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The Honorable David J. Kautter  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Ave., N.W.  
Washington, D.C. 20220

The Honorable Charles Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Ave., N.W.  
Washington, D.C. 20224

The Honorable William Paul  
Principal Deputy Chief Counsel and Deputy Chief Counsel  
Internal Revenue Service  
1111 Constitution Ave., N.W.  
Washington, D.C. 20224

**Re: Proposed BEAT Regulations (104259-18)**

Dear Sirs:

On behalf of the National Foreign Trade Council ("NFTC"), I would like to express our appreciation to the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("Service") for your efforts in developing the recently issued proposed BEAT regulations (the "Proposed BEAT Regulations").

The NFTC, organized in 1914, is an association of approximately 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial and service activities and the NFTC therefore seeks to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. The NFTC's emphasis is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax inequities in the treatment of U.S. companies operating abroad. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment and through direct investment in facilities abroad. Foreign trade is fundamental to the economic growth of U.S. companies.

The Proposed BEAT Regulations are highly complex and would have a very significant impact on U.S. income tax administration and compliance. In light of that complexity, and the significant number of issues that we have with the Proposed BEAT Regulations, we urge the Treasury and the Service to revise the regulations as discussed below.

We have divided our comments into the following 10 categories:

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1. Application of Code section 15 to new Code section 59A(b)(1)(A), implementing the 5% one year exception. Prop. Treas. Reg. Sec. 1.59A-5(c)(3) should not be included in the final BEAT regulations. Code section 15 should not apply to the first year 5% BEAT tax rate.
2. The SCM Exemption. Proposed Regulations should be adopted as final with the addition that payments to a related foreign party for contract R&D services should be specifically included in the SCM exemption.
3. Exemption for Customer Services. The final regulations should exempt from BEAT any payment to a related foreign party for services performed outside the US for the benefit of an unrelated customer.
4. Inbound Nonrecognition Transactions. The final regulations should explicitly exclude nonrecognition transactions (in which the U.S. taxpayer obtains only a carryover tax basis in the acquired asset) from the definition of base erosion payment.
5. Loss on the Sale of an Asset. Final regulations should clarify that a taxpayer's loss on the sale of an asset to a foreign related party does not give rise to a BEAT payment, particularly a loss deferred under Code section 267.
6. Section 301 Distributions. The final regulations should explicitly provide that no base erosion payment arises in a distribution to which Code section 301 applies, including Code section 302(d) redemptions.
7. Aggregation. The final BEAT regulations should provide for an election to apply the aggregation rules for purposes of BEMTA.
8. Treatment of Certain Tax Credits. Transition AMT credits should be excluded from the definition of credits allowed under Chapter 1 in Prop. Treas. Reg. Sec. 1.59A-5(b)(2)(i). The General Business Credit ("GBC") and foreign tax credits ("FTCs") generated in pre-2018 tax years and utilized in a post-2017 tax year should be excluded from the definition of credits allowed under Chapter 1 in Prop. Treas. Reg. Sec. 1.59A-5(b)(2)(i), or include FTCs as reductions to these credits in Treas. Reg. Sec. 1.59A-5(b)(2)(ii) (resulting in 80% exclusion).
9. Losses on Reinsurance Assumed into the U.S. Claims payments made by a U.S. insurance company to a foreign related insurance company in respect of reinsurance of risks assumed into the U.S. should be excluded from the definition of base erosion payments under Code section 59A(d)(1).
10. Application of BEAT to Related Party Hedging Payments. Hedging payments which act to reduce gross income (whether by inclusion as an element of COGS in calculating or as a reduction in gross receipts) should not be considered Base Erosion Payments.

1. **Base Erosion Minimum Tax Amount – Application of Code Section 15**

Prop. Treas. Reg. Sec. 1.59A-5(c)(3) provides that in the case of a taxpayer using a taxable year other than the calendar year, Code section 15 applies to any taxable year beginning after January 1, 2018. The implication of this is that Treasury intends that a blended BEAT tax rate between 5% and 10% (rather than the statutory 5% rate), will apply to fiscal year taxpayers for their fiscal year that begins in calendar year 2018, which will necessarily be their first year subject to BEAT. This position is

manifestly contrary to the unambiguous words of the statute. Treasury would exceed its regulatory authority if it adopts Prop. Treas. Reg. Sec. 1.59A-5(c)(3) in the final regulations.

