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February 19, 2019

U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

**Via Online Submission**

**RE: Proposed Base Erosion and Anti-Abuse Tax Regulations**

Dear Sir or Madam:

On December 21, 2018, the Internal Revenue Service (the Service) and the U.S. Department of the Treasury (the Treasury) published proposed regulations (the Proposed Regulations)[1] under new section 59A,[2] which imposes a tax on the base-erosion minimum tax amount (as defined) of certain taxpayers.[3] Section 59A was enacted as part of Public Law 115-97,[4] colloquially known as the "Tax Cuts & Jobs Act" (the Act). The Treasury and Service (collectively, the Government) requested public comments regarding the Proposed Regulations no later than February 19, 2019. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the Government's request for comments.

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1 REG-104259-18, 83 Fed. Reg. 65,956. (Dec. 21, 2018).

2 Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended (the Code) and all "§" references are to the Treasury regulations promulgated thereunder.

3 The tax imposed by section 59A is hereinafter referred to as the "BEAT."

4 Act of Dec. 22, 2017, Pub. L. No. 115-97, 131 Stat. 2054.

**TEI Background**

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in North and South America, Europe, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our more than 7,000 individual members represent over 2,800 of the leading companies around the world.

TEI members are responsible for administering the tax affairs of their companies and must contend daily with provisions of the tax law relating to the operation of business enterprises, including the new BEAT regime, along with many other aspects of the Act. We believe that the diversity and professional experience of our members enables TEI to bring a balanced and practical perspective to the issues raised by the Proposed Regulations, and we are eager to assist the Government in its important effort to effectively and efficiently implement the Act.

**Executive Summary**

TEI commends the Government for issuing proposed guidance under section 59A in such a timely manner. The BEAT is a new regime under the Code, and thus early details regarding how Treasury and the Service will implement section 59A are helpful to taxpayers who fall within the BEAT's scope. In particular, TEI commends the Government for clarifying that the definition of a base erosion payment only applies to the mark-up component of payments made to foreign affiliates for low-margin services and not to the entire payment. TEI also welcomes the regulatory exception to the definition of a BEAT payment for payments that are treated as effectively connected income in the hands of the payee, as such payments are not truly "base eroding." TEI also commends the Service and Treasury for concluding that the base erosion percentage applied to net operating losses (NOLs) should be based on the year in which a NOL arose (as opposed to the year in which the NOL is utilized) as this is the only way to ensure the base erosion percentage rule achieves a rational result. Furthermore, treating the BEAT add-back for pre-Act NOLs into a post-Act year as zero is consistent with the statute and legislative history. TEI recommends the Government affirm all of these points in the final BEAT regulations.

Immediately below is a summary of TEI's comments regarding how the Proposed Regulations could be modified to ease the compliance and administrative burden imposed on taxpayers and the Service alike, as well as our recommendations to better fit the final BEAT regulations within the BEAT regime's purpose and scope. Our detailed recommendations follow this Executive Summary.

1. The Government should provide additional clarity regarding the types of services that qualify for the services cost method exception to the definition of a BEAT payment, as detailed in Section 1. below.
2. Payments that are subpart F income in the hands of the payee should be excluded from the definition of a BEAT payment.

3. Final regulations should not apply the BEAT to nonrecognition transactions, as discussed in Section 4. below.
4. Payments that result in a recognized loss for the payor should not be encompassed by the definition of a BEAT payment.
5. The exception for affiliated groups with de minimis banks or broker-dealers should be modified as discussed in Section 5. below. In addition, Treasury and the Service should include a transitory ownership exception where a bank or securities dealer is a member of an affiliated group during a brief period of the taxable year.
6. Proposed Treasury regulation section 1.59A-5(c)(3) should be revised to provide that section 15 does not apply to any taxable year that begins in 2018 and thus no "blended" BEAT rate is appropriate for such a year.
7. Taxpayers with multiple consolidated groups should be permitted to elect to be treated as a single aggregate person for the determination of the base erosion minimum tax amount and for the determination of the base erosion percentage.
8. The final regulations should explicitly confirm that depreciation deductions allocated to a taxpayer by a partnership that are attributable to property contributed to the partnership by a foreign related partner are not treated as base erosion tax benefits if such property was contributed to the partnership prior to the effective date of the BEAT.
9. The BEAT anti-abuse rule should be clarified as set forth in Section 9. below.
10. Taxpayers should be permitted to elect to use net operating losses against their BEAT liability under a "recomputation" approach, as discussed in Section 10. below.

