2019 Required Amendments List (2019 RA List). Beginning with the 2019 RA List, all Required Amendments Lists (RA Lists) will apply to both individually designed plans qualified under § 401(a) (qualified individually designed plans) and individually designed plans that satisfy the requirements of § 403(b) (§ 403(b) individually designed plans).

Section 5 of Rev. Proc. 2016-37, 2016-29 I.R.B. 136, provides, generally, that in the case of a qualified individually designed plan, the remedial amendment period for a disqualifying provision arising as a result of a change in qualification requirements is extended to the end of the second calendar year that begins after the issuance of the RA List on which the change in qualification requirements appears. Similarly, section 5 of Rev. Proc. 2019-39, 2019-42 I.R.B. 945, provides that, with respect to a form defect in a § 403(b) individually designed plan, the remedial amendment period arising as a result of a change in § 403(b) requirements ends on the last day of the second calendar year that begins after the issuance of the RA List on which the change in § 403(b) requirements appears. Pursuant to these sections, December 31, 2021, generally is the last day of the remedial amendment period with respect to (1) a disqualifying provision arising as a result of a change in qualification requirements that appears on the 2019 RA List and (2) a form defect arising as a result of a change in § 403(b) requirements that appears on the 2019 RA List. In addition, under section 8.01 of Rev. Proc. 2016-37 and section 6.01 of Rev. Proc. 2019-39, December 31, 2021, generally is also the plan amendment deadline for a disqualifying provision arising as a result of a change in qualification requirements that appears on the 2019 RA List and for a form defect arising as a result of a change in § 403(b) requirements that appears on the 2019 RA List. Later dates may apply to a governmental plan (as defined in § 414(d)) pursuant to sections 5.06(3) and 8.01 of Rev. Proc. 2016-37 and sections 5.03(2)(c) and 6.01 of Rev. Proc. 2019-39. References to qualification requirements and to § 403(b) requirements in Parts III and IV of this notice are referred to, separately and collectively, as "requirements."

II. BACKGROUND

Section 401(b) of the Internal Revenue Code (Code) provides a remedial amendment period during which a plan may be amended retroactively to comply with the qualification requirements under § 401(a). Section 1.401(b)-1 describes the disqualifying provisions that may be amended retroactively and the remedial amendment period during which retroactive amendments may be adopted. That regulation also grants the Commissioner the discretion to designate certain plan provisions as disqualifying provisions and to extend the remedial amendment period.

Sections 5.05(3) and 5.06(3) of Rev. Proc. 2016-37 extend the remedial amendment period for individually designed plans to correct disqualifying provisions that arise as a result of a change in qualification requirements. Under section 5.05(3), the remedial amendment period for a plan that is not a governmental plan (as defined in § 414(d)) is extended to the end of the second calendar year that begins after the issuance of the RA List on which the change in qualification requirements appears. Section 5.06(3) provides a special rule for governmental plans that may further extend the remedial amendment period in some cases.

Section 8.01 of Rev. Proc. 2016-37 provides that the plan amendment deadline with respect to a disqualifying provision described in section 5 of Rev. Proc. 2016-37 is the date on which the remedial amendment period ends with respect to that disqualifying provision.

Section 21.02 of Rev. Proc. 2013-22, 2013-18 I.R.B. 985, establishes a remedial amendment period that permits an eligible employer to retroactively correct form defects in its written § 403(b) plan.

Section 3 of Rev. Proc. 2017-18, 2017-5 I.R.B. 743, provides that the remedial amendment period for a form defect in a § 403(b) plan ends on March 31, 2020. Thus, this § 403(b) remedial amendment period applies to form defects first occurring on or before March 31, 2020.

Section 5.01 of Rev. Proc. 2019-39 establishes a system of recurring remedial amendment periods for § 403(b) individually designed plan form defects first occurring after March 31, 2020.

Section 5.03(1)(c) of Rev. Proc. 2019-39 provides that with respect to a form defect relating to, or integral to, a change in § 403(b) requirements, the remedial amendment period for a § 403(b) individually designed plan that is not a governmental plan (as defined in § 414(d)) ends on the last day of the second calendar year that begins after the issuance of the RA List on which the change in requirements appears. Section 5.03(2)(c) provides a special rule for governmental plans that could further extend the remedial amendment period in some cases.

Section 6.01 of Rev. Proc. 2019-39 provides that the plan amendment deadline with respect to a form defect in a § 403(b) individually designed plan first occurring after March 31, 2020, is the date on which the remedial amendment period ends with respect to that form defect.

Section 7 of Rev. Proc. 2019-39 extends the § 403(b) remedial amendment period with respect to form defects first occurring on or before March 31, 2020, to the later of (1) March 31, 2020, or (2) the end of the remedial amendment period provided under section 5 of Rev. Proc. 2019-39.

Section 9 of Rev. Proc. 2016-37 and section 8.01 of Rev. Proc. 2019-39 provide that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to publish an RA List annually. In general, a change in qualification requirements will not ap-

pear on an RA List until guidance with respect to that change (including, in certain cases, model amendments) has been provided in regulations or in other guidance published in the Internal Revenue Bulletin. However, in the discretion of the Treasury Department and the IRS, a change in qualification requirements may be included on an RA List in other circumstances, such as in cases in which a statutory change is enacted and the Treasury Department and the IRS anticipate that no guidance will be issued.

III. CONTENT AND ORGANIZATION OF RA LIST

In general, an RA List includes statutory and administrative changes in requirements that are first effective during the plan year in which the list is published.[1] However, an RA List does not include guidance issued or legislation enacted after the list has been prepared and also does not include:

- Statutory changes in requirements for which the Treasury Department and the IRS expect to issue guidance (which would be included on an RA List issued in a future year);
- Changes in requirements that permit (but do not require) optional plan provisions, in contrast to changes in requirements that cause existing plan provisions (which may include optional plan provisions previously adopted) to become disqualifying provisions or § 403(b) form defects;[2] or
- Changes in the tax laws affecting qualified individually designed plans or § 403(b) individually designed plans that do not change the requirements under § 401(a) or § 403(b) (such as changes to the tax treatment of plan distributions, or changes to the funding requirements for qualified individually designed plans).

The RA List is divided into two parts. Part A covers changes in requirements that generally would require an amendment to most plans or to most plans of the type affected by the change.

Part B includes changes in requirements that the Treasury Department and the IRS anticipate will not require amendments to most plans, but might require an amendment because of an unusual plan provision in a particular plan. For example, if a change affects a particular requirement that most plans incorporate by reference, Part B would include the change because a particular plan might not incorporate the requirement by reference and, thus, might include language inconsistent with the change.

Annual, monthly, or other periodic changes to (1) the various dollar limits that are adjusted for cost of living increases as provided in § 415(d) or other Code provisions, (2) the spot segment rates used to determine the applicable interest rate under § 417(e)(3), and (3) the applicable mortality table under § 417(e)(3), are treated as included on the RA List for the year in which such changes are effective even though they are not directly referenced on that RA List. The Treasury Department and the IRS anticipate that few plans have language that will need to be amended on account of these changes.

The fact that a change in a requirement is included on the RA List does not mean that a plan must be amended as a result of that change. Each plan sponsor must determine whether a particular change in a requirement requires an amendment to its plan.

IV. 2019 REQUIRED AMENDMENTS LIST

Part A. *Changes in requirements that generally would require an amendment to most plans or to most plans of the type affected by the change*.

- *Final regulations relating to hardship distributions* (84 FR 49651 (Sept. 23, 2019)). Plans (including § 403(b) individually designed plans) that (1) provide for a suspension of an employee's elective deferrals or employee contributions as a condition for obtaining a hardship distribution of elective deferrals or (2) do not require a representation from an employee who requests a hardship distribution that he or she has insufficient cash or other liquid assets reasonably available to satisfy the need, must be amended as necessary to eliminate the suspension and provide for the representation, for hardship distributions made on or after January 1, 2020.
  Note: The prohibition on a qualified plan's or 403(b) plan's suspension of elective deferrals and employee contributions as a condition for obtaining a hardship distribution of elective deferrals applies not only to the plan making the hardship distribution but also to all of the employer's other qualified plans, § 403(b) plans (and, if the employer is an eligible employer described in § 457(e)(1)(A), eligible deferred compensation plans, as described in § 457(b)).
- *Final regulations regarding cash balance/hybrid defined benefit plans* (79 FR 56442 (Sept. 19, 2014), 80 FR 70680 (Nov. 16, 2015)). Collectively bargained cash balance/hybrid defined benefit plans maintained pursuant to one or more collective bargaining agreements ratified on or before November 13, 2015, and which constitute collectively bargained plans under § 1.436-1(a)(5)(ii)(B), must be amended to the extent necessary to comply with those portions of the regulations regarding market rate of return and other requirements that first became applicable to the plan for the plan year beginning on or after the later of: (1) January 1, 2017, and (2) the earlier of (a) January 1, 2019, and (b) the date on which the last of those collective bargaining agreements terminates (determined without regard to any extension thereof on or after November 13, 2015). See § 1.411(b)(5)-1(f)(2)(i)(B)(*3*).
  Note: The relief from the anti-cutback requirements of § 411(d)(6) provided in § 1.411(b)(5)-1(e)(3)(vi) applies only to plan amendments that are

[1] RA Lists also may include changes in requirements that were first effective in a prior year that were not included on a prior RA List under certain circumstances, such as changes in requirements that were issued or enacted after the prior year's RA List was prepared.

[2] The remedial amendment period and plan amendment deadline for discretionary changes to the terms of a qualified individually designed plan are governed by sections 5.05(2), 5.06(2), and 8.02 of Rev. Proc. 2016-37. The remedial amendment period and plan amendment deadline for discretionary changes to the terms of a § 403(b) individually designed plan are governed by sections 5.03(1)(b), 5.03(2)(b), and 6.02 of Rev. Proc. 2019-39. These deadlines for discretionary changes are not affected by the inclusion of a change in requirements on an RA List.

adopted before the effective date of those regulations.

See also Notice 2016-67, 2016-47 I.R.B. 748, which addresses the applicability of the market rate of return rules to implicit interest pension equity plans.

Part B. *Other changes in requirements that may require an amendment.*

- *None*

V. DRAFTING INFORMATION

The principal author of this notice is Angelique Carrington of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Ms. Carrington at (202) 317-4148 (not a toll-free number).

Foreign Currency Guidance under Section 987

Notice 2019-65

SECTION 1. PURPOSE

This Notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to amend the regulations under section 987 to defer the applicability date of the final regulations under section 987, as well as certain related final and temporary regulations, by one additional year.

The final regulations under section 987 were identified in Notice 2017-38, 2017-30 I.R.B. 147 (July 24, 2017), as significant tax regulations requiring additional review pursuant to Executive Order 13789. As part of that review, the Treasury Department and the IRS are considering changes to the final regulations that would allow taxpayers to elect to apply alternative rules for transitioning to the final regulations and alternative rules for determining section 987 gain or loss as discussed in the Second Report to the President on Identifying and Reducing Tax Regulatory Burdens published on October 16, 2017 (82 Fed. Reg. 48013).

SECTION 2. BACKGROUND

.01 *Final and Temporary Regulations*.

(1) *The 2016 Final Regulations and the Temporary Regulations*.

On December 8, 2016, the Treasury Department and the IRS published Treasury Decision 9794 (81 Fed. Reg. 88806), which contains final regulations relating to the determination of the taxable income or loss of a taxpayer with respect to a qualified business unit (QBU) subject to section 987 (a section 987 QBU); the timing, amount, character, and source of any section 987 gain or loss; and amendments to existing regulations under sections 861, 985, 988 and 989 (the 2016 final regulations). On that same date, the Treasury Department and the IRS also published Treasury Decision 9795 (81 Fed. Reg. 88854), which contains temporary regulations under section 987, including the following: rules relating to the recognition and deferral of foreign currency gain or loss under section 987 in connection with certain QBU terminations and certain other transactions; an annual deemed termination election for a section 987 QBU; an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; rules regarding the treatment of section 988 transactions of a section 987 QBU; rules regarding QBUs with the U.S. dollar as their functional currency; rules regarding combinations and separations of section 987 QBUs; rules regarding the translation of income used to pay creditable foreign income taxes; and rules regarding the allocation of assets and liabilities of section 987 aggregate partnerships (the temporary section 987 regulations). Treasury Decision 9795 also contains temporary regulations under section 988 requiring the deferral of certain section 988 loss that arises with respect to related-party loans (the temporary section 988 regulations, and with the temporary section 987 regulations, the temporary regulations). The Treasury Department and the IRS concurrently published a notice of proposed rulemaking by cross-reference to the temporary regulations. *See* REG-128276-12, 81 Fed. Reg. 88882 (December 8, 2016).

(2) *Deferral Notices*.

On October 16, 2017, the Treasury Department and the IRS published Notice 2017-57, 2017-42 I.R.B. 325 (October 16, 2017), announcing that future guidance would defer the applicability date of the 2016 final regulations and certain of the temporary regulations by one year. On June 25, 2018, the Treasury Department and the IRS published Notice 2018-57, 2018-26 I.R.B. 774 (June 25, 2018), announcing that future guidance would defer the applicability date of the 2016 final regulations and certain of the temporary regulations by one additional year.

(3) *The 2019 Final Regulations*.

On May 13, 2019, the Treasury Department and the IRS published Treasury Decision 9857 (84 Fed. Reg. 20790), which finalized the temporary regulations dealing with combinations and separations of section 987 QBUs and the recognition and deferral of foreign currency gain or loss under section 987 in connection with certain QBU terminations and certain other transactions (the 2019 final regulations). Treasury Decision 9857 also withdrew temporary regulations under §1.987-7T regarding the allocation of assets and liabilities of certain partnerships. All other portions of the temporary regulations remain outstanding.

.02 *Applicability Dates*.

(1) *The 2016 Final Regulations*.

The 2016 final regulations were effective on December 7, 2016. Dates of applicability for §§1.987-1 through 1.987-10 are provided in §1.987-11(a). Specifically, §1.987-11(a) states that, except as otherwise provided in §1.987-11, §§1.987-1 through 1.987-10 apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Corresponding provisions under sections 861, 985, 988, and 989 also apply to taxable years be-

ginning on or after one year after the first day of the first taxable year following December 7, 2016. *See* §§1.861-9T(g)(2)(vi); 1.985-5(g); 1.988-1(i); 1.988-4(b)(2)(ii); 1.989(a)-1(b)(4); 1.989(a)-1(d)(4). Following the amendments to such regulations described in Notice 2017-57 and Notice 2018-57, the 2016 final regulations would apply to taxable years beginning on or after the first day of the first taxable year following December 7, 2019.

