Final regulations. All
[...]
under section 6031 of the Code (the
regulations'') in the Federal Register
The final regulations retain the basic
be neither over-count nor under-
close consideration with future
guidance projects.
The final regulations provide
guidance under sections 59A, 1502, and
Part IV of this Summary of
addresses the calculation of
gross receipts and the base erosion
percentage when either the taxpayer or
a member of the taxpayer's aggregate
group has a short taxable year. Part II.B
of this Summary of Comments and
addresses considerations relating to when a
member joins or leaves an aggregate
Part II.C of this Summary of
addresses the application of the
aggregate group rules to predecessors
and successors.
A. Rules Relating to the Determination
of Gross Receipts and the Base Erosion
Percentage for a Short Taxable Year

Section 1.59A–2(c)(3) provides that a
taxpayer that is a member of an
aggregate group measures the gross
receipts and base erosion percentage of
its aggregate group for a taxable year by
reference to the taxpayer's gross
receipts, base erosion tax benefits,
and deductions for the taxable year,
and the gross receipts, base erosion tax
benefits, and deductions of each member of
the aggregate group for the taxable year of
the member that ends with or within the
taxpayer's taxable year (the "with-or-
within method"). Proposed § 1.59A–
2(c)(5) required a taxpayer with a
taxable year of fewer than 12 months (a
short taxable year) to annualize its own
gross receipts 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) also
provided that a taxpayer with a short
taxable year must use a reasonable
approach to determine the gross receipts
and base erosion percentage of its
aggregate group members for the short
taxable year. The proposed regulations
indicated that, in determining whether the
taxpayer's aggregate group satisfies
the gross receipts test and base erosion
percentage test for the taxpayer's short
taxable year, a reasonable approach
would neither over-count nor under-
count the gross receipts, base erosion
tax benefits, and deductions of the members of the taxpayer’s aggregate group, even if the taxable year of a member or members of the aggregate group does not end with or within the short period. Proposed § 1.59A–2(c)(5). The preamble to the proposed regulations requested comments on whether more specific guidance was needed, and if so, how the gross receipts and base erosion percentage of an aggregate group should be determined when the applicable taxpayer has a short taxable year. REG–112607–19, 84 FR 67046, 67047 (December 6, 2019).

A comment supported the rule in the proposed regulations allowing a taxpayer to use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group for a short taxable year and viewed more detailed guidance regarding short taxable years to be unnecessary. The comment stated that the operation of the with-or-within method, in conjunction with a reasonable approach to taking into account gross receipts, base erosion tax benefits, and deductions of aggregate group members, would prevent either the over-counting or under-counting of items in situations involving short taxable years. However, this comment also suggested that a reasonable approach would exclude the gross receipts, base erosion tax benefits, and deductions of an aggregate group member if the member’s taxable year did not end with or within a short taxable year of the taxpayer. The Treasury Department and the IRS agree that a reasonable approach should prevent over-counting and under-counting. Therefore, the final regulations retain the rule in the proposed regulations that permits the use of a reasonable approach to determine whether a taxpayer’s aggregate group meets the gross receipts test and base erosion percentage test with respect to a short taxable year of the taxpayer.

However, the Treasury Department and the IRS are concerned that when a member does not have a taxable year that ends with or within a short taxable year of a taxpayer, some taxpayers may take the view (as suggested in the comment described in the preceding paragraph) that excluding the gross receipts, base erosion tax benefits, and deductions of the member from the taxpayer’s aggregate group is a reasonable approach. The Treasury Department and the IRS do not view such exclusions as a reasonable approach. Accordingly, the final regulations clarify that such a method constitutes an unreasonable approach. § 1.59A–2(c)(5)(i)(B). In addition, to provide guidance for taxpayers in determining whether a particular approach is reasonable and does not over-count nor under-count, the final regulations include examples of methods that may or may not constitute a reasonable approach. See id.

B. Members Leaving and Joining an Aggregate Group

1. Close of Taxable Year Rule for Determining Gross Receipts and Base Erosion Percentage

a. When the Deemed Closing of a Taxable Year Occurs

The proposed regulations provided guidance clarifying how the gross receipts and the base erosion percentage of an aggregate group are determined when members join or leave a taxpayer’s aggregate group, such as through a sale of the stock of a member to a third party. Proposed § 1.59A–2(c)(4) provided that, in determining the gross receipts and the base erosion percentage of a taxpayer’s aggregate group, only items of members that occur during the period that they were members of the taxpayer’s aggregate group are taken into account. Under this rule, items of a member that occur before the member joins the aggregate group of the taxpayer or after the member leaves the aggregate group of the taxpayer are not taken into account in determining the gross receipts or base erosion percentage of the taxpayer’s aggregate group.

To implement this cut-off rule and determine which items occurred while a corporation was a member of a particular aggregate group, proposed § 1.59A–2(c)(4) treated a corporation that joins or leaves an aggregate group (in a transaction that does not otherwise result in a taxable year-end) as having a deemed taxable year-end. Specifically, proposed § 1.59A–2(c)(4) provided that this deemed taxable year-end occurs immediately before the corporation joins or leaves the aggregate group (“time-of-transaction rule”). The proposed regulations permitted a taxpayer to 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 without a closing of the books.

Comments requested that the deemed taxable year-end occur at the end of the day, rather than immediately before the time of the transaction, to better align with other provisions of the Code and regulations. Comments noted that an end-of-day rule would be more consistent with provisions of the Code and regulations such as section 381 and § 1.1502–76(b). See section 381 (providing that an acquiring corporation succeeds to and takes into account certain attributes as of the close of the day, rather than the time of the acquisition transaction); § 1.1502–76(b) (providing that, when a member joins or leaves a consolidated group, it has a taxable year-end at the end of the day).

The final regulations adopt this recommendation. Specifically, when a corporation has a deemed taxable year-end under § 1.59A–2(c)(4), the deemed taxable year-end is treated as occurring at the end of the day of the transaction. § 1.59A–2(c)(4)(ii). Thus, a new taxable year is deemed to begin at the beginning of the day after the transaction. A taxpayer determines items attributable to the deemed short taxable years ending upon and beginning the day after the deemed taxable year-end by either deeming a close of the corporation’s books or, in the case of items other than extraordinary items, making a pro-rata allocation without a closing of the books. § 1.59A–2(c)(4).

Extraordinary items that occur on the day of, but after, the transaction that causes the corporation to join or leave the aggregate group are treated as occurring in the deemed taxable year beginning the next day. For this purpose, the term “extraordinary items” has the meaning provided in § 1.1502–76(b)(2)(ii)(C). This term is also expanded to include any other payment that is not made in the ordinary course of business and that would be treated as a base erosion payment.

b. Alternative to Deemed Year-End Approach

One comment supported the approach in the proposed regulations to the deemed year-end rule, which it noted allows taxpayers flexibility to choose between the pro-rata allocation or closing of the books methods. However, the comment also expressed support for a simplified “no-cut-off” alternative to the deemed year-end framework in the proposed regulations, which could reduce the need for sharing information between a selling aggregate group and a purchaser.

Under the comment’s simplified “no-cut-off” alternative, there would be no deemed year-end upon a corporation’s entry to or exit from an aggregate group; rather, the corporation’s full year would be taken into account by the acquiring aggregate group. The comment acknowledged that this simplified approach would result in the “acquiring” aggregate group including no items for the year and the “acquiring” aggregate group taking into
account all of the corporation’s items for the year, which may be distortionary. The comment also suggested that it may be appropriate to backstop this simplified “no-cut-off” rule with an anti-abuse rule that requires a deemed year-end if the transaction is arranged with a principal purpose of enabling a taxpayer to fall below the gross receipts or base erosion percentage thresholds.

The final regulations do not adopt the simplified “no-cut-off” alternative. Although that alternative may simplify some elements of compliance with the aggregate group rules, the Treasury Department and the IRS have determined that a rule that determines the gross receipts and base erosion tax benefits of an aggregate group should include only the gross receipts, base erosion tax benefits, and deductions of entities attributable to the period in which they were members of the aggregate group. The “no-cut-off” alternative proposed is inherently less precise and has the potential for abuse. For example, in the case of an acquisition near the end of a taxable year, the “no-cut-off” alternative could shift nearly a full year’s items from the seller’s aggregate group to the acquirer’s aggregate group.

In addition, the Treasury Department and the IRS have determined that the additional subjectivity that would result from coupling the rule with an anti-abuse backstop to address the potential for abuse identified in the comment would lead to less certainty with respect to a key threshold in determining whether a taxpayer is subject to the BEAT.

2. Aggregate Group Members With Different Taxable Years Leading to Over-and-Under-Counting of Gross Receipts

A comment expressed concern that the deemed close of the taxable year that occurs when a member joins or leaves an aggregate group would create the potential for over-counting of gross receipts, base erosion tax benefits, and deductions of a member when applied in conjunction with the with-or-within method. This situation can arise when the taxpayer and a member of the aggregate group have different taxable years.

The comment illustrated this concern with the following example. A taxpayer has a calendar taxable year and its aggregate group includes DC, a domestic corporation with a June 30 year-end. On November 30, 2020, DC leaves the taxpayer’s aggregate group. The comment explained that, under the with-or-within rule of § 1.59A–2(c)(3), the taxpayer is required to not only take into account DC’s gross receipts for the full taxable year ending June 30, 2020, but also a second short taxable year of July 1, 2020, through November 30, 2020 (a 5-month short taxable year). This result occurs because, from the perspective of the taxpayer, both DC’s full 12-month taxable year and DC’s 5-month short taxable year end “with or within” the taxpayer’s calendar taxable year ending on December 31, 2020. As a result, the taxpayer would include 17 months of gross receipts from DC in taxpayer’s taxable year ending December 31, 2020.

The comment recommended that an annualization rule or another alternative apply to the gross receipts test so that a taxpayer is not required to take into account more than 12 months of gross receipts of an aggregate group member when a member joins or leaves an aggregate group.

The comment also suggested that an annualization rule may be appropriate for the base erosion percentage test because an annualization rule would avoid over-weighting base erosion tax benefits and deductions. Depending on the taxpayer’s particular facts, the comment noted that this suggested rule could cause a taxpayer’s aggregate group to satisfy the base erosion percentage test or to fall below the relevant threshold established for that tax.

The final regulations adopt this comment. Section 1.59A–2(c)(5)(ii)(A) provides that, if a member of a taxpayer’s aggregate group has more than one taxable year that ends with or within the taxpayer’s taxable year and together those taxable years are comprised of more than 12 months, then the member’s gross receipts, base erosion tax benefits, and deductions for those years are annualized to 12 months for purposes of determining the gross receipts and base erosion percentage of the taxpayer’s aggregate group. To annualize, the amount is multiplied by 365 and the result is divided by the total number of days in the year or years. The final regulations also adopt a corresponding rule to address short taxable years of members. Specifically, if a member of the taxpayer’s aggregate group changes its taxable year-end, and as a result the member’s taxable year (or years) ending with or within the taxpayer’s taxable year is comprised of fewer than 12 months, then for purposes of determining the gross receipts and base erosion percentage of the taxpayer’s aggregate group, the member’s gross receipts, base erosion tax benefits, and deductions for that year (or years) ending to 12 months. § 1.59A–2(c)(5)(ii)(B). This rule does not apply if the change in the taxable year-end is a result of the application of § 1.1502–76(a), which provides that new members of a consolidated group adopt the common parent’s taxable year. But see § 1.59A–2(c)(5)(iii) (providing an anti-abuse rule that applies to transactions with a principal purpose of changing the period taken into account for the gross receipts test or the base erosion percentage test).

