What's News in Tax

Analysis that matters from Washington National Tax

How Does BEAT Apply to Inbound Companies?

February 5, 2018

by Sean Foley, Craig Myers, and Atsushi Shibata, KPMG LLP[*]

The new base erosion and anti-abuse tax ("BEAT") may be imposed on U.S. subsidiaries and branches of foreign companies. This article considers how related companies will be aggregated to determine whether the BEAT applies and cautions about new related reporting requirements.

New section 59A[1] establishes the BEAT, which works as a type of minimum tax affecting companies with larger amounts of outbound payments to related parties.

For the BEAT to apply to a company, there are two tests:

- First, the average annual U.S. gross receipts for the three-tax-year period ending with the preceding tax year must be at least $500 million.
- Second, the "base erosion percentage" must be three percent or higher (two percent for certain financial institutions). The base erosion percentage is the ratio of outbound deductible payments to related foreign persons over all deductions (excluding any net operating loss deduction, the participation exemption, and the new deduction for foreign-derived intangible

[*] Sean Foley is Global Leader, Global Transfer Pricing Dispute Resolution Services and a principal in the Economic and Valuation Services group of Washington National Tax. Craig Myers is a manager and Atsushi Shibata is an associate in the Economic and Valuation Services practice in Silicon Valley.

[1] P.L. 115-97, 131 Stat. 2054, § 14401(a) (2017) (H.R. 1). Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

income (FDII) and global intangible low-taxed income (GILTI)). Exclusions are provided for certain amounts paid for services that qualify for the services cost method under section 482, certain qualified derivative payments, and fixed, determinable, annual, or periodical income to the extent that it is subject to withholding.

Controlled Group and Single Employer Rule for Inbound Companies

The $500 million gross receipts test and the base erosion percentage test are applied on a controlled group basis by treating all members of the controlled group as one person. The group is established under the "single employer rule" of section 52(a), which substitutes "more than 50 percent" for "at least 80 percent" in section 1563(a)(1) (controlled group of corporations).

Generally, a group of U.S. companies owned directly by a foreign company would not be a controlled group under the single employer rule because section 1563(b)(2)(C) excludes foreign corporations from the controlled group. New section 59A(e)(3), however, turns off this exclusion. As a result, U.S. companies that are owned more than 50 percent by a foreign corporation are all part of the same controlled group for purposes of the BEAT. Section 59A(e)(2) only includes effectively connected income ("ECI") of the foreign corporation in determining the gross receipts threshold. As result, only the gross receipts of the U.S. single employer group, together with any ECI of the foreign parent group are aggregated to test whether the group has average receipts of $500 million. And while the statute is not entirely clear, it appears that payments to U.S. group members and to U.S. branches of foreign group members are ignored in calculating the base erosion percentage for the single employer group.

The aggregation rule described above applies only for purposes of determining whether a taxpayer is subject to BEAT and for calculating the base erosion percentage. The calculation of any incremental tax liability, however, appears to be done on a taxpayer entity-by-entity filing basis, not on the basis of the BEAT controlled group. This is because a number of the tax attributes used in the calculation of the BEAT liability, including net operating losses and tax credits, are only calculated on a taxpayer basis. Thus, consolidated filers would calculate their BEAT liability on a consolidated basis, while taxpayers that do not file consolidated returns would calculate their BEAT liability individually.

In sum, related companies are aggregated for purposes of establishing the $500 million and three percent BEAT thresholds if the companies are owned more than 50 percent by a common U.S. or foreign parent corporation. Inbound groups will have to aggregate the U.S. gross receipts and tax deductions of all their more-than-50-percent-owned U.S. subsidiaries, as well as any U.S. branches of non-U.S. group members, to determine whether the BEAT applies to each subsidiary.

Reporting Requirements

The new law also amended section 6038A(b) to require disclosure of such additional information as the Treasury Department determines necessary for determining an applicable taxpayer's base erosion minimum tax amount, base erosion payments, and base erosion tax benefits. These disclosures are

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

required if either the reporting corporation under 6038A or the foreign corporation under 6038C (i.e., certain foreign corporations engaged in U.S. trade or business) is an applicable taxpayer under the threshold analysis of section 59A. Finally, under amended section 6038A(d), penalties for failure to report required disclosures under section 6038A(b) are increased from $10,000 to $25,000 for each tax year to which the failure occurs.

As a result of the new reporting requirements under section 6038A(b), if a controlled group is caught by the BEAT thresholds, even a subsidiary that has no BEAT liability may have to report the required BEAT information.

Some U.S. subsidiaries of foreign groups may have challenges in obtaining the required data to perform the BEAT threshold calculations. From a practical standpoint, the foreign parent may have to take on the responsibility for collecting the data or, alternatively, the group might designate one U.S. entity to collate the necessary data from relevant group entities to assess the applicability of BEAT.

□ □ □ □

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.