(2) *The Temporary Regulations*.

Similarly, §§1.987-1T (other than §§1.987-1T(g)(2)(i)(B) and (g)(3)(i)(H)), 1.987-3T, 1.987-6T, 1.988-1T, and 1.988-2T(i) (the related temporary regulations) apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. *See* §§1.987-1T(h); 1.987-3T(f); 1.987-6T(d); 1.988-1T(j); 1.988-2T(j). Following the amendments described in Notice 2017-57 and Notice 2018-57, the related temporary regulations and the portions of the notice of proposed rulemaking that cross-referenced the related temporary regulations (the related proposed regulations) would apply to taxable years beginning on or after the first day of the first taxable year following December 7, 2019. All other provisions in the temporary regulations are subject to different applicability dates. *See* §§1.987-1T(h) (concerning §§1.987-1T(g)(2)(i)(B) and (g)(3)(i)(H)); 1.987-8T(g); 1.988-2T(j).

(3) *The 2019 Final Regulations*.

The 2019 final regulations were effective on May 13, 2019. Dates of applicability for the 2019 final regulations are provided in §§1.987-2(e), 1.987-4(h), and 1.987-12(j). Specifically, §§1.987-2(e)(2) and 1.987-4(h)(2) provide that §§1.987-2(c)(9), 1.987-4(c)(2), and 1.987-4(f) apply to taxable years beginning on or after the day that is three years after the first day of the first taxable year following December 7, 2016. Thus, §§1.987-2(c)(9), 1.987-4(c)(2), and 1.987-4(f) of the 2019 final regulations would also apply to taxable years beginning on or after the first day of the first taxable year following December 7, 2019.

Section 1.987-12(j) generally provides that, subject to certain exceptions, §1.987-12 applies to any deferral event or outbound loss event that occurs on or after January 6, 2017 and to any deferral event or outbound loss event that occurs as a result of an entity classification election made under §301.7701-3 filed on or after January 6, 2017, and that is effective before January 6, 2017.

(4) *Early Application*.

A taxpayer may apply the 2016 final regulations, the related temporary regulations, the related proposed regulations, and §§1.987-2(c)(9), 1.987-4(c)(2), and 1.987-4(f) of the 2019 final regulations to taxable years beginning after December 7, 2016, provided the taxpayer consistently applies those regulations to such taxable years with respect to all section 987 QBUs directly or indirectly owned by the taxpayer on the transition date as well as all section 987 QBUs directly or indirectly owned on the transition date by members that file a consolidated return with the taxpayer or by any controlled foreign corporation, as defined in section 957, in which a member owns more than 50 percent of the voting power or stock value, as determined under section 958(a). *See* §§1.861-9T(g)(2)(vi); 1.985-5(g); 1.987-1T(h); 1.987-2(e)(2); 1.987-3T(f); 1.987-4(h)(2); 1.987-6T(d); 1.987-11(b); 1.988-1(i); 1.988-1T(j); 1.988-2T(j); 1.988-4(b)(2)(ii); 1.989(a)-1(b)(4); 1.989(a)-1(d)(4).

The transition date is the first day of the first taxable year to which §§1.987-1 through 1.987-10 are applicable with respect to a taxpayer under §1.987-11. Section 1.987-11(c).

SECTION 3. AMENDED APPLICABILITY DATE

The Treasury Department and the IRS intend to amend §§1.861-9T, 1.985-5, 1.987-11, 1.988-1, 1.988-4, and 1.989(a)-1 of the 2016 final regulations and §§1.987-2 and 1.987-4 of the 2019 final regulations to apply to taxable years beginning on or after the first day of the first taxable year following December 7, 2020 (the amended applicability date). Thus, following the amendments described in this notice, for a taxpayer whose first taxable year after December 7, 2020, begins on January 1, 2021, the 2016 final regulations and §§1.987-2(c)(9), 1.987-4(c)(2), and 1.987-4(f) of the 2019 final regulations would apply for the taxable year beginning on January 1, 2021.

The related temporary regulations, which expire on December 6, 2019, will not become applicable. After the related temporary regulations expire, the amended applicability date will apply for purposes of the related proposed regulations.

A taxpayer may choose to apply the 2016 final regulations, the related temporary regulations (if applicable), the related proposed regulations, and §§1.987-2(c)(9), 1.987-4(c)(2), and 1.987-4(f) of the 2019 final regulations to a taxable year beginning after December 7, 2016 and before the amended applicability date provided the taxpayer consistently applies those regulations to such taxable years with respect to all section 987 QBUs directly or indirectly owned by the taxpayer on the transition date as well as all section 987 QBUs directly or indirectly owned on the transition date by members that file a consolidated return with the taxpayer or by any controlled foreign corporation, as defined in section 957, in which a member owns more than 50 percent of the voting power or stock value, as determined under section 958(a).

SECTION 4. TAXPAYER RELIANCE

Before the issuance of the amendments to the regulations described in section 3 of this Notice, taxpayers may rely on the provisions of this Notice regarding those proposed amendments.

SECTION 5. DRAFTING INFORMATION

The principal author of this Notice is Azeka J. Abramoff of the Office of Associate Chief Counsel (International). For further information regarding this Notice, contact Azeka J. Abramoff at (202) 317-6938 (not a toll-free number).

Reporting of Positive Tax Basis Capital Accounts not Required Until 2020 Partnership Taxable Years; Net Unrecognized Section 704(c) Gain or Loss Defined; Publicly Traded Partnerships not Required to Report Net Unrecognized Section 704(c) Gain or Loss; Certain Reporting of Section 465 At-Risk Activities not Required Until 2020 Partnership Taxable Years; Penalty Relief

Notice 2019-66

BACKGROUND

This notice provides that the requirement to report partners' shares of partnership capital on the tax basis method will not be effective for 2019 (for partnership taxable years beginning in calendar 2019) but will be effective beginning in 2020 (for partnership taxable years that begin on or after January 1, 2020). For 2019, partnerships and other persons must report partner capital accounts consistent with the reporting requirements in the 2018 forms and instructions, including the requirement to report negative tax basis capital accounts on a partner-by-partner basis. This notice also clarifies the 2019 requirement for partnerships and other persons to report a partner's share of "net unrecognized Section 704(c) gain or loss" by defining this term for purposes of the reporting requirement. Additionally, this notice exempts publicly traded partnerships from the requirement to report their partners' shares of net unrecognized Section 704(c) gain or loss until further notice. This notice also provides that the requirement added by the draft instructions for 2019 for partnerships to report to partners information about separate "Section 465 at-risk activities" will not be effective until 2020. Finally, this notice provides relief from certain reporting penalties imposed by the Internal Revenue Code (Code).

REPORTING PARTNER TAX BASIS CAPITAL ACCOUNTS

A draft of the 2019 Form 1065, Schedule K-1, Item L, and a draft of the 2019 Form 8865, Schedule K-1, Item F, both released September 30, 2019, and related draft instructions for the 2019 Form 1065, U.S. Return of Partnership Income (to which the draft instructions for the 2019 Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, refer), and the 2019 Form 1065, Schedule K-1, both released October 29, 2019, proposed to require partner tax basis capital reporting by all partnerships and certain other persons and to prohibit the reporting of partner capital under section 704(b) of the Code (Section 704(b)), generally accepted accounting principles (GAAP), or any other method for 2019.

Based on comments received, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have become aware that certain persons required to file Forms 1065 or 8865 may be unable to timely comply with the requirement to report partner capital on the tax basis method for 2019. This notice provides that partnerships and other persons required to furnish and file Form 1065, Schedule K-1 or Form 8865, Schedule K-1, will not be required to report partner capital accounts in Item L of the 2019 Form 1065, Schedule K-1, or in Item F of the 2019 Form 8865, Schedule K-1, using the tax basis method for 2019.

Instead, partnerships and other persons must report partner capital accounts for 2019 consistent with the reporting requirements for the 2018 Forms 1065, Schedule K-1, or 8865, Schedule K-1, as applicable. This means that partnerships and other persons may continue to report partner capital accounts on Forms 1065, Schedule K-1, Item L, or 8865, Schedule K-1, Item F, using any method available in 2018 (tax basis, Section 704(b), GAAP, or any other method) for 2019. These partnerships and other persons must include a statement identifying the method upon which a partner's capital account is reported. The final instructions for the 2019 Forms 1065, Schedule K-1, Item L and 8865, Schedule K-1, Item F, are expected to include additional details on how such reporting should be done.

For 2019 partnership taxable years, partner "tax basis capital" must be calculated as provided in the 2018 Form 1065 and Schedule K-1 instructions. Beginning with the 2018 partnership taxable year, if a partner's tax basis capital was negative at the beginning or end of a partnership's taxable year, a partnership or other person is required to report on line 20 of a partner's Schedule K-1, using Code AH, such partner's beginning and ending tax basis capital. Partnerships and other persons who follow this notice and report partner capital accounts for 2019 in Item L of the Form 1065, Schedule K-1, or in Item F of the Form 8865, Schedule K-1, by using a method other than the tax basis method must continue to comply with the requirement in the 2018 forms and instructions with respect to negative tax basis capital accounts.

The IRS website for Form 1065 Frequently Asked Questions (FAQs), "Negative Tax Basis Capital Account Reporting Requirements," provides guidance on the calculation of a partner's tax basis capital account in FAQ 2, and, for clarity, the definition of tax basis capital includes (A)(v) and (B)(vii) of FAQ 2. Additionally, in lieu of following the definition of tax basis capital in FAQ 2, partnerships and other persons may instead use the partner outside basis safe harbor approach referenced in FAQ 6. If a partnership or other person uses the safe harbor approach, the partnership or other person must attach a statement to the partner's Schedule K-1 with the information described in (2)(d)(iii) of FAQ 8. Other than the information described in (2)(d)(iii) of FAQ 8, the remainder of FAQ 8 is inapplicable for 2019, including the penalty relief and extension of time to file described therein, which applied only for 2018. The FAQs are found at: https://www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions. In preparation for filing partnership tax returns for the 2020 taxable year, further guidance will be published that provides, and requests comments on, the definition of partner tax basis capital.

REPORTING PARTNERS' SHARES OF NET UNRECOGNIZED SECTION 704(c) GAIN OR LOSS

A draft of the 2019 Forms 1065, Schedule K-1, Item N and 8865, Schedule K-1, Item G, released September 30, 2019, and related draft instructions for the 2019 Form 1065 (to which the draft instructions for the 2019 Form 8865 refer), and the 2019 Form 1065, Schedule K-1, both released October 29, 2019, proposed to require partnerships to report partners' shares of net unrecognized Section 704(c) gain or loss as of the beginning and end of the partnership's 2019 taxable year. The draft instructions to these forms did not include a definition of "net unrecognized Section 704(c) gain or loss." Solely for purposes of completing the 2019 Forms 1065, Schedule K-1, Item N, and 8865, Schedule K-1, Item G, this notice defines a partner's share of "net unrecognized Section 704(c) gain or loss" as the partner's share of the net (net means aggregate or sum) of all unrecognized gains or losses under section 704(c) of the Code (Section 704(c)) in partnership property, including Section 704(c) gains and losses arising from revaluations of partnership property.

Commenters have requested additional guidance with respect to Section 704(c) computations, such as guidance with respect to the issues described in Notice 2009-70, 2009-34 I.R.B. 255. For purposes of reporting for 2019, partnerships and other persons should generally resolve these issues in a reasonable manner, consistent with prior years' practice for purposes of applying Section 704(c) to partners.

Net unrecognized Section 704(c) gain or loss reporting will not apply to publicly traded partnerships (defined in section 7704 of the Code) and their partners for 2019, and thereafter, until further notice.

AT-RISK ACTIVITY REPORTING

The draft of the 2019 Form 1065, Item K, released September 30, 2019, requires partnerships to indicate if they have aggregated activities for purposes of the at-risk limitation rules under section 465 of the Code (Section 465). The draft of the instructions for the 2019 Form 1065, Schedule K-1 (to which the draft instructions for the 2019 Form 8865 refer), released October 29, 2019, included a new paragraph at page 12, At-Risk Limitations, At-Risk Activity Reporting Requirements, that would expressly require partnerships or other persons that have items of income, loss, or deduction reported on the Schedule K-1 from more than one activity that may be subject to limitation under Section 465 at the partner level to report certain additional information separately for each activity on an attachment to a partner's Schedule K-1. The new paragraph would require the partnership or other person to identify the at-risk activity, the items of income, loss, or deduction for the activity, other items of income, loss, or deduction, partnership liabilities, and any other information that relates to the activity, such as distributions and partner loans. This requirement in the draft instructions for the 2019 Form 1065 is in addition to longstanding at-risk reporting requirements included in the instructions to the Form 1065. See Part II, Information About the Partner; Item K Partner's Share of Liabilities.

Based on comments received, the Treasury Department and the IRS have become aware that certain partnerships and other persons may be unable to timely comply with the newly added requirement to report additional information about each at-risk activity separately for 2019. Partnerships and other persons required to furnish and file Form 1065, Schedule K-1, or Form 8865, Schedule K-1, will not be required to report information for each at-risk activity separately for 2019 that was not previously required to be reported for the 2018 partnership taxable year. Partnerships must still indicate in Item K on Form 1065 whether they have aggregated activities for Section 465 at-risk purposes for 2019.

Nothing in this notice relieves partnerships and partners from complying with the requirements of Form 6198, At-Risk Limitations, for 2019. In particular, partnerships must continue to comply with the instructions to Form 6198 for 2019, which require partnerships to furnish their partners with a separate statement of income, expenses, and deductions for each at-risk and not-at-risk activity.

PENALTY RELIEF

Taxpayers who follow the provisions of this notice will not be subject to any penalty for reporting in accordance with the guidance provided in this notice, including a penalty under section 6722 for failure to furnish correct payee statements, section 6698 for failure to file a partnership return that shows required information, and section 6038 for failure to furnish information required on a Schedule K-1 (Form 8865).

CONTACT INFORMATION

The principal author of this notice is Kara Altman of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Kara Altman at 202-317-5576 (not a toll-free number).

Updated Mortality Improvement Rates and Static Mortality Tables for Defined Benefit Pension Plans for 2021

Notice 2019-67

PURPOSE

This notice specifies updated mortality improvement rates and static mortality tables to be used for defined benefit pension plans under § 430(h)(3)(A) of the Internal Revenue Code (Code) and section 303(h)(3)(A) of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, as amended (ERISA). These updated mortality improvement rates and static tables, which are being issued pursuant to the regulations under § 430(h)(3)(A), apply for purposes of calculating the funding target and other items for valuation dates occurring during the 2021 calendar year.

