# Base Erosion and Anti-Abuse Tax

## PART 2

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An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

*D. 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). Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that these regulations will primarily affect aggregate groups of corporations with average annual gross receipts of at least $500 million and that make payments to foreign related parties. Generally only large businesses both have substantial gross receipts and make payments to foreign related parties.

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public about the impact of this proposed rule on small entities.

Pursuant to section 7805(f), these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

*E. 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 in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2018, that threshold is approximately $150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

*F. 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 proposed 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.

**Comments and Request for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the ''Addresses'' heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules.

All comments will be available at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Statement of Availability of IRS Documents**

IRS revenue procedures, revenue rulings, notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov.*

**Drafting Information**

The principal authors of the proposed regulations are Sheila Ramaswamy and Karen Walny of the Office of Associate Chief Counsel (International) and Julie Wang and John P. Stemwedel of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

**Partial Withdrawal of Proposed Regulations**

Accordingly, under the authority of 26 U.S.C. 7805 and 26 U.S.C. 1502, § 1.1502–2 of the notice of proposed rulemaking (IA–57–89) published in the **Federal Register** on December 30, 1992 (57 FR 62251) is withdrawn.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

## PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by revising the entry for § 1.6038A–2 and adding entries 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, 1.59A–10, 1.1502–59A, 1.1502–100, 1.6038A–2, and 1.6038A–2(a)(3) and (b)(7) to read in part as follows:

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

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§ 1.59A–1 also issued under 26 U.S.C. 59A(i).

§ 1.59A–2 also issued under 26 U.S.C. 59A(i).

§ 1.59A–3 also issued under 26 U.S.C. 59A(i).

§ 1.59A–4 also issued under 26 U.S.C. 59A(i).

§ 1.59A–5 also issued under 26 U.S.C. 59A(i).

§ 1.59A–6 also issued under 26 U.S.C. 59A(i).

§ 1.59A–7 also issued under 26 U.S.C. 59A(i).

§ 1.59A–8 also issued under 26 U.S.C. 59A(i).

§ 1.59A–9 also issued under 26 U.S.C. 59A(i).

§ 1.59A–10 also issued under 26 U.S.C. 59A(i).

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§ 1.1502–59A also issued under 26 U.S.C. 1502.

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§ 1.1502–100 also issued under 26 U.S.C. 1502.

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§ 1.6038A–2 also issued under 26 U.S.C. 6001, 6038A, and 6038C.

§§ 1.6038A–2(a)(3) and (b)(7) also issued under 26 U.S.C. 6038A(b)(2).

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■ **Par. 2.** Sections 1.59A–1 through 1.59A–10 are added to read as follows:

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

(a) *Purpose.* This section and §§ 1.59A–2 through 1.59A–10 (collectively, the ''section 59A regulations'') provide rules under section 59A to determine the amount of the base erosion and anti-abuse tax. Paragraph (b) of this section provides definitions applicable to the section 59A regulations. Section 1.59A–2 provides rules regarding how to determine whether a taxpayer is an applicable taxpayer. Section 1.59A–3 provides rules regarding base erosion payments and base erosion tax benefits. Section 1.59A–4 provides rules for calculating

modified taxable income. Section 1.59A–5 provides rules for calculating the base erosion minimum tax amount. Section 1.59A–6 provides rules relating to qualified derivative payments. Section 1.59A–7 provides rules regarding application of section 59A to partnerships. Section 1.59A–8 is reserved for rules regarding the application of section 59A to certain expatriated entities. Section 1.59A–9 provides an anti-abuse rule to prevent avoidance of section 59A. Finally, § 1.59A–10 provides the applicability date for the section 59A regulations.

(b) *Definitions.* For purposes of this section and §§ 1.59A–2 through 1.59A–10, the following terms have the meanings described in this paragraph (b).

(1) *Aggregate group.* The term *aggregate group* means the group of corporations determined by—

(i) Identifying a controlled group of corporations as defined in section 1563(a), except that the phrase ''more than 50 percent'' is substituted for ''at least 80 percent'' each place it appears in section 1563(a)(1) and the determination is made without regard to sections 1563(a)(4) and (e)(3)(C), and

(ii) Once the controlled group of corporations is determined, excluding foreign corporations except with regard to income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations published under 26 CFR chapter I. Notwithstanding the foregoing, if a foreign corporation determines its net taxable income under an applicable income tax treaty of the United States, it is excluded from the controlled group of corporations except with regard to income taken into account in determining its net taxable income.

(2) *Applicable section 38 credits.* The term *applicable section 38 credits* means the credits allowed under section 38 for the taxable year that are properly allocable to—

(i) The low-income housing credit determined under section 42(a),

(ii) The renewable electricity production credit determined under section 45(a), and

(iii) The investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.

(3) *Applicable taxpayer.* The term *applicable taxpayer* means a taxpayer that meets the requirements set forth in § 1.59A–2(b).

(4) *Bank.* The term *bank* means an entity defined in section 581.

(5) *Base erosion and anti-abuse tax rate.* The term *base erosion and anti-abuse tax rate* means the percentage that the taxpayer applies to its modified taxable income for the taxable year to calculate its base erosion minimum tax amount. See § 1.59A–5(c) for the base erosion and anti-abuse tax rate applicable to the relevant taxable year.

(6) *Business interest expense.* The term *business interest expense,* with respect to a taxpayer and a taxable year, has the meaning provided in § 1.163(j)–1(b)(2).

(7) *Deduction.* The term *deduction* means any deduction allowable under chapter 1 of subtitle A of the Internal Revenue Code.

(8) *Disallowed business interest expense carryforward.* The term *disallowed business interest expense carryforward* has the meaning provided in § 1.163(j)–1(b)(9).

(9) *Domestic related business interest expense.* The term *domestic related business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a related party that is not a foreign related party.

(10) *Foreign person.* The term *foreign person* means any person who is not a United States person. For purposes of the preceding sentence, a United States person has the meaning provided in section 7701(a)(30), except that any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States is not a United States person. See § 1.59A–7(b) for rules applicable to partnerships.

(11) *Foreign related business interest expense.* The term *foreign related business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a foreign related party.

(12) *Foreign related party.* The term *foreign related party* means a foreign person, as defined in paragraph (b)(10) of this section, that is a related party, as defined in paragraph (b)(17) of this section, with respect to the taxpayer. In addition, for purposes of § 1.59A–3(b)(4)(v)(B), a foreign related party also includes the foreign corporation's home office or a foreign branch of the foreign corporation. See § 1.59A–7(c) for rules applicable to partnerships.

(13) *Gross receipts.* The term *gross receipts* has the meaning provided in § 1.448–1T(f)(2)(iv).

(14) *Member of an aggregate group.* The term *member of an aggregate group* means a corporation that is included in an aggregate group, as defined in paragraph (b)(1) of this section.

(15) *Registered securities dealer.* The term *registered securities dealer* means any dealer as defined in section 3(a)(5) of the Securities Exchange Act of 1934 that is registered, or required to be registered, under section 15 of the Securities Exchange Act of 1934.

(16) *Regular tax liability.* The term *regular tax liability* has the meaning provided in section 26(b).

(17) *Related party*—(i) *In general.* A *related party,* with respect to an applicable taxpayer, is—

(A) Any 25-percent owner of the taxpayer;

(B) Any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer; or

(C) A controlled taxpayer within the meaning of § 1.482–1(i)(5) together with, or with respect to, the taxpayer.

(ii) *25-percent owner.* With respect to any corporation, a *25-percent owner* means any person who owns at least 25 percent of—

(A) The total voting power of all classes of stock of the corporation entitled to vote; or

(B) The total value of all classes of stock of the corporation.

(iii) *Application of section 318.* Section 318 applies for purposes of paragraphs (b)(17)(i) and (ii) of this section, except that—

(A) ''10 percent'' is substituted for ''50 percent'' in section 318(a)(2)(C); and

(B) Section 318(a)(3)(A) through (C) are not applied so as to consider a United States person as owning stock that is owned by a person who is not a United States person.

(18) *TLAC long-term debt required amount.* The term *TLAC long-term debt required amount* means the specified minimum amount of debt that is required pursuant to 12 CFR 252.162(a).

(19) *TLAC securities amount.* The term *TLAC securities amount* is the sum of the adjusted issue prices (as determined for purposes of § 1.1275–1(b)) of all TLAC securities issued and outstanding by the taxpayer.

(20) *TLAC security.* The term *TLAC security* means an eligible internal debt security, as defined in 12 CFR 252.161.

(21) *Unrelated business interest expense.* The term *unrelated business interest expense* for any taxable year is the taxpayer's business interest expense paid or accrued to a party that is not a related party.

**§ 1.59A–2 Applicable taxpayer.**

(a) *Scope.* This section provides rules for determining whether a taxpayer is an applicable taxpayer. Paragraph (b) of this section defines an applicable taxpayer. Paragraph (c) of this section

provides rules for determining whether a taxpayer is an applicable taxpayer by reference to the aggregate group of which the taxpayer is a member. Paragraph (d) of this section provides rules regarding the gross receipts test. Paragraph (e) of this section provides rules regarding the base erosion percentage calculation. Paragraph (f) of this section provides examples illustrating the rules of this section.

(b) *Applicable taxpayer.* For purposes of section 59A, a taxpayer is an applicable taxpayer with respect to any taxable year if the taxpayer—

(1) Is a corporation, but not a regulated investment company, a real estate investment trust, or an S corporation;

(2) Satisfies the gross receipts test of paragraph (d) of this section; and

(3) Satisfies the base erosion percentage test of paragraph (e) of this section.

(c) *Aggregation rules.* A taxpayer that is a member of an aggregate group determines its gross receipts and its base erosion percentage on the basis of the aggregate group as of the end of the taxpayer's taxable year. For these purposes, transactions that occur between members of the taxpayer's aggregate group that were members of the aggregate group as of the time of the transaction are not taken into account. In the case of a foreign corporation that is a member of an aggregate group, only transactions that relate to income effectively connected with, or treated as effectively connected with, the conduct of a trade or business in the United States are disregarded for this purpose. In the case of a foreign corporation that is a member of an aggregate group and that determines its net taxable income under an applicable income tax treaty of the United States, only transactions that are taken into account in determining its net taxable income are disregarded for this purpose.

(d) *Gross receipts test*—(1) *Amount of gross receipts.* A taxpayer, or the aggregate group of which the taxpayer is a member, satisfies the gross receipts test if it has average annual gross receipts of at least $500,000,000 for the three-taxable-year period ending with the preceding taxable year.

(2) *Period for measuring gross receipts for an aggregate group*—(i) *Calendar year taxpayers that are members of an aggregate group.* In the case of a corporation that has a calendar year and that is a member of an aggregate group, the corporation applies the gross receipts test in paragraph (d)(1) of this section on the basis of the gross receipts of the aggregate group for the three-calendar-year period ending with the preceding calendar year, without regard to the taxable year of any other member of the aggregate group.

(ii) *Fiscal year taxpayers that are members of an aggregate group.* In the case of a corporation that has a fiscal year and that is a member of an aggregate group, the corporation applies the gross receipts test in paragraph (d)(1) of this section on the basis of the gross receipts of the aggregate group for the three-fiscal-year period ending with the preceding fiscal year of the corporation, without regard to the taxable year of any other member of the aggregate group.

(3) *Gross receipts of foreign corporations.* With respect to any foreign corporation, only gross receipts that are taken into account in determining income that is effectively connected with the conduct of a trade or business within the United States are taken into account for purposes of paragraph (d)(1) of this section. In the case of a foreign corporation that is a member of an aggregate group and that determines its net taxable income under an applicable income tax treaty of the United States, the foreign corporation includes only gross receipts that are attributable to transactions taken into account in determining its net taxable income.

(4) *Gross receipts of an insurance company.* For any corporation that is subject to tax under subchapter L or any corporation that would be subject to tax under subchapter L if that corporation were a domestic corporation, gross receipts are reduced by return premiums, but are not reduced by any reinsurance premiums paid or accrued.

(5) *Gross receipts from partnerships.* See § 1.59A–7(b)(5)(ii).

(6) *Taxpayer not in existence for entire three-year period.* If a taxpayer was not in existence for the entire three-year period referred to in paragraph (d)(1) of this section, the taxpayer determines a gross receipts average for the period that it was in existence, taking into account paragraph (d)(7) of this section.

(7) *Treatment of short taxable year.* If a taxpayer has a taxable year of fewer than 12 months (a short period), gross receipts are annualized by multiplying the gross receipts for the short period by 365 and dividing the result by the number of days in the short period.

(8) *Treatment of predecessors.* For purposes of determining gross receipts under this paragraph (d), any reference to a taxpayer includes a reference to any predecessor of the taxpayer. For this purpose, a predecessor includes the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation.

(9) *Reductions in gross receipts.* Gross receipts for any taxable year are reduced by returns and allowances made during that taxable year.

(10) *Gross receipts of consolidated groups.* For purposes of section 59A, the gross receipts of a consolidated group are determined by aggregating the gross receipts of all of the members of the consolidated group. See § 1.1502–59A(b).

(e) *Base erosion percentage test*—(1) *In general.* A taxpayer, or the aggregate group of which the taxpayer is a member, satisfies the base erosion percentage test if its base erosion percentage is three percent or higher.

(2) *Base erosion percentage test for banks and registered securities dealers*—(i) *In general.* A taxpayer that is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a bank (as defined in § 1.59A–1(b)(4)) or a registered securities dealer (as defined in section § 1.59A–1(b)(15)) satisfies the base erosion percentage test if its base erosion percentage is two percent or higher.

(ii) *Aggregate groups.* An aggregate group of which a taxpayer is a member and that includes a bank or a registered securities dealer that is a member of an affiliated group (as defined in section 1504(a)(1)) will be subject to the base erosion percentage threshold described in paragraph (e)(2)(i) of this section.

(iii) *De minimis exception for banking and registered securities dealer activities.* An aggregate group that includes a bank or a registered securities dealer that is a member of an affiliated group (as defined in section 1504(a)(1)) is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section for a taxable year, if, in that taxable year, the total gross receipts of the aggregate group attributable to the bank or the registered securities dealer represent less than two percent of the total gross receipts of the aggregate group, as determined under paragraph (d) of this section. When there is no aggregate group, a consolidated group that includes a bank or a registered securities dealer is not treated as including a bank or registered securities dealer for purposes of paragraph (e)(2)(i) of this section for a taxable year, if, in that taxable year, the total gross receipts of the consolidated group attributable to the bank or the registered securities dealer represent less than two percent of the total gross receipts of the consolidated group, as determined under paragraph (d) of this section.

(3) *Computation of base erosion percentage*—(i) *In general.* The taxpayer's base erosion percentage for any taxable year is determined by dividing—

(A) The aggregate amount of the taxpayer's (or in the case of a taxpayer that is a member of an aggregate group, the aggregate group's) base erosion tax benefits (as defined in § 1.59A–3(c)(1)) for the taxable year, by

(B) The sum of—

(*1*) The aggregate amount of the deductions (including deductions for base erosion tax benefits described in § 1.59A–3(c)(1)(i) and base erosion tax benefits described in § 1.59A–3(c)(1)(ii)) allowable to the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) under chapter 1 of Subtitle A for the taxable year;

(*2*) The base erosion tax benefits described in § 1.59A–3(c)(1)(iii) with respect to any premiums or other consideration paid or accrued by the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) to a foreign related party for any reinsurance payment taken into account under sections 803(a)(1)(B) or 832(b)(4)(A) for the taxable year; and

(*3*) Any amount paid or accrued by the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, any member of the aggregate group) resulting in a reduction of gross receipts described in § 1.59A–3(c)(1)(iv) for the taxable year.