Code section 15 is drafted very narrowly. It applies only when there is a change in tax rate that is effective on a particular date or a change in tax rate that is effective for years beginning or ending on or after a certain date. In that case, the impact of the tax rate change is blended for fiscal years that include that date.

Code section 15 does not apply to the language of new Code section 59A(b)(1)(A) (which implements the 5% one year exception). New Code section 59A(b)(1)(A) does not reference tax years beginning (or ending) after a certain date as is specified in Code section 15. Rather, it specifies that the 5% rate applies to “tax years beginning in calendar year 2018.” In contrast, new Code section 59A(b)(2) (which prescribes a change in BEAT tax rate from 10% to 12.5%) was specifically drafted to fall within the purview of Code section 15. It provides that the change in BEAT tax rate from 10% to 12.5% is effective for “any taxable year beginning after 12/31/25.” If Congress had intended for the 5% one-year exceptional BEAT tax rate to qualify as a rate change within the meaning of Code section 15, it could have used the same statutory language in Code section 59A(b)(1)(A) – as it did in Code section 59A(b)(2).

Congress purposefully did not utilize the same language in Code section 59A(b)(1)(A) (the 5% rate) as it did in Code section 59A(b)(2) (the change from 10% to 12.5%) because Congress did not intend for the 5% rate to qualify as a change in tax rate within the meaning of Code section 15. The 5% rate was intended as a full one-year exception to the generally applicable 10% BEAT tax rate. The Conference Agreement specifically addresses this point. Footnote 1547 states that a “5 percent rate applies for one year for base erosion payments paid or accrued in taxable years beginning after December 31, 2017.” Congress intended the 5% rate to apply for a full year. The same paragraph of the Conference Agreement that contains that footnote clearly refers to the fact that the “10-percent rate is changed to 12.5%” for taxable years beginning after December 31, 2025. Thus, it is very clear that Congress intended the change from 10% to 12.5% to qualify as a “change” in tax rates within the meaning of Code section 15, but for the 5% rate to be a full one-year exception applicable to all taxpayers regardless of fiscal year-end.

The 5% BEAT tax rate operates more like a threshold than a tax rate. Many taxpayers would not be subject (or only minimally subject) to BEAT at the 5% rate. Congress enacted the 5% rate in order to make a taxpayer’s first year subject to BEAT a transition year. However, under the Proposed BEAT Regulations, a fiscal year taxpayer may be subject to significant BEAT at a blended tax rate higher than 5% for the first year that it is subject to BEAT. As a result, imposing a blended higher tax rate in the first year may randomly result in a fiscal year taxpayer being subject to BEAT for its first year based solely upon the timing of its fiscal year end rather than its economic results for that first year. Imposing this blended rate on fiscal year taxpayers for their first fiscal year subject to BEAT deprives fiscal year taxpayers of the one-year Congressionally-prescribed transition period.

### ***Recommendation***

Prop. Treas. Reg. Sec. 1.59A-5(c)(3) is manifestly contrary to the unambiguous language of Code section 59A(b). Treasury would exceed its regulatory authority if it adopts this Prop. Treas. Reg. Sec. 1.59A-5(c)(3) in the final BEAT regulations. As such, Prop. Treas. Reg. Sec. 1.59A-5(c)(3) should not be included in the final BEAT regulations.

