

## 35th Annual TEI-SJSU High Tech Tax Institute

# Still Keeping to the BEAT

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## Presenters

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# Agenda

- 1 Overview of the BEAT
- 2 Proposed BEAT Regulations
- 3 Outbound Structures
- 4 Inbound Structures



## Overview of the BEAT

# Base Erosion and Anti-Abuse Tax (BEAT)

- Section 59A is an alternative minimum tax imposed on US corporate taxpayers making “base erosion payments”
- 10% tax on “modified taxable income” (5% in 2018, 12.5% after 2025)
  - 1% higher rate for certain banks and securities dealers
- Key concepts
  - Applicable taxpayer
  - Base erosion percentage
  - Base erosion tax benefit
  - Base erosion payment
  - Base erosion minimum tax

## Applicable Taxpayer under the BEAT

- Three requirements:
  - A corporation other than an RIC, REIT, or S corporation
  - \$500 million in average gross receipts in preceding 3 years
  - A “base erosion percentage” of 3% or more (2% for certain banks and securities dealers)
- Aggregate all persons treated as a single employer under section 52
  - Only include foreign corporations with ECI
- Staying below the 3% threshold turns off the BEAT!

## Base Erosion Percentage

Ratio of “base erosion tax benefits” to:

- Total deductions
- Plus other base erosion tax benefits related to reinsurance and payments to surrogate foreign corporations (SFCs) that reduce gross receipts
- Minus deductions under sections 172, 245A, and 250
- Minus payments for certain excluded services and qualified derivatives

$$\frac{\text{Base Erosion Tax Benefits}}{\text{Deductions + Other Benefits – Excluded Deductions}}$$

## Base Erosion Tax Benefit

In general ...

any **deduction** allowed for  
 an amount **paid or accrued**  
 by a **corporation**  
 to a **foreign** person  
 that is a **related** party

## Base Erosion Payment

- Payment to a foreign related party
  - for which a deduction is allowable
  - to acquire depreciable property
  - premium or other consideration for reinsurance
- Special rule for a foreign related person that becomes a SFC after November 9, 2017
  - Payments to the SFC or foreign affiliates of the SFC that reduce gross receipts (e.g., COGS)

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## Base Erosion Payment Exceptions

- Payments that reduce gross receipts (e.g., COGS) other than to a SFC
- Payments at cost for low-margin services
  - Services qualify for the services cost method (without regard to the business judgment rule)
  - Exception applies to the cost, without a mark-up
- Payments for qualified derivative contracts
- Payments subject to withholding tax at full statutory rate

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# Base Erosion Minimum Tax

The BEAT tax equals the excess of

- Modified taxable income × the BEAT tax rate, over
- Regular tax liability, reduced (but not below zero) by excess of credits allowed over R&D credits + limited §38 credits

Modified taxable income equals

- Regular taxable income
- Plus base erosion tax benefits
- Plus base erosion percentage × NOL deduction under §172

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## Proposed BEAT Regulations

## SCM Exception

- Propose regulations confirm that cost reimbursement qualifies, while mark-up on costs does not
- Qualifying for the exception
  - Not on “black list” of Treas. Reg. §1.482-9(b)(4)
  - On “white list” of “specified covered services” in Rev. Proc. 2007-13  
**OR** median comparable mark-up of 7% or less
- Can you charge more than 7% mark-up and still qualify?
- Include stock-based compensation in the cost base?

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## Anti-Abuse Rules

**Statute** targets avoidance through

- unrelated parties, conduits, or other intermediaries
- transactions that
  - characterize payments as not subject to BEAT, or
  - substitute payments not subject to BEAT for payments that are subject to BEAT

**Proposed regulations** address only these transactions, with “a principal purpose” of avoiding BEAT

- Intermediary as a conduit
- Increase the denominator of the Base Erosion Percentage
- Avoid rules applicable to banks and registered securities dealers

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# Non-Recognition Transactions

- Proposed regulations treat non-cash consideration in non-recognition transactions as an amount “paid or accrued” to acquire property
- Thus depreciation/amortization of basis in transferred assets is a base erosion tax benefit
- Deemed non-cash consideration also can give rise to a BEAT issue
- Does not apply to section 301 distributions

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# Other Issues in Proposed Regulations

- No netting of reciprocal payment obligations
  - But net deduction okay if computed on net basis under “generally applicable tax law”
  - No detail provided on principles like conduit and substance-over-form
- Base erosion percentage applied to NOL carryforwards based on year in which the NOL arose
- Generally apply the aggregate approach to partnerships
- Exceptions for ECI and 988 losses
  - What about payments subject to subpart F or GILTI?

