


# Do you know the BEAT?

**By Forrest Milder**

In the past few days, you may have heard about a new tax that is currently part of the Senate's 2017 tax bill. It's called the Base Erosion Anti-avoidance Tax, or BEAT, and is a minimum tax that, if adopted, would apply only to certain taxpayers. Unfortunately, many of those taxpayers are also the companies that invest in projects that rely on tax credits, and the BEAT is computed in a way that may squander these credits, depending on the taxpayer's particular situation. Read on for a discussion of how the BEAT could adversely affect the tax credit marketplace if it is adopted as part of the legislation now pending in Congress. Of course, like much of what's in the tax bill, the proposal described here could change significantly, or be dropped from the legislation altogether, so keep an eye out for updates.

## Overview

In an effort to minimize their tax liability, American corporations with international affiliates sometimes (1) incur deductible fees to those affiliates and/or (2) direct gross income to these affiliates. In this way, these corporations reduce their American taxable income and the corresponding American tax liability. The proposed BEAT is intended to assure that companies that take advantage of this strategy still pay a minimum U.S. tax.

Here's how it would work. The BEAT would apply to "applicable taxpayers." These are corporations (other than regulated investment companies, REITS and S corporations) that have average annual gross receipts of at least $500 million for the most-recent three-year period and a "base erosion percentage" (more on this below) of 4 percent or more for that taxable year.

The base erosion percentage is computed by determining the company's deductions paid or accrued to a related foreign company, and reductions in gross receipts that are paid or accrued to a related foreign company, and then dividing this amount by most of the corporation's other allowable deductions. Of course, this is an oversimplification of how the math is done—there are complex rules for doing these computations—but simply stated, the BEAT would apply to corporations with average annual revenues of $500 million for the past three years whose deductions and/or shifting of revenues to affiliated foreign companies exceeds 4 percent of their other deductions.

Under the proposed law, if a corporation is an applicable taxpayer, then it does two further computations. First, it computes its normal taxable income, but without claiming the deductions associated with otherwise-deductible payments to foreign affiliates, and multiplies that amount by

10 percent (with the percentage increasing to 12.5 percent in 2025). We'll call this amount the "Ten Percent Computation." The corporation also computes its tax liability using the conventional tax system. We'll call this its "Conventional Tax Liability." The corporation then compares the Ten Percent Computation to its Conventional Tax Liability. If the Ten Percent Computation is greater, then the corporation owes a minimum tax equal to the difference between the two numbers. That minimum tax is the BEAT.

It's important to note how this computation is done. Because the BEAT is equal to the difference between the corporation's Ten Percent Computation and its Conventional Tax Liability, anything that decreases the corporation's Conventional Tax Liability makes this number larger and results in a higher BEAT.

Here's the part of the proposed new tax that has the tax equity community concerned. Computing the corporation's Conventional Tax Liability takes the Low Income (LIHTC), Renewable Energy (RETC), Historic (HTC) and New Markets (NMTC) tax credits, but not the R&D credit, into account as reductions in that liability. When these credits reduce a taxpayer's Conventional Tax Liability, this simply widens the gap between the Ten Percent Computation and the corporation's Conventional Tax Liability, thereby creating a corresponding increase in the BEAT. As a result, if the BEAT becomes law in its current form, LIHTC, RETC, HTC, and NMTC credits may lose some or all of their effectiveness for many taxpayers, making them a far less desirable investment.

## Illustration

Assume that the BEAT has become law, and that the maximum corporate tax rate has been reduced to 20 percent.

Corporation A is an applicable taxpayer. Suppose that it has $20,000 of income, less $10,000 of deductions not attributable to base erosion, and a deductible payment to a foreign affiliate of $5,500. Further presume that it has a low-income housing tax credit of $100. On these facts, the Ten Percent Computation is as follows: $20,000 of income less $10,000 of non-base-erosion deductions multiplied by 10 percent, or $1,000. A's Conventional Tax Liability is $20,000 of income less $15,500 of ***all*** deductions, multiplied by the new maximum corporate tax rate of 20 percent, or $900, ***further reduced*** by its $100 of LIHTC credits to $800. Now, let's compute the BEAT. On these facts, A's BEAT is $200, i.e., its Ten Percent Computation of $1,000 less its Conventional Tax Liability of $800. Thus, A's total tax liability is $1,000, consisting of $800 of conventional tax liability plus $200 of BEAT.

Compare this to the computation of the BEAT if A had no tax credits. The Ten Percent Computation would still be $1,000, as described above. However, A's Conventional Tax Liability would now be $900, because this time, there is no LIHTC to further reduce A's tax liability. So, the BEAT would be the Ten Percent Computation, $1,000 less A's Conventional Tax Liability, $900, or $100. Of course, A's total tax liability—$900 of conventional tax liability plus $100 of BEAT—still totals $1,000. In other words, in computing the BEAT, corporation A didn't get any benefit from its $100 of tax credits. Its final tax bill was $1,000 either way, regardless of whether it had any tax credits.

## Takeaways

People have noted a few things about the BEAT. In particular, we'll note the following two:

- First, the BEAT can be retroactive, because it can apply to tax credits generated by previously closed transactions for which the tax credit accrues after the BEAT becomes effective. For example, if a corporation invested in an LIHTC transaction in 2015, with a ten-year credit period running from 2015 through 2024, then starting in 2018, the computation of the BEAT might make the LIHTCs worth less, or even nothing at all.

- Second, it is hard to calculate how the BEAT will affect any particular applicable taxpayer, because the computation depends on whether the BEAT is larger than the corporation's traditional tax liability that can vary greatly from year-to-year.

  For example, assume that a taxpayer's Ten Percent Computation is $1,000, but its Conventional Tax Liability is $2,000, and it has $200 of tax credits. On those facts, the corporation's Conventional Tax Liability, even after allowing for its tax credits, is $1,800, and this is already larger than the Ten Percent Computation. Accordingly, the BEAT will *not* affect this corporation's tax liability or its ability to use the credits. On the other hand, another corporation might have facts like those in my first illustration and its tax credits would be worthless.

As noted previously, the BEAT only appears in the Senate version of the proposed tax bill, and many tax credit and financial trade associations are actively engaged in trying to get the proposal modified or eliminated. For example, one proposal would allow 90% of a taxpayer's LIHTC, HTC, RETC and NMTC to escape the effect of the BEAT and provide a carryforward for the remainder. Still, for now, the bottom line is that if the BEAT becomes law, it may serve to reduce the interest of big international players in tax credits.

For more information about the content of this alert, please contact your regular Nixon Peabody attorney or:


- Forrest Milder at **fmilder@nixonpeabody.com** or 617-345-1055
- Richard S. Goldstein at **rgoldstein@nixonpeabody.com** or 202-585-8730