## **2. The SCM Exception**

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Prop. Treas. Reg. Sec. 1.59A-3(b) provides clarification that for cases where the total amount paid for services includes a markup, the cost component is excluded from the definition of “base erosion payments” for services that meet requirements of the Services Cost Method of Treas. Reg. Sec. 1.482-9 (the “SCM exception”). Only the markup will be subject to the BEAT. The reasoning underlying the proposed regulation is consistent with existing treatment of payments for low margin services that constitute routine day-to-day commercial transactions and do not create a base erosion risk. The Proposed BEAT Regulations also state that taxpayers are not required to separate the cost and markup components of charges into two separate accounts. To require otherwise would impose undue administrative and compliance costs, contrary to the intent of Congress to enact tax reform that supports the competitiveness of American companies.

The Proposed BEAT regulations interpret the SCM exception to apply to the cost component of any amount paid for services that satisfy the requirements of the regulatory services cost method, with two exceptions: (i) the business judgment rule in Treas. Reg. Sec. 1.482-9(b)(5) does not apply, and (ii) a different rule is provided to ensure the maintenance of adequate books and records. Accordingly, payments for services on the “excluded activities” list of Treas. Reg. Sec. 1.482-9(b)(4), such as R&E, do not qualify for the SCM exception.

### ***Recommendation***

Prop. Treas. Reg. Sec. 1.59A-3(b) should, in large part, be affirmed in the final BEAT regulations. That said, the final BEAT regulations should also provide that the cost element of payments for R&E by a U.S. person that owns the IP being developed or enhanced do not constitute base erosion payments. Because the SCM exception is limited to the cost element of any service fee, no U.S. tax base erosion can result from applying the exception to R&E payments. Moreover, if the SCM exception is limited to R&E fees paid by a U.S. taxpayer that owns the relevant IP, the exception will apply only to U.S. base enhancing arrangements. This supports the policy objectives of the BEAT and the legislation overall.

### **3. Additional Services Exception**

Often, large industrial products are sold in conjunction with service agreements to maintain and repair (including with spare parts) the equipment, and for U.S. headquartered manufacturers such service agreements are managed centrally from the United States. The equipment is serviced in the U.S. and around the globe, depending on the convenience of the customer and the efficient operations of affiliated service centers, as determined by the U.S.-based management. The unintended consequence occurs when a manufacturer subcontracts with its related foreign affiliate to maintain equipment it has manufactured and sold to the global customer, pursuant to a service contract. The affiliate secures and installs the needed spare parts and performs the necessary maintenance services. The manufacturer pays the affiliate for this legitimate activity, which is critical to the underlying original sale of the equipment. The maintenance and repair services are performed outside the U.S., on equipment that is located outside the U.S., for the benefit of an unrelated customer. But, currently, in the case of a U.S. manufacturer contracting with its affiliate, the deductible payment might be caught by the BEAT.

Without clarification that these deductible payments are not caught by the BEAT, the BEAT regime may impose steep additional costs on manufacturers, fail to effectively protect the tax base, and negatively impact U.S. headquarters, harming growth and job creation in the U.S.

### ***Recommendation***

Due to potential harmful impact on the manufacturing economy, when the BEAT regulations are finalized, Treasury should clarify instances in which certain payments arising from servicing and

maintenance of equipment developed and manufactured by U.S. taxpayers to related parties outside the United States do not properly fall within the BEAT regime, as these instances do not present a base erosion risk.

Proposed Language

**[1.59A-[X]](a) Treatment of Payments for Services to Unrelated Customers—**

A payment to a related party shall not be treated as a base erosion payment if:

- (1) The payment is for services provided by the related party directly to or for the benefit of an unrelated customer;
- (2) The services are performed outside the United States.

**4. Scope of “Paid or Accrued” in the Context of Inbound Nonrecognition Transactions**

Code section 59A(d) defines a “base erosion payment” as any amount paid or accrued by a taxpayer to a foreign related party and with respect to which a deduction is allowable. Code section 59A(d)(2) provides that such term shall also include any amount paid or accrued by the taxpayer to a related foreign person in connection with the acquisition by the taxpayer from such person of property of a character subject to the allowance for depreciation or amortization. Code section 59A(c)(2)(A)(ii) then provides that such depreciation or amortization allowed would be considered a “base erosion tax benefit” that must be added back to taxable income in calculating “modified taxable income”.