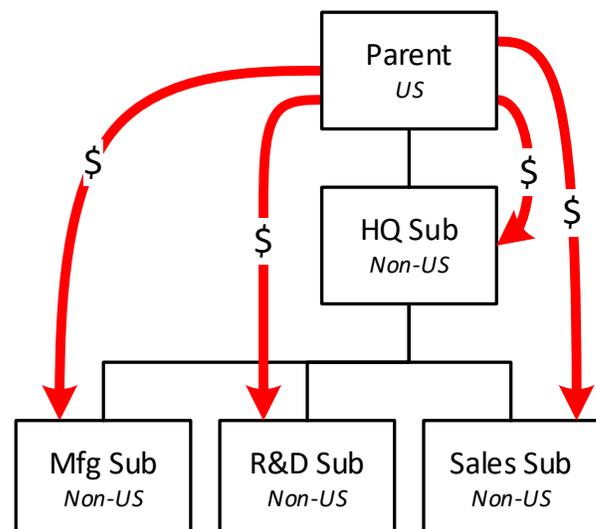
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# Outbound Structures

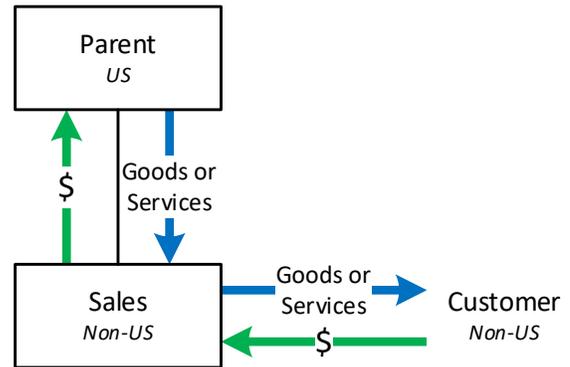
## Outbound Service Fees

- Contract manufacturing could be included in COGs
- SCM exception likely applies to G&A services
- Sales and R&D likely treated as base erosion payments
- What about marketing or data center costs?



## Convert Sales Agent to Reseller

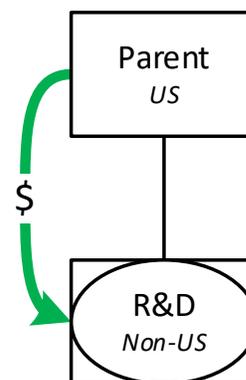
- No more outbound payment
- Subpart F treatment of sales income generally the same
- Possible transfer pricing impact on sales profit
- Not always easy/possible to change the contracting party



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## R&D Service Branch

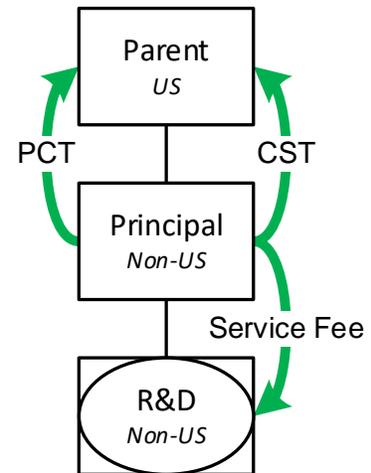
- Eliminates outbound payment
- Foreign branch income
  - Separate FTC basket
  - Not FDII



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## Cost Sharing

- R&D services fee disregarded
- R&D costs included in IDC pool
- CST could be US-inbound
- PCT royalty also US-inbound, and could qualify for FDII rate