**TEI Comments**

1. Exception for BEAT Payments Under the Services Cost Method

Section 59A(d)(5) provides that a "base erosion payment" shall not include any amount paid or accrued for services if "such services are services which meet the requirements for eligibility for use of the services cost method under section 482" and "such amount constitutes the total services cost with no markup component." Despite this language, a question remained as to whether this provision applied to amounts paid that include a markup under the arm's length principle or similar transfer pricing rules required by payee jurisdictions. The Proposed Regulations permit bifurcation of the cost of low-margin services from the related mark-up and apply the BEAT only to the markup portion of such payment. TEI commends the Government for this clarification and the related documentation flexibility as it relieves taxpayers of a significant tracking burden.

In addition to the above, TEI recommends the Government provide additional clarity regarding the services qualifying for this exception, which allows a deduction for costs (with no markup component) for services that would be eligible for the services cost method (SCM) under section 482 without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure. Disregarding the requirements of the general "business judgment rule" (described at Treasury regulation section 1.482-9(b)(5)), should also allow taxpayers to claim the costs of otherwise qualifying services that are on the so-called "blacklist" at Treasury regulation section 1.482-9(b)(4). The list of excluded services are specific examples of the "business judgment rule," and the exclusion of both from the SCM relies on the same policy rationale. Thus, the final BEAT regulations should provide that services qualify for the exception under section 59A(d)(5) unless they do not qualify for the SCM under Treasury regulation section 1.482-9(b)(3) (i.e., services that are neither specified covered services nor low margin covered services). This result is well within the Government's authority given that the statute itself references a standard set forth in Treasury regulations. In addition, this would further place low-margin services on a consistent footing with the BEAT's exclusion of many of the activities listed at Treasury regulation section 1.482-9(b)(4) under the cost of goods sold (COGS) exception (e.g., manufacturing, production, extraction, construction, and reselling, among even broader potential costs that could be capitalized into COGS), as the statute appears to have intended based on the inclusion of the SCM exception.

2. Exception for BEAT Payments Constituting Subpart F income to the Payee

As noted above, the Proposed Regulations except from the definition of a BEAT payment "[a]mounts paid or accrued to a foreign related party that are subject to federal income taxation as income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations."[5] In TEI's view this is sound tax policy as otherwise such BEAT payments might be subject to double taxation and, as the Preamble states, the Government has "determined that it is appropriate in defining a base erosion payment to consider the U.S. tax treatment of the foreign recipient."[6] Section 988 losses are also excepted from the definition of a BEAT payment under a separate rationale, as the Preamble states "these losses do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party."[7] Again, this is sound tax policy. In addition, the Government has seen fit to provide an exception for interest paid or accrued on total loss-absorbing capacity (TLAC) securities issued by certain foreign "global systemically important banking organizations" from the definition of base erosion payments.[8] In the Preamble, the Government identified the exclusion as necessary and

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5 Prop. Treas. Reg. § 1.59A-3(b)(3)(iii).
6 83 Fed. Reg. 65,963.
7 *Id.*
8 *Id.*

appropriate to carry out the provisions of section 59A, "including regulations addressing specifically enumerated situations."[9]

TEI applauds the exceptions for payments that are ECI to the recipient and for section 988 losses as examples of sound tax policy from the standpoint that such transactions either do not impact the U.S. tax base or do not present base erosion concerns, which are the primary Congressional purposes behind enacting the BEAT. In addition, the exception for TLAC securities shows the flexibility of the Government to consider sector specific issues. For similar reasons, TEI recommends the following exception to the definition of a BEAT payment.

Payments should be excluded from the BEAT to the extent they are treated as subpart F income in the hands of the foreign payee. As with the ECI exception, it is unlikely that these payments are "base eroding" and thus treating them as a BEAT payment would likely result in double taxation – once as an "add back" as part of the BEAT calculation and then again as a subpart F inclusion of the U.S. shareholder of the CFC payee. TEI submits that the policy rationale for an exception for such payments is at least as strong as that for payments that are ECI to the recipient, and far stronger than that for interest on TLAC securities or a general exception for section 988 losses.