Prop. Treas. Reg. Sec. 1.59A-3(b)(2)(i) provides that “an amount paid or accrued” includes an amount paid or accrued using any form of consideration, including cash, property, stock, or the assumption of a liability. The Preamble to the Proposed BEAT Regulations notes that this interpretation of the phrase “paid or accrued” may have the result of causing a base erosion payment to arise as a result of a U.S. taxpayer’s depreciation or amortization of the carryover tax basis of an asset it acquired from a related taxpayer by way of a capital contribution under Code section 351, tax-free liquidation under Code section 332, or in a tax-free reorganization under Code section 368.

Section III(A)(1) of the Preamble to the Proposed BEAT Regulations notes that Treasury specifically decided not to include an exception for assets acquired via these types of nonrecognition transactions despite Treasury’s understanding that the U.S. taxpayer would typically take only a carryover tax basis in the asset and would potentially be importing income-producing assets into the U.S., thereby increasing its U.S. tax base.

Thus, Treasury itself acknowledges that assets acquired pursuant to these nonrecognition transactions do not present the same base erosion concerns as other amounts that may be considered base erosion payments. In this regard it is noted that Treasury believes it has the authority to exempt from the definition of base erosion payment amounts that it believes do not present the same base erosion concerns as other types of deductions that arise in connection with payments to a foreign related party. For example, in Prop. Treas. Reg. Sec. 1.59A-3(b)(3)(iv), Treasury created an exemption from the definition of base erosion payment for exchange losses from Code section 988 transactions described in Treas. Reg. Sec. 1.988-1(a)(1). In Section III(B)(4) of the Preamble to the Proposed BEAT Regulations, Treasury states its reason for this: “The Treasury Department and the IRS have determined that these losses do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party.” It is clear that the amortization of a carryover tax basis of an asset acquired by a U.S. taxpayer from a related party in a nonrecognition transaction would not create the same base erosion concerns as other types of deductions and that Treasury should likewise exempt such amounts from the rules of Code section 59A.

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In order to treat the amortization of the carryover basis in these situations as a base erosion payment, the Treasury Department would necessarily have to deem a payment in certain cases. For example, if a foreign parent company contributes a depreciable asset to its 100%-owned US subsidiary as a tax-free capital contribution under Code section 351, and the U.S. subsidiary issues no actual shares to the foreign parent in return for such contribution, Treasury is proposing to take the position that the U.S. subsidiary should be deemed to issue shares and those deemed-issued shares should be considered an amount paid or accrued by the U.S. subsidiary for the receipt of the contributed asset. This is the case even though there is no resulting change in the percentage ownership of the US subsidiary by the foreign parent. This is clearly an outrageous result that was not intended by Congress. In promulgating Code section 59A, Congress clearly contemplated actual payments by US taxpayers to foreign related parties.

BEAT should not apply to transactions under which U.S. taxpayers do not obtain a step-up in the tax basis of the acquired asset. While we understand that there may be concerns with taxpayer's abusing the system by engaging in non-US relevant basis step-up transactions immediately prior to a tax-free inbound transfers, rules more narrowly tailored to combat inappropriate basis step up transactions should be employed rather than the blanket rule specified in the preamble to the proposed regulations. In that regard, we recommend looking at rules similar to the 5-year active trade or business rules in the Code section 355 regulations to specify those instances when assets would qualify as not being "recently stepped up assets" such that depreciation or amortization on the carry-over basis would not be considered a base erosion payment.

An implicit purpose of BEAT is to encourage U.S. taxpayers to move ownership of income-producing assets, including intellectual property, into the U.S. (from related foreign entities). Yet this broad application of the "paid or accrued" concept in the context of nonrecognition transactions penalizes U.S. taxpayers for doing precisely that. If U.S. taxpayers cannot deduct amortization or depreciation at least with respect to their carryover tax basis, there would be a global economic tax detriment as a result of moving IP ownership to the U.S. (as, following the transfer to the US, the foreign entity could no longer even amortize its historic tax basis in the asset).