For example, assume that an aggregate group member and the taxpayer both have calendar-year taxable years; then, as of January of 2021, the aggregate group member changes its taxable year-end to January 31. Under these facts, the taxpayer’s 2021 calendar year would only include the gross receipts, base erosion tax benefits, and deductions of the one-month short year of the aggregate group member because that is the only taxable year of the member that ends with or within the taxpayer’s calendar taxable year taxable year. Gross receipts would be undercounted, and the member’s contribution to the aggregate group’s base erosion percentage would be given insufficient weight in the taxpayer’s 2021 calendar year. This difference would not resolve itself in subsequent years because, in the taxpayer’s 2022 taxable year and each taxable year thereafter, the taxpayer will take into account only a 12-month period with respect to the aggregate group member—the taxable year from February 1 through January 31. Thus, absent this rule, the equivalent of 11 months of the member’s contribution to the gross receipts and base erosion percentage would not be taken into account by the aggregate group because the taxpayer’s 2021 calendar year computation would only include one month of aggregate group member activity. Accordingly, the final regulations provide that the member’s gross receipts, base erosion tax benefits, and deductions for its one-month short-year ending January 31, 2021, are extrapolated and annualized to a full 12-month period solely for purposes of determining the gross receipts and base erosion percentage of the taxpayer’s aggregate group when resulting from a change in taxable year. § 1.59A–2(c)(5)(ii)(B).

The final regulations also adopt a corresponding anti-abuse rule to address other types of transactions that may achieve a similar result of excluding gross receipts or base erosion percentage items of a taxpayer or a member of the taxpayer’s aggregate group that are undertaken with a principal purpose of avoiding applicable taxpayer status. See § 1.59A–2(c)(5)(iii). Assuming a requisite principal purpose, an example
that could implicate this rule includes a transaction in which a taxpayer that is close to satisfying the gross receipts test transfers a portion of its revenue-generating assets to a newly formed domestic corporation that is a member of the taxpayer’s aggregate group (but not a member of the taxpayer’s consolidated group) and that has a different taxable year that does not end with or within the taxpayer’s current taxable year. Another example, also assuming a requisite principal purpose, includes a transaction in which the stock of a member of the taxpayer’s aggregate group is transferred to a consolidated group that is also a member of the taxpayer’s aggregate group and that has a different taxable year that does not end with or within the taxpayer’s current taxable year.

3. Deferred Deductions

A comment requested that § 1.59A–2(c)(4) be revised to clarify the treatment of items that are paid or accrued in a period before the date the corporation joins a taxpayer’s aggregate group. As an example, the comment described a corporation’s payment of interest to a foreign related party that gives rise to a base erosion payment in the taxable year of the payment, but that is not a base erosion tax benefit because the item is not currently deductible due to the limitations on deducting business interest expense in section 163(j). The comment suggested that, if the corporation subsequently becomes a member of an aggregate group of a different taxpayer (for example, because the corporation is sold to an unrelated buyer, and thereafter becomes a member of the buyer’s aggregate group), the buyer’s aggregate group should not have to take into account the base erosion tax benefit in the buyer’s base erosion percentage when the business interest expense becomes deductible under section 163(j).

The final regulations do not adopt this comment. Under the statutory framework of the BEAT, whether a deduction is a base erosion tax benefit is determined solely with respect to whether the amount was a base erosion payment when it was paid or accrued. Section 59A(c)(2) and § 1.59A–3(c)(1) do not restate the base erosion payment to determine whether the payee continues to be a foreign related party of the taxpayer when the taxpayer claims the deduction.

C. Predecessors and Successors

Proposed § 1.59A–2(c)(6)(i) provided that, in determining gross receipts, any reference to a taxpayer includes a reference to any predecessor of the taxpayer, including the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation. To prevent over-counting, the proposed regulations provided that, 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. Proposed § 1.59A–2(c)(6)(ii).

A comment recommended taking into account gross receipts of foreign predecessor corporations only to the extent the gross receipts are taken into account in determining income that is effectively connected with the conduct of a U.S. trade or business (“ECI”) of the foreign predecessor corporation, which would be consistent with the ECI rule for gross receipts of foreign corporations in § 1.59A–2(d). The final regulations adopt this comment. Section 1.59A–2(c)(6)(i) clarifies that the operating rules set forth in § 1.59A–2(c) (aggregation rules) and § 1.59A–2(d) (gross receipts test) apply to the same extent in the context of the predecessor rule. Thus, the ECI limitation on gross receipts in § 1.59A–2(d)(3) continues to apply to the successor.

III. Election To Waive Allowable Deductions

For purposes of determining a taxpayer’s base erosion tax benefits and the base erosion percentage, the proposed regulations provided that all deductions that could be properly claimed by a taxpayer are treated as allowed deductions. Proposed § 1.59A–3(c)(5). However, if a taxpayer elected to forego a deduction and followed specified procedures (the “BEAT waiver election”), the proposed regulations provided that the foregone deduction would not be treated as a base erosion tax benefit. Proposed § 1.59A–3(c)(6). Generally, under the proposed regulations, any deduction waived pursuant to the BEAT waiver election is waived for all U.S. federal income tax purposes. Proposed § 1.59A–3(c)(6)(i)(A). The proposed regulations permitted a taxpayer to make the BEAT waiver election on its original filed Federal income tax return, on an amended return, or during the course of an examination of the taxpayer’s income tax return for the relevant taxable year pursuant to procedures prescribed by the Commissioner. Proposed § 1.59A–3(c)(6)(iii).

Part III.A of this Summary of Comments and Explanation of Revisions addresses when a taxpayer is eligible to make the BEAT waiver election. Part III.B of this Summary of Comments and Explanation of Revisions addresses whether deductions waived pursuant to the BEAT waiver election should be included in the denominator of the base erosion percentage. Part III.C of this Summary of Comments and Explanation of Revisions addresses comments on the decrease of deductions waived. Part III.D of this Summary of Comments and Explanation of Revisions addresses comments on the inclusion of reinsurance premiums paid in the BEAT waiver election. Part III.E of this Summary of Comments and Explanation of Revisions addresses comments relating to revoking certain elections and making late elections to allow taxpayers to take into account the BEAT waiver election. Part III.F of this Summary of Comments and Explanation of Revisions addresses comments relating to procedural aspects of the BEAT waiver election. Part III.G of this Summary of Comments and Explanation of Revisions addresses comments relating to the application of the BEAT waiver election to partnerships. Part III.H of this Summary of Comments and Explanation of Revisions addresses the application of the BEAT waiver election to consolidated groups. Part III.I of this Summary of Comments and Explanation of Revisions addresses the interaction of the BEAT waiver election with other regulations.

A. Eligibility for the BEAT Waiver Election

Proposed § 1.59A–3(c)(5) provided that the BEAT waiver election is the sole method by which a deduction that could be properly claimed by taxpayer for the taxable year is not taken into account for BEAT purposes (the “primacy rule”). Proposed § 1.59A–3(c)(6)(i) provided that, “[s]olely for purposes of paragraph (c)(1) of this section” (the definition of a base erosion tax benefit), the amount of allowed deductions is reduced by the amount of deductions that are properly waived. A comment suggested that the phrase “solely for purposes of” in proposed § 1.59A–3(c)(6)(i) is unclear. The comment interpreted the proposed regulations as providing that a taxpayer can make the BEAT waiver election only if the waiver of a deduction, when taken together with any waivers by other members of the taxpayer’s aggregate group, would lower the taxpayer’s base erosion percentage below the base erosion percentage threshold applicable to the taxpayer. The comment also recommended that the Treasury Department and the IRS clarify that the primary rule and the BEAT waiver election do not affect a
the proposed regulations ensure that the taxpayer’s ability to not claim allowable deductions for tax purposes other than section 59A. The final regulations explicitly clarify that, in order to make or increase the BEAT waiver election under § 1.59A–3(c)(6), the taxpayer must determine that the taxpayer could be an applicable taxpayer for BEAT purposes but for the BEAT waiver election. § 1.59A–3(c)(6)(i). Thus, for example, a controlled foreign corporation that does not have income that is effectively connected with the conduct of a trade or business in the United States cannot make a BEAT waiver election because the controlled foreign corporation cannot be an applicable taxpayer.

In addition, when a taxpayer does not make a BEAT waiver election (or when this waiver is not permitted), § 1.59A–3(c)(5) and § 1.59A–3(c)(6)(i) have no bearing on whether or how a taxpayer’s failure to claim an allowable deduction, or to otherwise “waive” a deduction, is respected or taken into account for tax purposes other than section 59A. See generally § 1.59A–3(c)(5). In other words, the BEAT waiver election should not affect any existing law addressing “waiver” outside of the specific situation covered by the BEAT waiver (electing not to claim a deduction in order to avoid applicable taxpayer status).

B. Effect of the BEAT Waiver Election on the Base Erosion Percentage

Proposed § 1.59A–2(e)(3)(iii)(G) provided that any deduction not allowed in determining taxable income for the taxable year is not taken into account when determining the denominator of the base erosion percentage. See the proposed § 1.59A–3(c)(6)(i)(A)(1) (generally providing that a waived deduction is treated as having been waived for all purposes of the Code and regulations). A comment asserted that a waived deduction should nonetheless be included in the denominator of the base erosion percentage.

The final regulations do not adopt this comment. This recommendation is inconsistent with § 1.59A–2(e)(3)(ii)(G), which provides that the denominator of the base erosion percentage does not include any deduction that is not allowed in determining taxable income for the taxable year. A waived deduction is not allowed in determining taxable income for the year. See § 1.59A–3(c)(6)(i). By providing that the denominator to the base erosion percentage includes only items allowed in determining taxable income for the taxable year, the denominator operates symmetrically with the numerator because the numerator—base erosion tax benefits—includes only those deductions and other items “allowed by [Chapter 1 of the Code].” See section 59A(c)(2)(A)(i).

C. Reduction of Waived Deductions During Audit or on an Amended Return

The proposed regulations provided that a taxpayer may make or increase a BEAT waiver election on an amended Federal income tax return or during the course of an examination of the taxpayer’s income tax return. See proposed § 1.59A–3(c)(6)(ii). However, a taxpayer could not decrease the amount of deductions waived under the BEAT waiver election or revoke that election on any amended Federal income tax return or during an examination. See proposed § 1.59A–3(c)(6)(iii).

Comments requested that the final regulations permit taxpayers to decrease the amount of deductions that are waived either by filing an amended Federal income tax return or during an examination. Some comments suggested that no policy concerns existed that should prevent taxpayers from being able to reduce the amount of a previously waived deduction. Comments also noted that, given that the proposed regulations permit taxpayers to increase waived amounts on an amended return or during an audit, permitting taxpayers to reduce any waived amounts would not create any additional administrative burden for the IRS.