This notice also includes a modified unisex version of the mortality tables for use in determining minimum present value under § 417(e)(3) of the Code and section 205(g)(3) of ERISA for distribu-

tions with annuity starting dates that occur during stability periods beginning in the 2021 calendar year.

BACKGROUND

Section 412 of the Code provides minimum funding requirements that generally apply for defined benefit plans. Section 412(a)(2) provides that § 430 sets forth the minimum funding requirements that apply to defined benefit plans that are not multiemployer plans or CSEC plans. Section 430(a) defines the minimum required contribution for such a plan by reference to the plan's funding target for the plan year. Under § 430(d)(1), a plan's funding target for a plan year generally is the present value of all benefits accrued or earned under the plan as of the first day of that plan year.

Section 430(h)(3) provides rules regarding the mortality tables that generally are used under § 430. Under § 430(h)(3)(A), except as provided in § 430(h)(3)(C) or (D), the Secretary is to prescribe by regulation mortality tables to be used in determining any present value or making any computation under § 430. Those tables are to be based on the actual experience of pension plans and projected trends in that experience. Section 430(h)(3)(B) requires the Secretary to revise any table in effect under § 430(h)(3)(A) at least every 10 years to reflect the actual experience of pension plans and projected trends in that experience.

Section 430(h)(3)(C) provides that, upon request by a plan sponsor and approval by the Secretary, substitute mortality tables that meet the applicable requirements may be used in lieu of the standard mortality tables provided under § 430(h)(3)(A). Section 430(h)(3)(D) provides for the use of separate mortality tables with respect to certain individuals who are entitled to benefits on account of disability.

Mortality Tables for Purposes of § 430

Section 1.430(h)(3)-1 provides rules regarding the mortality tables used under § 430(h)(3)(A) for plan years beginning on or after January 1, 2018. The mortality tables used under § 430(h)(3)(A) are based on the tables in the RP-2014 Mortality Tables Report,[3] adjusted for mortality improvement. Section 1.430(h)(3)-1(d) sets forth base mortality tables with a base year of 2006.

Section 1.430(h)(3)-1(a) permits plan sponsors to apply the projection of mortality improvement in either of two ways: through use of static tables that are updated annually to reflect expected improvements in mortality or through use of generational tables. Section 1.430(h)(3)-1(a)(2)(i)(C) provides that, for valuation dates occurring in years after 2018, updated mortality improvement rates that take into account new data for mortality improvement trends of the general population, along with static mortality tables that reflect those updated mortality improvement rates, will be provided through guidance published in the Internal Revenue Bulletin. Notice 2018-2, 2018-2 I.R.B. 281, and Notice 2019-26, 2019-15 I.R.B. 943, provide mortality improvement rates and static mortality tables that apply for valuation dates occurring during 2019 and 2020, respectively.

Section 1.430(h)(3)-2 provides rules for the use of substitute mortality tables that are based on the mortality experience of the plan. Pursuant to § 1.430(h)(3)-2(c)(3)(ii), substitute mortality tables are developed using the mortality improvement rates used under § 1.430(h)(3)-1.

Application of These Tables for Other Funding Rules

Section 431 provides the minimum funding standards for multiemployer plans described in § 414(f) that are subject to § 412. Section 431(c)(6)(D)(iv) provides that the Secretary may by regulation prescribe mortality tables to be used in determining current liability for purposes of § 431(c)(6)(B). Section 1.431(c)(6)-1 provides that the same mortality assumptions that apply for purposes of § 430(h)(3)(A) and § 1.430(h)(3)-1(a)(2) are used to determine a multiemployer plan's current liability for purposes of applying the full-funding rules of § 431(c)(6). For this purpose, a multiemployer plan may apply either the static mortality tables or the generational mortality tables (as updated pursuant to §1.430(h)(3)-1(a)(2)(i)(C) and (a)(3)).

Section 433 provides the minimum funding standards for CSEC plans described in § 414(y). Section 433(h)(3)(B)(i) provides that the Secretary may by regulation prescribe mortality tables to be used in determining current liability for purposes of § 433(c)(7)(C). Section 1.433(h)(3)-1(a) provides that the mortality tables described in § 430(h)(3)(A) are to be used to determine current liability under § 433(c)(7)(C).

Application of Mortality Tables for Minimum Present Value Requirements under § 417(e)(3)

Section 417(e)(3) generally provides that the present value of certain accelerated forms of benefit under a qualified pension plan (including single-sum distributions) must not be less than the present value of the accrued benefit using applicable interest rates and the applicable mortality table. Section 417(e)(3)(B) defines the term "applicable mortality table" as the mortality table specified for the plan year under § 430(h)(3)(A) (without regard to § 430(h)(3)(C) or (D)), modified as appropriate by the Secretary.

Rev. Rul. 2007-67, 2007-2 CB 1047, provides that, except as otherwise stated in future guidance, the applicable mortality table under § 417(e)(3) is a static mortality table set forth in published guidance that is developed based on a fixed blend of 50 percent of the static male combined mortality rates and 50 percent of the static female combined mortality rates used under § 1.430(h)(3)-1. Rev. Rul. 2007-67 also provides that the applicable mortality table for a calendar year applies to distributions with annuity starting dates that occur during stability periods that begin during that calendar year.

MORTALITY IMPROVEMENT RATES FOR 2021

The mortality improvement rates for valuation dates occurring during 2021

[3] The RP-2014 Mortality Tables Report, as revised November 2014, is available at https://www.soa.org/Files/Research/Exp-Study/research-2014-rp-report.pdf.

are the mortality improvement rates in the Mortality Improvement Scale MP-2019 Report (issued by the Retirement Plans Experience Committee (RPEC) of the Society of Actuaries and available at https://www.soa.org/resources/experience-studies/2019/mortality-improvement-scale-mp-2019/).

STATIC MORTALITY TABLES FOR 2021

The static mortality tables that apply under § 430(h)(3)(A) for valuation dates occurring during 2021 are set forth in the appendix to this notice. The mortality rates in these tables have been developed from the methodology and base mortality rates set forth in § 1.430(h)(3)-1(c) and (d) using the mortality improvement rates specified in the previous section of this notice.

The static mortality table that applies under § 417(e)(3) for distributions with annuity starting dates occurring during stability periods beginning in 2021 is set forth in the appendix to this notice in the column labeled "Unisex." The mortality rates in this table are derived from the mortality tables specified under § 430(h)(3)(A) for 2021 in accordance with the procedures set forth in Rev. Rul. 2007-67.

REQUEST FOR COMMENTS

As provided in § 430(h)(3)(B), the Department of the Treasury (Treasury Department) is required to revise the mortality tables used under § 430(h)(3)(A) at least every 10 years to reflect the actual mortality experience of pension plans and projected trends in that experience.[4] On October 23, 2019, RPEC released the Pri-2012 Private Retirement Plans Mortality Tables Report (the Pri-2012 Mortality Tables Report).[5] The mortality tables in that report are based on a study of mortality experience of private-sector defined benefit pension plans in the United States covering calendar years 2010 through 2014. Comments are requested as to whether there are other studies of actual mortality experience of individuals covered by pension plans and projected trends in that experience that should be considered for use in developing mortality tables for future use under § 430.[6] For example, should the mortality tables under § 430(h)(3)(A) be developed taking into account studies that examine the mortality experience of individuals covered by large public-sector pension plans, such as RPEC's Pub-2010 Public Retirement Plans Mortality Tables Report?[7] In addition, comments are requested as to which of the tables in the Pri-2012 Mortality Tables Report should be used to develop § 430(h)(3)(A) mortality tables, if the Pri-2012 Mortality Tables Report were to be used for that purpose. For example, should the § 430(h)(3)(A) mortality tables include separate retiree and contingent survivor tables, as are provided in the Pri-2012 Mortality Tables Report?

Any comments must be received by February 28, 2020. Taxpayers may submit comments electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and Notice 2019-0053). Alternatively, taxpayers may submit hard copy submissions to:

CC:PA:LPD:PR (Notice 2019-67), Room 5203, Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C., 20044

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

CC:PA:LPD:PR (Notice 2019-67), Courier's Desk, Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: CC:PA:LPD:PR

All comments received will be available for public inspection on www.regulations.gov.

Drafting Information

The principal authors of this notice are Arslan Malik and Linda S. F. Marshall of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Arslan Malik or Linda Marshall at (202) 317-6700 (not a toll-free number).

[4] The Treasury Department is required to review the mortality tables used to determine the current liability for multiemployer plans and CSEC plans every 5 years under §§ 431(c)(6)(D)(vi) and 433(h)(3)(B)(ii), respectively.
[5] The Pri-2012 Mortality Tables Report is available at https://www.soa.org/globalassets/assets/files/resources/experience-studies/2019/pri-2012-mortality-tables-report.pdf).
[6] The mortality tables developed for future use under § 430 would also be used for the other purposes specified in this notice for which the mortality tables under § 430 are used.
[7] The Pub-2010 Public Retirement Plans Mortality Report is available at https://www.soa.org/globalassets/assets/files/resources/research-report/2019/pub-2010-mort-report.pdf.

APPENDIX
Mortality Tables for 2021
Valuation Dates Occurring During 2021 and Distributions Subject to
§ 417(e)(3) with Annuity Starting Dates During Stability Periods Beginning in 2021

	Male	Male	Male	Female	Female	Female	Unisex
Age	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Table for Distributions Subject to § 417(e)(3)
0	0.003638	0.003638	0.003638	0.003191	0.003191	0.003191	0.003415
1	0.000213	0.000213	0.000213	0.000200	0.000200	0.000200	0.000207
2	0.000146	0.000146	0.000146	0.000132	0.000132	0.000132	0.000139
3	0.000122	0.000122	0.000122	0.000099	0.000099	0.000099	0.000111
4	0.000096	0.000096	0.000096	0.000075	0.000075	0.000075	0.000086
5	0.000085	0.000085	0.000085	0.000069	0.000069	0.000069	0.000077
6	0.000077	0.000077	0.000077	0.000064	0.000064	0.000064	0.000071
7	0.000069	0.000069	0.000069	0.000060	0.000060	0.000060	0.000065
8	0.000059	0.000059	0.000059	0.000056	0.000056	0.000056	0.000058
9	0.000048	0.000048	0.000048	0.000052	0.000052	0.000052	0.000050
10	0.000041	0.000041	0.000041	0.000049	0.000049	0.000049	0.000045
11	0.000043	0.000043	0.000043	0.000051	0.000051	0.000051	0.000047
12	0.000066	0.000066	0.000066	0.000060	0.000060	0.000060	0.000063
13	0.000087	0.000087	0.000087	0.000068	0.000068	0.000068	0.000078
14	0.000109	0.000109	0.000109	0.000076	0.000076	0.000076	0.000093
15	0.000131	0.000131	0.000131	0.000084	0.000084	0.000084	0.000108
16	0.000153	0.000153	0.000153	0.000091	0.000091	0.000091	0.000122
17	0.000177	0.000177	0.000177	0.000097	0.000097	0.000097	0.000137
18	0.000202	0.000202	0.000202	0.000103	0.000103	0.000103	0.000153
19	0.000230	0.000230	0.000230	0.000107	0.000107	0.000107	0.000169
20	0.000256	0.000256	0.000256	0.000108	0.000108	0.000108	0.000182
21	0.000290	0.000290	0.000290	0.000112	0.000112	0.000112	0.000201
22	0.000324	0.000324	0.000324	0.000114	0.000114	0.000114	0.000219
23	0.000349	0.000349	0.000349	0.000120	0.000120	0.000120	0.000235
24	0.000366	0.000366	0.000366	0.000125	0.000125	0.000125	0.000246
25	0.000356	0.000356	0.000356	0.000129	0.000129	0.000129	0.000243
26	0.000352	0.000352	0.000352	0.000135	0.000135	0.000135	0.000244
27	0.000355	0.000355	0.000355	0.000143	0.000143	0.000143	0.000249
28	0.000364	0.000364	0.000364	0.000151	0.000151	0.000151	0.000258
29	0.000379	0.000379	0.000379	0.000161	0.000161	0.000161	0.000270
30	0.000397	0.000397	0.000397	0.000175	0.000175	0.000175	0.000286
31	0.000420	0.000420	0.000420	0.000189	0.000189	0.000189	0.000305
32	0.000446	0.000446	0.000446	0.000206	0.000206	0.000206	0.000326
33	0.000471	0.000471	0.000471	0.000223	0.000223	0.000223	0.000347
34	0.000494	0.000494	0.000494	0.000241	0.000241	0.000241	0.000368
35	0.000515	0.000515	0.000515	0.000258	0.000258	0.000258	0.000387
36	0.000531	0.000531	0.000531	0.000274	0.000274	0.000274	0.000403
37	0.000548	0.000548	0.000548	0.000292	0.000292	0.000292	0.000420

