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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-112607-19]

RIN 1545-BP36

Additional Rules Regarding Base Erosion and Anti-Abuse Tax

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 **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**.

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 Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.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 **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER],** 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

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[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.

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 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. <u>Return of a partnership with respect to base erosion payments and base erosion tax benefits</u>

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 [**INSERT DATE OF FILING IN THE FEDERAL REGISTER**]. 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 **[INSERT DATE**

OF PUBLICATION IN FEDERAL REGISTER], 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 cut-off 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

[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).

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). 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

[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.

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 economic 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

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[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.

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-		

Form	Type of Filer	OMB Number(s)	Status
	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 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.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, is amended by adding paragraphs (c)(2)(ii), (c)(4) through (6), and paragraph (f)(2) to read as follows:

<u>§1.59A-2 Applicable taxpayer</u>.

* * * * * *

(c) * * *

(2) * * *

(ii) <u>Change in the composition of an aggregate group</u>. 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. Section 1.59A-3, as added in a final rule published elsewhere in this issue of the Federal Register, effective **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, 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 **[INSERT DATE OF PUBLICATION IN THE**

FEDERAL REGISTER], 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 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, 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 **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]**.

(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 [**EFFECTIVE DATE OF FINAL RULE**], and §§1.59A-7(c)(5)(v) and 1.59A-9(b)(5) and (6) apply to taxable years ending on or after **[INSERT DATE OF FILING IN THE FEDERAL REGISTER].** 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 **[INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]** 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.

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