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CLIENT ALERT

Tax Reform in Small Bites: Beating the BEAT (Base Erosion and Anti-Abuse Tax)

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Companies with at least $500 million U.S. gross receipts that make deductible payments to foreign affiliates should review whether the new Base Erosion and Anti-Abuse (BEAT) minimum tax will increase their tax costs in 2018. The BEAT tax can result in extremely high effective rates of U.S. tax.

The Tax Cuts and Jobs Act of 2017 added the BEAT minimum tax, new Internal Revenue Code section 59A. The BEAT minimum tax is due if the BEAT tax amount is greater than the regular corporate tax for a year. The BEAT tax amount is computed as 10 percent (5 percent transitionally for years beginning in 2018 and 12.5 percent for years beginning in 2026 or later) of modified taxable income. Modified taxable income is essentially regular taxable income calculated without the allowance of deductions for amounts paid or accrued to related foreign persons or depreciation or amortization deductions with respect to property acquired from related foreign persons.

Because the BEAT tax is a minimum tax, companies with high taxable income compared to their deductible payments to foreign affiliates may not be subject to the tax. Ignoring tax credits, the 10 percent BEAT tax will begin to apply when payments to foreign affiliates exceed taxable income by more than 10 percent. For example, a taxpayer with $100 of regular taxable income, and regular corporate tax of $21, would be subject to the 10% BEAT tax if deductible payments to foreign affiliates exceed $110, which would result in modified taxable income in excess of $210, and a 10 percent BEAT tax amount in excess of the $21 regular corporate tax.

Companies with BEAT tax exposure should review their tax situation:

- It may be possible to restructure intercompany transactions so that related party payments are made from foreign affiliates to the U.S., rather than from the U.S. to the foreign affiliate (subject to potential anti-abuse regulations).
- Some payments relating to sales of products in the U.S. might properly be accounted for under the inventory method as cost of goods sold (COGS), rather than as deductible payments. Payments included in COGS reduce BEAT modified taxable income in the same manner as they reduce regular taxable income. A change of accounting method may be necessary, requiring IRS approval.
- Some payments to foreign affiliates for administrative services might properly be accounted for at cost, or with only a modest markup, and the cost portion of the payment may qualify for deduction from BEAT modified taxable income.
- It may be desirable to restructure operations to cause more income to be subject to U.S. tax as such additional income may have a low marginal tax rate when the effect of the BEAT tax is taken into account.

The BEAT tax may be challenged internationally for favoring domestic companies over foreign companies in potential violation of the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures or other international agreements. Regardless of the outcome of such a challenge, the BEAT is part of the U.S. tax law and must be dealt with until Congress changes the law.

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