Overview of the Base Erosion and Anti-Abuse Tax: Section 59A

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Overview of the Base Erosion and Anti-Abuse Tax (the "BEAT")

- Certain large corporations are subject to an additional tax (the BEAT) that is based in part on the extent to which they have made deductible payments to related foreign parties.
- The amount of tax is the difference between (1) 10 percent of modified taxable income ("MTI") and (2) regular (pre-credit) tax liability reduced by certain credits.
  - MTI is generally regular taxable income increased by (1) certain payments to related foreign parties and (2) a certain portion of a taxpayer's net operating loss ("NOL") deduction, if any.
- Starting in 2026, the rate on MTI increases to 12.5 percent and regular (pre-credit) tax liability is reduced by generally all credits for purposes of the BEAT calculation.

Who Is Subject to the BEAT?

- The BEAT applies to an **applicable taxpayer**, which is any taxpayer that:
  - Is a corporation other than a RIC, a REIT, or an S corporation;
  - Has average annual gross receipts of at least $500 million over the three preceding taxable years; and
  - Has a base erosion percentage for the taxable year of at least three percent (two percent for certain banks and securities dealers).
- A taxpayer that is a member of an aggregate group determines its status as an applicable taxpayer by reference to the gross receipts and the base erosion percentage of the aggregate group. (Prop. Treas. Reg. sec. 1.59A-2(c).)
  - An aggregate group generally means all members of a controlled group, excluding foreign corporations to the extent their income is not subject to U.S. tax. (Prop. Treas. Reg. sec. 1.59A-1(b)(1).)

Base Erosion Payment: Definition

- Taxpayers calculate their BEAT liability (if any) by first determining their **base erosion payments**, which are generally any amounts paid or accrued by a taxpayer in taxable years beginning after December 31, 2017, to a related foreign party for which a deduction from gross income is allowable, and include:
  - Royalty payments;
  - Interest payments;
  - Payments for services;
  - Amounts paid or accrued to a related foreign party in connection with the acquisition of property that is depreciable or amortizable; and
  - Reinsurance premiums.
- Payments reflected in cost of goods sold are generally treated as reductions in gross receipts, rather than as deductions from gross income, so are generally not considered base erosion payments.

Base Erosion Payment: Exceptions

- Certain payments to foreign related parties are not considered base erosion payments, including:
  - Payments for certain low-margin services to the extent the amount paid reflects the total services cost (Prop. Treas. Reg. sec. 1.59A-3(b)(3)(i));
  - Qualified derivative payments;
  - Payments that are taken into account as effectively connected income by the taxpayer's related foreign party and therefore subject to net-basis U.S. tax ("ECI exception") (Prop. Treas. Reg. sec. 1.59A-3(b)(3)(iii));
  - Interest payments on certain securities that the Federal Reserve requires financial institutions to hold (Prop. Treas. Reg. sec. 1.59A-3(b)(3)(v)); and
  - Any disallowed interest expense in section 163(j)(2) that is carried forward from a taxable year beginning before January 1, 2018 (Prop. Treas. Reg. sec. 1.59A-3(b)(3)(vii)).
- Note that taxpayers may make base erosion payments yet not be subject to the BEAT if they do not meet the criteria for being an applicable taxpayer.

Base Erosion Payment: Example

- Assume Corporation A, a car manufacturer that is an applicable taxpayer, makes the following payments to related foreign parties:
  - $400 million in royalty payments for the use of intellectual property held by a related foreign party;
  - $300 million in payments for automobile parts manufactured by the related foreign party and imported by Corporation A; and
  - $100 million in interest payments on a loan from a related foreign party as part of that related foreign party's U.S.-based banking operations.
- The royalty payment is generally a base erosion payment.
- The payment for automobile parts is generally not a base erosion payment because it is generally reflected in cost of goods sold and is treated as a reduction in gross receipts (and not a deduction from gross income).
- While interest payments are potential base erosion payments, in this example the interest payment is excluded as a base erosion payment because it satisfies the ECI exception and is included in the U.S. taxable income of the related foreign party.

Base Erosion Tax Benefit

- Mechanically, base erosion payments enter the calculation of BEAT liability as base erosion tax benefits.
- A **base erosion tax benefit** generally reflects the reduction in taxable income arising from a base erosion payment.
  - For payments subject to U.S. withholding tax, the base erosion tax benefit is scaled down to the extent that the withholding tax rate is subject to the general 30-percent rate (which may be reduced by treaty) for purposes of computing MTI and the base erosion percentage. (Prop. Treas. Reg. secs. 1.59A-3(c)(2) and (3) and 1.59A-4(b)(2)(i).)