(ii) *Certain items not taken into account in denominator.* Except as provided in paragraph (e)(3)(viii) of this section, the amount under paragraph (e)(3)(i)(B) of this section is determined by not taking into account—

(A) Any deduction allowed under section 172, 245A, or 250 for the taxable year;

(B) Any deduction for amounts paid or accrued for services to which the exception described in § 1.59A–3(b)(3)(i) applies;

(C) Any deduction for qualified derivative payments that are not treated as base erosion payments by reason of § 1.59A–3(b)(3)(ii);

(D) Any exchange loss within the meaning of § 1.988–2 from a section 988 transaction as described in § 1.988–1(a)(1);

(E) Any deduction for amounts paid or accrued to foreign related parties with respect to TLAC securities that are not treated as base erosion payments by reason of § 1.59A–3(b)(3)(v); and

(F) Any deduction not allowed in determining taxable income from the taxable year.

(iii) *Effect of treaties on base erosion percentage determination.* In computing the base erosion percentage, the amount of the base erosion tax benefit with respect to a base erosion payment on which tax is imposed by section 871 or 881 and with respect to which tax has been deducted and withheld under section 1441 or 1442 is equal to the gross amount of the base erosion tax benefit before the application of the applicable treaty multiplied by a fraction equal to—

(A) The rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed under the treaty; over

(B) The rate of tax imposed without regard to the treaty.

(iv) *Amounts paid or accrued between members of a consolidated group.* See § 1.1502–59A(b).

(v) *Deductions and base erosion tax benefits from partnerships.* See § 1.59A–7(b).

(vi) *Mark-to-market positions.* For any position with respect to which the taxpayer (or in the case of a taxpayer that is a member of an aggregate group, a member of the aggregate group) applies a mark-to-market method of accounting for federal income tax purposes, the taxpayer must determine its gain or loss with respect to that position for any taxable year by combining all items of income, gain, loss, or deduction arising with respect to the position during the taxable year, regardless of how each item arises (including from a payment, accrual, or mark) for purposes of paragraph (e)(3) of this section. See paragraph (f)(1) of this section (*Example 1*) for an illustration of this rule. For purposes of section 59A, a taxpayer computes its losses resulting from positions subject to a mark-to-market regime under the Internal Revenue Code based on a single mark for the taxable year on the earlier of the last business day of the taxpayer's taxable year and the disposition (whether by sale, offset, exercise, termination, expiration, maturity, or other means) of the position, regardless of how frequently a taxpayer marks to market for other purposes. See § 1.59A–3(b)(2)(iii) for the application of this rule for purposes of determining the amount of base erosion payments.

(vii) *Computing the base erosion percentage when members of an aggregate group have different taxable years*—(A) *Calendar year taxpayers that are members of an aggregate group.* In the case of a taxpayer that has a calendar year and that is a member of an aggregate group, the taxpayer applies the base erosion percentage in paragraph (e)(1) or (2) of this section (and determines the base erosion percentage used in § 1.59A–4(b)(2)(ii)) on the basis of the base erosion percentage for the calendar year in the manner set forth in paragraph (e)(3) of this section, without regard to the taxable year of any other member of the aggregate group. See paragraph (f)(2) of this section (*Example 2*) for an illustration of this rule. For purposes of applying paragraph (e)(3)(vi) of this section, all members of the aggregate group are treated as having a calendar year.

(B) *Fiscal year taxpayers that are members of an aggregate group.* In the case of a taxpayer that has a fiscal year and that is a member of an aggregate group, the taxpayer applies the base erosion percentage test in paragraph (e)(1) or (2) of this section (and determines the base erosion percentage used in § 1.59A–4(b)(2)(ii)) on the basis of the base erosion percentage for its fiscal year in the manner set forth in paragraph (e)(3) of this section, without regard to the taxable year of any other member of the aggregate group. See paragraph (f)(2) of this section (*Example 2*) for an illustration of this rule. For purposes of applying paragraph (e)(3)(vi) of this section, all members of the aggregate group are treated as having the taxpayer's fiscal year.

(C) *Transition rule for aggregate group members with different taxable years.* For purposes of this paragraph (e)(3)(vii), if the taxpayer has a different taxable year than another member of the taxpayer's aggregate group, each taxpayer that is a member of the aggregate group determines the availability of the exception in § 1.59A–3(b)(3)(vi) (amounts paid or accrued in taxable years beginning before January 1, 2018) by using the taxpayer's taxable year for all members of the taxpayer's aggregate group.

(viii) *Certain payments that qualify for the effectively connected income exception and another base erosion payment exception.* Subject to paragraph (c) of this section (transactions that occur between members of the taxpayer's aggregate group), a payment that qualifies for the effectively connected income exception described in § 1.59A–3(b)(3)(iii) and either the service cost method exception described in § 1.59A–3(b)(3)(i), the qualified derivative payment exception described in § 1.59A–3(b)(3)(ii), or the TLAC exception described in § 1.59A–3(b)(3)(v) is not subject to paragraph (e)(3)(ii)(B), (C), or (E) of this section and those amounts are included in the denominator of the base erosion percentage if the foreign related party who received the payment is not a member of the aggregate group.

(f) *Examples.* The following examples illustrate the rules of this section.

(1) *Example 1: Mark-to-market.* (i) *Facts.* (A) Foreign Parent (FP) is a foreign corporation that owns all of the stock of domestic corporation (DC) and foreign corporation (FC). FP and FC are foreign related parties of DC under § 1.59A–1(b)(12) but not members of the aggregate group. DC is a registered securities dealer that does not hold any securities for investment. On January 1 of year 1, DC enters into two interest rate swaps for a term of two years, one with unrelated Customer A as the counterparty (position A) and one with unrelated Customer B as the counterparty (position B). Each of the swaps provides for semiannual periodic payments to be made or received on June 30 and December 31. No party makes any payment to any other party upon initiation of either of the swaps (that is, they are entered into at-the-money). DC is required to mark-to-market positions A and B for federal income tax purposes. DC is a calendar year taxpayer.

(B) For position A in year 1, DC makes a payment of $150 on June 30, and receives a payment of $50 on December 31. There are no other payments in year 1. On December 31, position A has a value to DC of $110 (that is, position A is in-the-money by $110).

(C) For position B in year 1, DC receives a payment of $120 on June 30, and makes a payment of $30 on December 31. There are no other payments in year 1. On December 31, position B has a value to DC of ($130) (that is, position B is out-of-the-money by $130).

(ii) *Analysis.* (A) With respect to position A, based on the total amount of payments made and received in year 1, DC has a net deduction of $100. In addition, DC has a mark-to-market gain of $110. As described in paragraph (e)(3)(vi) of this section, the mark-to-market gain of $110 is combined with the net deduction of $100 resulting from the payments. Therefore, with respect to position A, DC has a gain of $10, and thus has no deduction in year 1 for purposes of section 59A.

(B) With respect to position B, based on the total amount of payments made and received in year 1, DC has net income of $90. In addition, DC has a mark-to-market loss of $130. As described in paragraph (e)(3)(vi) of this section, the mark-to-market loss of $130 is combined with the net income of $90 resulting from the payments. Therefore, with respect to position B, DC has a loss of $40, and thus has a $40 deduction in year 1 for purposes of section 59A.

(2) *Example 2: Determining gross receipts test and base erosion percentage when aggregate group members have different taxable years.* (i) *Facts.* Foreign Parent (FP) is a foreign corporation that owns all of the stock of a domestic corporation that uses a calendar year (DC1) and a domestic corporation that uses a fiscal year ending on January 31 (DC2). FP does not have income effectively connected with the conduct of a trade or business within the United States. DC2 is a member of DC1's aggregate group, and DC1 is a member of DC2's aggregate group.

(ii) *Analysis.* (A) For DC1's tax return filed for the calendar year ending December 31, 2026, DC1 determines its gross receipts based on gross receipts of DC1 and DC2 for the calendar years ending December 31, 2023, December 31, 2024, and December 31, 2025. Further, DC1 determines its base erosion percentage for the calendar year ending December 31, 2026, on the basis of transactions of DC1 and DC2 for the calendar year ending December 31, 2026.

(B) For DC2's tax return filed for the fiscal year ending January 31, 2027, DC2 determines its gross receipts based on gross receipts of DC2 and DC1 for the fiscal years ending January 31, 2024, January 31, 2025, and January 31, 2026. Further, DC2 determines its base erosion percentage for the fiscal year ending January 31, 2027, on the basis of transactions of DC2 and DC1 for the fiscal year ending January 31, 2027.

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

(a) *Scope.* This section provides definitions and related rules regarding base erosion payments and base erosion tax benefits. Paragraph (b) of this section provides definitions and rules regarding base erosion payments. Paragraph (c) of this section provides rules for determining the amount of base erosion tax benefits. Paragraph (d) of this section provides examples illustrating the rules described in this section.

(b) *Base erosion payments*—(1) *In general.* Except as provided in paragraph (b)(3) of this section, a *base erosion payment* means—

(i) Any amount paid or accrued by the taxpayer to a foreign related party of the taxpayer and with respect to which a deduction is allowable under chapter 1 of subtitle A of the Internal Revenue Code;

(ii) Any amount paid or accrued by the taxpayer to a foreign related party of the taxpayer in connection with the acquisition of property by the taxpayer from the foreign related party if the character of the property is subject to the allowance for depreciation (or amortization in lieu of depreciation);

(iii) Any premium or other consideration paid or accrued by the taxpayer to a foreign related party of the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A); or

(iv) Any amount paid or accrued by the taxpayer that results in a reduction of the gross receipts of the taxpayer if the amount paid or accrued is with respect to—

(A) A surrogate foreign corporation, as defined in section 59A(d)(4)(C)(i), that is a related party of the taxpayer (but only if the corporation first became a surrogate foreign corporation after November 9, 2017); or

(B) A foreign person that is a member of the same expanded affiliated group, as defined in section 59A(d)(4)(C)(ii), as the surrogate foreign corporation.

(2) *Operating rules*—(i) *Amounts paid or accrued in cash and other consideration.* For purposes of paragraph (b)(1) of this section, 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.

(ii) *Transactions providing for net payments.* Except as otherwise provided in paragraph (b)(2)(iii) of this section or as permitted by the Internal Revenue Code or the regulations, the amount of any base erosion payment is determined on a gross basis, regardless of any contractual or legal right to make or receive payments on a net basis. For this purpose, a right to make or receive payments on a net basis permits the parties to a transaction or series of transactions to settle obligations by offsetting any amounts to be paid by one party against amounts owed by that party to the other party. For example, any premium or other consideration paid or accrued by a taxpayer to a foreign related party for any reinsurance payments is not reduced by or netted against other amounts owed to the taxpayer from the foreign related party or by reserve adjustments or other returns.

(iii) *Amounts paid or accrued with respect to mark-to-market position.* For any transaction with respect to which the taxpayer applies the mark-to-market method of accounting for federal income tax purposes, the rules set forth in § 1.59A–2(e)(3)(vi) apply to determine the amount of base erosion payment.

(iv) *Coordination among categories of base erosion payments.* A payment that does not satisfy the criteria of one category of base erosion payment may be a base erosion payment described in one of the other categories.

(v) *Certain domestic passthrough entities*—(A) *In general.* If an applicable taxpayer pays or accrues an amount that would be a base erosion payment except for the fact that the payment is made to a specified domestic passthrough, then the applicable taxpayer will be treated as making a base erosion payment to each specified foreign related party for purposes of section 59A and §§ 1.59A–2 through 1.59A–10. This rule has no effect on the taxation of the specified domestic passthrough under subchapter J or subchapter M of the Code (as applicable).

(B) *Amount of base erosion payment.* The amount of the base erosion payment is equal to the lesser of the amount paid or accrued by the applicable taxpayer to or for the benefit of the specified

domestic passthrough and the amount of the deduction allowed under section 561, 651 or 661 to the specified domestic passthrough with respect to amounts paid, credited, distributed, deemed distributed or required to be distributed to a specified foreign related party.

(C) *Specified domestic passthrough.* For purposes of this paragraph (b)(2)(v), specified domestic passthrough means:

(*1*) A domestic trust that is not a grantor trust under subpart E of subchapter J of Chapter 1 of the Code (''domestic trust'') and which domestic trust is allowed a deduction under section 651 or section 661 with respect to amounts paid, credited, or required to be distributed to a specified foreign related party;

(*2*) A real estate investment trust (as defined in § 1.856–1(a)) that pays, or is deemed to pay, a dividend to a specified foreign related party for which a deduction is allowed under section 561; or

(*3*) A regulated investment company (as defined in § 1.851–1(a)) that pays, or is deemed to pay, a dividend to a specified foreign related party for which a deduction is allowed under section 561.

(D) *Specified foreign related party.* For purposes of this paragraph (b)(2)(v), specified foreign related party means, with respect to a specified domestic passthrough, any foreign related party of an applicable taxpayer that is a direct or indirect beneficiary or shareholder of the specified domestic passthrough.

(vi) *Transfers of property to related taxpayers.* If a taxpayer owns property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation) with respect to which paragraph (c)(1)(ii) of this section applies, and the taxpayer sells, exchanges, or otherwise transfers the property to another taxpayer that is a member of an aggregate group that includes the taxpayer, any deduction for depreciation (or amortization in lieu of deprecation) by the transferee taxpayer remains subject to paragraph (c)(1)(ii) of this section to the same extent the amounts would have been so subject in the hands of the transferor. See paragraph (d)(7) of this section (*Example 7*) for an illustration of this rule.

(3) *Exceptions to base erosion payment.* Paragraph (b)(1) of this section does not apply to the types of payments or accruals described in paragraphs (b)(3)(i) through (vii) of this section.

(i) *Certain services cost method amounts*—(A) *In general.* Amounts paid or accrued by a taxpayer to a foreign related party for services that meet the requirements in paragraph (b)(3)(i)(B) of this section, but only to the extent of the total services cost of those services. Thus, any amount paid or accrued to a foreign related party in excess of the total services cost of services eligible for the services cost method exception (the mark-up component) remains a base erosion payment. For this purpose, services are an activity as defined in § 1.482–9(l)(2) performed by a foreign related party (the renderer) that provides a benefit as defined in § 1.482–9(l)(3) to the taxpayer (the recipient).

(B) *Eligibility for the services cost method exception.* To be eligible for the services cost method exception, all of the requirements of § 1.482–9(b) must be satisfied, except that:

(*1*) The requirements of § 1.482–9(b)(5) do not apply for purposes of determining eligibility for the service cost method exception in this section; and

(*2*) Adequate books and records must be maintained as described in paragraph (b)(3)(i)(C) of this section, instead of as described in § 1.482–9(b)(6).

(C) *Adequate books and records.* Permanent books of account and records must be maintained for as long as the costs with respect to the services are incurred by the renderer. The books and records must be adequate to permit verification by the Commissioner of the amount charged for the services and the total services costs incurred by the renderer, including a description of the services in question, identification of the renderer and the recipient of the services, calculation of the amount of profit mark-up (if any) paid for the services, and sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services in question in accordance with § 1.482–9(k).

(D) *Total services cost.* For purposes of this section, total services cost has the same meaning as total services costs in § 1.482–9(j).

(ii) *Qualified derivative payments.* Any qualified derivative payment as described in § 1.59A–6.

(iii) *Effectively connected income*—(A) *In general.* Amounts paid or accrued to a foreign related party that are subject to federal income taxation as income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations. This paragraph (b)(3)(iii) applies only if the taxpayer receives a withholding certificate on which the foreign related party claims an exemption from withholding under section 1441 or 1442 because the amounts are effectively connected income.