### ***Recommendation***

When finalized, Prop. Treas. Reg. Sec. 1.59A-3(b)(2)(i) should **explicitly exclude** nonrecognition transactions (to the extent the U.S. taxpayer obtains only a carryover tax basis in the acquired asset) from the definition of base erosion payment

At a minimum, the final BEAT regulations should permit companies to engage in post-acquisition restructuring to transfer IP to the U.S. following third-party acquisitions, without giving rise to a BEAT payment. To the extent the basis of IP transferred into the U.S. in a nonrecognition transaction that is attributable to a third-party acquisition, amortization of such basis should not constitute a base erosion tax benefit.

As noted above, if the concern is that taxpayers may abuse the system by engaging in non-U.S. relevant basis step-up transactions immediately prior to a tax-free inbound transfers, rules more narrowly tailored to combat inappropriate basis step up transactions could be employed rather than the blanket rule specified in Proposed BEAT Regulations. Again, as noted above, we recommend looking at rules similar to the 5-year active trade or business rules in the Code section 355 regulations to specify those instances when assets would qualify as not being "recently stepped up assets" such that depreciation or amortization on the carry-over basis would not be considered a base erosion payment.

5. **Scope of “paid or accrued” in the Context of Losses Recognized on the Sale of Property to a Foreign Related Entity**

Code section 59A(d) defines a “base erosion payment” as any amount paid or accrued by a taxpayer to a foreign related party with respect to which a deduction is allowable. Code section 59A(d)(2) provides that such term shall also include any amount paid or accrued by the taxpayer to a foreign related party in connection with the taxpayer’s acquisition from such foreign related party of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation). Code section 59A(c)(2)(A)(ii) then provides that such depreciation or amortization would be considered a “base erosion tax benefit” that must be added back to taxable income in calculating “modified taxable income.”

Prop. Treas. Reg. Sec. 1.59A-3(b)(2)(i) provides that “an amount paid or accrued” includes an amount paid or accrued using any form of consideration, including cash, property, stock, or the assumption of a liability. The last paragraph of Section III(A)(1) of the Preamble to the Proposed Regulations notes that, as a result of this interpretation of the phrase “paid or accrued”, “a base erosion payment also includes a payment to a foreign related party resulting in a recognized loss; for example, a loss recognized on the transfer of property to a foreign related party.”

The attempt by Treasury to apply this broad interpretation of “paid or accrued” to losses incurred by a US taxpayer on the sale of an asset to a foreign related party would be manifestly contrary to an unambiguous statute and would exceed Treasury’s regulatory authority.

Code section 59A(d)(1) defines a base erosion payment as a tax-deductible payment by a US taxpayer to a foreign related party. Neither the purchase of an asset nor the sale of an asset involve payments that are themselves tax-deductible for US tax purposes. The purchase or sale transaction may generate corollary tax consequences (e.g., gain, loss, amortization, depreciation etc.) – but the transfer of the property itself is not tax-deductible. This is why Congress felt compelled to specify in Code section 59A(d)(2) that a base erosion payment also includes, not only payments that are immediately tax-deductible, but also payments by the U.S. taxpayer for the purchase of amortizable or depreciable assets. Congress had to further specify in Code section 59A(c)(2)(A)(ii) that, in those asset purchase cases, the amortization or depreciation of the purchased asset would be considered the base erosion tax benefit. With this language, Congress prescribed the sphere of transactions that would be encompassed by BEAT. The fact that Congress specifically addressed a U.S. taxpayer’s purchase of assets, but did not specifically include a U.S. taxpayer’s sale of an asset, demonstrates that Congress intended the BEAT rule to apply only to a U.S. taxpayer’s purchase of property from a foreign related party – ***not*** to the U.S. taxpayer’s sale of property to a related foreign party. If Congress had intended for Code section 59A to apply to a loss recognized by a U.S. taxpayer on the sale of an asset to related foreign party, it would have drafted language that specifically covered that situation in the same manner as it did for purchases of assets by U.S. taxpayers.