Base Erosion Percentage: General Formula

$$Base\ Erosion\ Percentage\ = \frac{BETB}{TDED\ - ODED\ - EBEP}$$

where:

$BETB$ = Base erosion tax benefits

$TDED$ = Total deductions and any base erosion tax benefits

$ODED$ = Deductions allowed under secs. 172, 245A, and 250

$EBEP$ = Payments (except those satisfying the ECI exception) that are excluded as base erosion payments

Base Erosion Percentage: Definition

- A taxpayer's **base erosion percentage** for a taxable year is generally the percentage equal to the total amount of base erosion tax benefits of the taxpayer for that year divided by the sum of (1) the total amount of deductions allowable to the taxpayer for that year and (2) any base erosion tax benefits not reflected in (1), such as reinsurance premiums.
  - The denominator is computed without regard to certain deductions: the deduction for net operating losses (sec. 172); the deduction for the foreign-source portion of a dividend received from certain foreign corporations (sec. 245A); and the deduction for global intangible low-taxed income and foreign-derived intangible income (sec. 250). These deductions do not generally reflect payments made by the taxpayer.
  - The denominator is also generally computed without regard to any payment that is excluded as a base erosion payment (which are generally excluded from the numerator as well).
  - Payments that meet the ECI exception are excluded from the numerator but are included in the denominator. (Prop. Treas. Reg. sec. 1.59A-2(e)(3)(ii).)

Base Erosion Percentage: Example

- Assume a taxpayer pays its employees $80m in salary (all of which is deductible) and makes $20m in royalty payments to a related foreign party. These are the only payments made by the taxpayer.
- The base erosion percentage equals the total base erosion tax benefits of $20m divided by the $100m in total deductions, or 20 percent.

General Formula for BEAT

BEAT Liability =

(10% × Modified Taxable Income)

– Adjusted Regular Tax Liability

where:

Modified Taxable Income =

Regular Taxable Income

\+ Base Erosion Tax Benefits

\+ Base Erosion Percentage of NOL Deduction

Adjusted Regular Tax Liability =

Regular Tax Liability

– Certain Credits

BEAT Calculation Part 1: Modified Taxable Income

- **Modified taxable income** generally equals regular taxable income + any base erosion tax benefits + the base erosion percentage of any NOL deduction.
  - The base erosion percentage of any particular NOL deduction item equals the amount of the NOL deduction multiplied by the base erosion percentage computed for the taxable year in which the associated loss arose. (Prop. Treas. Reg. sec. 1.59A-4(b)(2)(ii).)
  - Note that taxpayers are generally allowed to deduct base erosion tax benefits and NOLs when computing regular taxable income, so these amounts are effectively added back in computing modified taxable income.

Modified Taxable Income: Example

- Assume a taxpayer has $300m in regular taxable income, $90m in base erosion tax benefits, and a $100m NOL deduction arising from a year in which its base erosion percentage was 10 percent.

Modified Taxable Income: Example (cont.)

MTI =	\$300m	Regular Taxable Income
+	\$90m	Base Erosion Tax Benefits
+	\$10m	10% × \$100m NOL
=	\$400m	

BEAT Calculation Part 2: Regular Tax Liability Reduced by Certain Credits

- A taxpayer's BEAT liability equals the difference between (1) 10 percent of modified taxable income and (2) regular (pre-credit) tax liability reduced by certain credits ("**adjusted regular tax liability**").
  - Adjusted regular tax liability equals regular (pre-credit) tax liability reduced (but not below zero) by generally all credits except for the sec. 41 research credit and a certain portion of the low-income housing credit, the renewable energy production credit, and the energy investment credit.
  - Note that the term "adjusted regular tax liability" appears in the preamble to the proposed Treasury Regulations but not the statute.
- Starting in 2026, adjusted regular tax liability equals regular (pre-credit) tax liability reduced by generally all credits, including the specific credits described above.
- The reduction of regular (pre-credit) tax liability by credits increases potential BEAT liability.

BEAT Example

- Assume the following facts for a taxpayer that is an applicable taxpayer (and not a bank or securities dealer):
  - $600m in gross receipts;
  - $100m in deductible salary payments to U.S. employees;
  - $50m in interest payments to a related foreign party;
  - $250m in royalty payments to a related foreign party;
  - $2m in foreign tax credits; and
  - $3m in research credits.