(B) *Application to certain treaty residents.* Notwithstanding paragraph (b)(3)(iii)(A) of this section, if a foreign related party determines its net taxable income under an applicable income tax treaty, amounts paid or accrued to the foreign related party taken into account in determining its net taxable income.

(iv) *Exchange loss on a section 988 transaction.* Any exchange loss within the meaning of § 1.988–2 from a section 988 transaction described in § 1.988–1(a)(1) that is an allowable deduction and that results from a payment or accrual by the taxpayer to a foreign related party of the taxpayer.

(v) *Amounts paid or accrued with respect to TLAC securities*—(A) *In general.* Except as provided in paragraph (b)(3)(v)(B) of this section, amounts paid or accrued to foreign related parties with respect to TLAC securities.

(B) *Limitation on exclusion for TLAC securities.* The amount excluded under paragraph (b)(3)(v)(A) of this section is no greater than the product of the scaling ratio and amounts paid or accrued to foreign related parties with respect to TLAC securities for which a deduction is allowed.

(C) *Scaling ratio.* For purposes of this paragraph (b)(3)(v), the scaling ratio for a taxable year of a taxpayer is a fraction the numerator of which is the average TLAC long-term debt required amount and the denominator of which is the average TLAC securities amount. The scaling ratio may in no event be greater than one.

(D) *Average TLAC securities amount.* The average TLAC securities amount for a taxable year is the average of the TLAC securities amounts for the year, computed at regular time intervals in accordance with this paragraph. The TLAC securities amounts used in calculating the average TLAC securities amount is computed on a monthly basis.

(E) *Average TLAC long-term debt required amount.* The average TLAC long-term debt required amount for a taxable year is the average of the TLAC long-term debt required amounts, computed on a monthly basis.

(vi) *Amounts paid or accrued in taxable years beginning before January 1, 2018.* Any amount paid or accrued in taxable years beginning before January 1, 2018.

(vii) *Business interest carried forward from taxable years beginning before January 1, 2018.* Any disallowed business interest described in section 163(j)(2) that is carried forward from a taxable year beginning before January 1, 2018.

(4) *Rules for determining the amount of certain base erosion payments.* The following rules apply in determining the deductible amount that is a base erosion payment.

(i) *Interest expense allocable to a foreign corporation's effectively connected income*—(A) *Method described in § 1.882–5(b) through (d).* A foreign corporation that has interest expense allocable under section 882(c) to income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States applying the method described in § 1.882–5(b) through (d) has base erosion payments under paragraph (b)(1)(i) of this section for the taxable year equal to the sum of—

(*1*) The interest expense on a liability described in § 1.882–5(a)(1)(ii)(A) or (B) (direct allocations) or interest expense on U.S.-booked liabilities, as described in § 1.882–5(d)(2), that is paid or accrued by the foreign corporation to a foreign related party; and

(*2*) The interest expense on U.S.-connected liabilities in excess of U.S.-booked liabilities (hereafter, excess U.S.-connected liabilities), as described in § 1.882–5(d)(5), multiplied by a fraction, the numerator of which is the foreign corporation's average worldwide liabilities due to a foreign related party, and the denominator of which is the foreign corporation's average total worldwide liabilities. For purposes of this fraction, any liability that is a U.S.-booked liability or is subject to a direct allocation is excluded from both the numerator and the denominator of the fraction.

(B) *Separate currency pools method.* A foreign corporation that has interest expense allocable under section 882(c) to income that is, or is treated as, effectively connected with the conduct of a trade or business within the United States applying the separate currency pools method described in § 1.882–5(e) has a base erosion payment under paragraph (b)(1)(i) of this section for the taxable year equal to the sum of—

(*1*) The interest expense on a liability described in § 1.882–5(a)(1)(ii)(A) or (B) (direct allocations) that is paid or accrued by the foreign corporation to a foreign related party; and

(*2*) The interest expense attributable to each currency pool, as described in § 1.882–5(e)(1)(iii), multiplied by a fraction equal to the foreign corporation's average worldwide liabilities denominated in that currency and that is due to a foreign related party over the foreign corporation's average total worldwide liabilities denominated in that currency. For purposes of this fraction, any liability that has a direct allocation is excluded from both the numerator and the denominator.

(C) *U.S.-booked liabilities in excess of U.S.-connected liabilities.* A foreign corporation that is computing its interest expense under the method described in § 1.882–5(b) through (d) and that has U.S.-booked liabilities in excess of U.S.-connected liabilities must apply the scaling ratio pro-rata to all interest expense consistent with § 1.882–5(d)(4) for purposes of determining the amount of allocable interest expense that is a base erosion payment.

(D) *Liability reduction election.* A foreign corporation that elects to reduce its liabilities under § 1.884–1(e)(3) must reduce its liabilities on a pro-rata basis, consistent with the requirements under § 1.884–1(e)(3)(iii), for purposes of determining the amount of allocable interest expense that is a base erosion payment.

(ii) *Other deductions allowed with respect to effectively connected income.* A deduction allowed under § 1.882–4 for an amount paid or accrued by the foreign corporation to a foreign related party (including a deduction for an amount apportioned in part to effectively connected income and in part to income that is not effectively connected income) is treated as a base erosion payment under paragraph (b)(1) of this section.

(iii) *Depreciable property.* Any amount paid or accrued by the foreign corporation to a foreign related party of the taxpayer in connection with the acquisition of property by the foreign corporation from the foreign related party if the character of the property is subject to the allowance for depreciation (or amortization in lieu of depreciation) is a base erosion payment to the extent the property so acquired is used, or held for use, in the conduct of a trade or business within the United States.

(iv) *Coordination with ECI exception.* For purposes of this paragraph (b)(4), amounts paid or accrued to a foreign related party treated as effectively connected income (or, in the case of foreign related party that determines net taxable income under an applicable income tax treaty, such amounts that are taken into account in determining net taxable income) are not treated as paid to a foreign related party. Additionally, for purposes of paragraph (b)(4)(i)(A)(*2*) or (b)(4)(i)(B)(*2*) of this section, a liability with interest paid or accrued to a foreign related party that is treated as effectively connected income (or, in the case of foreign related party that determines net taxable income under an applicable income tax treaty, interest taken into account in determining net taxable income) is treated as a liability not due to a foreign related party.

(v) *Coordination with certain tax treaties*—(A) *Allocable expenses.* If a foreign corporation elects to determine its taxable income pursuant to business profits provisions of an income tax treaty rather than provisions of the Internal Revenue Code, or the regulations published under 26 CFR chapter I, for determining effectively connected income, and the foreign corporation does not apply §§ 1.882–5 and 1.861–8 to allocate interest and other deductions, then in applying paragraphs (b)(4)(i) and (ii) of this section, the foreign corporation must determine whether each allowable deduction attributed to the permanent establishment in its determination of business profits is a base erosion payment under paragraph (b)(1) of this section.

(B) *Internal dealings under certain income tax treaties.* If, pursuant to the terms of an applicable income tax treaty, a foreign corporation determines the profits attributable to a permanent establishment based on the assets used, risks assumed, and functions performed by the permanent establishment, then any deduction attributable to any amount paid or accrued (or treated as paid or accrued) by the permanent establishment to the foreign corporation's home office or to another branch of the foreign corporation (an ''internal dealing'') is a base erosion payment to the extent such payment or accrual is described under paragraph (b)(1) of this section.

(vi) *Business interest expense arising in taxable years beginning after December 31, 2017.* Any disallowed business interest expense described in section 163(j)(2) that resulted from a payment or accrual to a foreign related party that first arose in a taxable year beginning after December 31, 2017, is treated as a base erosion payment under paragraph (b)(1)(i) of this section in the year that the business interest expense initially arose. See paragraph (c)(4) of this section for rules that apply when business interest expense is limited under section 163(j)(1) in order to determine whether the disallowed business interest is attributed to business interest expense paid to a person that is not a related party, a foreign related party, or a domestic related party.

(c) *Base erosion tax benefit*—(1) *In general.* Except as provided in paragraph (c)(2) of this section, a base erosion tax benefit means:

(i) In the case of a base erosion payment described in paragraph (b)(1)(i) of this section, any deduction that is

allowed under chapter 1 of subtitle A of the Internal Revenue Code for the taxable year with respect to that base erosion payment;

(ii) In the case of a base erosion payment described in paragraph (b)(1)(ii) of this section, any deduction allowed under chapter 1 of subtitle A of the Internal Revenue Code for the taxable year for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with that payment;

(iii) In the case of a base erosion payment described in paragraph (b)(1)(iii) of this section, 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 insurance, 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; or

(iv) In the case of a base erosion payment described in paragraph (b)(1)(iv) of this section, any reduction in gross receipts with respect to the payment in computing gross income of the taxpayer for the taxable year for purposes of chapter 1 of subtitle A of the Internal Revenue Code.

(2) *Withholding tax exception to base erosion tax benefit.* Except as provided in paragraph (c)(3) of this section, any base erosion tax benefit attributable to any base erosion payment is not taken into account as a base erosion tax benefit if tax is imposed on that payment under section 871 or 881, and the tax has been deducted and withheld under section 1441 or 1442.

(3) *Effect of treaty on base erosion tax benefit.* If any treaty between the United States and any foreign country reduces the rate of tax imposed by section 871 or 881, the amount of base erosion tax benefit that is not taken into account under paragraph (c)(2) of this section is equal to the amount of the base erosion tax benefit before the application of paragraph (c)(2) of this section multiplied by a fraction of—

(i) The rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed under the treaty; over

(ii) The rate of tax imposed without regard to the treaty.

(4) *Application of section 163(j) to base erosion payments*—(i) *Classification of payments or accruals of business interest expense based on the payee.* The following rules apply for corporations and partnerships:

(A) *Classification of payments or accruals of business interest expense of a corporation.* For purposes of this section, in the year that business interest expense of a corporation is paid or accrued the business interest expense is classified as foreign related business interest expense, domestic related business interest expense, or unrelated business interest expense.

(B) *Classification of payments or accruals of business interest expense by a partnership.* For purposes of this section, in the year that business interest expense of a partnership is paid or accrued, the business interest expense that is allocated to a partner is classified separately with respect to each partner in the partnership as foreign related business interest expense, domestic related business interest expense, or unrelated business interest expense.

(C) *Classification of payments or accruals of business interest expense that is subject to the exception for effectively connected income.* For purposes of paragraph (c)(4)(i)(A) and (B) of this section, business interest expense paid or accrued to a foreign related party to which the exception in paragraph (b)(3)(iii) of this section (effectively connected income) applies is classified as domestic related business interest expense.

(ii) *Ordering rules for business interest expense that is limited under section 163(j)(1) to determine which classifications of business interest expense are deducted and which classifications of business interest expense are carried forward*—(A) *In general.* Section 163(j) and the regulations published under 26 CFR chapter I provide a limitation on the amount of business interest expense allowed as a deduction in a taxable year by a corporation or a partner in a partnership. In the case of a corporation with a disallowed business interest expense carryforward, the regulations under section 163(j) determine the ordering of the business interest expense deduction that is allowed on a year-by-year basis by reference first to business interest expense incurred in the current taxable year and then to disallowed business interest expense carryforwards from prior years. To determine the amount of base erosion tax benefit under paragraph (c)(1) of this section, this paragraph (c)(4)(ii) sets forth ordering rules that determine the amount of the deduction of business interest expense allowed under section 163(j) that is classified as paid or accrued to a foreign related party for purposes of paragraph (c)(1)(i) of this section. This paragraph (c)(4)(ii) also sets forth similar ordering rules that apply to disallowed business interest expense carryforwards for which a deduction is permitted under section 163(j) in a later year.

(B) *Ordering rules for treating business interest expense deduction and disallowed business interest expense carryforwards as foreign related business interest expense, domestic related business interest expense, and unrelated business interest expense*—(*1*) *General ordering rule for allocating business interest expense deduction between classifications.* For purposes of paragraph (c)(1) of this section, if a deduction for business interest expense is not subject to the limitation under section 163(j)(1) in a taxable year, the deduction is treated first as foreign related business interest expense and domestic related business interest expense (on a pro-rata basis), and second as unrelated business interest expense. The same principle applies to business interest expense of a partnership that is deductible at the partner level under § 1.163(j)–6(f).

(*2*) *Ordering of business interest expense incurred by a corporation.* If a corporation's business interest expense deduction allowed for any taxable year is attributable to business interest expense paid or accrued in that taxable year and to disallowed business interest expense carryforwards from prior taxable years, the ordering of business interest expense deduction provided in paragraph (c)(4)(ii)(B)(*1*) of this section among the classifications described therein applies separately for the carryforward amount from each taxable year, following the ordering set forth in § 1.163(j)–5(b)(2). Corresponding adjustments to the classification of disallowed business interest expense carryforwards are made consistent with this year-by-year approach. For purposes of section 59A and this section, an acquiring corporation in a transaction described in section 381(a) will succeed to and take into account the classification of any disallowed business interest expense carryforward. See § 1.381(c)(20)–1.

(*3*) *Ordering of business interest expense incurred by a partnership and allocated to a corporate partner.* For a corporate partner in a partnership that is allocated a business interest expense deduction under § 1.163(j)–6(f), the ordering rule provided in paragraph (c)(4)(ii)(B)(*1*) of this section applies separately to the corporate partner's allocated business interest expense deduction from the partnership; that deduction is not comingled with the business interest expense deduction addressed in paragraph (c)(4)(ii)(B)(*1*) or (*2*) of this section or the corporate partner's items from any other partnership. Similarly, when a corporate

partner in a partnership is allocated excess business interest expense from a partnership under the rules set forth in § 1.163(j)–6(f) and the excess interest expense becomes deductible to the corporate partner, that partner applies the ordering rule provided in paragraph (c)(4)(ii)(B)(*1*) of this section separately to that excess interest expense on a year-by-year basis. Corresponding adjustments to the classification of disallowed business interest expense carryforwards are made consistent with this year-by-year and partnership-by-partnership approach.

(d) *Examples.* The following examples illustrate the application of this section. For purposes of all the examples, assume that the taxpayer is an applicable taxpayer and all payments apply to a taxable year beginning after December 31, 2017.

(1) *Example 1: Determining a base erosion payment.* (i) *Facts.* FP is a foreign corporation that owns all of the stock of FC, a foreign corporation, and DC, a domestic corporation. FP has a trade or business in the United States with effectively connected income (USTB). DC owns FDE, a foreign disregarded entity. DC pays interest to FDE and FC. FDE pays interest to USTB. All interest paid by DC to FC and by FDE to USTB is deductible by DC in the current year for regular income tax purposes. FDE also acquires depreciable property from FP during the taxable year. FP's income from the sale of the depreciable property is not effectively connected with the conduct of FP's trade or business in the United States. DC and FP (based only on the activities of USTB) are applicable taxpayers under § 1.59A–2(b).

(ii) *Analysis.* The payment of interest by DC to FC is a base erosion payment under paragraph (b)(1)(i) of this section because the payment is made to a foreign related party and the interest payment is deductible. The payment of interest by DC to FDE is not a base erosion payment because the transaction is not a payment to a foreign person and the transaction is not a deductible payment. With respect to the payment of interest by FDE to USTB, if FP's USTB treats the payment of interest by FDE to USTB as income that is effectively connected with the conduct of a trade or business in the United States pursuant to section 864 or as profits attributable to a U.S. permanent establishment of a tax treaty resident, and if DC receives a withholding certificate from FP with respect to the payment, then the exception in paragraph (b)(3)(iii) of this section applies. Accordingly, the payment from DC, through FDE, to USTB is not a base erosion payment even though the payment is to the USTB of FP, a foreign related party. The acquisition of depreciable property by DC, through FDE, is a base erosion payment under paragraph (b)(1)(ii) of this section because there is a payment to a foreign related party in connection with the acquisition by the taxpayer of property of a character subject to the allowance for depreciation and the exception in paragraph (b)(3)(iii) of this section does not apply because FP's income from the sale of the depreciable property is not effectively connected with the conduct of FP's trade or business in the United States. See § 1.59A–2 for the application of the aggregation rule with respect to DC and FP's USTB.