	Male	Male	Male	Female	Female	Female	Unisex
Age	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Table for Distributions Subject to § 417(e)(3)
38	0.000566	0.000566	0.000566	0.000311	0.000311	0.000311	0.000439
39	0.000586	0.000586	0.000586	0.000332	0.000332	0.000332	0.000459
40	0.000611	0.000611	0.000611	0.000354	0.000354	0.000354	0.000483
41	0.000638	0.000645	0.000638	0.000377	0.000375	0.000377	0.000508
42	0.000672	0.000731	0.000673	0.000403	0.000426	0.000403	0.000538
43	0.000716	0.000866	0.000718	0.000433	0.000506	0.000433	0.000576
44	0.000768	0.001045	0.000773	0.000467	0.000615	0.000467	0.000620
45	0.000830	0.001269	0.000840	0.000505	0.000753	0.000507	0.000674
46	0.000903	0.001538	0.000920	0.000549	0.000922	0.000555	0.000738
47	0.000987	0.001856	0.001015	0.000600	0.001126	0.000613	0.000814
48	0.001082	0.002226	0.001123	0.000656	0.001368	0.000680	0.000902
49	0.001188	0.002656	0.001248	0.000718	0.001652	0.000757	0.001003
50	0.001307	0.003150	0.001390	0.000789	0.001982	0.000849	0.001120
51	0.001440	0.003375	0.001536	0.000869	0.002094	0.000941	0.001239
52	0.001591	0.003617	0.001730	0.000961	0.002234	0.001056	0.001393
53	0.001750	0.003855	0.001951	0.001065	0.002404	0.001192	0.001572
54	0.001929	0.004108	0.002210	0.001183	0.002607	0.001352	0.001781
55	0.002133	0.004386	0.002598	0.001314	0.002845	0.001604	0.002101
56	0.002372	0.004697	0.003110	0.001458	0.003116	0.001932	0.002521
57	0.002655	0.005048	0.003560	0.001614	0.003423	0.002230	0.002895
58	0.002991	0.005442	0.004070	0.001781	0.003766	0.002551	0.003311
59	0.003388	0.005887	0.004634	0.001956	0.004143	0.002910	0.003772
60	0.003850	0.006382	0.005276	0.002140	0.004550	0.003334	0.004305
61	0.004384	0.006930	0.005998	0.002335	0.004990	0.003876	0.004937
62	0.004989	0.007529	0.006793	0.002540	0.005460	0.004467	0.005630
63	0.005668	0.008181	0.007654	0.002757	0.005954	0.005161	0.006408
64	0.006426	0.008892	0.008486	0.002992	0.006490	0.005805	0.007146
65	0.007256	0.009654	0.009374	0.003245	0.007065	0.006512	0.007943
66	0.008085	0.010500	0.010336	0.003594	0.007707	0.007344	0.008840
67	0.008991	0.011430	0.011310	0.003980	0.008416	0.008135	0.009723
68	0.009994	0.012469	0.012380	0.004418	0.009223	0.008994	0.010687
69	0.011119	0.013649	0.013577	0.004912	0.010131	0.009936	0.011757
70	0.012363	0.014964	0.014896	0.005474	0.011166	0.010973	0.012935
71	0.013770	0.016465	0.016402	0.006114	0.012341	0.012151	0.014277
72	0.015355	0.018167	0.018109	0.006839	0.013668	0.013483	0.015796
73	0.017135	0.020093	0.020039	0.007666	0.015174	0.014996	0.017518
74	0.019145	0.022282	0.022233	0.008604	0.016875	0.016707	0.019470
75	0.021407	0.024765	0.024721	0.009670	0.018802	0.018647	0.021684
76	0.023953	0.027591	0.027553	0.010890	0.021010	0.020872	0.024213
77	0.026805	0.030796	0.030765	0.012287	0.023544	0.023429	0.027097
78	0.030008	0.034447	0.034424	0.013870	0.026437	0.026352	0.030388

	Male	Male	Male	Female	Female	Female	Unisex
Age	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Non-Annuitant Table	2021 Annuitant Table	2021 Optional Combined Table for Small Plans	2021 Table for Distributions Subject to § 417(e)(3)
79	0.033580	0.038586	0.038573	0.015675	0.029768	0.029720	0.034147
80	0.037591	0.043316	0.043316	0.017736	0.033623	0.033623	0.038470
81	0.039501	0.048449	0.048449	0.019500	0.037852	0.037852	0.043151
82	0.043105	0.054292	0.054292	0.022881	0.042662	0.042662	0.048477
83	0.048463	0.060950	0.060950	0.027939	0.048204	0.048204	0.054577
84	0.055612	0.068541	0.068541	0.034693	0.054517	0.054517	0.061529
85	0.064599	0.077116	0.077116	0.043183	0.061669	0.061669	0.069393
86	0.075538	0.086868	0.086868	0.053455	0.069776	0.069776	0.078322
87	0.088387	0.097823	0.097823	0.065541	0.078909	0.078909	0.088366
88	0.103230	0.110093	0.110093	0.079481	0.089101	0.089101	0.099597
89	0.120037	0.123727	0.123727	0.095272	0.100387	0.100387	0.112057
90	0.138867	0.138867	0.138867	0.112950	0.112950	0.112950	0.125909
91	0.154865	0.154865	0.154865	0.126557	0.126557	0.126557	0.140711
92	0.171350	0.171350	0.171350	0.140982	0.140982	0.140982	0.156166
93	0.187876	0.187876	0.187876	0.156090	0.156090	0.156090	0.171983
94	0.204431	0.204431	0.204431	0.171750	0.171750	0.171750	0.188091
95	0.220714	0.220714	0.220714	0.187912	0.187912	0.187912	0.204313
96	0.239277	0.239277	0.239277	0.205461	0.205461	0.205461	0.222369
97	0.258199	0.258199	0.258199	0.223790	0.223790	0.223790	0.240995
98	0.277883	0.277883	0.277883	0.242864	0.242864	0.242864	0.260374
99	0.298113	0.298113	0.298113	0.262598	0.262598	0.262598	0.280356
100	0.318689	0.318689	0.318689	0.282807	0.282807	0.282807	0.300748
101	0.339457	0.339457	0.339457	0.303388	0.303388	0.303388	0.321423
102	0.360080	0.360080	0.360080	0.324029	0.324029	0.324029	0.342055
103	0.380363	0.380363	0.380363	0.344643	0.344643	0.344643	0.362503
104	0.399976	0.399976	0.399976	0.364830	0.364830	0.364830	0.382403
105	0.418469	0.418469	0.418469	0.384680	0.384680	0.384680	0.401575
106	0.436337	0.436337	0.436337	0.404077	0.404077	0.404077	0.420207
107	0.453187	0.453187	0.453187	0.422297	0.422297	0.422297	0.437742
108	0.469111	0.469111	0.469111	0.439597	0.439597	0.439597	0.454354
109	0.483871	0.483871	0.483871	0.455886	0.455886	0.455886	0.469879
110	0.497769	0.497769	0.497769	0.471033	0.471033	0.471033	0.484401
111	0.502821	0.502821	0.502821	0.485228	0.485228	0.485228	0.494025
112	0.502061	0.502061	0.502061	0.498255	0.498255	0.498255	0.500158
113	0.501305	0.501305	0.501305	0.503569	0.503569	0.503569	0.502437
114	0.500602	0.500602	0.500602	0.501604	0.501604	0.501604	0.501103
115	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000
116	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000
117	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000
118	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000
119	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000	0.500000
120	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000	1.000000

Part IV

Notice of Proposed Rulemaking

Additional Rules Regarding Base Erosion and Anti-Abuse Tax

REG-112607-19

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the base erosion and anti-abuse tax imposed on certain large corporate taxpayers with respect to certain payments made to foreign related parties. The proposed regulations would affect corporations with substantial gross receipts that make payments to foreign related parties.

DATES: Written or electronic comments and requests for a public hearing must be received by February 4, 2020.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-112607-19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-112607-19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112607-19), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Sheila Ramaswamy, Azeka J. Abramoff, or Karen Walny at (202) 317-6938; concerning submissions of comments and requests for a public hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under sections 59A and 6031 of the Internal Revenue Code (the "Code"). The Tax Cuts and Jobs Act, Pub. L. 115-97 (2017) (the "Act"), which was enacted on December 22, 2017, added section 59A to the Code. Section 59A imposes on each applicable taxpayer a tax equal to the base erosion minimum tax amount for the taxable year (the "base erosion and anti-abuse tax" or "BEAT").

The Act also added reporting obligations regarding this tax for 25-percent foreign-owned corporations subject to section 6038A and foreign corporations subject to section 6038C and addressed other issues for which information reporting under those sections is important to tax administration.

On December 21, 2018, the Treasury Department and the IRS published proposed regulations (REG-104259-18) under section 59A, and proposed amendments to 26 CFR part 1 under sections 383, 1502, 6038A, and 6655 in the **Federal Register** (83 FR 65956) (the "2018 proposed regulations"). On December 6, 2019**,** the Treasury Department and the IRS published final regulations (the "final regulations") under sections 59A, 383, 1502, 6038A, and 6655. These proposed regulations propose other regulations under sections 59A and 6031.

Explanation of Provisions

I. *Overview*

These proposed regulations provide guidance under sections 59A and 6031 regarding certain aspects of the BEAT. Part II of this Explanation of Provisions describes proposed modifications to the rules set forth in the final regulations relating to how a taxpayer determines its aggregate group for purposes of determining gross receipts and the base erosion percentage. Part III of this Explanation of Provisions describes proposed regulations providing an election to waive deductions. Part IV of this Explanation of Provisions describes proposed regulations addressing the application of the BEAT to partnerships.

II. *Determination of a Taxpayer's Aggregate Group*

For certain purposes, including the determination of gross receipts described in section 59A(e)(2) and the base erosion percentage described in section 59A(c)(4), section 59A(e)(3) and §1.59A-1(b)(1) generally aggregate a group of corporations ("aggregate group") on the basis of persons treated as a single employer under section 52(a), which treats members of the same controlled group of corporations (as defined in section 1563(a) with certain modifications) as one person. To determine gross receipts, section 59A(e)(2) requires the application of rules similar to, but not necessarily the same as, section 448(c)(3)(B), (C), and (D). The 2018 proposed regulations provided rules for determining the aggregate group for applying the gross receipts test as well as the base erosion percentage test. Generally, the 2018 proposed regulations provided that each taxpayer determines its gross receipts and base erosion percentage by reference to its own taxable year, taking into account the results of other members of its aggregate group during that taxable year. *See* 2018 proposed §1.59A-2(d)(2).

Comments to the 2018 proposed regulations recommended that the determination of gross receipts and the base erosion percentage of a taxpayer's aggregate group be made on the basis of the taxpayer's taxable year and the taxable year of each member of its aggregate group that ends with or within the applicable taxpayer's taxable year (the "with-or-within method"). In response to the comments to

the 2018 proposed regulations, the final regulations generally adopt the with-or-within method. §1.59A-2(c)(3). The final regulations do not include specific rules regarding how the with-or-within method applies in certain situations. These proposed regulations provide guidance regarding certain applications of the aggregate group rules and request comments regarding these rules in light of the with-or-within method.

A. *Rules relating to the determination of gross receipts for a short taxable year*

The 2018 proposed regulations provided guidance regarding the determination of gross receipts for purposes of section 59A. In the case of a taxpayer that has a short taxable year, the 2018 proposed regulations annualized the gross receipts of the taxpayer by multiplying the gross receipts for the short taxable year by 365 and dividing the result by the number of days in the short taxable year. *See* 2018 proposed §1.59A-2(d)(7).

One comment to the 2018 proposed regulations expressed concern that determining the gross receipts of a taxpayer by annualizing a short taxable year could yield inappropriate results when combined with the rule providing that any reference to a taxpayer includes a reference to its predecessor. For example, the comment asserted that if the taxpayer has a full taxable year but a predecessor had a short taxable year, it is not clear whether the taxable year of the predecessor should be annualized first and then combined with the year of the taxpayer or whether the taxable years of the taxpayer and its predecessor should be combined first, in which case no annualization may be necessary. The final regulations do not include a rule on short taxable years. Instead, and to allow taxpayers an additional opportunity to comment, these proposed regulations provide updated guidance with respect to short taxable years (in particular, for situations when an aggregate group has a member with a short taxable year).

In the case of a taxpayer that has a short taxable year, solely for purposes of section 59A, these proposed regulations continue to annualize the gross receipts of the taxpayer by multiplying the gross receipts for the short taxable year by 365 and dividing the result by the number of days in the short taxable year. Proposed §1.59A-2(c)(5). However, the Treasury Department and the IRS recognize that the with-or-within method in §1.59A-2(c)(3) must be adjusted to prevent the understatement or overstatement of the gross receipts, base erosion tax benefits, and deductions of an aggregate group in the case of a taxpayer with a short taxable year. For example, the with-or-within method would completely exclude the taxable year of certain members of an aggregate group if the taxable year of those members did not end with or within the taxpayer's short taxable year.[1] In other instances, the with-or-within method combined with an annualization approach might over-count the gross receipts of other aggregate group members if the method is applied by annualizing the full taxable years of the other members of the aggregate group that end with or within the taxpayer's short taxable year. Specifically, the regulation's requirement that a taxpayer annualize gross receipts when it has a short taxable year could be read to mean that gross receipts of aggregate group members (which may have full taxable years that end with or within the taxpayer's taxable year) also be annualized on the basis of the taxpayer's short taxable year, which could result in over-counting. In light of these concerns, these proposed regulations provide that a taxpayer with a short taxable year must use a reasonable approach to determine the base erosion percentage of its aggregate group and whether the taxpayer or its aggregate group satisfies the gross receipts test and base erosion percentage in section 59A. A reasonable approach should neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group of the taxpayer.

The Treasury Department and the IRS request comments on whether more specific guidance is needed, and if so, the best approach for determining the gross receipts and base erosion percentage of an aggregate group for purposes of section 59A when the applicable taxpayer or another member of an aggregate group has a short taxable year. The approach should neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group. The approach should also appropriately account for short taxable years that result from a change in a taxpayer's taxable year end (in which case the preceding and following taxable years would be full taxable years) and short taxable years that result from changes in ownership, such as a joining or leaving a consolidated group (in which case the preceding or succeeding taxable year may also be a short taxable year).

B. *Members leaving and joining an aggregate group*

A member may join or leave the aggregate group of a taxpayer because of a change in ownership of the member such as a sale of the member to a third party. A comment to the 2018 proposed regulations requested clarity on whether the determination of gross receipts and the base erosion percentage of an aggregate group takes into account the gross receipts, base erosion tax benefits, and deductions of a member of the aggregate group for the period before the member joins the group or the period after the member leaves the group. In response to this comment, the proposed regulations provide guidance that clarifies the treatment of members that join or leave the aggregate group of a taxpayer.

To determine the gross receipts and the base erosion percentage of a taxpayer with respect to its aggregate group for purposes of section 59A, these proposed regulations take into account only items of members that occur during the period that they

[1] For example, assume FC, a foreign corporation, wholly owns DC1, DC2, and DC3, each domestic corporations. DC1, DC2, and DC3 each have a calendar year taxable year. Pursuant to the with-or-within method, DC1 includes in its aggregate group for Year 1 the taxable years of DC2 and DC3 ending on December 31, Year 1. Subsequently, DC1 changes its taxable year end to November 30. Accordingly, DC1 has a short taxable year beginning January 1, Year 2 and ending November 30, Year 2. No taxable year of DC2 or DC3 ends with or within the taxable year of DC1 ending November 30, Year 2. Nonetheless, it would not be appropriate to wholly exclude the gross receipts, base erosion tax benefits, and deductions of DC2 and DC3 from the aggregate group of DC1 for the taxable year ending November 30, Year 2.

were members of the taxpayer's aggregate group. Proposed §1.59A-2(c)(4). Items of members that occur before a member joins an aggregate group of a taxpayer or after a member leaves an aggregate group of a taxpayer are not taken into account by the taxpayer. Solely for purposes of determining which items occurred while a corporation was a member of an aggregate group under section 59A, a corporation is treated as having a deemed taxable year end when the corporation joins or leaves an aggregate group of a taxpayer. The taxpayer may determine items attributable to this deemed short taxable year by either deeming a close of the corporation's books or, in the case of items other than extraordinary items (as defined in §1.1502-76(b)(2)(ii)(C)), making a pro-rata allocation. *See* proposed §1.59A-2(c)(4). For an illustration of this proposed rule, see proposed §1.59A-2(f)(2), Example 2.