The final regulations do not adopt this comment. The BEAT waiver election was proposed, in part, in response to comments to prior proposed regulations recommending that the Treasury Department and the IRS clarify whether a deduction that is not claimed is not taken into account for BEAT purposes. The proposed regulations also included the waiver election, in part, to address taxpayer concerns that, due to the cliff effect of applicable taxpayer status, a marginal amount of base erosion tax benefits could have a greater effect on overall tax liability. The ability to decrease waived amounts does not further the policy goal of addressing the cliff effect of applicable taxpayer status. The proposed regulations provided taxpayers significant flexibility through the BEAT waiver election, which permits taxpayers to choose deductions to waive based on tax optimization and to elect to increase waived deductions at various points after filing their original return, including during an examination. See proposed § 1.59A–3(c)(6)(iii). The Treasury Department and the IRS are concerned that expanding taxpayer electivity to permit the reduction of waived amounts will increase uncertainty to the IRS as it assesses tax return positions. The Treasury Department and the IRS are concerned that this uncertainty about taxpayers’ return positions will negatively affect the ability of the IRS to efficiently conduct and close examinations.

D. Waiver of Life and Non-Life Reinsurance Premiums

The BEAT waiver election in the proposed regulations specifically referenced deductions. Proposed § 1.59A–3(c)(6). Comments noted that the term “base erosion tax benefits” includes certain reductions to gross income related to reinsurance that may be treated as reductions to gross receipts, not deductions. See § 1.59A–3(b)(1)(iii) (defining a base erosion payment to include “[a]ny premium or other consideration paid or accrued by the taxpayer to a foreign related party of the taxpayer for reinsurance”). The Treasury Department and the IRS are concerned that final regulations permit a waiver for insurance-related base erosion payments for which a deduction is allowed under the Code for a taxable year. . . . Similarly, the proposed regulations ensure that the denominator of the base erosion percentage only takes account deductions allowed under the Code by providing that the denominator of the base erosion percentage does not include deductions that are not allowed in determining taxable income for the taxable year.

1 See REG–104259–18, 83 FR 65958 (December 21, 2018) (The preamble to the 2018 proposed regulations provided “[t]he numerator of the base erosion percentage only takes into account base erosion tax benefits, which generally are base erosion payments for which a deduction is allowed under the Code for a taxable year. . . . Similarly, the proposed regulations ensure that the denial to gross premiums written on insurance contracts for premiums and other consideration paid or accrued by the taxpayer to a foreign related party of the taxpayer for reinsurance described in § 1.59A–3(c)(6)(iii) as “any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity reinsurance, or any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance.”). Because premiums that are reductions to gross income do not technically fit within the terminology used in the waiver provisions, comments requested that final regulations permit a waiver for those items.

The Treasury Department and the IRS have determined that the policy rationale for providing the BEAT waiver election applies to life and non-life related base erosion payments, and therefore the BEAT waiver election should be
available with respect to base erosion tax benefits described in § 1.59A–3(b)(1)(ii). The final regulations include a provision for the waiver of amounts treated as reductions to gross premiums and other consideration that would otherwise be base erosion tax benefits within the definition of section 59A(c)(2)(A)(iii) and provide that similar operational and procedural rules apply to this waiver, such as the rule providing that the waiver applies for all purposes of the Code and regulations. See § 1.59A–3(c)(5). The BEAT waiver election affects the base erosion tax benefits of the taxpayer, not the amount of premium that the taxpayer pays to a foreign insurer or reinsurer (or the amount received by that foreign insurer or reinsurer); therefore, for example, the waiver of reduction to gross premiums and other consideration (or of premium payments that are deductions for federal income tax purposes) does not reduce the amount of any insurance premium payments that are subject to insurance excise tax under section 4371.

E. Revoking Elections and Retroactive Elections in Connection With Bonus Depreciation and Research and Experimentation Capitalization and Amortization

Comments asserted that certain taxpayers filed elections in connection with their 2018 tax returns to either (i) elect under section 59(e)(4) to capitalize and amortize over a 10-year period certain expenses of research and experimentation ("R&E") expenditures that would otherwise be deductible in the year incurred, or (ii) elect not to claim an additional allowance for depreciation under section 168(k) ("bonus depreciation") before the issuance of the proposed regulations that provided taxpayers with the option of the BEAT waiver election. The section 59(e)(4) and bonus depreciation elections are revocable only with the consent of the Secretary. The comments implied that, if taxpayers had known about the BEAT waiver election when they filed their returns, the taxpayers would have made the elections under section 168(k) ("bonus depreciation") before the issuance of the proposed regulations that provided taxpayers with the option of the BEAT waiver election. The section 59(e)(4) and bonus depreciation elections are revocable only with the consent of the Secretary. The comments implied that, if taxpayers had known about the BEAT waiver election when they filed their returns, the taxpayers would have made the elections under section 168(k) ("bonus depreciation") before the issuance of the proposed regulations that provided taxpayers with the option of the BEAT waiver election.

Another comment recommended that the Treasury Department and the IRS also permit taxpayers to make retroactive elections to capitalize and amortize costs under section 59A(e)(4) or to not claim bonus depreciation under section 168(k) to provide relief from "permanent BEAT consequences." The comment cited an example where the taxpayer is entitled to additional deductions or has less regular taxable income in a taxable year as a result of an audit; consequently, the taxpayer had an "unintended" tax liability under section 59A. The comment proposed that the Treasury Department and the IRS permit a taxpayer to retroactively elect to capitalize costs that were previously reported as deductible in the taxable year.

The final regulations do not adopt the recommendations to provide guidance permitting taxpayers to automatically revoke prior capitalization elections under sections 59(e)(4) and 168(k) or make late elections. In both cases, the recommendations would expressly permit taxpayers to use hindsight to change their elections to reduce or eliminate BEAT liability or regular income tax. The use of hindsight in elections involves tax policy considerations broader than the interaction of the BEAT and the elections under section 59(e)(4) and section 168(k). Because these recommendations involve tax policy considerations that are not just limited to the application of the BEAT, the decision to permit revoking or making a late election is beyond the scope of the final regulations.

F. Procedures for Making the BEAT Waiver Election

1. Documentation Requirements

Proposed § 1.59A–3(c)(6)(i) required taxpayers to report certain information to make the BEAT waiver election. Under the proposed regulations, a taxpayer was required to provide, among other information, a detailed description of the item or property to which the deduction relates, including sufficient information to identify the item on the taxpayer’s books and records. Proposed § 1.59A–3(c)(6)(ii)(A).

A comment suggested that the final regulations eliminate the information required by § 1.59A–3(c)(6)(ii)(A) through (C) (the detailed description, the date or period of the payment or accrual; and the citation for the deduction). The comment stated that the final regulations should eliminate § 1.59A–3(c)(6)(ii)(A) because a streamlined disclosure that included only the amount deducted (proposed § 1.59A–3(c)(6)(ii)(B)), amount waived (proposed § 1.59A–3(c)(6)(ii)(E)), tax return line item (proposed § 1.59A–3(c)(6)(ii)(F)), and foreign recipient (proposed § 1.59A–3(c)(6)(ii)(C)) would provide sufficient information for the IRS to determine the validity of the election without creating an undue burden on taxpayers. While the comment characterized the information reporting requirements as “onerous,” it did not explicitly describe how or why this requirement is onerous.

The final regulations retain the requirements of proposed § 1.59A–3(c)(6)(ii)(A) through (C). See § 1.59A–3(c)(6)(ii)(B)(4) through (5). In administering the BEAT waiver election, the IRS has an interest in obtaining information regarding the deductions being waived and the item or property to which the deduction relates, including sufficient information to identify the item on the taxpayer’s books and records and to have information about the Code section under which the deduction arises. However, the Treasury Department and the IRS acknowledge that requiring a "detailed" description of the item or property to which the deduction relates is not necessary for this purpose, particularly given that § 1.59A–3(c)(6)(ii)(B) requires sufficient information to identify the item or property on the taxpayer’s books. Accordingly, § 1.59A–3(c)(6)(ii)(B)(1) of the final regulations omits the requirement to provide a "detailed" description. Section 1.59A–3(c)(6)(ii)(B)(6) and (7) is also revised to make certain non-substantive, clarifying changes.

2. Partial Waivers

Proposed § 1.59A–3(c)(6)(ii)(B) provided that, if a taxpayer makes the election to waive a deduction, in whole or in part, the election is disregarded for certain purposes. A comment observed that the proposed regulations do not expressly provide that the BEAT waiver election permits a partial waiver of a deduction. The comment also suggested that procedural forms should be clear in this regard. The final regulations have been revised to state more explicitly that a deduction may be waived in part. See § 1.59A–3(c)(6)(i); see also §§ 1.59A–3(c)(6)(ii)(B)(4) and (5), and 1.59A–3(c)(6)(iii)(B). Additionally, the IRS plans to revise Form 8991, Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts, to incorporate reporting requirements relating to the reporting of deductions that taxpayers have partially waived.

3. Procedures for BEAT Waiver During the Course of an Examination

Proposed § 1.59A–3(c)(6)(iii) generally provided that a taxpayer may make the
BEAT waiver election on its original filed Federal income tax return, on an amended return, or during the course of an examination pursuant to procedures prescribed by the Commissioner. The preamble to the proposed regulations indicated that, 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 would apply. REG–112607–19, 84 FR 67046, 67048 (December 06, 2019). The current procedures for submitting affirmative tax return changes during an examination, which are set forth in the Internal Revenue Manual (IRM), apply together with the provisions in section 6402 and the regulations thereunder (§§ 301.6402–1 through 301.6402–7).

A comment argued that the final regulations should expand upon the procedures of the IRM and permit a taxpayer to make the BEAT waiver election at any time during the course of an examination, including after all other adjustments have been agreed upon. Additionally, the comment recommended that the IRS consider providing a streamlined procedure for taxpayers to make the BEAT waiver election in connection with examinations that would not require the filing of an amended return because filing an amended return could be burdensome.

The final regulations do not adopt these recommendations because the IRM already provides a procedure that permits taxpayers to submit informal claims, including the BEAT waiver election, during the course of an examination. See IRM section 4.46.3.7. The Treasury Department and the IRS view this IRM procedure as serving an important tax administration function—preserving the IRS’s ability to conduct an audit efficiently and ensuring that the IRS has sufficient time to evaluate the merits of the claims. In addition, the Treasury Department and the IRS have determined that it is in the interest of sound tax administration to address procedures regarding claims in the Internal Revenue Manual rather than in the regulations. Further, the Code, regulations, and the IRM are clear that the taxpayer retains a statutory right to submit an amended return that can include a waiver election or increase the waived deductions.

G. Application of the BEAT Waiver Election to Partnerships

Comments recommended generally that the BEAT waiver election be expanded to expressly permit a waiver in connection with deductions that are allocated from a partnership. Some comments recommended that the final regulations clarify that the BEAT waiver election is made by the partner, rather than by the partnership. These comments suggested certain corresponding changes necessary to coordinate the tax treatment of partners and partnerships. Specifically, a comment recommended that the waived deductions be treated as non-deductible expenditures under section 705(a)(2)(B)—thereby reducing the adjusted basis of a partner’s interest in a partnership—to prevent a corporate partner from subsequently benefitting from waived partnership deductions when disposing of its interest in the partnership.