(2) *Example 2: Interest allocable under § 1.882–5.* (i) *Facts.* FC, a foreign corporation, has income that is effectively connected with the conduct of a trade or business within the United States. FC determines its interest expense under the three-step process described in §§ 1.882–5(b) through (d) with a total interest expense of $125x. The total interest expense is comprised of interest expense of $100x on U.S.-booked liabilities ($60x paid to a foreign related party and $40x paid to unrelated persons) and $25x of interest on excess U.S.-connected liabilities. FC has average total liabilities (that are not U.S.-booked liabilities) of $10,000x and of that number $2000x are liabilities held by a foreign related party. FC is an applicable taxpayer with respect to its effectively connected income. Assume all of the interest expense is deductible in the current taxable year and that none of the interest is subject to the effectively connected income exception in paragraph (b)(3)(iii) of this section.

(ii) *Analysis.* Under paragraph (b)(4)(i) of this section, the total amount of interest expense determined under § 1.882–5 that is a base erosion payment is $65x ($60x + 5x). FC has $60x of interest on U.S.-booked liabilities that is paid to a foreign related party and that is treated as a base erosion payment under paragraph (b)(4)(i)(A)(*1*) of this section. Additionally, $5x of the $25x of interest on excess U.S.-connected liabilities is treated as a base erosion payment under paragraph (b)(4)(i)(A)(*2*) of this section ($25x * ($2000x/$10,000x)).

(3) *Example 3: Interaction with section 163(j).* (i) *Facts.* Foreign Parent (FP) is a foreign corporation that owns all of the stock of DC, a domestic corporation that is an applicable taxpayer. In Year 1, DC has adjusted taxable income, as defined in section 163(j)(8), of $1000x and pays the following amounts of business interest expense: $420x that is paid to unrelated Bank, and $360x that is paid to FP. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 1. None of the exceptions in paragraph (b)(3) of this section apply, and the interest is not subject to withholding.

(ii) *Analysis*—(A) *Classification of business interest.* In Year 1, DC is only permitted to deduct $300x of business interest expense under section 163(j)(1) ($1000x × 30%). Paragraph (c)(4)(ii)(B) of this section provides that for purposes of paragraph (c)(1) of this section the deduction is treated first as foreign related business interest expense and domestic related business interest expense (here, only FP); and second as unrelated business interest expense (Bank). As a result, the $300x of business interest expense that is permitted under section 163(j)(1) is treated entirely as the business interest paid to the related foreign party, FP. All of DC's $300x deductible interest is treated as an add-back to modified taxable income in the Year 1 taxable year for purposes of § 1.59A–4(b)(2)(i).

(B) *Ordering rules for business interest expense carryforward.* Under section 163(j)(2), the $480x of disallowed business interest ($420x + $360x − $300x) is carried forward to the subsequent year. Under paragraph (c)(4)(ii)(B)(*1*) and (*2*) of this section, the interest carryforward is correspondingly treated first as unrelated business interest expense, and second pro-rata as foreign related business interest expense and domestic related business interest expense. As a result, $420x of the $480x business interest expense carryforward is treated first as business interest expense paid to Bank and the remaining $60x of the $480x business interest expense carryforward is treated as interest paid to FP and as an add-back to modified taxable income.

(4) *Example 4: Interaction with section 163(j); carryforward.* (i) *Facts.* The facts are the same as in paragraph (d)(3) of this section (the facts in *Example 3*), except that in addition, in Year 2, DC has adjusted taxable income of $250x, and pays the following amounts of business interest expense: $50x that is paid to unrelated Bank, and $45x that is paid to FP. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 2. None of the exceptions in paragraph (b)(3) of this section apply.

(ii) *Analysis*—(A) *Classification of business interest.* In Year 2, for purposes of section 163(j)(1), DC is treated as having paid or accrued total business interest of $575x, consisting of $95x business interest expense actually paid in Year 2 and $480x of business interest expense that is carried forward from Year 1. DC is permitted to deduct $75x of business interest expense in Year 2 under the limitation in section 163(j)(1) ($250x × 30%). Section 1.163(j)–5(b)(2) provides that, for purposes of section 163(j), the allowable business interest expense is first attributed to amounts paid or accrued in the current year, and then attributed to amounts carried over from earlier years on a first-in-first-out basis from the earliest year. Accordingly, the $75x of deductible business interest expense is deducted entirely from the $95x business interest expense incurred in Year 2 for section 163(j) purposes. Because DC's business interest expense deduction is limited under section 163(j)(1) and because DC's total business interest expense is attributable to more than one taxable year, paragraph (c)(4)(ii)(B)(*2*) of this section provides that the ordering rule in paragraph (c)(4)(ii)(B)(*1*) of this section is applied separately to each annual amount of section 163(j) disallowed business interest expense carryforward. With respect to the Year 2 layer, which is deducted first, paragraph (c)(4)(ii)(B) of this section provides that, for purposes of paragraph (c)(1) of this section, the Year 2 $75x deduction is treated first as foreign related business interest expense and domestic related business interest expense (here, only FP, $45x); and second as unrelated business interest expense (Bank, $30x). Consequentially, all of the $45x deduction of business interest expense that was paid to FP in Year 2 is treated as a base erosion tax benefit and an add-back to

modified taxable income for the Year 2 taxable year for purposes of § 1.59A–4(b)(2)(i).

(B) *Ordering rules for business interest expense carryforward.* The disallowed business interest expense carryforward of $20x from Year 2 is correspondingly treated first as interest paid to Bank under paragraph (c)(4)(i) of this section. The disallowed business interest expense carryforward of $480x from the Year 1 layer that is also not allowed as a deduction in Year 2 remains treated as $420x paid to Bank and $60 paid to FP.

(5) *Example 5: Interaction with section 163(j); carryforward.* (i) *Facts.* The facts are the same as in paragraph (d)(4) of this section (the facts in *Example 4*), except that in addition, in Year 3, DC has adjusted taxable income of $4000x and pays no business interest expense. DC does not earn any business interest income or incur any floor plan financing interest expense in Year 3.

(ii) *Analysis.* In Year 3, DC is treated as having paid or accrued total business interest expense of $500x, consisting of $480x of business interest expense that is carried forward from Year 1 and $20x of business interest expense that is carried forward from Year 2 for purposes of section 163(j)(1). DC is permitted to deduct $1200x of business interest expense in Year 3 under the limitation in section 163(j)(1) ($4000x × 30%). For purposes of section 163(j), DC is treated as first deducting the business interest expense from Year 1 then the business interest expense from Year 2. See § 1.163(j)–5(b)(2). Because none of DC's $500x business interest expense is limited under section 163(j), the stacking rule in paragraph (c)(4)(ii) of this section for allowed and disallowed business interest expense does not apply. For purposes of § 1.59A–4(b)(2)(i), DC's add-back to modified taxable income is $60x determined by the classifications in paragraph (c)(4)(i)(A) of this section ($60x treated as paid to FP from Year 1).

(6) *Example 6: Interaction with section 163(j); partnership.* (i) *Facts.* The facts are the same as in paragraph (d)(4) of this section (the facts in *Example 4*), except that in addition, in Year 2, DC forms a domestic partnership (PRS) with Y, a domestic corporation that is not related to DC within the meaning of § 1.59A–1(b)(17). DC and Y are equal partners in partnership PRS. In Year 2, PRS has ATI of $100x and $48x of business interest expense. $12x of PRS's business interest expense is paid to Bank, and $36x of PRS's business interest expense is paid to FP. PRS allocates the items comprising its $100x of ATI $50x to DC and $50x to Y. PRS allocates its $48x of business interest expense $24x to DC and $24x to Y. DC classifies its $24x of business interest expense as $6x unrelated business interest expense (Bank) and $18x as foreign related business interest expense (FP) under paragraph (c)(4)(i)(B) of this section. Y classifies its $24x of business interest expense as entirely unrelated business interest expense of Y (Bank and FP) under paragraph (c)(4)(i)(B) of this section. None of the exceptions in paragraph (b)(3) of this section apply.

(ii) *Partnership level analysis.* In Year 2, PRS's section 163(j) limit is 30 percent of its ATI, or $30x ($100x × 30 percent). Thus, PRS has $30x of deductible business interest expense and $18x of excess business interest expense ($48x − $30x). The $30x of deductible business interest expense is includible in PRS's non-separately stated income or loss, and is not subject to further limitation under section 163(j) at the partners' level.

(iii) *Partner level allocations analysis.* Pursuant to § 1.163(j)–6(f)(2), DC and Y are each allocated $15x of deductible business interest expense and $9x of excess business interest expense. At the end of Year 2, DC and Y each have $9x of excess business interest expense from PRS, which under § 1.163(j)–6 is not treated as paid or accrued by the partner until such partner is allocated excess taxable income or excess business interest income from PRS in a succeeding year. Pursuant to § 1.163(j)–6(e), DC and Y, in computing their limit under section 163(j), do not increase any of their section 163(j) items by any of PRS's section 163(j) items.

(iv) *Partner level allocations for determining base erosion tax benefits.* The $15x of deductible business interest expense allocated to DC is treated first as foreign related business interest expense (FP) under paragraph (c)(4)(ii)(B) of this section. DC's excess business interest expense from PRS of $9x is classified first as the unrelated business interest expense with respect to Bank ($6x) and then as the remaining portion of the business interest expense paid to FP ($3x, or $18x − $15x). Under paragraph (c)(4)(ii)(B)(*3*) of this section, these classifications of the PRS items apply irrespective of the classifications of DC's own interest expense as set forth in paragraph (d)(4) of this section (*Example 4*).

(v) *Computation of modified taxable income.* For Year 2, DC is treated as having incurred base erosion tax benefits of $60x, consisting of the $15x base erosion tax benefit with respect to its interest in PRS that is computed in paragraph (d)(6)(iii) of this section (*Example 6*) and $45x that is computed in paragraph (d)(4) of this section (*Example 4*).

(7) *Example 7: Transfers of property to related taxpayers.* (i) *Facts.* FP is a foreign corporation that owns all of the stock of DC1 and DC2, both domestic corporations. DC1 and DC2 are both members of the same aggregate group but are not members of the same consolidated tax group under section 1502. In Year 1, FP sells depreciable property to DC1. On the first day of the Year 2 tax year, DC1 sells the depreciable property to DC2.

(ii) *Analysis*—(A) *Year 1.* The acquisition of depreciable property by DC1 from FP is a base erosion payment under paragraph (b)(1)(ii) of this section because there is a payment to a foreign related party in connection with the acquisition by the taxpayer of property of a character subject to the allowance for depreciation.

(B) *Year 2.* The acquisition of the depreciable property in Year 2 by DC2 is not itself a base erosion payment because DC2 did not acquire the property from a foreign related party. However, under paragraph (b)(2)(vi) of this section any depreciation expense taken by DC2 on the property acquired from DC1 is a base erosion payment and a base erosion tax benefit under paragraph (c)(1)(ii) of this section because the acquisition of the depreciable property was a base erosion payment by DC1 and the property was sold to a member of the aggregate group; therefore, the depreciation expense continues as a base erosion tax benefit to DC2 as it would have been to DC1 if it continued to own the property.

**§ 1.59A–4 Modified taxable income.**

(a) *Scope.* Paragraph (b)(1) of this section provides rules for computing modified taxable income. Paragraph (b)(2) of this section provides rules addressing how base erosion tax benefits and net operating losses affect modified taxable income. Paragraph (b)(3) of this section provides a rule for a holder of a residual interest in a REMIC. Paragraph (c) of this section provides examples illustrating the rules described in this section.

(b) *Computation of modified taxable income*—(1) *In general.* The term *modified taxable income* means a taxpayer's taxable income, as defined in section 63(a), determined with the additions described in paragraph (b)(2) of this section. Notwithstanding the foregoing, the taxpayer's taxable income may not be reduced to an amount less than zero as a result of a net operating loss deduction allowed under section 172. See paragraphs (c)(1) and (2) of this section (*Examples 1* and *2*).

(2) *Modifications to taxable income.* The amounts described in this paragraph (b)(2) are added back to a taxpayer's taxable income to determine its modified taxable income.

(i) *Base erosion tax benefits.* The amount of any base erosion tax benefit as defined in § 1.59A–3(c)(1).

(ii) *Certain net operating loss deductions.* The base erosion percentage, as described in § 1.59A–2(e)(3), of any net operating loss deduction allowed to the taxpayer under section 172 for the taxable year. For purposes of determining modified taxable income, the net operating loss deduction allowed does not exceed taxable income before taking into account the net operating loss deduction. See paragraph (c)(1) and (2) of this section (*Examples 1* and *2*). The base erosion percentage for the taxable year that the net operating loss arose is used to determine the addition under this paragraph (b)(2)(ii). For a net operating loss that arose in a taxable year beginning before January 1, 2018, the base erosion percentage for the taxable year is zero.

(3) *Rule for holders of a residual interest in a REMIC.* For purposes of

paragraph (b)(1) of this section, the limitation in section 860E(a)(1) is not taken into account for determining the taxable income amount that is used to compute modified taxable income for the taxable year.

(c) *Examples.* The following examples illustrate the rules of paragraph (b) of this section.

(1) *Example 1: Current year loss.* (i) *Facts.* A domestic corporation (DC) is an applicable taxpayer that has a calendar taxable year. In 2020, DC has gross income of $100x, a deduction of $80x that is not a base erosion tax benefit, and a deduction of $70x that is a base erosion tax benefit. In addition, DC has a net operating loss carryforward to 2020 of $400x that arose in 2016.

(ii) *Analysis.* DC's starting point for computing modified taxable income is $(50x), computed as gross income of $100x, less a deduction of $80x (non-base erosion tax benefit) and a deduction of $70x (base erosion tax benefit). Under paragraph (b)(2)(ii) of this section, DC's starting point for computing modified taxable income does not take into account the $400x net operating loss carryforward because the allowable deductions for 2020, not counting the NOL deduction, exceed the gross income for 2020. DC's modified taxable income for 2020 is $20x, computed as $(50x) + $70x base erosion tax benefit.

(2) *Example 2: Net operating loss deduction.* (i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (the facts in *Example 1*), except that DC's gross income in 2020 is $500x.

(ii) *Analysis.* DC's starting point for computing modified taxable income is $0x, computed as gross income of $500x, less: A deduction of $80x (non-base erosion tax benefit), a deduction of $70x (base erosion tax benefit), and a net operating loss deduction of $350x (which is the amount of taxable income before taking into account the net operating loss deduction, as provided in paragraph (b)(2)(ii) of this section ($500x − $150x)). DC's modified taxable income for 2020 is $70x, computed as $0x + $70x base erosion tax benefit. DC's modified taxable income is not increased as a result of the $350x net operating loss deduction in 2020 because the base erosion percentage of the net operating loss that arose in 2016 is zero under paragraph (b)(2)(ii) of this section.

**§ 1.59A–5 Base erosion minimum tax amount.**

(a) *Scope.* Paragraph (b) of this section provides rules regarding the calculation of the base erosion minimum tax amount. Paragraph (c) of this section describes the base erosion and anti-abuse tax rate applicable to the taxable year.