Even if a US taxpayer’s transfer of an asset to a related foreign entity were considered a base erosion payment, there is no tax deduction allowed as a direct result of that “payment” of property. Code section 59A(c)(2) provides that the base erosion benefit added back to taxable income is: (i) any deduction with respect to any base erosion payment described in Code section 59A(d)(1), and (ii) any deduction for depreciation or amortization with respect to the purchase of an asset as described in Code section 59A(d)(2). In the case of a U.S. taxpayer’s sale of an asset, the “payment” itself does not give rise to any tax deduction. In fact, the taxpayer could recognize gain as a result of the sale. Any gain or loss realized by the US taxpayer on the sale is an entirely separate computation and a corollary consequence to the transfer. If the taxpayer recognizes a loss, such loss is not a deduction of the base erosion payment. Congress would have had to draft specific statutory language if it had intended to treat such a loss as a BEAT payment. Treasury’s attempt to legislate this exceeds its regulatory authority and is manifestly contrary to the statute drafted by Congress.

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Further, the language of the Preamble makes no sense in the case of a U.S. taxpayer and a foreign related party that are more than 50% related within the meaning of Code section 267(f). In that case, there is no such thing as a loss “recognized” on the transfer of property to the foreign related party. Such loss would be deferred and would not be recognized until the related foreign party transfers the property to an unrelated third party. Code section 267 already prevents U.S. taxpayers from artificially manufacturing losses under these facts. Economically, the U.S. taxpayer’s sale of an asset directly to a third party should have the same U.S. tax consequences to the U.S. taxpayer as a sale via the related foreign entity (where the related foreign entity serves as a mere intermediary). For Treasury to seek to legislate disparate tax consequences to result from those two economically equivalent scenarios not only contradicts the statute but produces inequitable and unintended results.

An example of where this could occur would be a foreign global parent company that sells a global business line to a third party. The third party may not want to separately purchase the assets of the business line in each country. The third party may want to acquire a central company that owns the consolidated global business line. In that case, the U.S. subsidiary might sell the U.S. business line to its foreign parent. The foreign parent would then consolidate ownership of the various global business lines and sell the consolidated business line to the third party. The fact that the U.S. subsidiary sold the U.S. business line to its foreign parent rather than directly to the third party should not change the U.S. tax consequences of the sale. To artificially prescribe a different result is contrary to the clear language of the statute and would produce a distortive result to U.S. taxpayers.

In this regard, it is noted that Treasury believes it has the authority to exempt from the definition of base erosion payment, losses that it believes do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party. For example, in Prop. Treas. Reg. Sec. 1.59A-3(b)(3)(iv), Treasury created an exemption from the definition of base erosion payment for exchange losses from Code section 988 transactions described in Treas. Reg. Sec. 1.988-1(a)(1).

### ***Recommendation***

Given its suggestion in the Preamble, when it finalizes the BEAT regulations, Treasury should clarify that Prop. Reg. 1.59A-3(b)(2) does **not** apply to a taxpayer’s loss on the sale of an asset to a foreign related party.

## **6. Definition of Base Erosion Payment and Section 301 Transactions**

The preamble of the Proposed BEAT Regulations state that there is no base erosion payment in an “in-kind distribution subject to Code section 301.” This language does not appear in the proposed regulations.

### **Recommendation:**

The final BEAT Regulations should **explicitly** provide that no base erosion payment arises in a distribution to which Code section 301 applies, including Code section 302(d) redemptions.

## **7. Election to Apply Aggregation Rules to the Computation of BEMTA**

The Proposed BEAT Regulations do **not** provide an election to apply the aggregation rules for purposes of determining the base erosion minimum tax amount (“BEMTA”). Such an election would treat all taxpayer entities as a single economic unit, permitting groups with multiple consolidated returns

to be given full credit for the groups' contributions to the U.S. tax base. In certain instances, business, legal, or regulatory reasons prevent groups with multiple taxpayers from combining in a single consolidated return. But, regardless, they represent a single economic unit where they have a common parent, overall common management, share services and are generally treated as a single employer. An election to apply the aggregation rules for BEMTA would prevent inequitable results in the application of BEAT.