C. *Consolidated groups*

A comment to the 2018 proposed regulations expressed concern that gross receipts arising from intercompany transactions (as defined in §1.1502-13(b)(1)) might be treated as gross receipts of the selling member (S) when S deconsolidates from a consolidated group (original consolidated group) and separately joins a different aggregate group (new aggregate group). For purposes of section 59A, the comment to the 2018 proposed regulations recommended that the gross receipts resulting from intercompany transactions in which S engaged while a member of the original consolidated group should not be counted even after S becomes a member of the new aggregate group, despite S no longer being a member of the original consolidated group.

The Treasury Department and the IRS are studying whether it is appropriate to continue to eliminate gross receipts resulting from intercompany transactions when members deconsolidate and join a different aggregate group. Furthermore, the Treasury Department and the IRS are aware of more general questions regarding the proper treatment of gross receipts when members join or deconsolidate from a consolidated group. These issues are currently under study, and the proposed regulations reserve on such issues. The Treasury Department and the IRS request comments on the appropriate treatment of a deconsolidating member's gross receipts history as it relates to the original consolidated group and the acquiring consolidated group in the context of the BEAT aggregate group.

D. *Predecessors*

For purposes of determining gross receipts, the 2018 proposed regulations provided that a reference to a taxpayer includes a reference to any predecessor of the taxpayer. 2018 proposed §1.59A-2(c)(6)(i). The Treasury Department and the IRS, however, recognize that the aggregate groups of a taxpayer and its predecessor may overlap. As a result, an interpretation of the predecessor rule that simply adds the gross receipts of the predecessor to the gross receipts of the taxpayer's aggregate group could result in double counting of the gross receipts of corporations that are members of both aggregate groups. These proposed regulations clarify that, for purposes of section 59A, the gross receipts of those corporations included in both aggregate groups are not double counted. Proposed §1.59A-2(c)(6)(ii). The Treasury Department and the IRS request comments on appropriate methods of taking into account predecessors for purposes of determining gross receipts of an applicable taxpayer's aggregate group. An appropriate method should avoid double-counting and address whether to take into account the taxable year of a predecessor in determining whether to annualize a short taxable year of a taxpayer.

III. *Election to Waive Allowable Deductions*

The final regulations provide that, in general, the base erosion percentage for a taxable year is computed by dividing (1) the aggregate amount of base erosion tax benefits (the "numerator") by (2) the sum of the aggregate amount of deductions allowed plus certain other base erosion tax benefits (the "denominator"). *See* §1.59A-2(e)(3). In general, and consistent with section 59A(c)(2), the final regulations provide that a base erosion tax benefit is any deduction that is *allowed* under chapter 1 of subtitle A of the Code for the taxable year with respect to a base erosion payment. *See* §1.59A-3(c)(1)(i). The final regulations, consistent with section 59A(d)(1), define one category of a base erosion payment as any amount paid or accrued by the taxpayer to a foreign related party of the taxpayer and with respect to which a deduction is *allowable* under chapter 1 of subtitle A of the Internal Revenue Code. §1.59A-3(b)(1)(i).

Comments to the 2018 proposed regulations requested that the final regulations clarify that allowable deductions that a taxpayer declines to claim on its tax return are not "allowed" deductions, and therefore, the foregone deductions are not base erosion tax benefits. These proposed regulations provide that a taxpayer may forego a deduction and that those foregone deductions will not be treated as a base erosion tax benefit if the taxpayer waives the deduction for all U.S. federal income tax purposes and follows specified procedures. Proposed §1.59A-3(c)(6). If the taxpayer waives a deduction for purposes of section 59A, these proposed regulations provide that the taxpayer cannot claim the deduction for any purpose of the Code or regulations except as otherwise provided under the proposed regulations. *See* proposed §1.59A-3(c)(6)(ii).

The Treasury Department and the IRS are concerned that in adopting this approach, absent certain procedural rules, taxpayers that waive a deduction pursuant to the proposed regulations to reduce their amount of base erosion tax benefits could benefit by using some or all of the foregone deductions in a subsequent year, while still benefiting from the reduction of base erosion tax benefits made in the prior year. Accordingly, proposed §1.59A-3(c)(6) provides rules to address this concern. The proposed regulations also include certain reporting rules concerning deductions that are waived pursuant to the proposed regulations, and provide guidance on the time and manner for electing to waive deductions. Proposed §1.59A-3(c)(6)(i) and (iii).

Specifically, the proposed regulations provide that as a baseline, all deductions that could be properly claimed by a taxpayer for the taxable year, determined after giving effect to the taxpayer's permissible method of accounting and to any election, (such as the election under

section 173 to capitalize circulation expenditures or the election under section 168(g)(7) to use the alternative depreciation system of depreciation), are treated as allowed deductions solely for purposes of section 59A(c)(2)(A)(i), unless a taxpayer elects to waive certain deductions. *See* proposed §1.59A-3(c)(5) and (6). As a result, if a taxpayer does not make an election to waive a deduction that could be properly claimed by a taxpayer for the taxable year pursuant to the procedures in proposed §1.59A-3(c)(6), and the deduction otherwise meets the definition of a base erosion tax benefit, the deduction is treated as a base erosion tax benefit for purposes of section 59A. Consequently, the deduction is taken into account in the base erosion percentage, and is taken into account as an adjustment to modified taxable income. The proposed regulations provide that if a taxpayer elects to waive certain deductions, those deductions are waived for all tax purposes (except for certain purposes as explained in part III of this Explanation of Provisions) and, thus, are not taken into account as base erosion tax benefits. Proposed §1.59A-3(c)(6)(ii)(A)(*1*). The waiver applies only to the deduction, not to the underlying cost or expense. Thus, a waiver of any portion of a deduction associated with a particular cost or expense does not cause the corresponding portion of that cost or expense not to be a "cost" or "expense."

A taxpayer may make the election to waive deductions on its original filed Federal income tax return, by an amended return, or during the course of an examination of the taxpayer's income tax return for the relevant tax year pursuant to procedures prescribed by the Commissioner. Proposed §1.59A-3(c)(6)(iii). Unless the Commissioner prescribes specific procedures with respect to waiving deductions during the course of an examination, the same procedures that generally apply to affirmative tax return changes during an examination will apply. The Treasury Department and the IRS request comments related to the process for submitting an election under the proposed regulations during the course of an examination. The information related to this waiver must be reported on the appropriate forms, which are expected to include Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts,* (or a successor form). Until these proposed regulations are final, a taxpayer choosing to rely on these proposed regulations may attach a statement to the Form 8991 to make this election and include the information listed in proposed §1.59A-3(c)(6)(i) on that statement. A taxpayer makes the election on an annual basis, and the taxpayer does not need the consent of the Commissioner if the taxpayer chooses not to make the election for a subsequent taxable year. The proposed regulations provide that the election to waive a deduction pursuant to proposed §1.59A-3(c)(6) is disregarded for determining (1) the taxpayer's overall method of accounting or the taxpayer's method of accounting for any item; (2) whether a change in the taxpayer's overall plan of accounting or the taxpayer's treatment of a material item is a change in method of accounting under section 446(e) and §1.446-1(e); and (3) the amount allowable for depreciation or amortization for purposes of section 167(c) and section 1016(a)(2) or (3), and any other adjustment to basis under section 1016(a). Proposed §1.59A-3(c)(6)(ii)(B)(*1*)-(*3*). The proposed regulations also provide that the election to waive deductions does not constitute a method of accounting under section 446. Proposed §1.59A-3(c)(6)(ii)(C).

In addition, the proposed regulations provide that the waiver of deductions is treated as occurring before the allocation and apportionment of deductions under §§1.861-8 through -14T and 1.861-17 (such as for purposes of section 904). Proposed §1.59A-3(c)(6)(ii)(A)(*2*). However, the waiver of a deduction for interest expense that is directly allocable to income produced by a particular asset should not result in the allocation and apportionment of additional interest expense to that asset. Accordingly, the proposed regulations provide that to the extent a deduction for certain interest expense is waived that would have been directly allocated and resulted in a reduction of value of any asset for purposes of allocating and apportioning other interest expense, the asset value is still reduced as if the deduction had not been waived. Proposed §1.59A-3(c)(6)(ii)(A)(*3*).

The waiver of a deduction is also disregarded for purposes of applying the exclusive apportionment rule in §1.861-17(b), in determining the geographic source where the research and experimental activities that account for more than fifty percent of the amount of the deduction for research and experimentation was performed. Proposed §1.59A-3(c)(6)(ii)(B)(*4*). For example, if this exclusive apportionment rule would not apply in the absence of waiving deductions for research and experimentation performed outside the United States, then waiving those deductions will not result in the exclusive apportionment rule applying (on the basis of a smaller pool of deducted expenses, more than fifty percent of which relate to research and experimentation performed in the United States).

The waiver of a deduction is also disregarded for purposes of determining the price of a controlled transaction under section 482. Proposed §1.59A-3(c)(6)(ii)(B)(*5*). Accordingly, in determining whether a deduction that a taxpayer reports on its Federal income tax return with respect to a controlled transaction clearly reflects the taxpayer's income with respect to the controlled transaction, the IRS will consider the amount waived as if it were actually deducted. In addition, if a taxpayer applies a transfer pricing method that uses costs or expenses as an input (such as the cost plus method described in §1.482-3(d)), the costs or expenses associated with waived deductions continue to be treated as "costs" or "expenses" for purposes of the section 482 regulations because the waiver impacts the deductible amount only, not the amount of the underlying cost or expense.

Furthermore, the waiver of a deduction is disregarded for purposes of determining: (1) the amount of a taxpayer's earnings and profits, (2) any item as necessary to prevent a taxpayer from receiving the benefit of a waived deduction, and (3) any other item that is expressly identified in published guidance. Proposed §1.59A-3(c)(6)(ii)(B)(*6*)-(*8*).

To ensure a taxpayer is not able to reduce the amount of its base erosion tax benefits via a waiver of deductions in a prior year and then recover the waived deductions in a subsequent year by making an accounting method change, the proposed regulations provide that, by making the election to waive deductions, the

taxpayer agrees that if a change in method of accounting is made with respect to an item that had been waived, the previously waived portion of the item is not taken into account in determining the amount of adjustment under section 481(a). Proposed §1.59A-3(c)(6)(ii)(D). For an illustration of this proposed rule, see proposed §1.59A-3(d), Example 9. More generally, the Treasury Department and the IRS are studying the treatment of changes in method of accounting and the related section 481 adjustments for purposes of the BEAT. To the extent that a negative adjustment under section 481(a) relates to an increase in an item that would be a base erosion tax benefit, it is expected that the section 481(a) adjustment would also be taken into account as a base erosion tax benefit. In addition, the Treasury Department and the IRS are considering other consequences of adjustments under section 481(a), including (a) how positive adjustments under section 481(a) are taken into account for BEAT purposes and (b) whether a waiver similar to the waiver provided in proposed §1.59A-3(c)(6) should be permitted with respect to negative section 481(a) adjustments.

The Treasury Department and the IRS request comments regarding the election to waive deductions, including the reporting requirements and additional rules necessary to prevent a taxpayer from claiming a waived deduction in a subsequent year. The Treasury Department and the IRS also request comments on the effect of adjustments under section 481(a) on the BEAT, including in the context of waived items.

IV. *Application of the BEAT to Partnerships*

A. *Allocations by a partnership of income instead of deductions*

In general, the final regulations treat deductions allocated by the partnership to an applicable taxpayer resulting from a base erosion payment as a base erosion tax benefit. However, the Treasury Department and the IRS are cognizant that a partner in a partnership can obtain a similar economic result if the partnership allocates income items away from the partner instead of allocating a deduction to the partner through curative allocations. To the extent the partnership places a taxpayer in such an economically equivalent position by allocating less income to that partner in lieu of allocating a deduction to the partner through curative allocations, the proposed regulations provide that the partner is similarly treated as having a base erosion tax benefit to the extent of that substitute allocation. Proposed §1.59A-7(b)(5)(v).

B. *Effectively connected income ("ECI")*

Comments to the 2018 proposed regulations recommended that contributions of depreciable (or amortizable) property by a foreign related party to a partnership (in which an applicable taxpayer is a partner) or distributions of depreciable or amortizable property by a partnership (in which a foreign related party is a partner) to an applicable taxpayer be excluded from the definition of a base erosion payment to the extent that the foreign related party would receive (or would be expected to receive) allocations of income from that partnership interest that would be taxable to the foreign related party as ECI.

The Treasury Department and the IRS are considering additional guidance to address the treatment of a contribution by a foreign person to a partnership engaged in a U.S. trade or business, as well as transfers of partnership interests by a foreign person and transfers of property by the partnership with a foreign person as a partner to a related U.S. person. The Treasury Department and the IRS request comments addressing how these issues should be addressed, including rules to ensure that the foreign partner is treating the items allocated with respect to the property and any gain from the property as ECI.

C. *Partnership anti-abuse rules*

1. Derivatives on partnership interests

Section 1.59A-9(b) of the final regulations provides that certain transactions that have a principal purpose of avoiding section 59A will be disregarded or deemed to result in a base erosion payment. These proposed regulations provide an additional anti-abuse rule relating to derivatives on partnership interests. *See* proposed §1.59A-9(b)(5). The rule provides that a taxpayer is treated as having a direct interest in the partnership interest or asset if the taxpayer acquires a derivative on a partnership interest or asset with a principal purpose of eliminating or reducing a base erosion payment.

2. Allocations by a partnership to prevent or reduce a base erosion payment

The proposed regulations also provide an additional anti-abuse rule to prevent a partnership from allocating items of income with a principal purpose of eliminating or reducing the base erosion payments to a taxpayer not acting in a partner capacity on amounts paid to or accrued by a partnership that do not change the economic arrangement of the partners. For example, assume that a domestic corporation and a third party both pay equal amounts to a partnership with a foreign related party partner and an unrelated partner (each having equal interests in the partnership) for services. If the partnership allocates the income it receives from the domestic corporation to the unrelated partner while allocating an equivalent amount of income from the third party to the foreign related party partner with a principal purpose of eliminating the domestic corporation's base erosion payment, the domestic corporation must determine its base erosion payment as if the allocations had not been made and the partners shared the income proportionately. As a result, half of the domestic corporation's payment would be a base erosion payment.