(b) *In general.* With respect to any applicable taxpayer, the base erosion minimum tax amount for any taxable year is, the excess (if any) of—

(1) An amount equal to the base erosion and anti-abuse tax rate multiplied by the modified taxable income of the taxpayer for the taxable year, over

(2) An amount equal to the regular tax liability as defined in § 1.59A–1(b)(16) of the taxpayer for the taxable year, reduced (but not below zero) by the excess (if any) of—

(i) The credits allowed under chapter 1 of subtitle A of the Code against regular tax liability over

(ii) The sum of the credits described in paragraph (b)(3) of this section.

(3) *Credits that do not reduce regular tax liability.* The sum of the following credits are used in paragraph (b)(2)(ii) of this section to limit the amount by which the credits allowed under chapter 1 of subtitle A of the Internal Revenue Code reduce regular tax liability—

(i) *Taxable years beginning on or before December 31, 2025.* For any taxable year beginning on or before December 31, 2025—

(A) The credit allowed under section 38 for the taxable year that is properly allocable to the research credit determined under section 41(a);

(B) The portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of those applicable section 38 credits or the base erosion minimum tax amount (determined without regard to this paragraph (b)(3)(i)(B)); and

(C) Any credits allowed under sections 33 and 37.

(ii) *Taxable years beginning after December 31, 2025.* For any taxable year beginning after December 31, 2025, any credits allowed under sections 33 and 37.

(c) *Base erosion and anti-abuse tax rate*—(1) *In general.* For purposes of calculating the base erosion minimum tax amount, the base erosion and anti-abuse tax rate is—

(i) *Calendar year 2018.* For taxable years beginning in calendar year 2018, five percent.

(ii) *Calendar years 2019 through 2025.* For taxable years beginning after December 31, 2018, through taxable years beginning before January 1, 2026, 10 percent.

(iii) *Calendar years after 2025.* For taxable years beginning after December 31, 2025, 12.5 percent.

(2) *Increased rate for banks and registered securities dealers.* In the case of a taxpayer that is a member of an affiliated group (as defined in section 1504(a)(1)) that includes a bank or a registered securities dealer, the percentage otherwise in effect under paragraph (c)(1) of this section is increased by one percentage point.

(3) *Application of section 15.* Section 15 does not apply to any taxable year that includes January 1, 2018. See § 1.15–1(d). For a taxpayer using a taxable year other than the calendar year, section 15 applies to any taxable year beginning after January 1, 2018.

**§ 1.59A–6 Qualified derivative payment.**

(a) *Scope.* This section provides additional guidance regarding qualified derivative payments. Paragraph (b) of this section defines the term qualified derivative payment. Paragraph (c) of this section provides guidance on certain payments that are not treated as qualified derivative payments. Paragraph (d) defines the term derivative for purposes of section 59A. Paragraph (e) of this section provides an example illustrating the rules of this section.

(b) *Qualified derivative payment*—(1) *In general.* A *qualified derivative payment* means any payment made by a taxpayer to a foreign related party pursuant to a derivative with respect to which the taxpayer—

(i) Recognizes gain or loss as if the derivative were sold for its fair market value on the last business day of the taxable year (and any additional times as required by the Internal Revenue Code or the taxpayer's method of accounting);

(ii) Treats any gain or loss so recognized as ordinary; and

(iii) Treats the character of all items of income, deduction, gain, or loss with respect to a payment pursuant to the derivative as ordinary.

(2) *Reporting requirements*—(i) *In general.* No payment is a qualified derivative payment under paragraph (b)(1) of this section for any taxable year unless the taxpayer reports the information required in § 1.6038A–2(b)(7)(ix) for the taxable year.

(ii) *Failure to satisfy the reporting requirement.* If a taxpayer fails to satisfy the reporting requirement described in paragraph (b)(2)(i) of this section with respect to any payments, those payments will not be eligible for the qualified derivative payment exception described in § 1.59A–3(b)(3)(ii). A taxpayer's failure to report a payment as a qualified derivative payment does not impact the eligibility of any other payment which the taxpayer properly reported under paragraph (b)(2)(i) of this section from being a qualified derivative payment.

(3) *Amount of any qualified derivative payment.* The amount of any qualified derivative payment excluded from the denominator of the base erosion percentage as provided in § 1.59A–2(e)(3)(ii)(C) is determined as provided in § 1.59A–2(e)(3)(vi).

(c) *Exceptions for payments otherwise treated as base erosion payments.* A

payment does not constitute a qualified derivative payment if—

(1) The payment would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment; or

(2) In the case of a contract that has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

(d) *Derivative defined*—(1) *In general.* For purposes of this section, the term *derivative* means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following:

(i) Any share of stock in a corporation;

(ii) Any evidence of indebtedness;

(iii) Any commodity that is actively traded;

(iv) Any currency; or

(v) Any rate, price, amount, index, formula, or algorithm.

(2) *Exceptions.* The following contracts are not treated as derivatives for purposes of section 59A.

(i) *Direct interest.* A derivative contract does not include a direct interest in any item described in paragraph (d)(1)(i) through (v) of this section.

(ii) *Insurance contracts.* A derivative contract does not include any insurance, annuity, or endowment contract issued by an insurance company to which subchapter L applies (or issued by any foreign corporation to which the subchapter would apply if the foreign corporation were a domestic corporation).

(iii) *Securities lending and sale-repurchase transactions.* A derivative contract does not include any securities lending transaction, sale-repurchase transaction, or substantially similar transaction. Securities lending transaction and sale-repurchase transaction have the same meaning as provided in § 1.861–2(a)(7).

(3) *American depository receipts.* For purposes of section 59A, American depository receipts (or any similar instruments) with respect to shares of stock in a foreign corporation are treated as shares of stock in that foreign corporation.

(e) *Example.* The following example illustrates the rules of this section.

(1) *Facts.* Domestic Corporation (DC) is a dealer in securities within the meaning of section 475. On February 1, 2019, DC enters into a contract (Interest Rate Swap) with Foreign Parent (FP), a foreign related party, for a term of five years. Under the Interest Rate Swap, DC is obligated to make a payment to FP each month, beginning March 1, 2019, in an amount equal to a variable rate determined by reference to the prime rate, as determined on the first business day of the immediately preceding month, multiplied by a notional principal amount of $50 million. Under the Interest Rate Swap, FP is obligated to make a payment to DC each month, beginning March 1, 2019, in an amount equal to 5% multiplied by the same notional principal amount. The Interest Rate Swap satisfies the definition of a notional principal contract under § 1.446–3(c). DC recognizes gain or loss on the Interest Rate Swap pursuant to section 475. DC reports the information required to be reported for the taxable year under § 1.6038A–2(b)(7)(ix).

(2) *Analysis.* The Interest Rate Swap is a derivative as described in paragraph (d) of this section because it is a contract that references the prime rate and a fixed rate for determining the amount of payments. The exceptions described in paragraph (c) of this section do not apply to the Interest Rate Swap. Because DC recognizes ordinary gain or loss on the Interest Rate Swap pursuant to section 475(d)(3), it satisfies the condition in paragraph (b)(1)(ii) of this section. Because DC satisfies the requirement relating to the information required to be reported under paragraph (b)(2) of this section, any payment to FP with respect to the Interest Rate Swap will be a qualified derivative payment. Therefore, under § 1.59A–3(b)(3)(ii), the payments to FP are not base erosion payments.

**§ 1.59A–7 Application of base erosion and anti-abuse tax to partnerships.**

(a) *Scope.* This section provides rules regarding how partnerships and their partners are treated for purposes of section 59A. Paragraph (b) of this section provides the general application of an aggregate approach to partnerships for purposes of section 59A, including specific rules addressing the application of section 59A to amounts paid or accrued by a partnership to a related party, rules addressing the application of section 59A to amounts paid or accrued to a partnership from a related party, and other operating rules. Paragraph (c) of this section provides rules for determining whether a party is a foreign related party.

(b) *Application of section 59A to a partnership*—(1) *In general.* Except as otherwise provided in this section, section 59A is applied at the partner level in the manner described in this section. The provisions of section 59A must be interpreted in a manner consistent with this approach.

(2) *Payment made by a partnership.* Except as provided in paragraph (b)(4) of this section, for purposes of determining whether a payment or accrual by a partnership is a base erosion payment, any amount paid or accrued by a partnership is treated as paid or accrued by each partner based on the partner's distributive share of items of deduction (or other amounts that could be base erosion tax benefits) with respect to that amount (as determined under section 704).

(3) *Payment received by a partnership.* For purposes of determining whether a payment or accrual to a partnership is a base erosion payment of the payor, any amount paid or accrued to a partnership is treated as paid or accrued to each partner based on the partner's distributive share of the income or gain with respect to that amount (as determined under section 704).

(4) *Exception for base erosion tax benefits of certain partners*—(i) *In general.* For purposes of determining a partner's amount of base erosion tax benefits, a partner does not take into account its distributive share of any partnership amount of base erosion tax benefits for the taxable year if—

(A) The partner's interest in the partnership represents less than ten percent of the capital and profits of the partnership at all times during the taxable year;

(B) The partner is allocated less than ten percent of each partnership item of income, gain, loss, deduction, and credit for the taxable year; and

(C) The partner's interest in the partnership has a fair market value of less than $25 million on the last day of the partner's taxable year, determined using a reasonable method.

(ii) *Attribution.* For purposes of paragraph (b)(4)(i) of this section, a partner's interest in a partnership or partnership item is determined by adding the interests of the partner and any related party of the partner (as determined under section 59A), taking into account any interest owned directly, indirectly, or through constructive ownership (applying the section 318 rules as modified by section 59A (except section 318(a)(3)(A) through (C) will also apply so as to consider a United States person as owning stock that is owned by a person who is not a United States person), but excluding any interest to the extent already taken into account).

(5) *Other relevant items*—(i) *In general.* For purposes of section 59A, subject to paragraph (b)(4) of this section, each partner is treated as owning its share of the partnership items determined under section 704, including the assets of the partnership, using a reasonable method with respect to the assets. For items that are allocated to the partners, the partner is treated as owning its distributive share (including of deductions and base erosion tax

benefits). For items that are not allocated to the partners, the partner is treated as owning an interest proportionate with the partner's distributive share of partnership income.

(ii) *Gross receipts*—(A) *In general.* For purposes of section 59A, each partner in the partnership includes a share of partnership gross receipts in proportion to the partner's distributive share (as determined under section 704) of items of gross income that were taken into account by the partnership under section 703.

(B) *Foreign corporation.* A foreign corporation takes into account a share of gross receipts only with regard to receipts that produce income that is effectively connected with the conduct of a trade or business within the United States. In the case of a foreign corporation that determines its net taxable income under an applicable income tax treaty, the foreign corporation takes into account its share of gross receipts only with regard to such gross receipts that are taken into account in determining its net taxable income.

(iii) *Registered securities dealers.* If a partnership, or a branch of the partnership, is a registered securities dealer, each partner is treated as a registered securities dealer unless the partner's interest in the registered securities dealer would satisfy the criteria for the exception in paragraph (b)(4) of this section. For purposes of applying the de minimis exception in § 1.59A–2(e)(2)(iii), the partner takes into account its distributive share of the relevant partnership items.

(iv) *Application of sections 163(j) and 59A(c)(3) to partners of partnerships.* See § 1.59A–3(c)(4).

(6) *Tiered partnerships.* If the partner of a partnership is a partnership, then paragraphs (b) and (c) of this section are applied again at the level of the partner, applying this paragraph successively until the partner is not a partnership. Paragraph (b)(4) of this section is only applied at the level where the partner is not itself a partnership.

(c) *Foreign related party.* With respect to any person that owns an interest in a partnership, the related party determination in section 59A(g) applies at the partner level.

**§ 1.59A–8 Application of base erosion and anti-abuse tax to certain expatriated entities. [Reserved]**

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

(a) *Scope.* This section provides rules for recharacterizing certain transactions according to their substance for purposes of applying section 59A and the section 59A regulations. Paragraph (b) of this section provides specific anti-abuse rules. Paragraph (c) of this section provides examples illustrating the rules of paragraph (b) of this section.

(b) *Anti-abuse rules*—(1) *Transactions involving unrelated persons, conduits, or intermediaries.* If a taxpayer pays or accrues an amount to one or more intermediaries (including an intermediary unrelated to the taxpayer) that would have been a base erosion payment if paid or accrued to a foreign related party, and one or more of the intermediaries makes (directly or indirectly) corresponding payments to or for the benefit of a foreign related party as part of a transaction (or series of transactions), plan or arrangement that has as a principal purpose avoiding a base erosion payment (or reducing the amount of a base erosion payment), the role of the intermediary or intermediaries is disregarded as a conduit, or the amount paid or accrued to the intermediary is treated as a base erosion payment, as appropriate.

(2) *Transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.* A transaction (or component of a transaction or series of transactions), plan or arrangement that has a principal purpose of increasing the deductions taken into account for purposes of § 1.59A–2(e)(3)(i)(B) (the denominator of the base erosion percentage computation) is disregarded for purposes of § 1.59A–2(e)(3).

(3) *Transactions to avoid the application of rules applicable to banks and registered securities dealers.* A transaction (or series of transactions), plan or arrangement that occurs among related parties that has a principal purpose of avoiding the rules applicable to certain banks and registered securities dealers in § 1.59A–2(e)(2) (base erosion percentage test for banks and registered securities dealers) or § 1.59A–5(c)(2) (increased base erosion and anti-abuse tax rate for banks and registered securities dealers) is not taken into account for purposes of § 1.59A–2(e)(2) or § 1.59A–5(c)(2).

(c) *Examples.* The following examples illustrate the application of paragraph (b) of this section. For purposes of all of the examples, assume that FP, a foreign corporation, owns all the stock of DC, a domestic corporation and an applicable taxpayer and that none of the foreign corporations are subject to federal income taxation with respect to income that is, or is treated as, effectively connected with the conduct of a trade or business in the United States under an applicable provision of the Internal Revenue Code or regulations thereunder. Also assume that all payments occur in a taxable year beginning after December 31, 2017.

(1) *Example 1: Substitution of payments that are not base erosion payments for payments that otherwise would be base erosion payments through a conduit or intermediary.* (i) *Facts.* FP owns Property 1 with a fair market value of $95x, which FP intends to transfer to DC. A payment from DC to FP for Property 1 would be a base erosion payment. Corp A is a domestic corporation that is not a related party with respect to DC. As part of a plan with a principal purpose of avoiding a base erosion payment, FP enters into an arrangement with Corp A to transfer Property 1 to Corp A in exchange for $95x. Pursuant to the same plan, Corp A transfers Property 1 to DC in exchange for $100x. Property 1 is subject to the allowance for depreciation (or amortization in lieu of depreciation) in the hands of DC.

(ii) *Analysis.* The arrangement between FP, DC, and Corp A is deemed to result in a $95x base erosion payment under paragraph (b)(1) of this section because DC's payment to Corp A would have been a base erosion payment if paid to a foreign related person, and Corp A makes a corresponding payment to FP as part of the series of transactions that has as a principal purpose avoiding a base erosion payment.

(2) *Example 2: Alternative transaction to base erosion payment.* (i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (the facts in *Example 1*), except that DC does not purchase Property 1 from FP or Corp A. Instead, DC purchases Property 2 from Corp B, a domestic corporation that is not a related party with respect to DC and that originally produced or acquired Property 2 for Corp B's own account. Property 2 is substantially similar to Property 1, and DC uses Property 2 in substantially the same manner that DC would have used Property 1.