3. Application of the BEAT to Nonrecognition Transactions[10]

The Proposed Regulations would apply the BEAT to nonrecognition transactions if such transactions import depreciable or amortizable property into the U.S. tax base.[11] Under section 59A(d)(2) a BEAT payment includes "any amount paid or accrued" to a related foreign person in connection with an "acquisition" of depreciable or amortizable property from such person. In TEI's view, the application of the BEAT to nonrecognition transactions under the Proposed fails these basic requirements of section 59A(d)(2). A natural reading of the BEAT's statutory language indicates it applies to straightforward purchases and other recognition transactions that import depreciation or amortization deductions into the U.S. tax base, and not to general nonrecognition transactions, such as those described in sections 332, 351, and 368.

Moreover, a broad application of the BEAT to nonrecognition transactions brings significant complexity and uncertainty into the administration of the BEAT regime. Such application treats as BEAT payments a broad class of transactions that are generally not thought of as base erosion payments. As such, the rule is a trap for the unwary, even before considering its negative policy effects.

These concerns can be illustrated with respect to post-mergers and acquisitions (M&A) integration activity. Newly acquired companies and business lines must be integrated with the existing business lines of the acquiring enterprise. How such integration is accomplished takes into account

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9 *Id*.

10 As defined by section 7701(a)(45), the term "nonrecognition transaction" means any disposition of property in a transaction in which gain or loss is not recognized in whole or in part for purposes of subtitle A (Income Taxes).

11 *See* 83 Fed. Reg. 65,960.

business and tax considerations. With respect to the latter, existing U.S. tax rules, such as the cost-sharing arrangements described in Treasury regulation section 1.482-7, provide regulatory benefits for intellectual property or other assets held by domestic entities. Post-acquisition structuring and restructuring is necessary to comply with these rules and is often accomplished through inbound nonrecognition transactions. If these ordinary integration activities produce adverse BEAT consequences, acquirors with U.S. activities will be at a competitive disadvantage in foreign asset acquisitions relative to buyers located and operating outside of the United States because of the relatively higher integration costs. Sound U.S. tax policy would encourage post-M&A integrations (among other nonrecognition transactions) that bring intellectual property or other assets into the United States.

As an example of the issues raised in the post-M&A integration context, consider the case of a U.S. based company acquiring a foreign company with significant U.S. operations. In such a case, the U.S. based company would need to consolidate the acquired U.S. operations into its existing operations. This consolidation would most likely be completed in the form of a section 351 contribution or section 368 reorganization. By applying the BEAT to such transactions, the Proposed Regulations place U.S. companies at a competitive disadvantage by increasing the costs of the post-merger integration and potentially hindering growth and operational efficiency, especially considering that a foreign acquirer would not need to restructure to consolidate operations.

A second example of the issues raised with defining certain nonrecognition transactions as BEAT payments is a liquidation under section 332, where applying the BEAT to property received in the liquidation of a foreign corporation (whether by means of a check-the-box election or otherwise) is inconsistent with both the statutory text and the policy underpinning the BEAT. Again, section 59A(d)(2) defines a "base erosion payment" to include amounts "paid or accrued" by a U.S. corporation in connection with the acquisition of property from a foreign corporation. In simple terms, a liquidation described in section 332 does not involve a payment or accrual by the parent to the liquidating subsidiary. Instead, the parent's interest in the subsidiary's stock is generally treated as cancelled for both tax and non-tax purposes. Treasury regulation section 1.332-1 implies that a section 332 liquidation cannot involve a payment because it is an "except[ion] from the general rule" of section 331, in which "amounts received by one corporation in complete liquidation of another . . . are treated as in full payment in exchange for stock" of the other corporation. In other words, no gain or loss is recognized in a section 332 liquidation precisely because no payment or accrual takes place for the liquidating corporation's property.

Penalizing U.S. corporations for bringing depreciable property into the United States via nonrecognition transactions is contrary to the intent of the BEAT. In order to counterbalance the participation exemption on foreign dividends, the BEAT provides a strong incentive for U.S. companies to bring their worldwide activities into the U.S. tax net. As a practical matter, U.S. multinationals do this by electing to disregard their foreign corporate subsidiaries, resulting in a deemed section 332 liquidation. It is hard to imagine that Congress intended to punish U.S. corporations for subjecting their foreign operations to full U.S. income tax in a statute designed to have the opposite effect.