D. *Return of a partnership with respect to base erosion payments and base erosion tax benefits*

Pursuant to section 6031 and §1.6031(a)-1(a), a domestic partnership must file a return of partnership income for each taxable year on the form prescribed for the partnership return. Pursuant to §1.6031(a)-1(b), with limited exceptions, a foreign partnership that has gross income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States or gross income (including gains) derived from sources within the United States must file a partnership return for its taxable year in

accordance with the rules for domestic partnerships (such a foreign partnership, a "reporting foreign partnership"). The partnership return must contain the information required by the prescribed form and the accompanying instructions. The IRS plans to update Form 1065, Schedule K, and Schedule K-1 to incorporate certain information that will be necessary for its partners to complete their Form 8991 or a successor form. The IRS expects that these revisions to the Form 1065, Schedule K, and Schedule K-1 will track the information required by the Form 8991.

As a result of these planned revisions, a domestic partnership and a reporting foreign partnership will be required to report the information required by Form 8991. *See* §1.6031(a)-1(a) and (b)(1)(i). Proposed §1.6031(a)-1(b)(7) provides that United States partners must determine the relevant information with respect to the base erosion payments and base erosion tax benefits of a foreign partnership that is not required to file a partnership return. For a partnership that is required to file a Form 1065 and Schedule K-1, the Commissioner is expected to receive sufficient information to examine the accuracy of the partners' liability under section 59A, including as a result of items allocated to the partner by the partnership. For a foreign partnership that is not required to file a Form 1065 and Schedule K-1, proposed §1.6031(a)-1(b)(7) is intended to ensure that the Commissioner receives similar information from the partners of that foreign partnership.

Proposed Applicability Date

The rules in the section 59A proposed regulations generally apply to taxable years beginning on or after the date that final regulations are filed with the **Federal Register**. The rules in proposed §§1.59A-7(c)(5)(v) and (g)(2)(x) and 1.59A-9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019. As proposed, the section 59A regulations will permit taxpayers to apply the rules therein in their entirety for taxable years beginning after December 31, 2017, and before the regulations apply. See section 7805(b)(7). If a taxpayer applies the 2018 proposed regulations to a taxable year ending on or before December 6, 2019, the determination as to whether the taxpayer is applying these proposed regulations in their entirety to such taxable year is made without regard to the application of §1.59A-2(c)(2)(ii), (c)(4), (c)(5), and (c)(6).

In addition, taxpayers may rely on the rules in the section 59A proposed regulations in their entirety for taxable years beginning after December 31, 2017, and before the final regulations are applicable.

The rules in the section 6031(a) proposed regulations generally apply to taxable years ending on or after the date that final regulations are filed with the **Federal Register**.

Special Analyses

Regulatory Planning and Review – Economic Analysis

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The Executive Order 13771 designation for any final rule resulting from the proposed regulation will be informed by comments received. The preliminary Executive Order 13771 designation for this proposed regulation is regulatory.

These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated these proposed regulations as significant under section 1(b) of the MOA. Accordingly, these proposed regulations have been reviewed by OIRA.

A. *Background*

The Tax Cuts and Jobs Act of 2017 (the "Act") added new section 59A, which imposes a Base Erosion and Anti-Abuse Tax ("BEAT") on certain deductions paid or accrued to foreign related parties. By taxing such payments, the BEAT "aims to level the playing field between U.S. and foreign-owned multinational corporations in an administrable way." Senate Committee on Finance, Explanation of the Bill, S. Prt. 115-20, at 391 (November 22, 2017).

In plain language, the tax is levied only on corporations with substantial gross receipts (a determination referred to as the gross receipts test) and for which the relevant deductions are three percent or higher (two percent or higher in the case of certain banks or registered securities dealers) of their total deductions (with certain exceptions), a determination referred to as the base erosion percentage test. This cutoff for the base erosion percentage test is referred to in these Special Analyses as the base erosion threshold.

A taxpayer that satisfies both the gross receipts test and the base erosion percentage test is referred to as an applicable taxpayer. A taxpayer is not an applicable taxpayer, and thus does not have any BEAT liability, if its base erosion percentage is less than the base erosion threshold.

Additional features of the BEAT also enter its calculation. The BEAT operates as a minimum tax, so an applicable taxpayer is only subject to additional tax under the BEAT if the tax at the BEAT rate multiplied by the taxpayer's modified taxable income exceeds the taxpayer's regular tax liability, reduced by certain credits. Because of this latter provision, the BEAT formula has the effect of imposing the BEAT on the amount of those tax credits. In general, tax credits are subject to the BEAT except the research credit under section 41, and a portion of low income housing credits, renewable electricity production credits under section 45, and certain investment tax credits under section 46. Notably, this means that the foreign tax credit is currently subject to the BEAT. In taxable years beginning after December 31, 2025, all tax credits are subject to the BEAT.

B. *Need for the proposed regulations*

Section 59A does not explicitly state whether an amount that is permitted as a deduction under the Code or regulations

but that is not claimed as a deduction on a taxpayer's tax return is potentially a base erosion tax benefit for purposes of the BEAT and the base erosion percentage test. Comments recommended that the Treasury Department and the IRS clarify the treatment of amounts that are allowable as a deduction but not claimed as a deduction on a taxpayer's tax return. These proposed regulations are needed to respond to these comments and to clarify the treatment of these amounts under section 59A. The proposed regulations are also needed to clarify certain aspects of the rules set forth in the final regulations relating to how a taxpayer determines its aggregate group for purposes of determining gross receipts and the base erosion percentage, and how the BEAT applies to partnerships.

C. *Overview of the proposed regulations*

The proposed regulations provide taxpayers an election to waive deductions that would otherwise be taken into account in determining whether the taxpayer is an applicable taxpayer subject to the BEAT. This change is analyzed in part D of these Special Analyses.

These proposed regulations also include modifications to the rules set forth in the final regulations relating to how a taxpayer determines its aggregate group for purposes of determining gross receipts and the base erosion percentage, and how the BEAT applies to partnerships. These latter modifications to the existing final rule are not expected to result in any substantial changes in taxpayer behavior.

D. *Economic Analysis*

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations compared to a no-action baseline that reflects anticipated Federal income tax-related behavior in the absence of these proposed regulations.

2. Economic Effects of the Election to Waive Deductions (Part III of the Explanation of Provisions)

a. Background and Alternatives Considered

Section 59A does not explicitly state whether an amount that is permitted as a deduction under the Code or regulations but that is not claimed as a deduction on the taxpayer's tax return is potentially a base erosion tax benefit for the purposes of the base erosion percentage test. A taxpayer may find waiving certain deductions advantageous if the waived deductions lower the taxpayer's base erosion percentage below the base erosion threshold, thus making section 59A inapplicable to the taxpayer. Comments recommended that the Treasury Department and the IRS clarify the treatment of allowable amounts that are not claimed as a deduction on the taxpayer's tax return for purposes of section 59A.

To address concerns about the treatment of these amounts permitted as deductions under law, the Treasury Department and the IRS considered two alternatives for the proposed guidance: (1) providing that all deductions that could be properly claimed by a taxpayer for the taxable year are taken into account for purposes of the base erosion percentage test (and for other purposes of the BEAT) even if a deduction is not claimed on the taxpayer's tax return (the "alternative regulatory approach"); or (2) providing that an allowable deduction that a taxpayer does not claim on its tax return is not taken into account in the base erosion percentage test or for other purposes of the BEAT, provided that certain procedural steps are followed. The proposed regulations adopt the latter approach.

Under the alternative regulatory approach, base erosion payments allowable as deductions but not claimed by a taxpayer would nonetheless be taken into account in the base erosion percentage. Thus, a taxpayer could not avoid satisfying the base erosion percentage test by not claiming certain deductions. Under the proposed regulations, base erosion payments allowable as deductions but waived by a taxpayer are not taken into account in the base erosion percentage test, assuming certain procedural steps are followed. The waived deductions are waived for all U.S. federal income tax purposes and thus, for example, the deductions are also not allowed for regular income tax purposes. If the taxpayer is not an applicable taxpayer because it waives deductions so as not to satisfy the base erosion percentage test, the taxpayer may continue to claim deductions for base erosion payments that are not waived, provided these deductions would otherwise be allowed.

b. Example

Consider a U.S.-parented multinational enterprise that satisfies the gross receipts test and that is not a bank or registered securities dealer. The U.S. corporation has gross income from domestic sources of $1000x and also has a net global intangible low-taxed income ("GILTI") inclusion of $500x.[2] The taxpayer has $870x of deductions pertinent to this example that are not base erosion tax benefits and $30x of deductions that are base erosion tax benefits. It is also assumed that the amount of foreign tax credits permitted under section 904(a) is $105x. This taxpayer's regular U.S. taxable income is $600x ($1000x + $500x - $870x - $30x), its regular U.S. tax rate is 21.0 percent, and its regular U.S. tax liability is $21x ($600x X 21% = $126x, less foreign tax credits of $105x ($126x - $105x)).

Under the alternative regulatory approach, the taxpayer is an applicable taxpayer because its base erosion percentage is 3.33 percent ($30x / $900x), which is greater than the three percent base erosion threshold. Because the taxpayer is subject to the BEAT, it must further compute its modified taxable income, which is $630x — its regular U.S. taxable income ($600x) plus its base erosion tax benefits ($30x).

[2] For simplification of this example, the $500x GILTI income is presented as the net of the global intangible low-tax income amount of the domestic corporation under section 951A, plus the section 78 gross up amount for foreign taxes, less the GILTI deduction under section 250(a)(1)(B). The deduction under section 250(a)(1)(B) is not taken into account in determining the base erosion percentage. See section 59A(c)(4)(B)(i).

The taxpayer determines its base erosion minimum tax amount as the excess of the BEAT rate (10 percent) multiplied by its modified taxable income $63x ($630x X 10%) over its regular U.S. tax liability of $21x, which is equal to $42x ($63x - $21x). In this example the total U.S. tax bill is $63x ($21x of regular tax and $42x of BEAT).

Under the proposed regulations, this taxpayer would have the option to waive all or part of its deductions that are base erosion payments so that its base erosion percentage would fall below the base erosion threshold. Specifically, the taxpayer could waive $3.10x of its deductions that are base erosion payments, yielding a base erosion percentage of less than the three percent base erosion threshold (base erosion tax benefits = $26.90x ($30x - $3.10x); base erosion percentage = $26.90x/($870x + $26.90x) = 2.99%). After taking into account this waiver, the taxpayer's regular taxable income would increase to $603.10x ($1000x + $500x - $870x - $26.90x), and its regular tax liability would increase to $21.65x ($603.10x X 21% = $126.65, less foreign tax credits of $105x = $21.65x).[3] The waiver is valuable to this taxpayer because its tax bill in this simple example is lower by $41.35x ($63x - $21.65x).

This example shows the difference in tax liability caused by allowing deductions to be waived and thus, the difference between the proposed regulations and the alternative regulatory approach. The next part D.2.c of these Special Analyses discusses the behavioral incentives and economic effects that can result from this tax treatment.

c. Economic Effects of these Proposed Regulations

The proposed regulations effectively allow a taxpayer to make payments that would be base erosion payments without becoming an applicable taxpayer. This provision reduces the effective tax on base erosion payments for at least some taxpayers, relative to the alternative regulatory approach. Because of this reduction, the proposed regulations may lead to a higher amount of base erosion payments than under the alternative regulatory approach.

Any additional base erosion payments under the proposed regulations would come from taxpayers who, under the alternative regulatory approach, would not be applicable taxpayers but would be close to being applicable taxpayers; that is, they would have base erosion percentages that were close to but below the base erosion threshold.

Taxpayers that would be applicable taxpayers under the alternative regulatory approach will not increase their base erosion payments under the proposed regulations. To see this point, consider an applicable taxpayer under the alternative regulatory approach with base erosion payments of $Y. If this taxpayer were to increase its base erosion payments by $10 and reduce its non-base erosion payments by $10 (that is, it has substituted base erosion payments for non-base erosion payments), its tax bill would generally increase by $1. The fact that this taxpayer chose base erosion payments of $Y rather than $Y+10 suggests that this substitution would be worth less than $1 to the taxpayer. The substitution is not worth the increased tax. Next consider this taxpayer under the proposed regulations. If it elects to waive sufficient deductions such that it is not an applicable taxpayer, then the marginal increase in its tax bill from the hypothetized substitution is $2.10. Thus, if this increase in base erosion payments (and substitution away from non-base erosion payments) is not worthwhile to the taxpayer under the alternative regulatory approach, it will not be worthwhile under the proposed regulations.

This example suggests that to the extent that there is any increase in base erosion payments under the proposed regulations, it will not come from taxpayers that would be applicable taxpayers under the alternative regulatory approach and will instead come from those taxpayers that would not be applicable taxpayers under the alternative regulatory approach. These taxpayers would be able, under the proposed regulations, to take on activities that increase their base erosion payments but, by waiving all or part of the deduction for these activities, avoid crossing the base erosion threshold. This is the set of taxpayers that will be the source of any economic effects arising from the proposed regulations.

As a result of the ability to waive deductions in the proposed regulations, taxpayers may change business behavior in two possible ways. First, businesses may expand economic activities in the United States even if those activities result in payments to foreign related parties (i.e., base erosion payments). For example, under the alternative regulatory approach a multinational enterprise may decide not to open an office or manufacturing plant in the United States if that incremental activity also resulted in incremental base erosion payments that would cause the taxpayer to become an applicable taxpayer. Under the proposed regulations, this business can expand its activities in the U.S. and avoid becoming an applicable taxpayer, provided it waived sufficient deductions to stay below the base erosion threshold.

Second, businesses already operating in the United States may not be discouraged from structuring transactions as base erosion payments under the proposed regulations. Under the alternative regulatory approach, a business might conduct its transactions through unrelated parties rather than with a foreign related party so that its base erosion percentage would remain below the base erosion threshold. Under the proposed regulations, this business could use a foreign related party rather than an unrelated party for these transactions, without paying the BEAT, again provided it waived sufficient deductions to stay below the base erosion threshold.

In each of these cases, a business adopting these strategies would be presumed to accrue a non-tax, economic benefit from using a foreign related party rather than an unrelated party to conduct this aspect of its business. Under the proposed regulations, there is no U.S. tax-related benefit tax associated with transacting with a foreign related party and thus any decisions made by a business to make a base erosion payment would occur because of the econom-

[3] Although the waiver increases the taxpayer's regular taxable income, the taxpayer's gross income (in the context of this example) is unchanged. Thus, only the tax liability needs to be compared across the regulatory approaches to determine whether the taxpayer would benefit from waiving deductions.

ic advantage it provides to the business, rather than that payment being avoided, diverted or otherwise distorted because it would result in the taxpayer becoming an applicable taxpayer subject to the BEAT. This economic advantage might arise, for example, because the business has a closer relationship with the foreign related party and its transactions with the foreign related party provide enhanced managerial control. This economic benefit accruing to this business would generally be beneficial to the U.S. economy; this is particularly true in the first case described in the preceding paragraphs. While taxpayers may have compliance costs related to deciding whether to waive deductions and ensuring that procedural rules are followed, any changes in compliance costs are expected to be small because the accounting required for the relevant deductions is essentially the same under both the proposed regulations and the alternative regulatory approach.