(ii) *Analysis.* Paragraph (b)(1) of this section does not apply to the transaction between DC and Corp B because Corp B does not make a corresponding payment to or for the benefit of FP as part of a transaction, plan or arrangement.

(3) *Example 3: Alternative financing source.* (i) *Facts.* On Date 1, FP loaned $200x to DC in exchange for Note A. DC pays or accrues interest annually on Note A, and the payment or accrual is a base erosion payment within the meaning of § 1.59A–3(b)(1)(i). On Date 2, DC borrows $200x from Bank, a corporation that is not a related party with respect to DC, in exchange for Note B. The terms of Note B are substantially similar to the terms of Note A. DC uses the proceeds from Note B to repay Note A.

(ii) *Analysis.* Paragraph (b)(1) of this section does not apply to the transaction between DC and Bank because Bank does not make a corresponding payment to or for the benefit of FP as part of the series of transactions.

(4) *Example 4: Alternative financing source that is a conduit.* (i) *Facts.* The facts are the same as in paragraph (c)(3)(i) of this section (the facts in *Example 3*) except that in

addition, with a principal purpose of avoiding a base erosion payment, and as part of the same plan or arrangement as the Note B transaction, FP deposits $250x with Bank. The difference between the interest rate paid by Bank to FP on FP's deposit and the interest rate paid by DC to Bank is less than one percentage point. The interest rate charged by Bank to DC would have differed absent the deposit by FP.

(ii) *Analysis.* The transactions between FP, DC, and Bank are deemed to result in a base erosion payment under paragraph (b)(1) of this section because DC's payment to Bank would have been a base erosion payment if paid to a foreign related person, and Bank makes a corresponding payment to FP as part of the series of transactions that has as a principal purpose avoiding a base erosion payment. See Rev. Rul. 87–89, 1987–2 C.B. 195, Situation 3.

(5) *Example 5: Transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.* (i) *Facts.* With a principal purpose of increasing the deductions taken into account by DC for purposes of § 1.59A–2(e)(3)(i)(B), DC enters into a long position with respect to Asset with Financial Institution 1 and simultaneously enters into a short position with respect to Asset with Financial Institution 2. Financial Institution 1 and Financial Institution 2 are not related to DC and are not related to each other.

(ii) *Analysis.* Paragraph (b)(2) of this section applies and the transactions between DC and Financial Institution 1 and DC and Financial Institution 2. These transactions are not taken into account for purposes of § 1.59A–2(e)(3)(i)(B) because the transactions have a principal purpose of increasing the deductions taken into account for purposes of § 1.59A–2(e)(3)(i)(B).

**§ 1.59A–10 Applicability date.**

Sections 1.59A–1 through 1.59A–9 apply to taxable years beginning after December 31, 2017.

■ **Par. 3.** Section 1.383–1 is amended by adding two sentences at the end of paragraph (d)(3)(i) to read as follows:

**§ 1.383–1 Special limitations on certain capital losses and excess credits.**

* * * * *

(d) * * *

(3) * * *

(i) * * * The application of section 59A is not a limitation contained in subtitle A for purposes of this paragraph (d)(3)(i). Therefore, the treatment of pre-change losses and pre-change credits in the computation of the base erosion minimum tax amount will not affect whether such losses or credits result in absorption of the section 382 limitation and the section 383 credit limitation.

* * * * *

■ **Par. 4.** Section 1.1502–2 is revised to read as follows:

**§ 1.1502–2 Computation of tax liability.**

(a) *Taxes imposed.* The tax liability of a group for a consolidated return year is determined by adding together—

(1) The tax imposed by section 11(a) in the amount described in section 11(b) on the consolidated taxable income for the year (reduced by the taxable income of a member described in paragraphs (a)(5) through (8) of this section);

(2) The tax imposed by section 541 on the consolidated undistributed personal holding company income;

(3) If paragraph (a)(2) of this section does not apply, the aggregate of the taxes imposed by section 541 on the separate undistributed personal holding company income of the members which are personal holding companies;

(4) If neither paragraph (a)(2) nor (3) of this section apply, the tax imposed by section 531 on the consolidated accumulated taxable income (see § 1.1502–43);

(5) The tax imposed by section 594(a) in lieu of the taxes imposed by section 11 on the taxable income of a life insurance department of the common parent of a group which is a mutual savings bank;

(6) The tax imposed by section 801 on consolidated life insurance company taxable income;

(7) The tax imposed by section 831(a) on consolidated insurance company taxable income of the members which are subject to such tax;

(8) Any increase in tax described in section 1351(d)(1) (relating to recoveries of foreign expropriation losses); and

(9) The tax imposed by section 59A on base erosion payments of taxpayers with substantial gross receipts.

(b) *Credits.* A group is allowed as a credit against the taxes described in paragraph (a) (except for paragraph (a)(9) of this section) of this section: the general business credit under section 38 (see § 1.1502–3), the foreign tax credit under section 27 (see § 1.1502–4), and any other applicable credits provided under the Internal Revenue Code. Any increase in tax due to the recapture of a tax credit will be taken into account. See section 59A and the regulations thereunder for credits allowed against the tax described in paragraph (a)(9) of this section.

(c) *Allocation of dollar amounts.* For purposes of this section, if a member or members of the consolidated group are also members of a controlled group that includes corporations that are not members of the consolidated group, any dollar amount described in any section of the Internal Revenue Code is apportioned among all members of the controlled group in accordance with the provisions of the applicable section and the regulations thereunder.

(d) *Applicability date*—(1) Except as provided in paragraph (d)(2) of this section, this section applies to any consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after the date of publication of the Treasury Decision adopting these rules as final regulations in the **Federal Register**.

(2) Paragraph (a)(9) of this section applies to consolidated return years beginning after December 31, 2017.

■ **Par.5.** Section 1.1502–4 is amended by revising paragraph (d)(3) to read as follows:

**§ 1.1502–4 Consolidated foreign tax credit.**

* * * * *

(d) * * *

(3) *Computation of tax against which credit is taken.* The tax against which the limiting fraction under section 904(a) is applied will be the consolidated tax liability of the group determined under § 1.1502–2, but without regard to paragraphs (a)(2), (3), (4), (8), and (9) of that section, and without regard to any credit against such liability.

* * * * *

■ **Par.6.** Section 1.1502–43 is amended by revising paragraph (b)(2)(i)(A) to read as follows:

**§ 1.1502–43 Consolidated accumulated earnings tax.**

* * * * *

(b) * * *

(2) * * *

(i) * * *

(A) The consolidated liability for tax determined without § 1.1502–2(a)(2) through (a)(4), and without the foreign tax credit provided by section 27, over

* * * * *

■ **Par.7.** Section 1.1502–47 is amended by revising paragraph (f)(7)(iii) to read as follows.

**§ 1.1502–47 Consolidated returns by life-nonlife groups.**

* * * * *

(f) * * *

(7) * * *

(iii) Any taxes described in § 1.1502–2 (other than by paragraphs (a)(1) and (d)(6) of that section).

* * * * *

■ **Par.8.** Section 1.1502–59A is added to read as follows:

**§ 1.1502–59A Application of section 59A to consolidated groups.**

(a) *Scope.* This section provides rules for the application of section 59A and the regulations thereunder (the *section*

*59A regulations,* see §§ 1.59A–1 through 1.59A–10) to consolidated groups and their members (as defined in § 1.1502–1(h) and (b), respectively). Rules in the section 59A regulations apply to consolidated groups except as modified in this section. Paragraph (b) of this section provides rules treating a consolidated group (rather than each member of the group) as a single taxpayer, and a single applicable taxpayer, as relevant, for certain purposes. Paragraph (c) of this section coordinates the application of the business interest stacking rule under § 1.59A–3(c)(4) to consolidated groups. Paragraph (d) of this section addresses how the base erosion minimum tax amount is allocated among members of the consolidated group. Paragraph (e) of this section sets forth definitions. Paragraph (f) of this section provides examples. Paragraph (g) of this section provides the applicability date and a transition rule.

(b) *Consolidated group as the applicable taxpayer*—(1) *In general.* For purposes of determining whether the consolidated group is an applicable taxpayer (within the meaning of § 1.59A–2(b)) and the amount of tax due pursuant to section 59A(a), all members of a consolidated group are treated as a single taxpayer. Thus, for example, members' deductions are aggregated in making the required computations under section 59A. In addition, items resulting from intercompany transactions (as defined in § 1.1502–13(b)(1)(i)) are disregarded for purposes of making the required computations. For example, additional depreciation deductions resulting from intercompany asset sales are not taken into account for purposes of applying the base erosion percentage test under § 1.59A–2(e).

(2) *Consolidated group as member of the aggregate group.* The consolidated group is treated as a single member of an aggregate group for purposes of § 1.59A–2(c).

(3) *Related party determination.* For purposes of section 59A and the section 59A regulations, if a person is a related party with respect to any member of a consolidated group, that person is a related party of the group and of each of its members.

(c) *Coordination of section 59A(c)(3) and section 163(j) in a consolidated group*—(1) *Overview.* This paragraph (c) provides rules regarding the application of § 1.59A–3(c)(4) to a consolidated group's section 163(j) interest deduction. The classification rule in paragraph (c)(3) of this section addresses how to determine if, and to what extent, the group's section 163(j) interest deduction is a base erosion tax benefit. These regulations contain a single-entity classification rule with regard to the deduction of the consolidated group's aggregate current year business interest expense (''BIE''), but a separate-entity classification rule for the deduction of the consolidated group's disallowed BIE carryforwards. Paragraph (c)(3) of this section classifies the group's aggregate current year BIE deduction, in conformity with § 1.59A–3(c)(4), as constituting domestic related current year BIE deduction, foreign related current year BIE deduction, or unrelated current year BIE deduction. The allocation rules in paragraph (c)(4) of this section then allocate to specific members of the group the domestic related current year BIE deduction, foreign related current year BIE deduction, and unrelated current year BIE deduction taken in the taxable year. Any member's current year BIE that is carried forward to the succeeding taxable year as a disallowed BIE carryforward is allocated a status as domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward under paragraph (c)(5) of this section. The status of any disallowed BIE carryforward deducted by a member in a later year is classified on a separate-entity basis by the deducting member under paragraph (c)(3) of this section, based on the status allocated to the member's disallowed BIE carryforward under paragraph (c)(5) of this section. This paragraph (c) also provides rules regarding the consequences of the deconsolidation of a corporation that has been allocated a domestic related BIE carryforward status, a foreign related BIE carryforward status, or an unrelated BIE carryforward status; and the consolidation of a corporation with a disallowed BIE carryforward classified as from payments to a domestic related party, foreign related party, or unrelated party.

(2) *Absorption rule for the group's business interest expense.* To determine the amount of the group's section 163(j) interest deduction, and to determine the year in which the member's business interest expense giving rise to the deduction was incurred or accrued, see §§ 1.163(j)–4(d) and 1.163(j)–5(b)(3).

(3) *Classification of the group's section 163(j) interest deduction*—(i) *In general.* Consistent with § 1.59A–3(c)(4)(i) and paragraph (b) of this section, the classification rule of this paragraph (c)(3) determines whether the consolidated group's section 163(j) interest deduction is a base erosion tax benefit. To the extent the consolidated group's business interest expense is permitted as a deduction under section 163(j)(1) in a taxable year, the deduction is classified first as from business interest expense paid or accrued to a foreign related party and business interest expense paid or accrued to a domestic related party (on a pro-rata basis); any remaining deduction is treated as from business interest expense paid or accrued to an unrelated party.

(ii) *Year-by-year application of the classification rule.* If the consolidated group's section 163(j) interest deduction in any taxable year is attributable to business interest expense paid or accrued in more than one taxable year (for example, the group deducts the group's aggregate current year BIE, the group's disallowed BIE carryforward from year 1, and the group's disallowed BIE carryforward from year 2), the classification rule in paragraph (c)(3)(i) of this section applies separately to each of those years, pursuant to paragraphs (c)(3)(iii) and (iv) of this section.

(iii) *Classification of current year BIE deductions.* Current year BIE deductions are classified under the section 59A regulations and this paragraph (c) as if the consolidated group were a single taxpayer that had paid or accrued the group's aggregate current year BIE to domestic related parties, foreign related parties, and unrelated parties. The rules of paragraph (c)(4) of this section apply for allocating current year BIE deductions among members of the consolidated group. To the extent the consolidated group's aggregate current year BIE exceeds its section 163(j) limitation, the rules of paragraph (c)(5) of this section apply.

(iv) *Classification of deductions of disallowed BIE carryforwards.* Each member of the group applies the classification rule in this paragraph (c)(3) to its deduction of any part of a disallowed BIE carryforward from a year, after the group applies paragraph (c)(5) of this section to the consolidated group's disallowed BIE carryforward from that year. Therefore, disallowed BIE carryforward that is actually deducted by a member is classified based on the status of the components of that carryforward, assigned pursuant to paragraph (c)(5) of this section.

(4) *Allocation of domestic related current year BIE deduction status and foreign related current year BIE deduction status among members of the consolidated group*—(i) *In general.* This paragraph (c)(4) applies if the group has domestic related current year BIE deductions, foreign related current year BIE deductions, or both, as a result of the application of the classification rule in paragraph (c)(3) of this section. Under this paragraph (c)(4), the domestic

related current year BIE, foreign related current year BIE, or both, that is treated as deducted in the current year are deemed to have been incurred pro-rata by all members that have current year BIE deduction in that year, regardless of which member or members actually incurred the current year BIE to a domestic related party or a foreign related party.

(ii) *Domestic related current year BIE deduction*—(A) *Amount of domestic related current year BIE deduction status allocable to a member.* The amount of domestic related current year BIE deduction status that is allocated to a member is determined by multiplying the group's domestic related current year BIE deduction (determined pursuant to paragraph (c)(3) of this section) by the percentage of current year BIE deduction allocable to such member in that year.

(B) *Percentage of current year BIE deduction allocable to a member.* The percentage of current year BIE deduction allocable to a member is equal to the amount of the member's current year BIE deduction divided by the amount of the group's aggregate current year BIE deduction.

(iii) *Amount of foreign related current year BIE deduction status allocable to a member.* The amount of foreign related current year BIE deduction status that is allocated to a member is determined by multiplying the group's foreign related current year BIE deduction (determined pursuant to paragraph (c)(3) of this section) by the percentage of current year BIE deduction allocable to such member (defined in paragraph (c)(4)(ii)(B) of this section).

(iv) *Treatment of amounts as having unrelated current year BIE deduction status.* To the extent the amount of a member's current year BIE that is absorbed under paragraph (c)(2) of this section exceeds the domestic related current year BIE deduction status and foreign related current year BIE deduction status allocated to the member under paragraph (c)(4)(ii) and (iii) of this section, such excess amount is treated as from payments or accruals to an unrelated party.

(5) *Allocation of domestic related BIE carryforward status and foreign related BIE carryforward status to members of the group*—(i) *In general.* This paragraph (c)(5) applies in any year the consolidated group's aggregate current year BIE exceeds its section 163(j) limitation. After the application of paragraph (c)(4) of this section, any remaining domestic related current year BIE, foreign related current year BIE, and unrelated current year BIE is deemed to have been incurred pro-rata by members of the group pursuant to the rules in paragraph (c)(5)(ii), (iii), and (iv) of this section, regardless of which member or members actually incurred the business interest expense to a domestic related party, foreign related party, or unrelated party.

(ii) *Domestic related BIE carryforward*—(A) *Amount of domestic related BIE carryforward status allocable to a member.* The amount of domestic related BIE carryforward status that is allocated to a member equals the group's domestic related BIE carryforward from that year multiplied by the percentage of disallowed BIE carryforward allocable to the member.