In this regard, Treasury has ample authority to provide such an election because Code section 59A is ambiguous as to whether the aggregation rules apply for purposes of Code section 59A(b). Treasury also has broad authority under Code section 7805 to promulgate regulations that would permit taxpayers to elect to apply the aggregation rules for purposes of determining BEMTA.

The aggregate approach for electing taxpayers could be easily administered with an appropriate schedule reflecting a pro rata allocation among tax groups. The aggregate approach is equitable, results in insignificant additional complexity, and causes little additional administrative burden. The use of an election would not burden taxpayers who would prefer not to use the aggregate approach, nor add a material administrative burden to taxpayers adopting the approach.

### ***Recommendation***

The final BEAT regulations should provide for an election to apply the aggregation rules for purposes of BEMTA.

## **8. Treatment of MTC, GBC, and FTC credit carryforwards into 2018**

The Alternative Minimum Tax (“AMT”) regime was repealed effective January 1, 2018, with a provision to allow full utilization of credit (against regular tax or as a refundable credit) in post-2017 tax years. In that regard, the Preamble to Proposed BEAT Regulations states: “To prevent an inappropriate understatement of a taxpayer’s adjusted regular tax liability the proposed regulations provide that credits for overpayment of taxes and for taxes withheld at source are not subtracted from the taxpayer’s regular tax liability because these credits relate to federal income tax paid for the current or previous year.”

Taxpayers also have credits generated in pre-2018 tax years that may carry forward to be utilized against regular tax in post-2017 tax years. Some of these credits may have been limited in earlier years due to net operating losses. The Proposed BEAT Regulation provides guidance on the treatment of credits generated before changes in BEAT provisions effective in 2026, but utilized post-2025. The Proposed BEAT Regulations also provide that the base erosion percentage for net operating losses generated pre-2018 is zero because BEAT applies to base erosion payments after 2017. The Proposed BEAT regulations do not address the treatment of credits generated before the BEAT effective date that reduce post-2017 regular tax liabilities.

### ***Recommendation***

Transition AMT credits should be excluded from the definition of credits allowed under Chapter 1 in Prop. Treas. Reg. Sec. 1.59A-5(b)(2)(i), as they are income taxes imposed in a previous tax year allowed as credits in a subsequent year (Code section 53(a)).

Further, either exclude the General Business Credit (“GBC”) and foreign tax credits (“FTCs”) generated in pre-2018 tax years and utilized in a post-2017 tax year from the definition of credits allowed under Chapter 1 in Prop. Treas. Reg. Sec. 1.59A-5(b)(2)(i), or include FTCs as reductions to

these credits in Treas. Reg. Sec. 1.59A-5(b)(2)(ii) (resulting in 80% exclusion).

#### **9. Losses on Reinsurance Assumed into the U.S.**

U.S. insurance companies investing in foreign markets are typically required by local regulators to operate through a local (foreign) subsidiary that is subject to local regulation to ensure solvency in meeting claims payments to local insureds. To effectively manage capital and volatility of losses, the foreign subsidiary may purchase reinsurance from its U.S. parent. The reinsurance transaction will increase the U.S. tax base, increase capital investment in the U.S., and increase U.S. employment through management of such contracts and assets.

The Preamble to the Proposed BEAT Regulations notes that “the proposed regulations also do not provide any specific rules for payments by a domestic reinsurance company to a foreign related insurance company.” The Proposed BEAT Regulations exclude interest paid or accrued on TLAC securities from the definition of base erosion payments: “Section 59A(i) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 59A, including regulations addressing specifically enumerated situations.” The Proposed BEAT Regulations also determine that exchange losses under Code section 988 “do not present the same base erosion concerns as other types of losses that arise in connection with payments to a foreign related party.” In exempting payments that are ECI in the hands of the foreign recipient, “The Treasury Department and the IRS have determined that it is appropriate... to consider the U.S. tax treatment of the foreign recipient.”