For these reasons, TEI strongly recommends the final regulations provide broad guidance that nonrecognition transactions do not implicate the BEAT. However, if the Government prefers a more narrowly tailored exception to the BEAT for nonrecognition transactions, it could look to a similar restriction in the separate return limitation year (SRLY) rules and provide an exception to the BEAT for nonrecognition transactions made within 12 months of acquiring depreciable or amortizable import property (and a provision providing a 12-month grace period from the date of enactment of the final section 59A regulations for depreciable and amortizable property currently held by the taxpayer) or, alternatively, restricting BEAT application to deductions which exceed the section 362/334 adjusted basis associated with the imported property.

4. Application of the BEAT to Recognized Loss Transactions

The Preamble to Proposed Regulations explains that base erosion payments include "a payment to a foreign related party resulting in a recognized loss," such as a sale of loss property to a foreign affiliate. As a statutory matter, it is not clear that loss sales involve payments "to a foreign related party." *Receipt* of cash or property by a U.S. person in exchange for an asset is inconsistent with the statutory requirement that a U.S. person has "paid or accrued" an amount for property. More troubling, the inclusion of loss transactions is difficult to reconcile with the policy underlying the BEAT – policing related-party "base erosion" transactions. Property held by a U.S. taxpayer with basis in excess of fair market value rightly produces U.S.-sourced economic loss and should therefore reduce U.S. taxable income when recognized and not be diminished or eliminated by treating it as a base-erosion "payment." If loss property, for example, were held under a mark-to-market regime, no BEAT issue would arise because such loss would be recognized upon a mark-down accrual instead of at the time of outbound sale. It is difficult to understand why property that is not (or cannot be) marked-to-market should be treated less favorably than property that is (or can be) marked-to-market.

In addition, targeting loss sales under the BEAT is largely unnecessary given the likely application of section 267, which will ordinarily defer or disallow losses from related party sales until an on-sale to an unrelated party. The Preamble's broad statutory reading therefore applies in practice in many cases only to distinguish between a taxpayer selling loss property directly to a third-party and a taxpayer selling such loss property to a foreign related party followed by a sale to a third-party. Such a distinction lacks statutory and policy justifications and imposes a new and substantial tracking burden on multinational corporations. TEI recommends that the final regulations clarify in the Preamble that related-party outbound transfers of loss property are not base erosion payments.

5. De Minimis Exception for Groups with Banks and/or Broker-Dealers

The Preamble describes an exception for members of an affiliated group that includes a bank or registered securities dealer where the bank or registered securities dealer activities are de minimis (i.e., where gross receipts attributable to the bank or the registered securities dealer are less than two percent of the aggregate group's total gross revenue) (the De Minimis Exception). In TEI's view this is a welcome and reasonable exception.

The policy behind this exception is described in the Preamble as follows:

> VIII. Rules Relating to Banks and Dealers for Purposes of Computing the Base Erosion Percentage and Determining the BEAT Rate for Computing [the base erosion minimum tax amount ("BEMTA")]
>
> …The proposed regulations provide a limited exception for members of an affiliated group that includes a bank or registered securities dealer where the bank or registered securities dealer activities are de minimis….
>
> In general, such thresholds reduce compliance costs for the large number of small taxpayers that would fall below such threshold without substantially affecting the BEAT base. For the de minimis exception for banks and registered securities dealers, in the absence of an exception, affiliated groups that are not principally engaged in banking or securities dealing would be incentivized to alter their business structure to eliminate minimal banks or registered securities dealers from their aggregate groups. These changes would give rise to tax-motivated, inefficient restructuring costs. A de minimis threshold reduces this potential inefficiency again without substantially affecting the BEAT base. In both cases, the thresholds were chosen to balance these competing concerns and to adhere to generally similar standards elsewhere in the Code.[12]

In light of this exception, TEI recommends the Government clarify that the De Minimis Exception applies not only to exclude an aggregate group with de minimis banking and registered securities dealer activities from the lower base erosion percentage threshold of 2-percent, but also for purposes of determining the BEAT rate, and, therefore, the one percent increased BEAT rate for banks and registered securities dealers would not apply to members of such aggregated group.