(B) *Percentage of disallowed BIE carryforward allocable to a member.* The percentage of disallowed BIE carryforward allocable to a member for a taxable year equals the member's disallowed BIE carryforward from that year divided by the consolidated group's disallowed BIE carryforwards from that year.

(iii) *Amount of foreign related BIE carryforward status allocable to a member.* The amount of foreign related BIE carryforward status that is allocated to a member equals the group's foreign related BIE carryforward from that year multiplied by the percentage of disallowed BIE carryforward allocable to the member (as defined in paragraph (c)(5)(ii)(B) of this section).

(iv) *Treatment of amounts as having unrelated BIE carryforward status.* If a member's disallowed BIE carryforward for a year exceeds the amount of domestic related BIE carryforward status and foreign related BIE carryforward status that is allocated to the member pursuant to paragraphs (c)(5)(ii) and (iii) of this section, respectively, the excess carryforward amount is treated as from payments or accruals to an unrelated party.

(v) *Coordination with section 381.* If a disallowed BIE carryforward is allocated a status as a domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward under the allocation rule of paragraph (c)(5) of this section, the acquiring corporation in a transaction described in section 381(a) will succeed to and take into account the allocated status of the carryforward for purposes of section 59A. See § 1.381(c)(20)–1.

(6) *Member deconsolidates from a consolidated group.* When a member deconsolidates from a group (the original group), the member's disallowed BIE carryforwards retain their allocated status, pursuant to paragraph (c)(5) of this section, as a domestic related BIE carryforward, foreign related BIE carryforward, or unrelated BIE carryforward (as applicable). Following the member's deconsolidation, no other member of the original group is treated as possessing the domestic related BIE carryforward status, foreign related BIE carryforward status, or unrelated BIE carryforward status that is carried forward by the departing member.

(7) *Corporation joins a consolidated group.* If a corporation joins a consolidated group (the acquiring group), and that corporation was allocated a domestic related BIE carryforward status, foreign related BIE carryforward status, or unrelated BIE carryforward status pursuant to paragraph (c)(5) of this section from another consolidated group (the original group), or separately has a disallowed BIE carryforward that is classified as from payments or accruals to a domestic related party, foreign related party, or unrelated party, the status of the carryforward is taken into account in determining the acquiring group's base erosion tax benefit when the corporation's disallowed BIE carryforward is absorbed.

(d) *Allocation of the base erosion minimum tax amount to members of the consolidated group.* For rules regarding the allocation of the base erosion minimum tax amount, see section 1552. Allocations under section 1552 take into account the classification and allocation provisions of paragraphs (c)(3) through (5) of this section.

(e) *Definitions.* The following definitions apply for purposes of this section—

(1) *Aggregate current year BIE.* The consolidated group's *aggregate current year BIE* is the aggregate of all members' current year BIE.

(2) *Aggregate current year BIE deduction.* The consolidated group's *aggregate current year BIE deduction* is the aggregate of all members' current year BIE deductions.

(3) *Applicable taxpayer.* The term *applicable taxpayer* has the meaning provided in § 1.59A–2(b).

(4) *Base erosion minimum tax amount.* The consolidated group's *base erosion minimum tax amount* is the tax imposed under section 59A.

(5) *Base erosion tax benefit.* The term *base erosion tax benefit* has the meaning provided in § 1.59A–3(c)(1).

(6) *Business interest expense.* The term *business interest expense,* with respect to a member and a taxable year, has the meaning provided in § 1.163(j)–1(b)(2), and with respect to a consolidated group and a taxable year, has the meaning provided in § 1.163(j)–4(d)(2)(iii).

(7) *Consolidated group's disallowed BIE carryforwards.* The term *consolidated group's disallowed BIE carryforwards* has the meaning provided in § 1.163(j)–5(b)(3)(i).

(8) *Current year BIE.* A member's *current year BIE* is the member's business interest expense that would be deductible in the current taxable year without regard to section 163(j) and that is not a disallowed business interest expense carryforward from a prior taxable year.

(9) *Current year BIE deduction.* A member's *current year BIE deduction* is the member's current year BIE that is permitted as a deduction in the taxable year.

(10) *Domestic related BIE carryforward.* The consolidated group's *domestic related BIE carryforward* for any taxable year is the excess of the group's domestic related current year BIE over the group's domestic related current year BIE deduction (if any).

(11) *Domestic related current year BIE.* The consolidated group's *domestic related current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to a domestic related party.

(12) *Domestic related current year BIE deduction.* The consolidated group's *domestic related current year BIE deduction* for any taxable year is the portion of the group's aggregate current year BIE deduction classified as from interest paid or accrued to a domestic related party under paragraph (c)(3) of this section.

(13) *Domestic related party.* A *domestic related party* is a related party that is not a foreign related party and is not a member of the same consolidated group.

(14) *Disallowed BIE carryforward.* The term *disallowed BIE carryforward* has the meaning provided in § 1.163(j)–1(b)(9).

(15) *Foreign related BIE carryforward.* The consolidated group's *foreign related BIE carryforward* for any taxable year, is the excess of the group's foreign related current year BIE over the group's foreign related current year BIE deduction (if any).

(16) *Foreign related current year BIE.* The consolidated group's *foreign related current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to a foreign related party.

(17) *Foreign related current year BIE deduction.* The consolidated group's *foreign related current year BIE deduction* for any taxable year is the portion of the consolidated group's aggregate current year BIE deduction classified as from interest paid or accrued to a foreign related party under paragraph (c)(3) of this section.

(18) *Foreign related party.* A *foreign related party* has the meaning provided in § 1.59A–1(b)(12).

(19) *Related party.* The term *related party* has the meaning provided in § 1.59A–1(b)(17), but excludes members of the same consolidated group.

(20) *Section 163(j) interest deduction.* The term *section 163(j) interest deduction* means, with respect to a taxable year, the amount of the consolidated group's business interest expense permitted as a deduction pursuant to § 1.163(j)–5(b)(3) in the taxable year.

(21) *Section 163(j) limitation.* The term *section 163(j) limitation* has the meaning provided in § 1.163(j)–1(b)(31).

(22) *Unrelated BIE carryforward.* The consolidated group's *unrelated BIE carryforward* for any taxable year is the excess of the group's unrelated current year BIE over the group's unrelated current year BIE deduction.

(23) *Unrelated current year BIE.* The consolidated group's *unrelated current year BIE* for any taxable year is the consolidated group's aggregate current year BIE paid or accrued to an unrelated party.

(24) *Unrelated current year BIE deduction.* The consolidated group's *unrelated current year BIE deduction* for any taxable year is the portion of the group's aggregate current year BIE deduction classified as from interest paid or accrued to an unrelated party under paragraph (c)(3) of this section.

(25) *Unrelated party.* An *unrelated party* is a party that is not a related party.

(f) *Examples.* The following examples illustrate the general application of this section. For purposes of the examples, a foreign corporation (FP) wholly owns domestic corporation (P), which in turn wholly owns S1 and S2. P, S1, and S2 are members of a consolidated group. The consolidated group is a calendar year taxpayer.

(1) *Example 1:* Computation of the consolidated group's base erosion minimum tax amount. (i) *The consolidated group is the applicable taxpayer.* (A) *Facts.* The members have never engaged in intercompany transactions. For the 2019 taxable year, P, S1, and S2 were permitted the following amounts of deductions (within the meaning of section 59A(c)(4)), $2,400x, $1,000x, and $2,600x; those deductions include base erosion tax benefits of $180x, $370x, and $230x. The group's consolidated taxable income for the year is $150x. In addition, the group satisfies the gross receipts test in § 1.59A–2(d).

(B) *Analysis.* Pursuant to paragraph (b) of this section, the receipts and deductions of P, S1, and S2 are aggregated for purposes of making the computations under section 59A. The group's base erosion percentage is 13% (($180x + $370x + $230x)/($2,400x + $1,000x + $2,600x)). The consolidated group is an applicable taxpayer under § 1.59A–2(b) because the group satisfies the gross receipts test and the group's base erosion percentage (13%) is higher than 3%. The consolidated group's modified taxable income is computed by adding back the members' base erosion tax benefits (and, when the consolidated group has consolidated net operating loss available for deduction, the consolidated net operating loss allowed times base erosion percentage) to the consolidated taxable income, $930x ($150x + $180x + $370x + $230x). The group's base erosion minimum tax amount is then computed as 10 percent of the modified taxable income less the regular tax liability, $61.5x ($930x × 10% − $150x × 21%).

(ii) *The consolidated group engages in intercompany transactions.* (A) *Facts.* The facts are the same as in paragraph (f)(1)(i)(A) of this section (the facts in *Example 1*(i)), except that S1 sold various inventory items to S2 during 2019. Such items are depreciable in the hands of S2 (but would not have been depreciable in the hands of S1) and continued to be owned by S2 during 2019.

(B) *Analysis.* The result is the same as paragraph (f)(1)(i)(A) of this section (the facts in *Example 1*(i)). Pursuant to paragraph (b)(2) of this section, items resulting from the intercompany sale (for example, gross receipts, depreciation deductions) are not taken into account in computing the group's gross receipts under § 1.59A–2(d) and base erosion percentage under § 1.59A–2(e)(3).

(2) *Example 2: Business interest expense subject to section 163(j) and the group's domestic related current year BIE and foreign related current year BIE for the year equals its section 163(j) limitation.* (i) *Facts.* During the current year (Year 1), P incurred $150x of business interest expense to domestic related parties; S1 incurred $150x of business interest expense to foreign related parties; and S2 incurred $150x of business interest expense to unrelated parties. The group's section 163(j) limitation for the year is $300x. After applying the rules in § 1.163(j)–5(b)(3), the group deducts $150x of P's Year 1 business interest expense, and $75x each of S1 and S2's Year 1 business interest expense. Assume the group is an applicable taxpayer for purposes of section 59A.

(ii) *Analysis*—(A) *Application of the absorption rule in paragraph (c)(2) of this section.* Following the rules in section 163(j), the group's section 163(j) interest deduction for Year 1 is $300x, and the entire amount is from members' Year 1 business interest expense.

(B) *Application of the classification rule in paragraph (c)(3) of this section.* Under paragraph (c)(3) of this section, the group's aggregate current year BIE deduction of $300x is first classified as payments or accruals to related parties (pro-rata among domestic related parties and foreign related parties), and second as payments or accruals to unrelated parties. For Year 1, the group has $150x of domestic related current year BIE and $150x of foreign related current year BIE, and the group's aggregate current year

BIE deduction will be classified equally among the related party expenses. Therefore, $150x of the group's deduction is classified as domestic related current year BIE deduction and $150x is classified as a foreign related current year BIE deduction.

(C) *Application of the allocation rule in paragraph (c)(4) of this section.* After the application of the classification rule in paragraph (c)(3) of this section, the group has $150x each of domestic related current year BIE deduction and foreign related current year BIE deduction from the group's aggregate current year BIE in Year 1. The domestic related current year BIE deduction and foreign related current year BIE deduction will be allocated to P, S1, and S2 based on each member's deduction of its Year 1 business interest expense.

(*1*) *Allocations to P.* The percentage of current year BIE deduction attributable to P is 50% (P's deduction of its Year 1 current year BIE, $150x, divided by the group's aggregate current year BIE deduction for Year 1, $300x). Thus, the amount of domestic related current year BIE deduction status allocated to P is $75x (the group's domestic related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to P, 50%); and the amount of foreign related current year BIE deduction status allocated to P is $75x (the group's foreign related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to P, 50%).

(*2*) *Allocations to S1 and S2.* The percentage of current year BIE deduction attributable to S1 is 25% (S1's deduction of its Year 1 current year BIE, $75x, divided by the group's aggregate current year BIE deduction for Year 1, $300x). Thus, the amount of domestic related current year BIE deduction status allocated to S1 is $37.5x (the group's domestic related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to S1, 25%); and the amount of foreign related current year BIE deduction status allocated to S1 is $37.5x (the group's foreign related current year BIE deduction, $150x, multiplied by the percentage of current year BIE deduction allocable to S1, 25%). Because S2 also deducted $75 of its Year 1 current year BIE, S2's deductions are allocated the same pro-rata status as those of S1 under this paragraph (f)(2)(ii)(C)(*2*).

(D) *Application of the allocation rule in paragraph (c)(5) of this section.* Although the group will have disallowed BIE carryforwards after Year 1 (the group's aggregate current year BIE of $450x ($150x + $150x + $150x) exceeds the section 163(j) limitation of $300x), all of the domestic related current year BIE and foreign related current year BIE in Year 1 has been taken into account pursuant to the classification rule in paragraph (c)(3) of this section. Thus, under paragraph (c)(5)(iv) of this section, each member's disallowed BIE carryforward is treated as from payments or accruals to unrelated parties.

(3) *Example 3: Business interest expense subject to section 163(j).* (i) *The group's domestic related current year BIE and foreign related current year BIE for the year exceeds its section 163(j) limitation.* (A) *Facts.* During the current year (Year 1), P incurred $60x of business interest expense to domestic related parties; S1 incurred $40x of business interest expense to foreign related parties; and S2 incurred $80x of business interest expense to unrelated parties. The group's section 163(j) limitation for the year is $60x. After applying the rules in § 1.163(j)–5(b)(3), the group deducts $20x each of P, S1, and S2's current year business interest expense. Assume the group is an applicable taxpayer for purposes of section 59A.

(B) *Analysis*—(*1*) *Application of the absorption rule in paragraph (c)(2) of this section.* Following the rules in section 163(j), the group's section 163(j) interest deduction is $60x, and the entire amount is from members' Year 1 business interest expense.

(*2*) *Application of the classification rule in paragraph (c)(3) of this section.* Under paragraph (c)(3) of this section, the group's $60x of aggregate current year BIE deduction is first classified as payments or accruals to related parties (pro-rata among domestic related parties and foreign related parties), and second as payments or accruals from unrelated parties. The group's total related party interest expense in Year 1, $100x (sum of the group's Year 1 domestic related current year BIE, $60x, and the group's Year 1 foreign related current year BIE, $40x), exceeds the group's aggregate current year BIE deduction of $60x. Thus, the group's aggregate current year BIE deduction will be classified, pro-rata, as from payments or accruals to domestic related parties and foreign related parties. Of the group's aggregate current year BIE deduction in Year 1, $36x is classified as a domestic related current year BIE deduction (the group's aggregate current year BIE deduction, $60x, multiplied by the ratio of domestic related current year BIE over the group's total Year 1 related party interest expense ($60x/($60x + $40x))); and $24x of the group's aggregate current year BIE deduction is classified as a foreign related current year BIE deduction (the group's section 163(j) interest deduction, $60x, multiplied by the ratio of foreign related current year BIE over the group's total Year 1 related party interest expense ($40x/($60x + $40x))).

(*3*) *Application of the allocation rule in paragraph (c)(4) of this section.* After the application of the classification rule in paragraph (c)(3) of this section, the group has $36x of domestic related current year BIE deduction and $24x of foreign related current year BIE deduction from the group's aggregate current year BIE in Year 1. The domestic related current year BIE deduction and foreign related current year BIE deduction will be allocated to P, S1, and S2 based on each member's current year BIE deduction in Year 1.

(*i*) *Allocation of the group's domestic related current year BIE deduction status.* Because each member is deducting $20x of its Year 1 business interest expense, all three members have the same percentage of current year BIE deduction attributable to them. The percentage of current year BIE deduction attributable to each of P, S1, and S2 is 33.33% (each member's current year BIE deduction in Year 1, $20x, divided by the group's aggregate current year BIE deduction for Year 1, $60x). Thus, the amount of domestic related current year BIE deduction status allocable to each member is $12x (the group's domestic related current year BIE deduction, $36x, multiplied by the percentage of current year BIE deduction allocable to each member, 33.33%).