The final regulations generally adopt these comments and, subject to certain special rules in connection with the centralized partnership audit regime enacted in the Bipartisan Budget Act of 2015 (the “BBA”), explicitly permit a corporate partner in a partnership to make a BEAT waiver election with respect to partnership items. § 1.59A–3(c)(6)(iv)(A). The final regulations also clarify that a partnership may not make a BEAT waiver election. § 1.59A–3(c)(6)(iv)(A). In addition, the final regulations provide that waived deductions are treated as non-deductible expenditures under section 705(a)(2)(B). See § 1.59A–3(c)(6)(iv)(B).

Further, the final regulations provide rules to conform the partner-level waiver with section 163(j). See § 1.59A–3(c)(6)(iv)(C). Specifically, the final regulations clarify that, when a partner waives a deduction that was taken into account by the partnership to reduce the partnership’s adjustable taxable income for purposes of determining the partnership-level section 163(j) limitation, the increase in the partner’s income resulting from the waiver is treated as a partner basis item (as defined in § 1.163(j)–6(b)(2)) for the partner, but not the partnership. Thus, the increase in the partner’s income resulting from the waiver is added to the partner’s section 163(j) limitation computation. § 1.59A–3(c)(6)(iv)(C). The partnership’s section 163(j) computations are not impacted by the partner’s waiver.

Another comment recommended that, if waiver of partnership deductions is permitted, the effect of the waiver should be reconciled with the centralized partnership audit regime enacted by the BBA in sections 6221 through 6241 (the “BBA audit procedures”). The BBA audit procedures, adjustments must be made at the partnership level. Generally, the partnership is liable for an imputed underpayment computed on the adjustments unless the partnership elects to “push out” the adjustments to the partners from the year to which the adjustments relate (reviewed year partners). Sections 6221, 6225, 6226, and 6227.

The final regulations clarify that a partner may make the BEAT waiver election with respect to an increase in a deduction that is attributable to an adjustment made under the BBA audit procedures, but only if the partner is taking into account the partnership adjustments either because the partnership elects to have the partners take into account the adjustments under sections 6226 or 6227, or because the partner takes into account the adjustments as part of an amended return filed pursuant to section 6225(c)(2)(A). § 1.59A–3(c)(6)(iv)(D). If the partner makes the BEAT waiver election, the partner will compute its additional reporting year tax (as described in § 301.6226–3) or the amount due under § 301.6225–2(d)(2)(ii)(A), treating the waived amount as provided in § 1.59A–3(c)(6).

The final regulations do not address the interaction of the BBA audit procedures and the BEAT more generally. As the BBA audit procedures continue to be implemented, the Treasury Department and the IRS will review the implementation and determine whether future BBA audit procedure guidance is required with respect to BEAT.

A comment observed that section 6222 generally requires a partner to treat a partnership item on its return consistently with the treatment of the item on the partnership return or otherwise to notify the IRS of this inconsistent treatment. This comment recommended that the final regulations coordinate and streamline the notification procedure under section 6222 and § 301.6222–1 with the information required under proposed § 1.59A–3(c)(6)(i)(A) through (G).

The final regulations do not reflect this comment because the reporting by a partner of the partnership item that is waived pursuant to the procedures set forth in § 1.59A–3(c)(6)(ii)(B) is consistent with the reporting of the item for purposes of section 6222. After the election is made, the partnership-related item is being reported properly at the partner level, after taking into account the partner’s facts and circumstances and application of the Code and regulations to that item (that is, the waiver). The fact that an item is waived pursuant to § 1.59A–3(c)(6) does not constitute inconsistent reporting for purposes of section 6222 but is merely
applying the Code and regulations to determine the taxability of that item. See § 301.6222–1(a) (requiring a partner to treat partnership-related items “consistent with the treatment of such items on the partnership return in all respects, including the amount, timing, and characterization of such items”); see generally § 1.59A–3(c)(6)(ii)(B) (requiring a taxpayer to report certain information in connection with waived items, including the amount waived and the amount claimed).

H. Application of the BEAT Waiver Election to Consolidated Groups

A comment recommended that the final regulations clarify that waived deductions attributable to a consolidated group member are treated as noncapital, nondeductible expenses that decrease the tax basis in the member’s stock for purposes of the stock basis rules in § 1.1502–32 to prevent the shareholder from subsequently benefitting from a waived deduction when disposing of the member’s stock. The final regulations adopt this clarifying comment. See § 1.59A–3(c)(6)(iii)(A)(4).

I. Interaction of Waived Deductions With Other Regulations

The proposed regulations included specific references to provisions of the Code and regulations that are not affected by the BEAT waiver election in proposed § 1.59A–3(c)(6)(iii)(B). The proposed regulations also provided that waived deductions are taken into account as necessary to prevent a taxpayer from receiving the benefit of a waived deduction. § 1.59A–3(c)(6)(iii)(B)(7). No comment addressed this aspect of the proposed regulations. The final regulations retain these rules, which may apply when other deductible expenses are taken into account for other specific purposes of the Code because the item was an expense (rather than because the item was deducted), such as the fact that waived deductions are still taken into account for purposes of determining the amount of the taxpayer’s earnings and profits under § 1.59A–3(c)(6)(iii)(B)(6).

IV. Application of the BEAT to Partnerships

The 2019 final regulations set forth operating rules for applying the BEAT to partnerships. In general, the final regulations provide that a partnership is treated as an aggregate of its partners and, accordingly, deem certain transactions to have occurred at the partnership level for BEAT purposes even though they may be treated as having occurred at the partnership level for other tax purposes. See generally § 1.59A–7.

A. Effectively Connected Income

Generally, the 2019 final regulations provide an exception (the “ECI exception”) whereby a base erosion payment does not result from amounts paid or accrued to a foreign related party that are subject to tax as ECI. § 1.59A–3(b)(3)(ii). To qualify for the ECI exception, the taxpayer must receive a withholding certificate on which the foreign related party claims an exemption from withholding under section 1441 or 1442 because the amounts are ECI. The 2019 final regulations do not set out specific rules for applying the ECI exception to transactions involving partnerships. The preamble to the proposed regulations stated that the Treasury Department and the IRS are considering additional guidance to address (i) the treatment of a contribution by a foreign person to a partnership engaged in a U.S. trade or business, (ii) transfers of partnership interests by a foreign person and (iii) transfers of property by the partnership with a foreign person as a partner to a related U.S. person. REG–112607–19, 84 FR 67046, 67049 (December 6, 2019). A comment generally supported applying an ECI exception to partnership transactions where the taxpayer is treated as making a base erosion payment as a result of a deemed transaction with a foreign related party, and where the foreign related party is subject to U.S. federal income tax on allocations of income from the partnership. The Treasury Department and the IRS generally agree with this comment and have revised the final regulations in § 1.59A–3(b)(3)(iii)(C) to expand the ECI exception to apply to certain partnership transactions. The expanded ECI exception in § 1.59A–3(b)(3)(iii)(C) applies if the exception in § 1.59A–3(b)(3)(iii)(A) or (B) would have applied to the payment or accrual as characterized under § 1.59A–7(b) and (c) for purposes of section 59A (assuming any necessary withholding certificate were obtained).

Thus, for example, if a U.S. taxpayer purchases an interest in a partnership from a foreign related party, then under the general BEAT partnership rules for transfers of a partnership interest, this transaction is treated as a transfer by the foreign related party of a portion of the partnership assets to the U.S. taxpayer. See § 1.59A–7(c)(3). To the extent that these partnership assets are used or held for use in connection with the conduct of a trade or business in the United States, this situation is similar to a situation where the foreign related party directly holds the assets that produce ECI (for example, in a U.S. branch). In that analogous situation, an acquisition of those assets by the U.S. taxpayer from the foreign related party would have been eligible for the ECI exception reflected in § 1.59A–3(b)(3)(iii).

The ECI exception reflected in § 1.59A–3(b)(3)(iii)(C) also may apply in other situations, such as when (i) a U.S. taxpayer contributes cash and a foreign related party of the U.S. taxpayer contributes depreciable property to the partnership (see § 1.59A–7(c)(3)(iii)), (ii) a partnership with a partner that is a foreign related party of the taxpayer partner engages in a transaction with the taxpayer (see § 1.59A–7(c)(1)), or (iii) a partnership engages in a transaction with a foreign related party of a partner in the partnership (id.).

The general ECI exception reflected in § 1.59A–3(b)(3)(iii)(A) would not apply if a U.S. person purchased depreciable or amortizable property from a foreign related party and that property was not held in connection with a U.S. trade or business. Similarly, when a U.S. person is treated as purchasing the same depreciable or amortizable property from a foreign related party under § 1.59A–7(c)(3)(iii) because the foreign related party contributes that property to a partnership, the ECI exception does not apply even though the property becomes a partnership asset after the transaction and the partnership uses the property in its U.S. trade or business.

To implement this addition, the final regulations include modified certification procedures similar to those set forth in § 1.59A–3(b)(3)(iii)(A) in order for the taxpayer to qualify for this exception. Specifically, the final regulations require a taxpayer to obtain a written statement from a foreign related party that is comparable to a withholding certification provided under § 1.59A–3(b)(3)(iii)(A), but which takes into account that the transaction is a deemed transaction under § 1.59A–7(b) or (c) rather than a transaction for which the foreign related party is required to report ECI. The taxpayer may rely on the written statement unless it has reason to know or actual knowledge that the statement is incorrect.

B. Treatment of Curative Allocations

The proposed regulations provided that if a partnership adopts the curative method of making section 709(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. Proposed § 1.59A–
must provide the information necessary to
successor) who is a partner in the partnership
to file a Form 8991 (or successor) or the related
instructions. This paragraph does not apply
to any partner described in § 1.59A–7(b)(4).
The cross-references contained in this
regulation, § 1.59A–7(b)(2) and § 1.59A–
7(b)(4), do not exist. The final
regulations clarify which partners are
intended to be excluded from the application
of proposed § 1.6031(a)–
1(b)(7). See § 1.6031(a)–1(b)(7). Section
1.6031(a)–1(b)(7) is also revised to make
certain clarifying changes.
Finally, § 1.59A–9(b)(6) is revised to
make certain clarifying changes.

V. Anti-Abuse Rules of § 1.59A–9 for
Basis Step-Up Transactions

Section 59A(d)(2) generally defines a
base erosion payment to include an
amount paid or accrued to a foreign
related party in connection with the
acquisition of depreciable or amortizable
depreciation property. However, § 1.59A–
3(b)(3)(iii) provides an
exception from base erosion payment
for certain amounts
transferred to or exchanged with a
foreign related party in a transaction
described in sections 332, 351, 355, and
368 (the "specified nonrecognition
transaction exception").
The specified nonrecognition
transaction exception was adopted in
the 2019 final regulations in response to
comments to proposed regulations
issued in 2018 that argued that the
depreciable or amortizable assets
acquired by a domestic corporation in
a nonrecognition transaction should not
be taken into account for purposes of the
BEAT because nonrecognition
transactions generally result in
carryover tax basis to the acquiring
corporation. TD 9885, 84 FR 66968,
66977. These comments also stated that
if that recommendation were to be adopted, an anti-abuse rule also could
be adopted to prevent taxpayers from
undermining this policy rationale for
the specified nonrecognition transaction
exemption by engaging in basis step-up
transactions immediately before an
inbound nonrecognition transaction.
The 2019 final regulations generally
adopted the approach recommended by
comments, including adopting a specific
targeted anti-abuse rule in § 1.59A–
9(b)(4). That rule provides that if a
transaction, plan, or arrangement has a
principal purpose of increasing the
adjusted basis of property that a
taxpayer acquires in a specified
nonrecognition transaction, the
nonrecognition exception of § 1.59A–
3(b)(3)(viii)(A) will not apply to the
nonrecognition transaction.
Additionally, § 1.59A–9(b)(4) contains an irrebuttable presumption that a
transaction, plan, or arrangement
between related parties that increases
the adjusted basis of property within the
six-month period before the taxpayer
acquires the property in a specified
nonrecognition transaction has a
principal purpose of increasing the
adjusted basis of property that a
taxpayer acquires in a nonrecognition
transaction.

