



## International Tax **ADVISORY** ■

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### The BEAT Goes On and On – New Final BEAT Regulations

On September 1, 2020, Treasury and the IRS released another set of [final regulations](#) (2020 Final Regulations) under Section 59A (commonly referred to as the base erosion and anti-abuse tax, or BEAT). The 2020 Final Regulations finalize the proposed regulations issued on December 2, 2019 (2019 Proposed Regulations) and generally retain [their basic approach and structure](#). Additionally, the 2020 Final Regulations make some modifications to the final regulations that were also issued on December 2, 2019 (2019 Final Regulations).

#### Background

As its name suggests, the BEAT of Section 59A introduced by the Tax Cuts and Jobs Act is meant to combat base erosion. It applies to corporate taxpayers (other than REITs, RICs, and S corporations) with annual gross receipts over \$500 million for the prior three years and whose base erosion percentage is 3% or higher (2% for banks). Generally, the BEAT operates as a minimum tax (5% for 2018, 10% for 2019 through 2025, and 12.5% for years after 2025) on certain payments to foreign related parties. The BEAT is calculated on the excess of modified taxable income over a taxpayer's regular tax liability, reduced by certain types of credits.

#### Key Takeaways

The 2020 Final Regulations are very similar to the 2019 Proposed Regulations, with a few important changes. The 2020 Final Regulations provide guidance and additional clarification on determining a taxpayer's aggregate group and how the BEAT applies to partnerships. The 2020 Final Regulations also make modifications to the potentially helpful election to waive deductions.

#### ***Additional clarifications about aggregate groups***

Section 59A determines the status of a corporation as an "applicable taxpayer" (meaning a taxpayer subject to the BEAT) by measuring gross receipts and the base erosion percentage by reference to the corporation's "aggregate group." This can get tricky when members of a taxpayer's aggregate group have different taxable years. The 2019 Final

Regulations state that the determination of gross receipts and the base erosion percentage of a taxpayer's aggregate group is based on the taxpayer's tax year and the tax year of each member of its aggregate group that ends with or within the applicable taxpayer's tax year (referred to as the "with-or-within method"). The 2019 Proposed Regulations provided guidance on the application of the aggregate group rules for purposes of the with-or-within method in situations involving group members with different taxable years or short taxable years, members that leave or join the group, and predecessor entities.

The 2020 Final Regulations generally retain the rules from the 2019 Proposed Regulations with some modifications. One modification relates to the deemed closing of a taxable year. The 2020 Final Regulations require that when a corporation has a deemed closing of a taxable year before joining or leaving the aggregate group, the deemed taxable year-end is treated as occurring at the end of the day of the transaction. As another modification, the 2020 Final Regulations indicate that if a member of an aggregate group has more than one taxable year that ends with or within the taxpayer's taxable year, and the years together add up to more than 12 months, the member's gross receipts, base erosion tax benefits, and deductions for those years are annualized for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group. The 2020 Final Regulations also provide a corresponding rule to address short tax years of members of aggregate groups.

The 2019 Proposed Regulations stated that taxpayers must use a "reasonable approach" to determine the base erosion percentage of the aggregate group and whether the taxpayer or its aggregate group satisfies the gross receipts test and base erosion percentage when a group member has a short taxable year. One problem with the 2019 Proposed Regulations was that they did not provide any guidance about what constitutes a reasonable approach. Thankfully, the 2020 Final Regulations offer guidance on what constitutes a reasonable approach, including examples of methods that may or may not constitute a reasonable approach. Specifically, the 2020 Final Regulations state that a method that excludes the gross receipts, base erosion tax benefits, and deductions of a member from the taxpayer's aggregate group does not constitute a reasonable approach.

### ***Application of the BEAT to partnerships***

The 2019 Final Regulations provided an exception whereby a base erosion payment does not result from amounts paid or accrued to a foreign related party that are subject to tax as effectively connected income (ECI). The 2020 Final Regulations expand this ECI exception to apply to certain partnership transactions. Under the 2020 Final Regulations, this exception now also applies to transactions where the taxpayer is treated as making a base erosion payment as a result of a deemed transaction with a foreign related party and where the foreign related party is subject to U.S. federal income tax on allocations of income from a partnership. The 2020 Final Regulations indicate that the ECI exception may also apply to situations such as when (1) a U.S. taxpayer contributes cash and a foreign related party of the U.S. taxpayer contributes depreciable property to the partnership; (2) a partnership with a partner that is a foreign related party of the taxpayer partner engages in a transaction with the taxpayer; or (3) a partnership engages in a transaction with a foreign related party of a partner in the partnership.

### ***Election to waive deductions***

The 2019 Proposed Regulations offered taxpayers the option to elect to waive deductions that could be treated as base erosion payments. By default, all deductions that could be properly claimed by a taxpayer for the taxable year (even if not actually claimed) are treated as allowed deductions unless a taxpayer elects to waive them. If the election is made, the waived deduction is excluded from the computation of the base erosion percentage and is not added back when determining modified taxable income. This provides taxpayers with an opportunity to reduce their base

erosion percentage below the 3% threshold, allowing them to escape the BEAT. This election was one of the most notable and taxpayer-favorable inclusions in the 2019 BEAT guidance.

The 2020 Final Regulations finalize the rules from the 2019 Proposed Regulations but make certain modifications and clarifications. The 2020 Final Regulations clarify that a taxpayer wanting to make or increase the BEAT waiver election must determine that it would be an applicable taxpayer for BEAT purposes without the BEAT waiver election. Of note to partnerships, the 2020 Final Regulations state that only a partner, not a partnership, can make a BEAT waiver election. In response to a comment that the requirement in the 2019 Proposed Regulations to provide a “detailed” description of the item or property to which the deduction relates was too onerous, the 2020 Final Regulations eliminate the word “detailed.” In response to a request for clarification of the provision in the 2019 Proposed Regulations that referred to waivers of deductions “in whole or in part,” the 2020 Final Regulations clarify that taxpayers may make BEAT waiver elections for portions of a deduction and not only deductions in their entirety.

To the dismay of many taxpayers, Treasury and the IRS rejected requests to allow taxpayers to decrease the amount of deductions waived by filing an amended income tax return. The preamble to the 2020 Final Regulations explains that “the ability to decrease waived amounts does not further the policy goal of addressing the cliff effect of applicable taxpayer status.” The preamble goes on to explain that Treasury and the IRS were concerned that expanding this flexibility in a taxpayer’s election would increase uncertainty for the IRS in its assessments and would negatively affect the ability of the IRS to efficiently conduct and close examinations.

### ***Applicability Dates***

The 2020 Final Regulations generally apply to tax years beginning on or after the day the final regulations are published in the *Federal Register*. One exception is that the rules related to partnership allocations of income and certain partnership anti-abuse rules apply to taxable years ending on or after December 2, 2019. Taxpayers may apply the 2020 Final Regulations retroactively, but the 2020 Final Regulations must be applied in their entirety for tax years beginning after December 31, 2017. Additionally, taxpayers may rely on the 2019 Proposed Regulations in their entirety for taxable years beginning after December 31, 2017, and before the date of publication of the 2020 Final Regulations in the *Federal Register*.

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Our tax team also joined our Intellectual Property Group for a webinar to discuss "[Tax and Litigation Implications of Intellectual Property Ownership & Licensing](#)."

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

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