The same policy considerations that led Treasury to include an exception from the application of the lower base erosion percentage threshold of 2-percent to aggregate groups with de minimis banking and registered securities dealer activities apply when determining the BEAT rate applicable to separate taxpayers within such aggregate group. Without an exception to the increased BEAT rate, affiliated groups that are not principally engaged in banking or securities dealing would not be incentivized to alter their business structure to eliminate minimal banks or registered securities dealers from their affiliated groups (to ensure that the entire affiliated group is not subject to an increased BEAT rate when computing the BEMTA). Providing an exception for separate taxpayers within an aggregate group that have de minimis banking and registered securities dealer activities would further the policy objective of minimizing tax-motivated, inefficient restructuring costs and would help to reduce the time and cost for the Service to audit such transactions. In addition, applying the De Minimis Exception when

[12] 83 Fed. Reg. 65,968 and 65,974.

determining the applicable BEAT rate helps to achieve the policy objective of fair and equal treatment (e.g., the same BEAT rate) to otherwise similar taxpayers, without substantially affecting the BEAT base. Thus, we believe that the above interpretation achieves a reasonable balance between the competing concerns that the Government must address.

To implement this recommendation, TEI suggests the following language be set forth under final regulations with respect to proposed Treasury regulation section 1.59A-5:

1.59A-5(c)(2) Increased rate for banks and registered securities dealers.

> 1.59A-2(e)(2)(iii) [emphasis added to indicate the suggested changes]:
>
> (iii) De minimis exception for banking and registered securities dealer activities. An aggregate group that includes a bank or a registered securities dealer that is a member of an affiliated group (as defined in section 1504(a)(1)) is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section, **and the affiliated group is not treated to include a bank or registered securities dealer for purposes of § 1.59A-5(c)(2)**, for a taxable year, if, in that taxable year, the total gross receipts of the aggregate group attributable to the bank or the registered securities dealer represent less than two percent of the total gross receipts of the aggregate group, as determined under paragraph (d) of this section. When there is no aggregate group, a consolidated group that includes a bank or a registered securities dealer is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section **and for purposes of § 1.59A-5(c)(2)** for a taxable year, if, in that taxable year, the total gross receipts of the consolidated group attributable to the bank or the registered securities dealer represent less than two percent of the total gross receipts of the consolidated group, as determined under paragraph (d) of this section.

We also request that the Government include a transitory ownership exception where a bank or securities dealer is a member of an affiliated group for only a short period during the tax year. This exception would provide that where a taxpayer disposes of a bank or registered securities dealer within a specified time period (e.g., within the first 90 days of the tax year), the taxpayer is not treated as a taxpayer described in section 59A(b)(3)(B). This exception would allow time for a taxpayer that acquires a group that includes an unwanted bank or registered securities dealer to dispose of such bank or securities dealer member of a target affiliated group without causing the entire acquiring affiliated group to become subject to the higher BEAT rate applicable to taxpayers with bank or registered securities dealer members for the entire tax year. We believe that this would be an equitable rule that is consistent with the policy of the bank and registered securities dealer rules (including the de minimis exception thereto).

6. "Blended" BEAT Rate under Section 15

Section 15 applies where a change in tax rate occurs and the effective date of the change does not coincide with the start of a taxpayer's taxable year. The provision employs a formula that results in a weighted average blended tax rate based on the portions of the taxpayer's taxable year falling before and after the effective date of the change in rate. Proposed Treasury regulation section 1.59A-5(c)(3) provides that section 15 applies to determine the BEAT rate for any taxable year of a fiscal year taxpayer which begins after January 1, 2018. Presumably this regulation would require a fiscal year taxpayer to determine the BEAT rate for its first taxable year subject to the BEAT by using the blended rate principles of section 15. But this is not the language used by section 59A and does not correspond to the language in section 15. Section 15(c) defines the effective date of a rate adjustment for changes to taxable years as such years "beginning after," "ending after," or "beginning on or after" a certain date. In contrast, section 59A(b) establishes ten percent as the default BEAT rate and applies a five percent rate (as an exception to the default rate) for "taxable years *beginning in* calendar year 2018" (emphasis added).[13]

Thus, that section 59A(b)*(1)(A)* uses the phrase "beginning in" (a term absent from section 15) instead of "beginning after" as Congress did in section 59A*(b)(2)* (a term within the purview of section 15) is a clear signal that Congress intended for the five percent BEAT rate to apply for a taxpayer's entire taxable year beginning in calendar year 2018. Thus, TEI recommends proposed Treasury regulation section 1.59A-5(c)(3) be revised to provide that section 15 does not apply to any taxable year that *begins in* 2018.