Taxpayers have expressed concern
about the breadth of the anti-abuse rule.
A comment stated that the anti-abuse
rule can create a "cliff effect" whereby a
minimal amount of pre-transaction
basis step-up could disqualify an entire
transaction that would have otherwise
qualified for the specified
nonrecognition transaction exception.
The comment recommended that the
anti-abuse rule exclude transactions
with a relatively small amount of basis
step-up or provide taxpayers with an
election to forego the basis step-up.

Section 1.59A–9(b)(4) has been
revised to adopt this comment. First, the
anti-abuse rule now provides that when
the rule applies, its effect is to turn off
the application of the specified
nonrecognition transaction exception only to the extent of the basis step-up
amount. This revision addresses the
comment’s concern regarding the cliff
effect of the rule.

Second, § 1.59A–9(b)(4) has been
revised to clarify that the transaction,
plan, or arrangement with a principal
purpose of increasing the adjusted basis
of property must also have a connection
to the acquisition of the property by the
taxpayer in a specified nonrecognition
transaction. This change is made
because the Treasury Department and
the IRS understand that some taxpayers
interpreted the prior version of the rule
to potentially apply to certain basis
step-up transactions (for example, a
qualified stock purchase for which an
election is made under section 338(g)),
even if that basis step-up transaction
had no factual connection with a later
specified nonrecognition transaction
(for example, the section 338(g)
transaction occurred many years before
the BEAT was enacted, but the property
still has a stepped-up basis that is being
depreciated or amortized when the
subsequent specified nonrecognition
transaction occurs). Sections 1.59A–
9(c)(11) (Example 10) and 1.59A–
9(c)(12) (Example 11) have also been
revised to reflect these changes.

VI. Possible Future Guidance
Concerning the QDP Reporting
Requirements

The preamble to the proposed
regulations indicated that comments to
the proposed regulations were required
to be received by February 4, 2020.

REG–112607–19, 84 FR 67046 (December 6, 2019). A comment was submitted after this date that recommended that the Treasury Department address the interaction of the QDP exception, the BEAT netting rule in § 1.59A–2(e)(3)(iv) (with respect to positions for which a taxpayer applies a mark-to-market method of accounting for U.S. federal income tax purposes), and the QDP reporting requirements in § 1.159A–6 and § 1.6038A–2(b)(7)(ix)—each in the 2019 final regulations. The comment recommended that the asserted ambiguities be addressed in revised final regulations, a revenue procedure or another type of written authoritative guidance. The Treasury Department and the IRS are studying this submission and considering whether future guidance may be appropriate.

Applicability Date
These final regulations generally apply to taxable years beginning on or after October 9, 2020. The rules in §§ 1.159A–7(c)(5)(v) and (g)(2)(x), and 1.159A–9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019.

Taxpayers may apply these final regulations in their entirety for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply these regulations in their entirety for all subsequent taxable years. See section 7805(b)(7). Alternatively, taxpayers may apply only § 1.159A–3(c)(5) and (6) for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply § 1.159A–3(c)(5) and (6) in their entirety for all subsequent taxable years. Taxpayers may also rely on §§ 1.159A–2(e)(2)(ii) and (c)(4) through (6), and 1.159A–3(c)(5) and (c)(6) of the proposed regulations in their entirety for taxable years beginning after December 31, 2017, and before October 9, 2020.

Special Analyses
I. Regulatory Planning and Review—Economic Analysis
Executive Orders 13771, 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 this regulation is regulatory.

These final regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (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 has designated these regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these regulations.

A. Background
The Tax Cuts and Jobs Act of 2017 (the “Act”) added new section 59A, which 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).

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 the corporation’s total deductions (with certain exceptions), a determination referred to as the “base erosion percentage test.” The applicable percentage in 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 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.

On December 6, 2019, the Treasury Department and the IRS published final regulations under sections 59A, 383, 1502, 6038A, and 6655 (the “2019 final regulations”) and also published proposed regulations (“proposed regulations”), which are being finalized here.

B. Need for the Final 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 deemed 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. Regulations are needed to respond to these comments and to clarify the treatment of these amounts under section 59A, including with respect to partnership items and reinsurance payments. Regulations are also needed to clarify certain aspects of the rules set forth in the 2019 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
These final regulations (“these regulations” or “the 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. The regulations also permit waiver of some reinsurance items that are also subject to the BEAT. These provisions are analyzed in part D of these Special Analyses.

These regulations also include modifications to the rules set forth in the 2019 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. The regulations further
address, in response to comments, technical issues that apply when a partner in a partnership elects to waive deductions, and when reinsurance items are waived—issues that were not addressed in the proposed regulations. These provisions are not expected to result in any meaningful changes in taxpayer behavior relative to the no-action baseline or alternative regulatory approaches and are not assessed in these Special Analyses.

The proposed regulations solicited comments on the economic effects of the election to waive deductions and more generally of the proposed regulations. No such comments were received.

D. Economic Analysis

1. Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of these final regulations compared to a no-action baseline that reflects anticipated Federal income tax-related behavior in the absence of these regulations.

2. Economic Effects of the Election To Waive Deductions

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 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 to prior proposed regulations 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: (1) Provide 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) provide 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. These 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 these 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 (with certain exceptions listed in the regulations) and thus, for example, the deductions are also not allowed for regular income tax purposes. If the taxpayer is not an applicable taxpayer because the taxpayer 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 $1,000x and also has a net global intangible low-taxed income (“GILTI”) inclusion of $500x. 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 ($1,000x + $500x − $870x − $30x), its regular U.S. tax rate is 21.0 percent, and its regular U.S. tax liability is $216x ($600x × 21% = $126x, less foreign tax credits of $105x = $216x). Under the alternative regulatory approach, the taxpayer is an applicable taxpayer because its base erosion percentage is 3.33 percent ($30x/$900x), which is greater than the three percent base erosion threshold. Because the taxpayer is subject to the BEAT, it must further compute its modified taxable income, which is $630x—its regular U.S. taxable income ($600x) plus its base erosion tax benefits ($30x). The taxpayer determines its base erosion minimum tax amount as the excess of the BEAT rate (10 percent) multiplied by its modified taxable income ($630x, thus yielding a base erosion minimum tax amount of $63x = $630x × 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 these regulations, this taxpayer would have the option to waive all or part of its deductions that are base erosion payments; this is potentially advantageous to the taxpayer if it allows the taxpayer’s base erosion percentage to 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 below 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 × 21% = $126.65, less foreign tax credits of $105x = $21.65x). 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 in tax liability between these regulations and the alternative regulatory approach. Part D.2.c of these Special Analyses discusses the behavioral incentives and economic effects that can result from this tax treatment.

3 Under the alternative regulatory approach, the taxpayer is an applicable taxpayer because its base erosion percentage is 3.33 percent ($30x/$900x), which is greater than the three percent base erosion threshold. Because the taxpayer is subject to the BEAT, it must further compute its modified taxable income, which is $630x—its regular U.S. taxable income ($600x) plus its base erosion tax benefits ($30x). The taxpayer determines its base erosion minimum tax amount as the excess of the BEAT rate (10 percent) multiplied by its modified taxable income ($630x, thus yielding a base erosion minimum tax amount of $63x = $630x × 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 these regulations, this taxpayer would have the option to waive all or part of its deductions that are base erosion payments; this is potentially advantageous to the taxpayer if it allows the taxpayer’s base erosion percentage to 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 below 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 × 21% = $126.65, less foreign tax credits of $105x = $21.65x). 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 in tax liability between these regulations and the alternative regulatory approach. 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 the Election To Waive Deductions

These regulations effectively allow a taxpayer to make payments that would be base erosion payments without becoming an applicable taxpayer and

\[3\] 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.
thus subject to the BEAT. Thus, this provision reduces the effective tax on base erosion payments for some taxpayers, relative to the alternative regulatory approach. Because of this reduction, these regulations may lead to a higher amount of base erosion payments than under the alternative regulatory approach.

The Treasury Department projects, based on a standard economic model, that any such higher amount of base erosion payments under these regulations would come from those taxpayers who, under the alternative regulatory approach, would not be applicable taxpayers but would be close to being applicable taxpayers; that is, the taxpayers who would potentially change behavior would be those taxpayers who, under the alternative regulatory approach, would have a base erosion percentage that was close to but below the base erosion threshold. No additional base erosion payments are projected under this model to come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.4

To see the logic behind this claim, consider an applicable taxpayer under the alternative regulatory approach with base erosion payments of SY. 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 chooses base erosion payments of SY rather than SY + 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 these 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 hypothesized 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 these regulations. This example suggests that to the extent that there is any increase in base erosion payments under these regulations (and substitution away from non-base erosion payments), it generally will not come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.

The example further suggests that any change in behavior will instead generally come from those taxpayers that would not be applicable taxpayers under the alternative regulatory approach. These taxpayers would be able, under these 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. The Treasury Department projects that this is the set of taxpayers that will be the primary source of any economic effects arising from these regulations. To the extent that this model does not capture all possible taxpayer circumstances, the Treasury Department recognizes that there may be some additional base erosion payments that come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.

As a result of the ability to waive deductions in these regulations, these taxpayers may change business behavior in two possible ways relative to the alternative regulatory approach. First, these 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. It would cause the taxpayer to become an applicable taxpayer. Under these 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. These activities would be accompanied by an increase in base erosion payments.

Second, businesses already operating in the United States may structure a greater proportion of their transactions as base erosion payments under these regulations relative to the alternative regulatory approach. 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 these regulations, this business could instead use a foreign related party (thus, the transaction would generally be a base erosion payment) rather than an unrelated party. If these transactions, without paying the BEAT, again provided it waived sufficient deductions to stay below the base erosion threshold.

In each of these cases, under the standard economic model 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 these final regulations, there would be no U.S. tax-related benefit 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. In these circumstances, these activities would generally be beneficial to the U.S. economy.

Although the standard economic model projects an increase in base erosion payments and a benefit to the U.S. economy under these regulations relative to the alternative regulatory approach, it does not yield clear implications for the economic value of these payments. An inference about the marginal value of a base erosion payment depends on the marginal tax incurred by base erosion payments near the base erosion threshold, which in turn 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 such as the additional BEAT tax liability relative to non-BEAT tax liability in situations when significant tax credits are also subject to BEAT (see generally, part I.A of this Special Analyses section).