Note that under the proposed regulations, a taxpayer would in general face a marginal tax rate that is 21 percentage points higher on its base erosion payments than on comparable deductions that are not base erosion payments. Economic analysis would conclude that the business will undertake a base erosion payment rather than a non-base erosion payment only if it provides a non-tax benefit at least this large. Businesses will choose a different mix of base erosion and non-base erosion payments under the alternative regulatory approach, but an analogous inference about the marginal value of a base erosion payment here (and thus of the difference between the proposed regulations and the alternative regulatory approach) is more complex because the marginal tax incurred by base erosion payments near the base erosion threshold depends on (i) how close the taxpayer would be to the threshold; (ii) the quantity of its base erosion payments that are below the base erosion threshold and subject to tax if the base erosion threshold is exceeded; and (iii) other factors affecting the potential BEAT liability. Because of these factors, the difference in the non-tax value to businesses of a marginal base erosion payment between the proposed regulations and alternative regulatory approach is complex and not readily inferred.

This said, as a general matter, for taxpayers who chose to waive deductions under the proposed regulations in order not to be applicable taxpayers, the Treasury Department and the IRS expect that relative to the alternative regulatory approach, the proposed regulations would tend to:

- Reduce tax costs of additional economic activity in the United States by those taxpayers in the situation where additional economic activity in the United States would tend to increase base erosion payments;
- Reduce tax-related incentives for otherwise economically inefficient business, contractual or accounting changes designed to avoid the taxpayer being an applicable taxpayer;
- Continue to fulfill the general intent and purpose of the statute by not providing tax incentives for certain large corporations to make deductible payments to foreign related parties in excess of 3 percent of the taxpayer's deductions; and
- Reduce the number of taxpayers that are applicable taxpayers and the overall amount of BEAT collected. This revenue effect is likely to be offset to some degree by the fact that some taxpayers are likely to elect to waive allowable deductions.

The Treasury Department and the IRS have not attempted to provide a quantitative estimate of the economic consequences of the proposed regulations relative to the alternative regulatory approach. Any increase in base erosion payments under the proposed regulations depends on the number of taxpayers that would be close to the base erosion threshold under the alternative regulatory approach, the quantity of base erosion payments they would have under the alternative regulatory approach, and, most importantly, the economic value provided by those base erosion payments relative to alternative economic decisions. These items are difficult to estimate with any reasonable precision in part because they involve economic activities, including potential new economic activity in the United States, that cannot be readily inferred from existing data or models available to the Treasury Department and the IRS.

In the absence of such quantitative estimates, the Treasury Department and the IRS have undertaken a qualitative analysis of the economic effects of the proposed regulations relative to the alternative regulatory approach.

The Treasury Department and the IRS solicit comments on these findings and more generally on the economic effects of these proposed regulations. The Treasury Department and the IRS particularly solicit data, other evidence, or models that could be used to enhance the rigor of the process by which the final regulations might be developed.

d. Number of Affected Taxpayers

These proposed regulations affect all corporate taxpayers that satisfy the gross receipts test, base erosion percentage test, and have base erosion payments. The Treasury Department and the IRS project that 3,500 – 4,500 taxpayers may be applicable taxpayers under the BEAT. This estimate is based on the number of filers that (1) filed the Form 1120 series of tax returns (except for the Form 1120-S), (2) filed a Form 5471 or Form 5472, and (3) reported gross receipts of at least $500 million. Because an applicable taxpayer is defined under section 59A(e)(1)(A) as a corporation other than a regulated investment company, a real estate investment trust, or an S corporation, the Treasury Department and the IRS have determined that taxpayers who filed the Form 1120 series of tax returns will be most likely to be affected by these proposed regulations. Additionally, the Treasury Department and the IRS estimated the number of filers likely to make payments to a foreign related party based on filers of the Form 1120 series of tax returns who also filed a Form 5471 or Form 5472 to determine the number of respondents. Finally, because an applicable taxpayer is defined under section 59A(e)(1)(B) as a taxpayer with average annual gross receipts of at least $500 million for the 3-taxable-year period ending with the preceding taxable year, the Treasury Department and the IRS estimated the scope of Affected Taxpayers based on the amount of gross receipts reported by taxpayers filing the Form 1120 series of tax returns.

These projections are based solely on data with respect to the taxpayer, without taking into account any members of the

taxpayer's aggregate group. As many as 100,000 – 110,000 additional taxpayers may be applicable taxpayers as a result of being members of an aggregate group.[4] This estimate is based on the number of taxpayers who filed a Form 1120 and also filed a Form 5471 or a Form 5472, but without regard to the gross receipts test. Current data do not permit an estimate of the number of taxpayers that would be close to the base erosion threshold.

E. *Paperwork Reduction Act*

The collections of information in these proposed regulations with respect to section 59A are in proposed §§1.59A-3(c)(5), and 1.6031(a)-1(b)(7). The collection of information in proposed §§1.59A-3(c)(5) is an election to waive deductions allowed under the Code. The election to waive deductions is made by a taxpayer on its original or amended income tax return. A taxpayer makes the election on an annual basis by completing Form 8991 or as provided in applicable instructions. The IRS is contemplating making additional changes to the Form 8991 to take these proposed regulations into account.

The collection of information in proposed §1.6031(a)-1(b)(7) requires a partner in a foreign partnership that: (1) is not required to file a partnership return and (2) has made a payment or accrual that is treated as a base erosion payment of a partner under §1.59A-7(b)(2), to provide the information necessary to report any base erosion payments on Form 8991. The IRS intends that this information will be collected by completing Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts*, Form 1065, and Schedule K-1. The IRS is contemplating making revisions to Form 1065, Schedule K, and Schedule K-1 to take these proposed regulations into account.

For purposes of the Paperwork Reduction Act, the reporting burden associated with the collections of information with respect to section 59A, will be reflected in the Paperwork Reduction Act Submission, associated with Form 8991 (OMB control number 1545-0123).

The current status of the Paperwork Reduction Act submissions related to BEAT is provided in the following table. The BEAT provisions are included in aggregated burden estimates for the OMB control numbers listed below which, in the case of 1545-0123, represents a total estimated burden time, including all other related forms and schedules for corporations, of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the BEAT requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions imposed prior to the Act. No burden estimates specific to the proposed regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations. In addition, when available, drafts of IRS forms are posted for comment at https://apps.irs.gov/app/picklist/list/draftTaxForms.htm.

Form	Type of Filer	OMB Number(s)	Status
Form 8991	Business (NEW Model)	1545-0123	Published in the FRN on 10/11/18. Public Comment period closed on 12/10/18.
	Link: https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-c-1120-f-1120-h-1120-nd		

Related New or Revised Tax Forms

	New	Revision of existing form	Number of respondents (2018, estimated)
Form 8991	Y		3,500 – 4,500

The number of respondents in the Related New or Revised Tax Forms table was estimated by Treasury's Office of Tax Analysis based on data from IRS Compliance Planning and Analytics using tax return data for tax years 2015 and 2016. Data for Form 8991 represent preliminary estimates of the total number of taxpayers which may be required to file the new Form 8991. Only certain large corporate taxpayers with gross receipts of at least $500 million are expected to file this form.

F. *Regulatory Flexibility Act*

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section

[4] These estimates are based on current tax filings for taxable year 2017 and do not yet include the BEAT. At this time, the Treasury Department and the IRS do not have readily available data to determine whether a taxpayer that is a member of an aggregate group will meet all tests to be an applicable taxpayer for purposes of the BEAT.

601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). This certification is based on the fact that these regulations will primarily affect aggregate groups of corporations with average annual gross receipts of at least $500 million and that make payments to foreign related parties. Generally only large businesses both have substantial gross receipts and make payments to foreign related parties.

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public about the impact of this proposed rule on small entities.

Pursuant to section 7805(f), these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

G. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately $154 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

H. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Comments and Request for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. See also parts II and III of the Explanation of Provisions (requesting specific comments related to the aggregate group rules in light of the with-or-without method and the election to waive allowable deductions, respectively) and parts II.C., II.D., and IV.B. of the Explanation of Provisions (requesting specific comments related to the appropriate treatment of a deconsolidating member's gross receipts history, appropriate methods of taking into account predecessors and successors for purposes of determining gross receipts of an applicable taxpayer's aggregate group, and the treatment of transactions involving partnerships engaged in a U.S. trade or business, respectively).

All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of the proposed regulations are Azeka J. Abramoff, Sheila Ramaswamy and Karen Walny of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2 Section1.59A-2, as added in a final rule published elsewhere in this issue of the Federal Register, effective December 6, 2019, is amended by adding paragraphs (c)(2)(ii), (c)(4) through (6), and paragraph (f)(2) to read as follows:

§1.59A-2 Applicable taxpayer.

* * * * * *

(c) * * *

(2) * * *

(ii) *Change in the composition of an aggregate group*. A change in ownership of the taxpayer (for example, a sale of the taxpayer to a third party) does not cause the taxpayer to leave its own aggregate group. Instead, any members of the taxpayer's aggregate group before the change in ownership that are no longer members following the change in ownership are treated as having left the taxpayer's aggregate group, and any new members that become members of the taxpayer's aggregate group following the change in ownership are treated as having joined the taxpayer's aggregate group. A change in ownership of another member of the aggregate group of the taxpayer (for example, a sale of the member to a third party) may result in the member joining or leaving the aggregate group of the taxpayer. See paragraph (c)(4) of this section for the treatment of members joining or leaving the aggregate group of a taxpayer.

* * * * *

(4) *Periods before and after a corporation is a member of an aggregate group*. Solely for purposes of this section, to determine the gross receipts and the base erosion percentage of the aggregate group of a taxpayer, the taxpayer takes into account only the portion of another corporation's taxable year during which the corporation is a member of the aggregate group of the taxpayer. The gross receipts of an aggregate group of a taxpayer attributable to a member of the aggregate group are not reduced as a result of the member leaving the aggregate group of the taxpayer. Solely for purposes of this paragraph (c), when a member joins or leaves the aggregate group of a taxpayer in a transaction that does not result in the member having a taxable year-end, the member is treated as having a taxable year end (deemed taxable year-end) immediately before joining or leaving the group. For purposes of this

paragraph (c)(4), a corporation that has a deemed taxable year-end may determine gross receipts, base erosion tax benefits, and deductions attributable to that year by either treating the corporation's books as closing at the deemed taxable year-end or, in the case of items other than extraordinary items (as defined in §1.1502-76(b)(2)(ii)(C)), allocating those items on a pro-rata basis without a closing of the books.

(5) *Treatment of short taxable year*. Solely for purposes of this section, if a taxpayer has a taxable year of fewer than 12 months (a short period), gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period. When a taxpayer has a taxable year that is a short period, the taxpayer must use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group for the short period. A reasonable approach should neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group of the taxpayer, even if the taxable year of a member or members of the aggregate group does not end with or within the short period.

(6) *Treatment of predecessors*—(i) *In general*. Solely for purposes of this section, in determining gross receipts under paragraph (d) of this section, any reference to a taxpayer includes a reference to any predecessor of the taxpayer. For this purpose, a predecessor includes the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation.

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

* * * * *

(f) * * *

(2) *Example 2: Member leaving an aggregate group*—(i) *Facts*. Parent Corporation wholly owns Corporation 1 and Corporation 2. Each corporation is a domestic corporation and a calendar year taxpayer that does not file a consolidated return. The aggregate group of Corporation 1 includes Parent Corporation and Corporation 2. At noon on June 30, Year 1, Parent Corporation sells the stock of Corporation 2 to Corporation 3, an unrelated domestic corporation, in exchange for cash consideration. Before the acquisition, Corporation 3 was not a member of an aggregate group. Corporation 2 and Corporation 3 do not file a consolidated return.

(ii) *Analysis*. (A) For purposes of section 59A, to determine the gross receipts and base erosion percentage of the aggregate group of Corporation 1 for calendar Year 1, Corporation 2 is treated as having a taxable year end immediately before noon on June 30, Year 1, as a result of the sale. The aggregate group of Corporation 1 takes into account only the gross receipts, base erosion tax benefits, and deductions of Corporation 2 attributable to the period from January 1 to immediately before noon on June 30 of Year 1. The same results apply to the aggregate group of Parent Corporation for calendar Year 1.

(B) For purposes of section 59A, to determine the gross receipts and base erosion percentage of the aggregate group of Corporation 2 for calendar Year 1, each of Parent Corporation, Corporation 1, and Corporation 3 are treated as having a taxable year end at immediately before noon on June 30, Year 1. Because Corporation 2 does not have a short taxable year, paragraph (c)(5) of this section does not apply. The aggregate group of Corporation 2 takes into account the gross receipts, base erosion tax benefits, and deductions of Parent Corporation and Corporation 1 attributable to the period from January 1 to immediately before noon on June 30 of Year 1, and the gross receipts, base erosion tax benefits, and deductions of Corporation 3 attributable to the period from noon on June 30 to December 31 of Year 1.

Par. 3. Sections 1.59A-3, as added in a final rule published elsewhere in this issue of the **Federal Register**, effective December 6, 2019, is amended by adding paragraphs (c)(5) and (6) and (d)(8) and (9) to read as follows:

§1.59A-3 Base erosion payments and base erosion tax benefits.

* * * * *

(c) * * *

(5) *Allowed deduction*. Solely for purposes of paragraph (c)(1) of this section, all deductions that could be properly claimed by a taxpayer for the taxable year (determined after giving effect to the taxpayer's permissible method of accounting and to any election, such as the election under section 173 to capitalize circulation expenditures or the election under section 168(g)(7) to use the alternative depreciation system of depreciation) are treated as allowed deductions under chapter 1 of subtitle A of the Internal Revenue Code.

(6) *Election to waive allowed deductions*—(i) *In general*. Solely for purposes of paragraph (c)(1) of this section, if a taxpayer elects to waive certain deductions, the amount of allowed deductions as defined in paragraph (c)(5) of this section is reduced by the amount of deductions that are properly waived under this paragraph (c)(6)(i). To make this election, a taxpayer must provide information related to each deduction waived as required by applicable forms and instructions issued by the Commissioner, including—

(A) A detailed description of the item or property to which the deduction relates, including sufficient information to identify that item or property on the taxpayer's books and records;

(B) The date on which, or period in which, the waived deduction was paid or accrued;

(C) The provision of the Internal Revenue Code (and regulations, as applicable) that allows the deduction for the item or property to which the election relates;

(D) The amount of the deduction that is claimed for the taxable year with respect to the item or property;

(E) The amount of the deduction being waived for the taxable year with respect to the item or property;

(F) A description of where the deduction is reflected (or would have been reflected) on the Federal income tax return (schedule and line number); and

(G) The name, EIN (if applicable), and country of organization of the foreign related party that is or will be the recipient of the payment that generates the deduction.