BEAT Example: Regular and Modified Taxable Income

Regular Taxable Income	\$600m	Gross Receipts
	– \$100m	Salary
	– \$50m	Interest to Related Foreign Party
	– \$250m	Royalties to Related Foreign Party
	= \$200m	Regular Taxable Income
Modified Taxable Income	\$200m	Regular Taxable Income
	+ \$50m	Interest to Related Foreign Party
	+ \$250m	Royalties to Related Foreign Party
	= \$500m	Modified Taxable Income

BEAT Example: Regular and Adjusted Regular Tax Liability (Pre-2026 and Post-2025)

Regular (Pre-Credit) Tax Liability (All Years)	\$200m	Regular Taxable Income
	× \$21%	Corporate Tax Rate
	= \$42m	Regular Tax Liability
Adj. Reg. Tax Liability (Pre-2026)	\$42m	Regular Tax Liability
	– \$2m	Foreign Tax Credit
	= \$40m	Adj. Reg. Tax Liability
Adj. Reg. Tax Liability (Post-2025)	\$42m	Regular Tax Liability
	– \$2m	Foreign Tax Credit
	– \$3m	Research Credit
	= \$37m	Adj. Reg. Tax Liability

BEAT Example: BEAT Liability (Pre-2026 and Post-2025)

BEAT Liability (Pre-2026)	\$50m	\$500m × 10% MTI Rate
	– \$40m	Adj. Reg. Tax Liability (Pre-2026)
	= **\$10m**	BEAT Liability (Pre-2026)
BEAT Liability (Post-2025)	\$62.5m	\$500m × 12.5% MTI Rate
	– \$37m	Adj. Reg. Tax Liability (Post-2025)
	= **\$25.5m**	BEAT Liability (Post-2025)

Certain Special Rules

- Certain banks and securities dealers are generally subject to a base erosion percentage threshold of two percent and a rate on modified taxable income that is one percentage point higher than the general rate.
- With respect to payments made to taxpayers that invert after November 9, 2017 (or related foreign persons), base erosion payments include amounts that constitute a reduction in gross receipts (e.*g*., cost of goods sold).

Data: Base Erosion Payments

Table 1.—Payments to Related Foreign Parties by Taxpayers with
$500 Million or More in Gross Receipts
(2014, millions of dollars)

	U.S. Multinationals	Foreign-Owned Domestic Corporations	Overall
All Corporations			
Total Base Erosion Payments	$ 153,226	$ 251,803	$ 405,028
Total Number of Corporations	1,451	1,123	2,574
Corporations with Base Erosion Percentage below 3-Percent Threshold*			
Base Erosion Payments	$ 18,862	$ 2,983	$ 21,845
Number of Corporations	1,040	288	1,328
Corporations with Base Erosion Percentage at or above 3-Percent Threshold**			
Base Erosion Payments	$ 134,364	$ 248,820	$ 383,183
Number of Corporations	411	835	1,246

* Below two percent for certain financial institutions

** At or above two percent for certain financial institutions

Note: The data is purely illustrative and reflects tabulations from tax year 2014 had the BEAT been in effect that year. The data does not account for changes in taxpayer behavior.

Data: Select Data Related to the BEAT

Table 2.—BEAT Tax Parameters for Taxpayers with $500 Million or More
in Gross Receipts and Base Erosion Percentage of Three Percent or More*
(2014, millions of dollars)

BEAT Tax Related Parameters	U.S. Multinationals	Foreign-Owned Domestic Corporations	Overall
NOL Deduction	$ 23,646	$ 22,143	$ 45,790
Foreign Tax Credits	$ 48,874	$ 7,678	$ 56,552
General Business Credits	$ 10,071	$ 2,431	$ 12,501
Median Base Erosion Percentage	7.75%	15.85%	12.85%
% Corporations with Base Erosion Percentage between 3% and 8%**	51.82%	21.68%	31.62%
Number of Corporations	411	835	1,246

* Two percent or more for certain financial institutions

** Between two percent and seven percent for certain financial institutions

Note: The data is purely illustrative and reflects tabulations from tax year 2014 had the BEAT been in effect that year. The data does not account for changes in taxpayer behavior.

Additional Resources

- Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), December 2018, pp. 399-409.
- REG–104259–18 (proposed regulations interpreting the base erosion and anti-abuse tax).