Because of these factors, the difference in the non-tax value to businesses of a marginal base erosion payment between these regulations and alternative regulatory approach is complex and cannot be readily inferred. In summary, for taxpayers who elect to waive deductions under these regulations, the Treasury Department and the IRS expect that relative to the alternative regulatory approach, these regulations would tend to:

Reduce tax costs of additional economic activity in the United States.

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4 To the extent that this model does not capture all possible taxpayer circumstances, the Treasury Department recognizes that there may be some additional base erosion payments that come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.
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 5 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 project that the final regulations will have economic effects greater than $100 million per year ($2020) relative to the no-action baseline. This determination is based on the substantial size of the businesses potentially affected by these regulations (3-year average annual gross receipts of $500 million or above) and the general responsiveness of business activity to effective tax rates,5 one component of which is the deductibility of base erosion payments. Based on these two magnitudes, even modest changes in the deductibility of base erosion tax benefits (and in the certainty of that deductibility) provided by the final regulations, relative to the no-action baseline, can be expected to have annual effects greater than $100 million ($2020). The Treasury Department and the IRS have not produced a more precise estimate of the economic consequences of these regulations relative to the alternative regulatory approach. The economic effects of these regulations depend on (i) the number of taxpayers that would be close to and below the base erosion threshold under the alternative regulatory approach; (ii) the increase in the quantity of base erosion payments they would have under these regulations relative to the alternative regulatory approach; and (iii) the economic consequences of those increased base erosion payments. Items (ii) and (iii) are particularly 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.

The Treasury Department recognizes that taxpayers may incur compliance costs related to deciding whether to waive deductions and ensuring that procedural rules are followed but projects that any such compliance costs will likely be small because the accounting required for the relevant deductions is essentially the same under both these regulations and the alternative regulatory approach. Under both these regulations and the alternative regulatory approach, an applicable taxpayer would have to calculate its BEAT liability. The only additional step a taxpayer that otherwise would be an applicable taxpayer may choose to take under these regulations is to calculate its tax liability with the waiver of certain deductions (all of which the taxpayer would already have documented) in order to avoid being an applicable taxpayer. The taxpayer would make this additional calculation to consider whether waiver of those deductions would result in a lower tax liability. Because these costs are likely to be relatively small, the Treasury Department and the IRS have not estimated the change in compliance costs of this waiver relative to the alternative regulatory approach.

d. Waiver of Reinsurance Payments

The BEAT waiver election in the proposed regulations generally allowed the waiver of deductions but did not include the waiver of other base erosion tax benefits that were not technically deductions. The term “base erosion tax benefits” includes certain reinsurance payments that are treated under the Code as reductions to gross income rather than deductions and thus, under the proposed regulations, would not be eligible for a waiver. Because a reduction to income is generally economically similar to a deduction, in response to comments, the Treasury Department and the IRS have determined that the policy rationale for providing the BEAT waiver election also applies to insurance-related base erosion payments. Thus, these regulations further provide for the waiver of amounts treated as reductions to gross premiums and related payments that would otherwise be base erosion tax benefits within the definition of section 59A(c)(2)(A)(iii).

This provision will generally lead to an increase in reinsurance payments that are base erosion payments, relative to the alternative regulatory approach. The Treasury Department projects that because these payments are economically similar to other payments that are allowed a waiver, this provision will treat similar income similarly and thereby improve the performance of the U.S. economy relative to a regulatory approach of not allowing a waiver for certain reinsurance items while allowing such a waiver for other deductions.

The Treasury Department and the IRS have not estimated the increase in reinsurance payments that are base erosion payments that is likely to result under these regulations, relative to the alternative regulatory approach, because currently available tax data include only (net) premiums and do not separately record reinsurance transactions. The Treasury Department and the IRS further have not estimated the economic consequences of taxpayers substituting reinsurance payments that are base erosion payments for reinsurance payments that would not be base erosion payments because the Treasury Department and the IRS do not have readily available models that could assess this value.

e. Number of Affected Taxpayers

These regulations affect all corporate taxpayers that satisfy the gross receipts test and base erosion percentage test and have base erosion payments. The Treasury Department and the IRS project that approximately 2,200 taxpayers are affected by these regulations. This estimate is based on the number of returns in the IRS’s Statistics of Income (SOI) corporate sample as of July 28, 2020, that are recorded as having Form 8991, Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts, attached and that reported gross receipts of $500 million or above in tax year 2018. These attachments have not yet been verified and could include blanks, duplicates, or forms that do not properly contain information related to the BEAT. Because this sample is preliminary, these returns have not yet been weighted for the extent to which they represent the population of corporate tax returns. This count includes paper returns.

These data show that 5,911 returns have Form 8991 attached. Of these, 2,222 tax returns show gross receipts of $500 million or more and 3,689 have gross receipts below $500 million in 2018. Although the BEAT test for applicable taxpayer status depends on the average of gross receipts over a three-year period, these tax data have not yet been linked to previous years’ data and thus do not reflect the 3-year average of gross receipts. Of these 5,911

tax returns, 393 returns paid the BEAT tax.

II. Paperwork Reduction Act

The collections of information in these final regulations with respect to section 59A are in §§ 1.59A–3(b)(3)(iii)(C), 1.59A–3(c)(6), and 1.6031(a)–1(b)(7). These final regulations retain the collections of information in the proposed regulations, with the addition of the collection of information in § 1.59A–3(b)(3)(iii)(C).

The collection of information in § 1.59A–3(b)(3)(iii)(C) permits an amount paid or accrued by a taxpayer to a partnership to be eligible for the base erosion payment exception with respect to effectively connected income. This exception applies to any amount treated as paid or accrued to a foreign related party under § 1.59A–7(b) or (c) to the extent that the exception for effectively connected income provided in § 1.59A–3(b)(3)(iii)(A) would have applied if the amount paid or accrued had been made directly by the taxpayer to the foreign related party. To be eligible for this exception, a foreign related party or partnership must certify to the taxpayer that a payment to a partnership would have been effectively connected income if paid directly to the foreign related party. Section 1.59A–3(b)(3)(iii)(C) was added in response to comments. The collection of information associated with this addition allows a taxpayer to verify that the recipient of an amount paid or accrued to a foreign related party is eligible for the exception in § 1.59A–3(b)(3)(iii)(C). The IRS may use this information to ensure compliance with § 1.59A–3(b)(3)(iii)(C). For purposes of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) (“PRA”), the reporting burden associated with § 1.59A–3(b)(3)(iii)(C) will be reflected in the PRA submission associated with Form 8991 (see chart at the end of this part II of this Special Analyses section for the status of the PRA submission for Form 8991). The estimated number of respondents for the reporting burden associated with § 1.59A–3(b)(3)(iii)(C) is based on the number of taxpayers who filed a Form 1120–F with Line Y(1) (“Did a partnership allocate to the corporation a distributive share of income from a directly owned partnership interest, any of which is ECI or treated as ECI by the partnership or the partner?”) checked “yes”. As provided below, the IRS estimates the number of affected filers to be approximately 6,000.

As explained in the preamble to the proposed regulations, the collection of information in § 1.59A–3(c)(6) relates to an election to waive deductions allowed under the Code. The election to waive deductions is made by a taxpayer on its original or amended income tax return. A taxpayer makes the election on an annual basis by completing Form 8991, or as provided in applicable instructions. The instructions for Form 8991 currently describe how a taxpayer may make this election. The Form 8991 for the 2020 taxable year will incorporate this election.

As explained in the preamble to the proposed regulations, the collection of information in § 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(c), to provide information necessary to report any base erosion payments on Form 8991. The IRS intends that this information will be collected by completing Form 8991.

The IRS is contemplating making revisions to Form 1065, Schedule K, and Schedule K–1 to take these final regulations into account, including through the proposed draft Schedules K–2 and K–3. In connection with the release of draft forms, the IRS invited comments from affected stakeholders. 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 the 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 3.344 billion hours and total estimated monetized costs of $61.558 billion ($2019). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the BEAT requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions imposed prior to the Act. No burden estimates specific to the final regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the final regulations. In addition, when available, drafts of IRS forms are posted for comment at www.irs.gov/draftforms.

<table>
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<th>OMB No.(s)</th>
<th>Status</th>
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<td>Business (NEW Model)</td>
<td>1545–0123</td>
<td>Approved by OIRA through 1/31/2021.</td>
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The number of respondents in the Related New or Revised Tax Forms table was estimated by Treasury’s Office of Tax Analysis based on the number of returns in the IRS’s Statistics of Income (SOI) corporate sample as of July 28, 2020, that are recorded as having Form 8991 attached and that reported gross receipts of $500 million or above in tax year 2018. Only certain large corporate taxpayers with gross receipts of at least $500 million are expected to file this form.

III. Regulatory Flexibility Act

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). This certification is based on the fact that the BEAT and these regulations affect only aggregate groups of corporations with average annual gross receipts of at least $500 million and that also make payments to foreign related parties in excess of the base erosion percentage test (that is, 3 percent or more of their deductible payments to foreign related parties). Generally, only large businesses both have substantial gross receipts and make a significant portion of their deductible payments to foreign related parties. The $500 million threshold for the gross receipts test is greater than any Small Business Administration size standard that is based on annual gross receipts. See generally 13 CFR part 121.

Pursuant to section 7805(f), the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

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

VI. Congressional Review Act

The Administrator of the Office of Information and Regulatory Affairs of the OMB has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (“CRA”). Under section 801(3) of the CRA, a major rule generally takes effect 60 days after the rule is published in the Federal Register. Accordingly, the Treasury Department and IRS are adopting these final regulations with the delayed effective date generally prescribed under the CRA.

Drafting Information

The principal authors of these final regulations are Sheila Ramaswamy, Karen Walny, and Azeka Abramoff 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.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1---INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.59A–0 is revised to read as follows:

§ 1.59A–0 Table of contents.

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

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

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(b) Definitions.
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(2) Applicable section 38 credits.
(3) Applicable taxpayer.
(4) Bank.
(5) Base erosion and anti-abuse tax rate.
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(7) Deduction.
(8) Disallowed business interest expense carryforward.
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(11) Foreign related business interest expense.
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(ii) Time and manner for election to waive deduction.

(A) In general.

(B) Information required to make the election to waive allowed deductions.

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(A) In general.

(1) Consistent treatment.

(2) No allocation and apportionment of waived deductions.
(3) Effect of waiver of deductions described in §§1.861–10 and 1.861–10T.

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(B) Effect of the election to waive deductions disregarded for certain purposes.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

(iv) Rules applicable to partners and partnerships.

(A) In general.

(B) Rule for determining the adjusted basis of a partner’s interest in a partnership.

(C) Rule for applying section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

(i) Facts.

(i) Facts.

(ii) Analysis.

(C) Not a method of accounting.

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(3) Analysis.

(2) Example 2: Not operating loss deduction.

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(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

(i) Facts.

(ii) Analysis.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

(iv) Rules applicable to partners and partnerships.

(A) In general.

(B) Rule for determining the adjusted basis of a partner’s interest in a partnership.

(C) Rule for applying section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

(i) Facts.

(ii) Analysis.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

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(ii) Analysis.

(1) Facts.

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(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

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(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

(i) Facts.

(ii) Analysis.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

(iv) Rules applicable to partners and partnerships.