(ii) *Effect of election to waive deduction*—(A) *In general*—(*1*) *Consistent treatment*. Except as otherwise provided in this paragraph (c)(6)(ii), any deduction

waived under paragraph (c)(6) of this section is treated as having been waived for all purposes of the Code and regulations.

(*2*) *No allocation and apportionment of waived deductions*. The waiver of deductions described in this paragraph (c)(6) is treated as occurring before the allocation and apportionment of deductions under §§1.861-8 through -14T and 1.861-17 (such as for purposes of section 904).

(*3*) *Effect of waiver of deductions described in §§1.861-10 and §1.861-10T*. To the extent that any waived deduction is interest expense that would have been directly allocated under the rules of §§1.861-10 or §1.861-10T and would have resulted in the reduction of value of any assets for purposes of allocating other interest expense under §§1.861-9 and 1.861-9T, the value of the assets is reduced to the same extent as if the taxpayer had not elected to waive the deduction.

(B) *Effect of the election to waive deductions disregarded for certain purposes*. If a taxpayer makes the election to waive a deduction, in whole or in part, under paragraph (c)(6)(i) of this section, the election is disregarded for determining—

(*1*) The taxpayer's overall method of accounting, or the taxpayer's method of accounting for any item, under section 446 and the regulations in this part under section 446;

(*2*) Whether a change in the taxpayer's overall plan of accounting or the taxpayer's treatment of a material item is a change in method of accounting under section 446(e) and §1.446-1(e);

(*3*) The amount allowable under subtitle A of the Code for depreciation or amortization for purposes of section 167(c) and section 1016(a)(2) or section 1016(a)(3) and any other adjustment to basis under section 1016(a);

(*4*) For purposes of applying the exclusive apportionment rule in §1.861-17(b), the geographic source where the research and experimental activities which account for more than fifty percent of the amount of the deduction for research and experimentation was performed;

(*5*) The application of section 482 and the regulations under section 482;

(*6*) The amount of the taxpayer's earnings and profits; and

(*7*) Any other item as necessary to prevent a taxpayer from receiving the benefit of a waived deduction.

(C) *Not a method of accounting*. The election described in paragraph (c)(6)(i) of this section is not a method of accounting under section 446 and the regulations in this part under section 446.

(D) *Effect of the election in determining section 481(a) adjustments*. A taxpayer making the election described in paragraph (c)(6)(i) of this section agrees that if the method of accounting for a waived deduction is changed, the amount of adjustment taken into account under section 481(a)(2) is determined without regard to the election described in paragraph (c)(6)(i) of this section. As a result, a waived deduction has no effect on the amount of a section 481(a) adjustment compared to what the adjustment would have been if the deduction had not been waived.

(iii) *Time and manner for election to waive deduction*. A taxpayer may make the election described in paragraph (c)(6)(i) of this section on its original filed Federal income tax return. In addition, a taxpayer may elect to waive deductions or increase the amount of deductions waived pursuant to the election described in paragraph (c)(6)(i) of this section on an amended Federal income tax return filed within the later of 3 years from the date the original return was filed, taking into account section 6501(b)(1), for the taxable year for which the election is made or the period described in section 6501(c)(4), or during the course of an examination of the taxpayer's income tax return for the relevant tax year pursuant to procedures prescribed by the Commissioner. However, a taxpayer may not decrease the amount of deductions waived by the election, or otherwise revoke the election that is described in paragraph (c)(6)(i) of this section on any amended Federal income tax return or during the course of an examination. To make the election, a taxpayer must complete the appropriate part of Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts,* (or successor), including the information described in paragraph (c)(6)(i) of this section and any other information required by the form or instructions. A taxpayer makes the election described in paragraph (c)(6)(i) of this section on an annual basis, and the taxpayer does not need the consent of the Commissioner if the taxpayer chooses not to make the election for a subsequent taxable year. The election described in paragraph (c)(6)(i) of this section may not be made in any other manner (for example, by filing an application for a change in accounting method).

(d) * * *

(8) *Example 8: Effect of election to waive deduction on method of accounting*—(i) *Facts*. DC, a domestic corporation, purchased and placed in service a depreciable asset (Asset A) from a foreign related party on the first day of its taxable year 1 for $100x. DC elects to use the alternative depreciation system under section 168(g) to depreciate all properties placed in service during taxable year 1. Asset A is not eligible for the additional first year depreciation deduction. Beginning in taxable year 1, DC depreciates Asset A under the alternative depreciation system using the straight-line depreciation method, a 5-year recovery period, and the half-year convention. This depreciation method, recovery period, and convention are permissible for Asset A under section 168(g). On its timely filed original Federal income tax return for taxable year 1, DC does not elect to waive any deductions and DC claims a depreciation deduction of $10x for Asset A. On its timely filed original Federal income tax return for taxable year 2, DC does not elect to waive any deductions and DC claims a depreciation deduction of $20x for Asset A. During taxable year 3, DC files an amended return for taxable year 1 to elect to waive the depreciation deduction for Asset A and reports in accordance with paragraph (c)(6)(i) of this section with its amended return for taxable year 1 that the amount of the waived depreciation deduction for Asset A is $10x and the amount of the claimed depreciation deduction is $0x.

(ii) *Analysis*— Pursuant to paragraph (c)(6)(ii)(B)(*1*) of this section, DC's election to waive the depreciation deduction for Asset A for taxable year 1 is disregarded for determining DC's method of accounting for Asset A. Accordingly, after DC's election to waive the depreciation deduction for Asset A for taxable year 1, DC's method of accounting for depreciation for Asset A continues to be the straight-line depreciation method, a 5-year recovery period, and the half-year convention. Pursuant to paragraph (c)(6)(ii)(C) of this section, the election made by DC in taxable year 3 on its amended return for taxable year 1 is not a method of accounting.

(9) *Example 9: Change of accounting method when taxpayer has waived a deduction*—(i) *Facts*. DC, a domestic corporation, purchased and placed in service a depreciable asset (Asset B) from a foreign related party on the first day of its taxable year 1 for $100x. DC elects to use the alternative depreciation system under section 168(g) to depreciate all properties placed in service during taxable year 1. Asset B is not eligible for the additional first year depreciation deduction. Beginning in taxable year 1, DC depreciates Asset B under the alternative depreciation system using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. Under this method of accounting, the depreciation deductions for Asset B are $5x for taxable year

1 and $10x for taxable year 2. However, for taxable years 1 and 2, DC elects to waive $3x and $6x, respectively, of the depreciation deductions for Asset B and reports the information required under paragraph (c)(6)(i) of this section with its returns. In taxable year 3, DC realizes that the correct recovery period for Asset B is 5 years. If DC had used the correct recovery period for Asset B, the depreciation deductions for Asset B would have been $10x for taxable year 1 and $20x for taxable year 2. DC timely files a Form 3115 to change its method of accounting for Asset B from a 10-year recovery period to a 5-year recovery period, beginning with taxable year 3. DC was not under examination as of the date on which it timely filed this Form 3115.

(ii) *Analysis*—(A) *Computation of the section 481(a) adjustment*. In determining the net negative section 481(a) adjustment for this method change, DC compares the depreciation deductions under its present method of accounting to the depreciation deductions under its proposed method of accounting. Pursuant to paragraph (c)(6)(ii)(D) of this section, DC agreed that, by making the election to waive depreciation deductions for Asset B, DC will not take into account the fact that depreciation deductions for Asset B were waived under paragraph (c)(6)(i) of this section. Accordingly, DC's net negative section 481(a) adjustment for this method change is $15x, which is calculated by determining the difference between the depreciation deductions for Asset B for taxable years 1 and 2 under DC's present method of accounting ($15x) and the depreciation deductions that would have been allowable for Asset B for taxable years 1 and 2 under DC's proposed method of accounting ($30x).

(B) *Computation of basis adjustments*. Pursuant to paragraph (c)(6)(ii)(B)(*3*) of this section, DC's elections to waive the depreciation deductions for Asset B for taxable years 1 and 2 are disregarded for determining the amount allowable for depreciation for purposes of section 1016(a)(2). The amount allowable for depreciation of Asset B is determined based on the proper method of computing depreciation for Asset B. Accordingly, Asset B's adjusted basis at the end of taxable year 1 is $90x ($100x - $10x) and at the end of taxable year 2 is $70x ($90x - $20x).

Par. 4. Section 1.59A-7, as added in a final rule published elsewhere in this issue of the Federal Register, effective December 6, 2019, is amended by adding paragraphs (c)(5)(v) and (g)(2)(x) to read as follows:

§1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

* * * * *

(c) * * *

(5) * * *

(v) *Allocations of income in lieu of deductions*. If a partnership adopts the curative method of making section 704(c) allocations under §1.704-3(c), the allocation of income to the contributing partner in lieu of a deduction allocation to the non-contributing partner is treated as a deduction for purposes of section 59A in an amount equal to the income allocation. See paragraph (g)(2)(x) of this section (*Example 10*) for an example illustrating the application of this paragraph (c)(5)(v).

* * * * *

(g) * * *

(2) * * *

(x) *Example 10: Section 704(c) and curative allocations*—(A) *Facts*. The facts are the same as in paragraph (d)(2)(ii)(A) of this section (the facts in *Example 2*), except that DC's property is not depreciable, PRS uses the traditional method with curative allocations under §1.704-3(c), and the curative allocations are to be made from operating income. Also assume that the partnership has $20x of gross operating income in each year and a curative allocation of the operating income satisfies the "substantially the same effect" requirement of §1.704-3(c)(3)(iii)(A).

(B) *Analysis*. The analysis and results are the same as in paragraph (d)(2)(i)(B) of this section (the analysis in *Example 1*), except that actual depreciation is $8x ($40x/5) per year and the ceiling rule shortfall under §1.704-3(b)(1) of $2x per year is corrected with a curative allocation of income from DC to FC is $2x per year. Solely for U.S. federal income tax purposes, each year FC is allocated $12x of total operating income and DC is allocated $8x of operating income. Both the actual depreciation deduction to DC and the curative allocation of income from DC are base erosion tax benefits to DC under paragraph (d)(1) of this section.

Par. 5. Section1.59A-9, as added in a final rule published elsewhere in this issue of the Federal Register, effective December 6, 2019, is amended by adding paragraphs (b)(5) and (6) to read as follows:

§1.59A-9 Anti-abuse and recharacterization rules.

* * * * *

(b) * * *

(5) *Transactions involving derivatives on a partnership interest*. If a taxpayer acquires a derivative on a partnership interest (or partnership assets) as part of a transaction (or series of transactions), plan or arrangement that has as a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment) and the partnership interest (or partnership assets) would have resulted in a base erosion payment had the taxpayer acquired that interest (or partnership asset) directly, then the taxpayer is treated as having a direct interest instead of a derivative interest for purposes of applying section 59A. A derivative interest in a partnership includes any contract (including any financial instrument) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined in whole or in part by reference to the partnership, including the amount of partnership distributions, the value of partnership assets, or the results of partnership operations.

(6) *Allocations to eliminate or reduce a base erosion payment*. If a partnership receives (or accrues) income from a person not acting in a partner capacity (including a person who is not a partner) and allocates that income to its partners with a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment) , then the taxpayer transacting with the partnership will determine its base erosion payment as if the allocations had not been made and the items of income had been allocated proportionately. The preceding sentence applies only when the allocations, in combination with any related allocations, do not change the economic arrangement of the partners to the partnership.

* * * * *

Par. 6. Section 1.59A-10, as added in a final rule published elsewhere in this issue of the Federal Register, effective December 6, 2019, is revised to read as follows:

§1.59A-10 Applicability date.

(a) *General applicability date*. Sections 1.59A-1 through 1.59A-9, other than the provisions described in the first sentence of paragraph (b) of this section, apply to taxable years ending on or after December 17, 2018. However, taxpayers may apply these regulations in their entirety for taxable years beginning after December 31, 2017, and ending before December 17, 2018. In lieu of applying these regulations, taxpayers may apply the provisions matching §§1.59A-1 through 1.59A-9 from the Internal Revenue Bulletin (IRB) 2019-02 (https://www.irs.gov/pub/irs-irbs/irb19-02.pdf) in their entirety for all taxable years ending on or before December 6, 2019.

(b) *Exception*. Sections 1.59A-2(c)(2)(ii) and (c)(4) through (6) and 1.59A-3(c)(5) and (6) apply to taxable years beginning on or after December 6, 2019, and §§1.59A-7(c)(5)(v) and 1.59A-9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019. However, taxpayers may apply these provisions in their entirety for taxable years beginning after December 31, 2017, and before the final regulations are applicable. If a taxpayer is applying the

provisions described in the last sentence of paragraph (a) of this section, the taxpayer's failure to apply §1.59A-2(c)(2)(ii) and (c)(4) through (6) to taxable years ending on or before December 6, 2019 is not taken into account for purposes of applying the preceding sentence.

* * * * *

Par. 7. Section 1.6031(a)-1 is amended by adding paragraphs (b)(7) and (f)(3) to read as follows:

§1.6031(a)-1 Return of partnership income.

* * * * *

(b) * * *

(7) *Filing obligation for certain partners of certain foreign partnerships with respect to base erosion payments*. If a foreign partnership is not required to file a partnership return and the foreign partnership has made a payment or accrual that is treated as a base erosion payment of a partner as provided in §1.59A-7(b)(2), a person required to file a Form 8991 (or successor) who is a partner in the partnership must provide the information necessary to report any base erosion payments on Form 8991 (or successor) or the related instructions. This paragraph does not apply to any partner described in §1.59A-7(b)(4).

* * * * *

(f) * * *

(3) Paragraph (b)(7) of this section applies to taxable years ending on or after the date that final regulations are filed with the **Federal Register**.

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on December 2, 2019, 4:15 p.m., and published in the issue of the Federal Register for December 6, 2019, 84 F.R. 67046)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletin 2019–52

AOD:

Announcements:

Notices:

Proposed Regulations:

Proposed Regulations:—Continued

Revenue Rulings:

Revenue Procedures:

Treasury Decisions:

Treasury Decisions:—Continued

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2019–52

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

Internal Revenue Service
Washington, DC 20224

Official Business
Penalty for Private Use, $300

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page *www.irs.gov*) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.