Reinsurance assumed by a U.S. reinsurer from a foreign affiliate is a specific situation where there are no base erosion concerns. Reinsurance assumed into the U.S. increases the U.S. tax base. U.S. insurers and reinsurers are, based on local regulation, compelled to operate through local subsidiaries. Loss payments from U.S. companies to foreign related parties directly fund payments to third party claimants. Amount and timing of payments are based on unrelated events (occurrence of a loss). Regulatory restrictions prevent any restructuring of this arrangement to allow for direct payment of claims to third parties (eliminating the foreign related party). Loss reimbursements under a reinsurance contract on a net basis have no tax consequences in the hands of the foreign related party as the reimbursement is offset by payment to a third party.

#### ***Recommendation***

Claims payments a U.S. insurance company makes to a foreign related insurance company in respect of reinsurance of risks assumed into the U.S. should be excluded from the definition of base erosion payments under Code section 59A(d)(1).

#### **10. Application of BEAT to Related Party Hedging Payments**

It is common for some large multinational groups in the energy industry to designate one or more members of their worldwide group as a hedging center to manage price risk related to commodities they produce or trade on the open market. Prevailing industry practice and applicable financial accounting standards generally require income, gain, loss or expense on commodity derivatives to be accounted for as items of costs-of-goods sold (“COGS”) or gross receipts and this treatment is, in many instances, echoed in the tax accounting treatment for such items. Under the plain language of Code section 59A(d)(1), and as echoed in the legislative history to Code section 59A, such payments are not deductions under Chapter 1 (that were the focus of Congress in enacting Code section 59A and are properly excluded from treatment as a BEP). Accordingly, providing for such regulatory guidance is not only within Treasury’s broad authority to issue such regulations “as may be

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necessary and appropriate to carry out the provisions” of Code section 59A, it is also necessary to ensure that Code section 59A is not applied to payments that were not intended to be caught within its scope.

While the comments (or examples) in the proposed regulations are appreciated, it is believed that further clarification is needed. This clarification is required and all the more important as not all taxpayers engaging in hedging activity are able to avail themselves of the qualified derivative payment exclusion provided for in Code section 59A(h)(1), which states that a “qualified derivative payment” shall not be treated as a BEP so long as a taxpayer recognizes gain or loss as if such derivative under a mark-to-market method of accounting.

Although commodity hedging activity may be held within a stand-alone special purpose vehicle, it is not uncommon for such activity to be undertaken by and through a legal entity that carries out other commodity related activities that are distinguishable from hedging. For example, a legal entity that engages in hedging activity may also own and operate a refinery or other non-trading productive asset, or these activities may reside within one consolidated group. Such co-location of hedging activity with other non-trading activity is generally dictated by commercial and operational considerations or it may be the result of the corporate evolution of these otherwise distinct lines of business. For groups that have operated under such a co-located model for an extended period, it can be prohibitively expensive and time consuming to arrange for such hedging activity to be separated from such other businesses from a legal entity perspective. Importantly, entities housing such co-located models or an entity within one consolidated group are also often unable to elect mark-to-market financial accounting methods as doing so may create significant business and financial distortions related to the non-trading activities housed within the legal entity, and therefore such taxpayers are unable to avail themselves of the qualified derivatives exception under Code section 59A(h)(1).

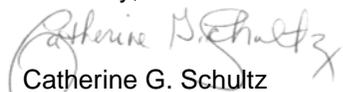
### **Recommendation**

For these reasons set forth above, we urge Treasury to issue regulatory guidance confirming that hedging payments which act to reduce gross income (whether by inclusion as an element of COGS in calculating or as a reduction in gross receipts) are not BEPs. Treasury and taxpayers would mutually benefit from further clarity on this important aspect of the BEAT.

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Again, thank you very much for the opportunity to provide these comments. Please do not hesitate to contact me should you have any questions on the above. We would be glad to meet with you to discuss these comments more fully and hereby formally request a public hearing to present our oral comments on the Proposed BEAT Regulations.

Sincerely,

  
Catherine G. Schultz  
Vice President for Tax Policy

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