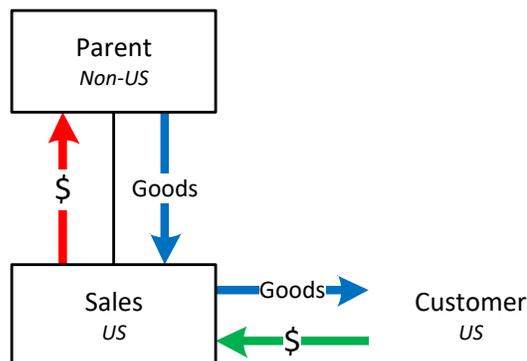


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# Inbound Structures

## US Reseller of Goods

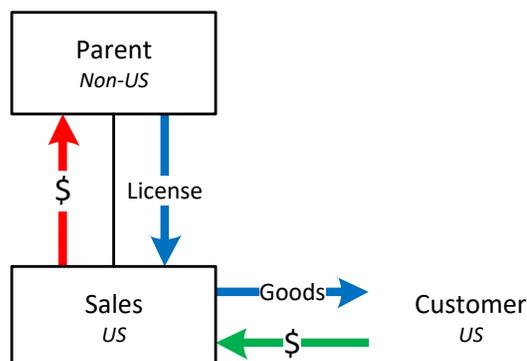
- BEAT generally not a problem
- Outbound payment is COGS
- Not a BEAT payment unless Parent is a new SFC
- Identify additional costs that can be capitalized to inventory cost



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## US Manufacturer of Goods

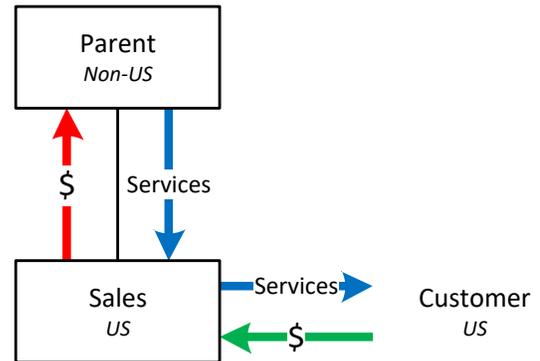
- BEAT should be manageable
- Royalty for licensed IP
- Royalty avoids BEAT if included in COGS under 263A
- May require change of accounting method



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## US Reseller of Services

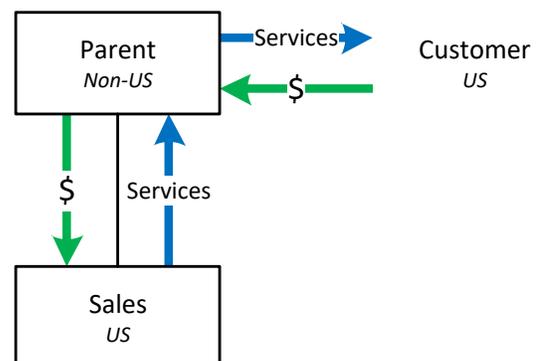
- In contrast to goods, resale of services is a problem
- Outbound payment is deductible, not a reduction in gross receipts
- BEAT payment unless services cost method applies



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## Convert US Reseller to Sales Agent

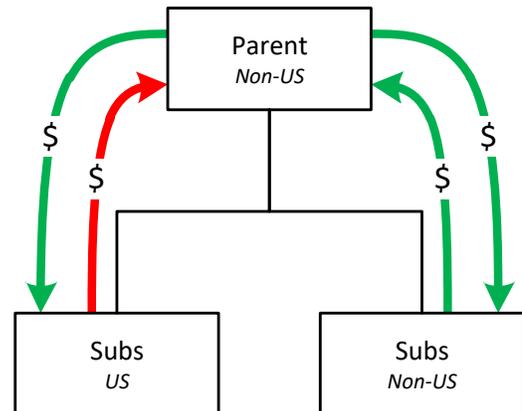
- No more outbound payment
- Royalty-free trademark license
- Not always easy/possible to change the contracting party



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## Shared Services Hub

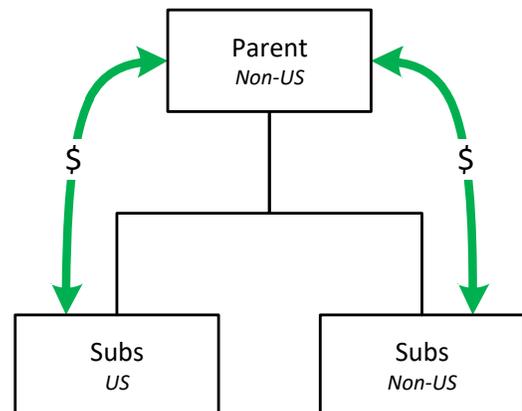
- BEAT on round-tripping of costs
- US share is BEAT, even if originally incurred in US
- This type of services may qualify for services cost method
- Still have issue on mark-up



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## Cost Contribution Arrangement

- Avoid round-tripping
  - Pool and allocate costs rather than charge in both directions
  - Recharge costs within US
- Can reduce or eliminate US-outbound payments



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# Questions