(A) In general.

(B) Rule for determining the adjusted basis of a partner’s interest in a partnership.

(C) Rule for applying section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.

(3) Analysis.

(i) Facts.

(ii) Analysis.

(i) Facts.

(ii) Analysis.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

(iv) Rules applicable to partners and partnerships.

(A) In general.

(B) Rule for determining the adjusted basis of a partner’s interest in a partnership.

(C) Rule for applying section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(ii) Analysis.

(1) Facts.

(3) Analysis.

(2) Example 2: Not operating loss deduction.

(ii) Analysis.
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(9) Example 8: Transactions to avoid the application of rules applicable to banks and registered securities dealers.
(i) Facts.
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(10) Example 9: Transactions that do not avoid the application of rules applicable to banks and registered securities dealers.
(i) Facts.
(ii) Analysis.
(11) Example 10: Acquisition of depreciable property in a nonrecognition transaction.
(i) Facts.
(ii) Analysis.

§ 1.59A–10 Applicability date

(a) General applicability date.
(b) Exception.

§ 1.59A–1 [Amended]

Par. 3. Section 1.59A–1 is amended by removing the language in the “Remove” column from wherever it appears and adding in its place the language in the “Add” column for each paragraph listed in the table, as set forth below.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Remove</th>
<th>Add</th>
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</thead>
<tbody>
<tr>
<td>(b)(6)</td>
<td>§ 1.163(j)(1)(b)(2)</td>
<td>§ 1.163(j)(1)(b)(3)</td>
</tr>
<tr>
<td>(b)(8)</td>
<td>§ 1.163(j)(1)(b)(9)</td>
<td>§ 1.163(j)(1)(b)(11)</td>
</tr>
</tbody>
</table>

Par. 4. Section 1.59A–2 is amended by:

1. In paragraph (c)(1), adding a sentence to the end of the paragraph.

2. Adding paragraphs (c)(2)(iii), (c)(4) through (6), and (c)(9).

3. In paragraph (f)(1), revising the paragraph heading.

4. Adding paragraph (f)(2).

The additions and revisions read as follows:

§ 1.59A–2 Applicable taxpayer.

* * * * *

(c) * * *

(1) * * * For purposes of this paragraph (c)(1), each payment or accrual is treated as a separate transaction.

(2) * * * Change in the composition of an aggregate group. A change in ownership of the taxpayer (for example, a sale of the taxpayer to a third party) does not cause the taxpayer to leave its own aggregate group. Instead, any members of the taxpayer’s aggregate group before the change in ownership that are no longer members following the change in ownership are treated as having left the taxpayer’s aggregate group, and any new members that become members of the taxpayer’s aggregate group following the change in ownership are treated as having joined the taxpayer’s aggregate group. A change in ownership of another member of the aggregate group of the taxpayer (for example, a sale of the member to a third party) may result in the member joining or leaving the aggregate group of the taxpayer. See paragraph (c)(4) of this section for the treatment of members joining or leaving the aggregate group of a taxpayer.

* * * * *

(4) Periods before and after a corporation is a member of an aggregate group—(i) In general. 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, base erosion tax benefits, and deductions of a corporation that are properly included in the gross receipts and base erosion percentage of the aggregate group of a taxpayer are not reduced as a result of the member leaving the aggregate group of the taxpayer.

(ii) Deemed taxable year-end. Solely for purposes of this paragraph (c), if a corporation leaves or joins the aggregate group of a taxpayer, the corporation is treated as ceasing to be a member of the aggregate group at the time of its taxable year-end, or becoming a member of the...
aggregate group immediately after the time of its taxable year-end, resulting from the transaction. For purposes of this paragraph (c), if a corporation joins or leaves an aggregate group in a transaction that does not result in the corporation having a taxable year-end, the corporation is treated as having a taxable year-end ("deemed taxable year-end") at the end of the day on which the transaction occurs.

(iii) Items allocable to deemed taxable years before and after deemed taxable year-end. Solely for purposes of this paragraph (c), a corporation that has a deemed taxable year-end determines gross receipts, base erosion tax benefits, and deductions attributable to the deemed taxable year ending upon, or beginning immediately after, the deemed taxable year-end by either treating the corporation's books as closing ("deemed closing of the books") at the deemed taxable year-end or, in the case of items other than extraordinary items, allocating those items on a pro-rata basis without a closing of the books. Extraordinary items are allocated to the deemed taxable year ending upon, or beginning immediately after, the deemed taxable year-end based on the day that they are taken into account. For purposes of applying this paragraph (c)(4)(iii), extraordinary items that are attributable to a transaction that occurs during the portion of the corporation’s day after the event resulting in the corporation joining or leaving the aggregate group are treated as taken into account at the beginning of the following day. Additionally, for purposes of applying this paragraph (c)(4)(iii), "extraordinary items" include the items enumerated in §1.1502–76(b)(2)(ii)(C) as well as any other payment not made in the ordinary course of business that would be treated as an extraordinary payment.

(5) Short taxable year—(i) Short period of the taxpayer—(A) In general. Solely for purposes of this section, if a taxpayer has a taxable year of fewer than 12 months (a short period), the gross receipts, base erosion tax benefits, and deductions of the taxpayer are annualized by multiplying the total amount for the short period by 365 and dividing the result by the number of days in the short period.

(B) Determining the gross receipts and base erosion percentage of the aggregate group of a taxpayer for a short period. When a taxpayer has a taxable year that is a short period and a member of the taxpayer's aggregate group does not have a taxable year that ends with or within the taxpayer's taxable year as a result of the taxpayer's 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. A reasonable approach does not include an approach that does not take into account the gross receipts, base erosion tax benefits, or deductions of the member. The taxpayer must consistently apply the reasonable approach. Examples of a reasonable approach may include an approach that takes into account 12 months of gross receipts, base erosion tax benefits, and deductions of the member by reference to—

(1) The 12-month period ending on the last day of the short period;

(2) The member's taxable year that ends nearest to the last day of the short period or that begins nearest to the first day of the short period; or

(3) An average of the two taxable years of the member ending before and after the short period.

(ii) Short period of a member of the taxpayer's aggregate group—(A) Multiple taxable years of a member of the taxpayer's aggregate group comprised of more than 12 months. If a member of a taxpayer's aggregate group has more than one taxable year ending with or within the taxpayer's taxable year, and the member's taxable years ending with or within the taxpayer's taxable year are comprised of more than 12 months in total, then the aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group. The aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized by multiplying the total amount for the member's taxable years by 365 and dividing the result by the total number of days in the taxable years of the member ending before and after the short period.

(B) Short period or periods of a member of the taxpayer's aggregate group comprised of fewer than 12 months from change in taxable year. If, as a result of a member of a taxpayer's aggregate group changing its taxable year-end (other than as a result of the application of §1.1502–76(a)), the member's taxable year or years ending with or within the taxpayer's taxable year are comprised of fewer than 12 months in total, then the aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized by multiplying the gross receipts and base erosion percentage of the taxpayer's aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized by multiplying the total amount for the member's taxable year or years by 365 and dividing the result by the total number of days in the taxable year or years.

(iii) Anti-abuse rule. If a taxpayer or a member of a taxpayer's aggregate group enters into a transaction (or series of transactions), plan, or arrangement with another corporation that is a member of the aggregate group or a foreign related party that has a principal purpose of changing the period taken into account under the gross receipts test or the base erosion percentage test to avoid applicable taxpayer status under paragraph (b) of this section, then the gross receipts test or base erosion percentage test, respectively, applies as if that transaction (or series of transactions), plan, or arrangement had not occurred.

(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 is the distributer or transferor corporation in a transaction described in section 381(a) in which the taxpayer is acquiring corporation. For purposes of determining the gross receipts of a predecessor that are taken into account by a taxpayer, the operating rules set forth in this paragraph (c) and in paragraph (d) of this section are applied to the same extent they were applied to the predecessor.

(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 of each member are taken into account only once.

(9) Consolidated groups. For the treatment of consolidated groups for purposes of determining gross receipts and base erosion tax benefits, see §1.1502–59A(b).

(f) * * * * *

(1) Example 1: Mark-to market * * *

(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 at the end of the day on June 30, Year 1, as a result of the sale. Corporation 2 leaves the aggregate group of Corporation 1 and Parent Corporation at the end of the day on June 30, Year 1. The aggregate group of Corporation 1 takes into account only the gross receipts, base erosion tax benefits, and deductions of Corporation 2 allocable to the period from January 1 to the end of the day on June 30, Year 1, in accordance with paragraph (c)(4)(ii) and (iii) of this section. The same results apply to the aggregate group of Parent Corporation for calendar Year 1. See paragraph (d)(1) and (2) of this section for the periods taken into account in determining whether the taxpayer or its aggregate group satisfies the gross receipts test.

(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 the end of the day on June 30, Year 1. Because Corporation 2 does not have a short taxable year, paragraph (c)(5)(i) 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 allocable to the period from January 1 to the end of the day on June 30, Year 1, and the gross receipts, base erosion tax benefits, and deductions of Corporation 3 allocable to the period from July 1 to December 31, Year 1 in accordance with paragraph (c)(4)(ii) and (iii) of this section. See paragraph (d)(1) and (2) of this section for the periods taken into account in determining whether the taxpayer or its aggregate group satisfies the gross receipts test.

* * * * *

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

* * * * *

(C) **Application to partnerships.** To the extent that paragraph (b)(3)(iii)(A) or (B) of this section would apply to a payment or accrual made directly by a taxpayer to a foreign related party, paragraph (b)(3)(iii)(A) or (B) of this section apply to an amount treated as paid or accrued by a taxpayer to a foreign related party under § 1.59A–7(b) or (c) generally applying aggregate principles to treat partnership transactions as partner-level transactions for purposes of section 59A. The certification requirement in paragraph (b)(3)(iii)(A) of this section is met if the taxpayer receives a written statement from the foreign related party that is comparable to the certification provided in paragraph (b)(3)(iii)(A) of this section but based on the deemed transaction under § 1.59A–7(b) or (c) and the extent to which paragraph (b)(3)(iii)(A) or (B) of this section would have applied to that deemed transaction. The taxpayer may rely on the written statement unless it has reason to know or actual knowledge that the statement is incorrect. * * * * *

(5) **Allowed deduction.** Solely for purposes of paragraph (c)(1) of this section, all deductions (and any premium or other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A)) 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.** If a taxpayer elects to waive certain deductions, in whole or in part, pursuant to this paragraph (c)(6)(i), the amount of allowed deductions as described in paragraph (c)(5) of this section is reduced by the amounts that are properly waived. In order to make the election or increase the amount of the deduction waived, the taxpayer must determine that it could satisfy the requirements of § 1.59A–2(b) absent the election to waive certain deductions. For rules applicable to partners and partnerships, see paragraph (c)(6)(iv) of this section. For rules addressing waiver of premium or other consideration paid or accrued by a taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A), see paragraph (c)(6)(v) of this section.

(ii) **Time and manner for election to waive deduction—(A) In general.** 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 three 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 taxable 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 8891, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts (or Successor),* including the information described in paragraph (c)(6)(ii)(B) 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 than as described in this paragraph (c)(6)(i) (for example, by filing an application for a change in accounting method).