7. Application of Aggregation Rules to the Base Erosion Minimum Tax Amount

TEI recommends the Government include in final regulations an election under the aggregation rules of section 59A(e)(3) to permit taxpayers with multiple consolidated groups to be treated as a single aggregate person for the determination of the BEMTA under section 59A(b) and for the determination of the base erosion percentage under section 59A(c)(4). The Proposed Regulations only permit the BEMTA to be calculated at the consolidated group level.

An aggregate approach for determining the BEMTA would treat all taxpayer entities as a single economic unit, permitting groups with multiple consolidated returns to be given full credit for the groups' contributions to the U.S. tax base. In certain instances, business, legal, or regulatory reasons prevent groups with multiple taxpayers from combining in a single consolidated return. Taxpayers with only a single entity or consolidated group will not be impacted by an aggregate approach. The aggregate approach can be easily administered with an appropriate schedule reflecting a pro-rata allocation among tax groups.

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[13] This is confirmed by the Conference Report to the Act, which states the "5 percent rate ***applies for one year*** for base erosion payments paid or accrued in taxable years beginning after December 31, 2017." [emphasis added] H. R. Rep. No. 115-466, at 656 (2017).

8. Treatment of Partnership Contributions Prior to January 1, 2018[14]

Under proposed Treasury regulation section 1.59A-3(b)(1)(ii), a base erosion payment includes any amount paid or accrued by an applicable taxpayer to a foreign related party of the taxpayer "in connection with" the acquisition of property by the taxpayer from the foreign related party if the character of the property is subject to the allowance for depreciation (or amortization in lieu of depreciation). Under proposed Treasury regulation section 1.59A-3(c)(1)(ii), in the case of a base erosion payment described in proposed Treasury regulation section 1.59A-3(b)(1)(ii), any deduction allowed for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with that payment constitutes a base erosion tax benefit.

The Preamble explains that if a partnership acquires property from a foreign related party of a taxpayer that is a partner in the partnership through a nontaxable contribution to the partnership, depreciation deductions attributable to such property that are allocated to the taxpayer generally are base erosion tax benefits, in part, because the partnership is treated as acquiring the property in exchange for an interest in the partnership under section 721.[15]

Consistent with the effective date of section 59A, the Proposed Regulations confirm that a deduction for depreciation with respect to property acquired by a base erosion payment is not a base erosion tax benefit if the deduction relates to a base erosion payment that occurred in a taxable year beginning before January 1, 2018. Thus, depreciation deductions allocated to a taxpayer by a partnership that are attributable to property contributed to the partnership by a foreign related partner should not be treated as base erosion tax benefits if such property was contributed to the partnership prior to the effective date of the BEAT. Although the Proposed Regulations and preamble suggest this conclusion in the partnership context, the regulations should confirm this result explicitly.

9. BEAT Anti-Abuse Rule

TEI commends the Government for drafting a sensible and narrow anti-abuse rule under section 59A. Proposed regulation section 1.59A-9(b) largely targets genuinely abusive transactions and in most cases should not apply to ordinary course business activities. Nevertheless, TEI believes that the rules could be improved in at least two respects. The final regulations should provide more detail, generally, on what constitutes "a principal purpose" of avoiding section 59A. Ambiguous anti-abuse provisions are especially troubling in the context of the BEAT. Because the statutory scheme of section 59A is almost entirely novel, there is little precedent from which to draw guidance when making difficult judgment calls, leading to increased taxpayer uncertainty. This uncertainty is compounded by the cliff effect associated with increasing your base erosion percentage – at the margin, a tremendously significant additional tax costs could turn on the treatment of a few relatively minor payment streams.

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[14] Prop. Treas. Reg. § 1.59A-3(b)-(c) - Base erosion payments / Base erosion tax benefits.