(*ii*) *Allocations of the group's foreign related current year BIE deduction status.* The amount of foreign related current year BIE deduction status allocable to each member is $8x (the group's foreign related current year BIE deduction, $24x, multiplied by the percentage of current year BIE deduction allocable to each member, 33.33%, as computed earlier in paragraph (f)(3) of this section (*Example 3*).

(*4*) *Application of the allocation rule in paragraph (c)(5) of this section.* In Year 1 the group has $60x of domestic related current year BIE, of which $36x is deducted in the year (by operation of the classification rule). Therefore, the group has $24x of domestic related BIE carryforward. Similarly, the group has $40x of foreign related current year BIE in Year 1, of which $24x is deducted in the year. Therefore, the group has $16x of foreign related BIE carryforward. The $24x domestic related BIE carryforward status and $16x foreign related BIE carryforward status will be allocated to P, S1, and S2 in proportion to the amount of each member's disallowed BIE carryforward.

(*i*) *Allocation to P.* The percentage of disallowed BIE carryforward allocable to P is 33.33% (P's Year 1 disallowed BIE carryforward, $40x ($60x − $20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x + $40x + 80x − $60x)). Thus, the amount of domestic related BIE carryforward status allocated to P is $8x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to P, 33.33%); and the amount of foreign related BIE carryforward status allocated to P is $5.33x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to P, 33.33%). Under paragraph (c)(5)(iv) of this section, P's disallowed BIE carryforward that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $26.67x ($40x P's disallowed BIE carryforward − $8x domestic related BIE carryforward status allocated to P − $5.33x foreign related BIE carryforward status allocated to P) is treated as interest paid or accrued to an unrelated party.

(*ii*) *Allocation to S1.* The percentage of disallowed BIE carryforward allocable to S1 is 16.67% (S1's Year 1 disallowed BIE carryforward, $20x ($40x − $20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x + $40x + 80x − $60x). Thus, the amount of domestic related BIE carryforward status allocated to S1 is $4x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to S1, 16.67%); and the amount of foreign related BIE carryforward status

allocated to S1 is $2.67x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to S1, 16.67%). Under paragraph (c)(5)(iv) of this section, S1's disallowed BIE that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $13.33x ($20x S1's disallowed BIE carryforward − $4x domestic related BIE carryforward status allocated to S1 − $2.67x foreign related BIE carryforward status allocated to S1) is treated as interest paid or accrued to an unrelated party.

(*iii*) *Allocation to S2.* The percentage of disallowed BIE carryforward allocable to S2 is 50% (S2's Year 1 disallowed BIE carryforward, $60x ($80x − $20x), divided by the group's Year 1 disallowed BIE carryforward, $120x ($60x + $40x + 80x − $60x). Thus, the amount of domestic related BIE carryforward status allocated to S2 is $12x (the group's domestic related BIE carryforward, $24x, multiplied by the percentage of disallowed BIE carryforward allocable to S2, 50%); and the amount of foreign related BIE carryforward status allocated to S2 is $8x (the group's foreign related BIE carryforward, $16x, multiplied by the percentage of disallowed BIE carryforward allocable to S2, 50%). Under paragraph (c)(5)(iv) of this section, S2's disallowed BIE that has not been allocated a status as either a domestic related BIE carryforward or a foreign related BIE carryforward will be treated as interest paid or accrued to an unrelated party. Therefore, $40x ($60x S2's disallowed BIE carryforward − $12x domestic related BIE carryforward status allocated to S2 − $8x foreign related BIE carryforward status allocated to S2) is treated as interest paid or accrued to an unrelated party.

(ii) *The group deducting its disallowed BIE carryforwards.* (A) *Facts.* The facts are the same as in paragraph (f)(3)(i)(A) of this section (the facts in *Example 3*(i)), and in addition, none of the members incurs any business interest expense in Year 2. The group's section 163(j) limitation for Year 2 is $30x.

(B) *Analysis*—(*1*) *Application of the absorption rule in paragraph (c)(2) of this section.* Following the rules in section 163(j), each member of the group is deducting $10x of its disallowed BIE carryforward from Year 1. Therefore, the group's section 163(j) deduction for Year 2 is $30x.

(*2*) *Application of the classification rule in paragraph (c)(3) of this section.* Under paragraph (c)(3)(iv) of this section, to the extent members are deducting their Year 1 disallowed BIE carryforward in Year 2, the classification rule will apply to the deduction in Year 2 after the allocation rule in paragraph (c)(5) of this section has allocated the related and unrelated party status to the member's disallowed BIE carryforward in Year 1. The allocation required under paragraph (c)(5) of this section is described in paragraph (f)(3)(i)(B)(*4*) of this section.

(*i*) *Use of P's allocated domestic related BIE carryforward status and foreign related BIE carryforward status.* P has $40x of Year 1 disallowed BIE carryforward, and P was allocated $8x of domestic related BIE carryforward status and $5.33x of foreign related BIE carryforward status. In Year 2, P deducts $10x of its Year 1 disallowed BIE carryforward. Under the classification rule of paragraph (c)(3) of this section, P is treated as deducting pro-rata from its allocated status of domestic related BIE carryforward and foreign related BIE carryforward. Therefore, P is treated as deducting $6x of its allocated domestic related BIE carryforward ($10x × $8x/($8x + $5.33x)), and $4x of its allocated foreign related BIE carryforward ($10x × $5.33x/$8x + $5.33x)). After Year 2, P has remaining $30x of Year 1 disallowed BIE carryforward, of which $2x has a status of domestic related BIE carryforward, $1.33x has the status of foreign related BIE carryforward, and $26.67x of interest treated as paid or accrued to unrelated parties.

(*ii*) *Use of S1's allocated domestic related BIE carryforward status and foreign related BIE carryforward status.* S1 has $20x of Year 1 disallowed BIE carryforward, and S1 was allocated $4x of domestic related BIE carryforward status and $2.67x of foreign related BIE carryforward status. In Year 2, S2 deducts $10x of its Year 1 disallowed BIE carryforward. Because S2's deduction of its Year 1 disallowed BIE carryforward, $10x, exceeds its allocated domestic related BIE carryforward status ($4x) and foreign related BIE carryforward status ($2.67x), all of the allocated related party status are used up. After Year 2, all of S1's Year 1 disallowed BIE carryforward, $10x, is treated as interest paid or accrued to an unrelated party.

(*iii*) *Use of S2's allocated domestic related BIE carryforward status and foreign related BIE carryforward status.* S2 has $60x of Year 1 disallowed BIE carryforward, and S2 was allocated $12x of domestic related BIE carryforward status and $8x of foreign related BIE carryforward status. In Year 2, S2 deducts $10x of its Year 1 disallowed BIE carryforward. Under the classification rule of paragraph (c)(3) of this section, S2 is treated as deducting $6x of its allocated domestic related BIE carryforward ($10x × $12x/($12x + $8x)), and $4x of its allocated foreign related BIE carryforward ($10x × $8x/$8x + $12x)). After Year 2, P has remaining $50x of Year 1 disallowed BIE carryforward, of which $6x has a status of domestic related BIE carryforward, $4x has the status of foreign related BIE carryforward, and $40x of interest treated as paid or accrued to unrelated parties.

(g) *Applicability date*—(1) *In general.* Except as provided in this paragraph (g), this section applies to taxable years beginning after December 31, 2017.

(2) *Application of section 59A if S joins a consolidated group with a taxable year beginning before January 1, 2018.* If during calendar year 2018 a corporation (S) joins a consolidated group during a consolidated return year beginning before January 1, 2018, then section 59A will not apply to S's short taxable year that is included in the group's consolidated return year, even though S's short taxable year begins after December 31, 2017.

■ **Par. 9.** Section 1.1502–100 is amended by revising paragraph (b) to read as follows:

**§ 1.1502–100 Corporations exempt from tax.**

* * * * *

(b) The tax liability for a consolidated return year of an exempt group is the tax imposed by section 511(a) on the consolidated unrelated taxable income for the year (determined under paragraph (c) of this section), and by allowing the credits provided in § 1.1502–2(b).

* * * * *

■ **Par. 10.** Section 1.6038A–1 is amended by adding a sentence to the end of paragraph (n)(2) and revising the last sentence of paragraph (n)(3) to read as follows:

**§ 1.6038A–1 General requirements and definitions.**

* * * * *

(n) * * *

(2) * * * Section 1.6038A–2(a)(3), (b)(6), and (b)(7) apply for taxable years beginning after December 31, 2017.

(3) * * * For taxable years ending on or before December 31, 2017, see § 1.6038A–4 as contained in 26 CFR part 1 revised as of April 1, 2018.

* * * * *

■ **Par. 11.** Section 1.6038A–2 is amended by

■ 1. Revising the headings for paragraphs (a) and (a)(1).

■ 2. Revising paragraph (a)(2).

■ 3. Adding paragraph (a)(3).

■ 4. Revising paragraphs (b)(1)(ii), (b)(2)(iv), and the second sentence of paragraph (b)(3).

■ 5. Redesignating paragraphs (b)(6) through (b)(9) as paragraphs (b)(8) through (b)(11).

■ 6. Adding new paragraphs (b)(6) and (7).

■ 7. Revising paragraph (c) and the first sentence of paragraph (d).

■ 8. Removing the language ''Paragraph (b)(8)'' from the second sentence of paragraph (g) and adding the language ''Paragraph (b)(10)'' in its place.

■ 9. Adding two sentences to the end of paragraph (g).

The revisions and additions read as follows:

**§ 1.6038A–2 Requirement of return.**

(a) *Forms required.* (1) *Form 5472.* * * *

(2) *Reportable transaction.* A reportable transaction is any transaction of the types listed in paragraphs (b)(3) and (4) of this section, and, in the case of a reporting corporation that is an applicable taxpayer, as defined under § 1.59A–2(b), any other arrangement

that, to prevent avoidance of the purposes of section 59A, is identified on Form 5472 as a reportable transaction. However, except as the Secretary may prescribe otherwise for an applicable taxpayer, the transaction is not a reportable transaction if neither party to the transaction is a United States person as defined in section 7701(a)(30) (which, for purposes of section 6038A, includes an entity that is a reporting corporation as a result of being treated as a corporation under § 301.7701–2(c)(2)(vi) of this chapter) and the transaction—

(i) Will not generate in any taxable year gross income from sources within the United States or income effectively connected, or treated as effectively connected, with the conduct of a trade or business within the United States, and

(ii) Will not generate in any taxable year any expense, loss, or other deduction that is allocable or apportionable to such income.

(3) *Form 8991.* Each reporting corporation that is an applicable taxpayer, as defined under § 1.59A–2(b), must make an annual information return on Form 8991. The obligation of an applicable taxpayer to report on Form 8991 does not depend on applicability of tax under section 59A or obligation to file Form 5472.

(b) * * *

(1) * * *

(ii) The name, address, and U.S. taxpayer identification number, if applicable, of all its direct and indirect foreign shareholders (for an indirect 25-percent foreign shareholder, explain the attribution of ownership); whether any 25-percent foreign shareholder is a surrogate foreign corporation under section 7874(a)(2)(B) or a member of an expanded affiliated group as defined in section 7874(c)(1); each country in which each 25-percent foreign shareholder files an income tax return as a resident under the tax laws of that country; the places where each 25-percent shareholder conducts its business; and the country or countries of organization, citizenship, and incorporation of each 25-percent foreign shareholder.

* * * * *

(2) * * *

(iv) The relationship of the reporting corporation to the related party (including, to the extent the form may prescribe, any intermediate relationships).

(3) * * * The total amount of such transactions, as well as the separate amounts for each type of transaction described below, and, to the extent the form may prescribe, any further description, categorization, or listing of transactions within these types, must be reported on Form 5472, in the manner the form prescribes. * * *

* * * * *

(6) *Compilation of reportable transactions across multiple related parties.* A reporting corporation must, to the extent and in the manner Form 5472 may prescribe, include a schedule tabulating information with respect to related parties for which the reporting corporation is required to file Forms 5472. The schedule will not require information (beyond totaling) that is not required for the individual Forms 5472. The schedule may include the following:

(i) The identity and status of the related parties;

(ii) The reporting corporation's relationship to the related parties;

(iii) The reporting corporation's reportable transactions with the related parties; and

(iv) Other items required to be reported on Form 5472.

(7) *Information on Form 5472 and Form 8991 regarding base erosion payments.* If any reporting corporation is an applicable taxpayer, as defined under § 1.59A–2(b), it must report the information required by Form 8991 and by any Form 5472 it is required to file, regarding:

(i) Determination of whether a taxpayer is an applicable taxpayer;

(ii) Computation of base erosion minimum tax amount, including computation of regular tax liability as adjusted for purposes of computing base erosion minimum tax amount;

(iii) Computation of modified taxable income;

(iv) Base erosion tax benefits;

(v) Base erosion percentage calculation;

(vi) Base erosion payments;

(vii) Amounts with respect to services as described in § 1.59A–3(b)(3)(i), including a breakdown of the amount of the total services cost and any mark-up component;

(viii) Arrangements or transactions described in § 1.59A–9;

(ix) Any qualified derivative payment, including:

(A) The aggregate amount of qualified derivative payments for the taxable year, including as determined by type of derivative contract;

(B) The identity of each counterparty and the aggregate amount of qualified derivative payments made to that counterparty; and

(C) A representation that all payments satisfy the requirements of § 1.59A–6(b)(2), and

(x) Any other information necessary to carry out section 59A.

* * * * *

(c) *Method of reporting.* All statements required on or with the Form 5472 or Form 8991 under this section and § 1.6038A–5 must be in the English language. All amounts required to be reported under paragraph (b) of this section must be expressed in United States currency, with a statement of the exchange rates used, and, to the extent the forms may require, must indicate the method by which the amount of a reportable transaction or item was determined.

(d) * * * A Form 5472 and Form 8991 required under this section must be filed with the reporting corporation's income tax return for the taxable year by the due date (including extensions) of that return. * * *

* * * * *

(g) * * * Paragraph (b)(7)(ix) of this section applies to taxable years beginning one year after final regulations are published in the **Federal Register**. Before these regulations are applicable, a taxpayer will be treated as satisfying the reporting requirement described in § 1.59A–6(b)(2) only to the extent that it reports the aggregate amount of qualified derivative payments on Form 8991.

**§ 1.6038A–4 [Amended]**

■ **Par. 12.** For each paragraph listed in the table, remove the language in the ''Remove'' column from wherever it appears and add in its place the language in the ''Add'' column as set forth below:

| Section | Remove | Add |
|---|---|---|
| Section 1.6038A–4(a)(1) | $10,000 | $25,000 |
| Section 1.6038A–4(a)(3) | 10,000 | 25,000 |
| Section 1.6038A–4(d)(1) | 10,000 | 25,000 |
| Section 1.6038A–4(d)(4) | 10,000 | 25,000 |
| Section 1.6038A–4(f) | 10,000 | 25,000 |
| Section 1.6038A–4(f) | 30,000 | 75,000 |

| Section | Remove | Add |
|---|---|---|
| Section 1.6038A–4(f) | 90,000 | 225,000 |

**§ 1.6655–5 [Amended]**

■ **Par. 13.** Section 1.6655–5 is amended by removing the language ''§ 1.1502–2(h)'' in paragraph (e) *Example 10* and adding the language''§ 1.1502–1(h)'' in its place.

**Kirsten Wielobob,**

*Deputy Commissioner for Services and Enforcement.*

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