(B) **Information required to make the election to waive allowed deductions.** To make this election, a taxpayer must maintain contemporaneous documentation and provide information related to each deduction waived as required by applicable forms and instructions issued by the Commissioner, including—

(1) A 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;
(2) The date on which, or period in which, the waived deduction was paid or accrued;
(3) 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;
(4) The amount of the deduction that is claimed for the taxable year with respect to the item or property;
(5) The amount of the deduction being waived for the taxable year with respect to the item or property;
(6) A description of where the deduction is reflected (or would have been reflected) on the Federal income tax return (such as a line number); and
(7) The name, Taxpayer Identification Number (or, if the foreign person does not have a Taxpayer Identification Number, the foreign equivalent), and country of organization of the foreign related party that is or will be the recipient of the payment that generates the deduction.

(iii) Effect of election to waive deduction—(A) In general—(1) Consistent treatment. Except as otherwise provided in this paragraph (c)(6)(iii), any deduction waived under paragraph (c)(6)(i) of this section is treated as having been waived for all purposes of the Internal Revenue Code and regulations.
(2) No allocation and apportionment of waived deductions. The waiver of deductions described in paragraph (c)(6)(i) of this section is treated as occurring before the allocation and apportionment of deductions under §§ 1.861–8 through 1.861–14T 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.
(4) Effect of the election to waive deductions on the stock basis of a consolidated group member. For purposes of § 1.1502–32, any deduction waived under paragraph (c)(6)(i) of this section is a noncapital, nondeductible expense under § 1.1502–32(b)(2)(ii).

(iv) Rules applicable to partners and partnerships—(A) In general. Except as provided in paragraph (c)(6)(iv)(D) of this section, deductions allocated to a corporate partner by a partnership may only be waived by the partner and not by the partnership, and then only to the extent the partner otherwise qualifies for the waiver under paragraph (c)(6) of this section. For purposes of complying with the documentation requirements in paragraph (c)(6)(i) of this section, the partner is not required to report the information in paragraphs (c)(6)(ii)(B)(2) and (3) of this section, and in lieu of reporting the information in paragraphs (c)(6)(ii)(B)(1) of this section, the partner is required to report the partnership from which the item is allocated.
(B) Rule for determining the adjusted basis of a partner's interest in a partnership. If a partner elects to waive a deduction or increases the amount of deduction waived with respect to deductions allocated to it by a partnership, the partner treats the waived amount as a nondeductible expenditure under section 705(a)(2)(B).
(C) Rule for applying section 163(j). If a partner waives a deduction pursuant to paragraph (c)(6)(iv)(A) of this section that was taken into account by the partnership in determining the partnership's adjusted taxable income for purposes of section 163(j), then the increase in the partner's income resulting from the waiver is treated by the partner (but not the partnership) as a partner basis item (as defined in § 1.163(j)(6)(b)(2)) for purposes of section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241. Except as provided in this paragraph (c)(6)(iv)(D), a partner is not permitted to waive any adjustment by the Secretary to any partnership-related items that is made pursuant to subchapter C of chapter 63. A partner in a partnership subject to subchapter C of chapter 63 may only make an election to waive any increase in a deduction due to an adjustment made under subchapter C of chapter 63 that the partner takes into account under section 6225(c)(2)(A), 6226, or 6227 in a manner consistent with paragraph (c)(6) of this section. If the partner makes an election under paragraph (c)(6)(i) of this section, the partner will compute its additional reporting year tax (as described in § 301.6226–3 of this chapter) or amount due under § 301.6225–2(d)(2)(ii)(A) of this chapter taking into account the rules in paragraph (c)(6)(i) of this section with respect to the increase in the deduction that is waived.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A). For purposes of paragraph (c)(6)(i) of this section, a taxpayer may elect to waive (or increase the amount waived of) any premium or other consideration paid or accrued by the taxpayer for any reinsurance payments under section 803(a)(1)(B) or 832(b)(4)(A) that would be a base erosion tax benefit.
within the meaning of section 59A(c)(2)(A)(iii), in accordance with the rules and principles of this paragraph (c)(6).

(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)(ii) of this section the 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)(iii)(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)(iii)(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)(ii) 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)(iii)(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)(iii)(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. 6. Section 1.59A–7 is amended by:
   1. Adding paragraph (c)(5)(v).
   2. In paragraph (e)(2)(ii), removing the language “§ 1.59A–2(d)(2)” and adding the language “§ 1.59A–2(d)(3)” in its place.

3. Adding paragraph (g)(2)(x).

The additions 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), an allocation of income to the partner to whom any built-in gain or built-in loss would be allocable under section 704(c) (the 704(c) partner), in an amount necessary to offset the effect of the ceiling rule (as defined in § 1.704–3(b)(1)), in lieu of a deduction allocation to a partner other than the 704(c) partner (a non-704(c) partner), is treated as a deduction to the non-704(c) partner 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)(ii)(B) of this section (the analysis in Example 1), except that actual depreciation is $8x ($50x – $42x) 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 of $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 paragraphs (c)(5)(v) and (d)(1) of this section.

**Par. 7.** Section 1.59A–9 is amended by:

1. For each paragraph listed in the table, removing the language in the “Remove” column wherever it appears and adding in its place the language in the “Add” column as set forth below:

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<tr>
<td>(c)(3)(i)</td>
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<td>plan or</td>
</tr>
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</table>

2. Revising paragraph (b)(4).
3. Adding paragraphs (b)(5) and (6).
4. Revising paragraphs (c)(11)(i) and (c)(12).

The revisions and addition read as follows:

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

* * * * *

(b) * * *

(4) **Nonrecognition transactions.** If a transaction (or series of transactions), plan, or arrangement (the first transaction) increases the adjusted basis of property that the taxpayer acquires in a transaction (the second transaction) that qualifies for the specified nonrecognition transaction exception in § 1.59A–3(b)(3)(viii)(A) (or would qualify, but for this paragraph (b)(4)), and a principal purpose of the first transaction was to increase the taxpayer’s depreciation or amortization deductions without increasing the taxpayer’s base erosion tax benefits, then § 1.59A–3(b)(3)(viii)(A) does not apply to the property acquired in the second transaction to the extent of the increase in adjusted basis. For purposes of this paragraph (b)(4), if a transaction (or series of transactions), plan, or arrangement between related parties increases the adjusted basis of property within the six-month period before the taxpayer acquires the property, the transaction (or series of transactions), plan, or arrangement is deemed to have such a principal purpose.

(5) **Transactions involving derivatives on a partnership interest.** If a taxpayer acquires a derivative on a partnership interest (or partnership assets) as part of a transaction (or series of transactions), plan, or arrangement that has as a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment) and the partnership interest (or partnership assets) would have resulted in a base erosion payment had the taxpayer acquired that interest (or partnership asset) directly, then the taxpayer is treated as having a direct interest instead of a derivative interest for purposes of section 59A. This paragraph (b)(5), however, does not apply to a derivative, as defined in section 59A(b)(4)(A)(v), on a partnership asset to the extent the payment pursuant to the derivative qualifies for the exception for qualified derivative payments in § 1.59A–3(b)(3)(ii) and § 1.59A–6. 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) an amount from a person not acting in a partner capacity (including a person who is not a partner) and allocates the income or loss with respect to that amount 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 (directly or indirectly) with the partnership will determine its base erosion payment as if the allocations had not been made and the items of income or loss 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.

(c) * * * * *

(i) **Analysis.** Paragraph (b)(4) of this section does not apply to DC’s acquisition of Property 1 because the purchase of Property 1 from U (first transaction) did not have a principal purpose of increasing DC’s adjusted basis of Property 1 without increasing DC’s base erosion tax benefits. The transaction is economically equivalent to an alternative transaction under which FP contributed $100x to DC and then DC purchased Property 1 from U. Further, the second sentence of paragraph (b)(4) of this section (providing that certain transactions are deemed to have a principal purpose of increasing the adjusted basis of property acquired in a second transaction) does not apply because FP purchased Property 1 from an unrelated party.

(ii) **Example 11: Transactions between related parties with a principal purpose of increasing the adjusted basis of property.** (i) Facts. The facts are the same as paragraph (c)(11)(i) of this section (the facts in Example 10), except that U is related to FP and DC.

(ii) **Analysis.** Paragraph (b)(4) of this section applies to DC’s acquisition of Property 1 because the transaction that increased the adjusted basis of Property 1 (the purchase of Property 1 from U) was between related parties, and within six months DC acquired Property 1 from FP in a specified nonrecognition transaction. Accordingly, the purchase of property from U (first transaction) is deemed to have a principal purpose of increasing the adjusted basis of Property 1 that DC acquires in the second transaction—the contribution of a transaction that qualifies as a specified nonrecognition transaction in part and would wholly qualify but for the application of paragraph (b)(4) of this section. Accordingly, the exception in § 1.59A–3(b)(3)(vii)(A) for specified nonrecognition transactions does not apply to the contribution of Property 1 to DC to the extent of the increased adjusted basis from the first transaction ($50x), and DC’s depreciation deductions with respect to Property 1 will be base erosion tax benefits to the extent of the $50x increase in adjusted basis in Property 1.

**Par. 8.** Section 1.59A–10 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 the regulations referred to in the first sentence of this paragraph, 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/irb/2019-02_IRB) in their entirety for all taxable years beginning after December 31, 2017 and ending on or before December 6, 2019.

(b) **Exception.** Sections 1.59A–2(c)(2)(ii) and (c)(4) through (6), 1.59A–3(b)(3)(iii)(C), 1.59A–3(c)(5) and (6), and
1.59A–9(b)(4) apply to taxable years beginning on or after October 9, 2020, and §§ 1.59A–7(c)(5)(v) and 1.59A–9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019. Taxpayers may apply those regulations in their entirety for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply them in their entirety for all subsequent taxable years. Alternatively, taxpayers may apply only § 1.59A–3(c)(5) and (6) for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply § 1.59A–3(c)(5) and (6) in their entirety for all subsequent taxable years.

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§ 1.1502–59A [Amended]

Par. 9. Section 1.1502–59A is amended by removing the language in the “Remove” column from wherever it appears and adding in its place the language in the “Add” column for each paragraph listed in the table, as set forth below.

Par. 10. Section 1.6031(a)–1 is amended by:

1. Adding paragraph (b)(7).
2. Designating paragraph (f) as paragraph (f)(1).
3. Adding paragraph (f)(2).

The additions 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(c), a partner in the foreign partnership who is a person required to file a Form 8991 (or successor) must include the information necessary to report those base erosion payments and base erosion tax benefits on Form 8991 (or successor) in accordance with the related instructions. A partner with a Form 8991 (or successor) filing requirement who is a partner in a foreign partnership that is not required to file a partnership return must obtain the necessary information to report any base erosion payments on Form 8991 (or successor) from the foreign partnership or from any other reliable records of these payments. This paragraph does not apply to any partner described in § 1.59A–7(d)(2).

(f) * * *

(2) Applicability date. Paragraph (b)(7) of this section applies to taxable years ending on or after October 9, 2020.

Sunita Lough,
Deputy Commissioner for Services and Enforcement.
David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).
[FR Doc. 2020–19959 Filed 10–8–20; 8:45 am]
BILLING CODE 4830–01–P