[15] *See* 83 Fed. Reg. 65,967.

Specifically, TEI requests clarification with respect to proposed Treasury regulation section 1.59A-9(b)(2), which disregards activities undertaken with "a principal purpose of increasing the deductions taken into account for . . . the denominator of the base erosion percentage computation." The example illustrating this provision is extremely helpful, and TEI agrees that non-economic deductions such as those described in the example should be disregarded for BEAT purposes. The text of the Proposed Regulations, however, can be read so that the rule is implicated any time a sophisticated taxpayer engages in a transaction giving rise to a deduction and the taxpayer has considered BEAT as a factor. TEI assumes the Government intends for the final regulation to cover only transactions similar to the example in form and intent but TEI requests that the rule itself be clarified to be more clearly limited to those types of transactions. TEI also requests the Government consider whether existing anti-abuse rules and judicial doctrines, including section 7701(o) (clarification of economic substance doctrine), are sufficient to police the abuses with which Congress was concerned.

10. Determining the Base Erosion Percentage of Net Operating Loss Deductions

For purposes of computing the base erosion percentage of any NOL deduction that is added back to taxable income, the base erosion percentage for the tax year that the NOL arose, rather than the base erosion percentage for the year the NOL is utilized, is the percentage applied. In addition, for an NOL that arose in a tax year beginning before January 1, 2018, the base erosion percentage applied for that tax year would be zero. TEI commends the Service and Treasury for concluding that the base erosion percentage is based on the year in which the NOL arose as this is the only way to ensure the rule achieves a rational result. Furthermore, treating the BEAT add-back for pre-TCJA losses into a post-TCJA year as zero is consistent with the statute and legislative record. Because the BEAT applies only to "base erosion payments" that are "paid or accrued" in taxable years beginning after 2017, the BEAT should not apply to base erosion payments that were paid or accrued in taxable years beginning prior to 2018, even if they resulted in an NOL carryforward. Thus, TEI supports the Government's position with respect to the "vintage" year and pre-2018 NOL base erosion percentages.

With respect to net operating losses and the calculation of modified taxable income, the Preamble states:

> The proposed regulations do not provide for the recomputation of income under an approach similar to the alternative minimum tax, which the Act repealed for corporations. . . . Under a recomputation approach, attributes that are limited based on taxable income would be subject to different annual limitations, and those attributes would have to be re-computed for purposes of section 59A. Applying this approach in a manner that reflects the results of the BEAT-basis recomputation to subsequent years would lead to parallel attributes that are maintained separately in a manner similar to the pre-Act corporate alternative minimum tax. . . . Consequently, the add-back approach also provides simplification relative to the recomputation approach because the add-back approach eliminates the need to engage in the more complex tracking of separate attributes on a BEAT basis in a manner similar to the repealed corporate AMT. The

Treasury Department and the IRS welcome comments on the add-back approach provided in the proposed regulations, and the practical effects of an alternative recomputation-based approach.

TEI agrees with the statement that an add-back approach "provides simplification relative to the recomputation approach". However, this simplification comes at the expense of some taxpayers' inability to use NOLs against their BEAT liability merely because of the year in which the NOL arose. That is, similarly situated taxpayers are treated differently depending solely on the accounting convention of the taxable year, and thus in TEI's view the added complexity of tracing separate attributes on a BEAT basis is justified based upon fairness and equity principles. Moreover, this added complexity would only affect taxpayers who find themselves in this situation (i.e., not all taxpayers would have address this complexity), and taxpayers have the prior example of how to track such attributes via the now repealed corporate alternative minimum tax (AMT) rules. For these reasons, TEI recommends that final regulations permit taxpayers with NOLs to calculate their modified taxable income under a recomputation approach similar to that of the repealed corporate AMT rules.

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TEI appreciates the opportunity to comment on the Proposed Regulations. TEI's comments were prepared jointly under the aegis of the Institute's Tax Reform Task Force and U.S. International Tax Committee. Should you have any questions regarding TEI's comments, please contact the Task Force's Chair Emily Whittenburg at 832.337.0827 or Emily.Whittenburg@shell.com, or Benjamin R. Shreck of the Institute's legal staff at 202.464.8353 or bshreck@tei.org.

Respectfully submitted,
Tax Executives Institute

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