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February 19, 2019

VIA HAND DELIVERY AND FEDERAL eRULEMAKING PORTAL

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

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Acting Chief Counsel and
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Internal Revenue Service
1111 Constitution Avenue, NW
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Re: Comments on Section 59A Proposed Regulations (Internal Revenue Service REG–104259–18) – Treatment of a Loss Recognized upon the Transfer of Property

Dear Messrs. Kautter, Rettig, and Paul:

The Tax Cuts and Jobs Act ("TCJA")[1] enacted the Base Erosion and Anti-Abuse Tax ("BEAT") under new section 59A.[2] Proposed regulations under section 59A were published in the Federal Register on December 21, 2018.[3] This letter responds to the request for comments regarding the proposed regulations and recommends that the regulations, when finalized, clarify that the recognition of a loss upon a transfer of property to a related foreign person does not give rise to a base erosion payment.

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[1] Pub. Law No. 115-97, 131 Stat. 2054 (Dec. 22, 2017).

[2] Unless otherwise specified, references to "sections" herein are to sections of the Internal Revenue Code of 1986, as amended (the "Code"), or to the Treasury regulations promulgated thereunder, as indicated.

[3] Notice of Proposed Rulemaking, Base Erosion and Anti-Abuse Tax (REG-104259-18), 83 Fed. Reg. 65956 (Dec. 21, 2018) (the "proposed regulations").

I. Overview

Under the BEAT, a "base erosion payment" includes several categories of payments, including "any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under this chapter" (the "deductible payment" rule).[4] The proposed regulations, in turn, define a "base erosion payment" under the deductible payment rule as "any amount paid or accrued 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."[5] Thus, the operative language of the regulation is essentially identical to the language of section 59A(d)(1) of the statute.

In the most straightforward example, a base erosion payment is the use of cash to pay a liability for a deductible item such as interest or royalties. The proposed regulations recognize, however, that it is possible for a base erosion payment to also occur through a transfer of property, and appropriately provide that a transfer of property instead of cash may also constitute a base erosion payment. This is consistent with other types of transfers; for example, a distribution of property instead of cash by a corporation with respect to its stock is a dividend to the shareholder without regard to whether the payment of the dividend is made in the form of cash or other property.

Although not directly addressed in the regulations, which, as noted above, essentially parrot the statutory language, the preamble to the proposed regulations states that the scope of a base erosion payment also includes any loss on property transferred to a related foreign person. Specifically, in discussing the definition of a base erosion payment, the preamble states that:

> because section 59A(d)(1) defines the first category of base erosion payment as "any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under this chapter," a base erosion payment also includes a payment to a foreign related party resulting in a recognized loss; for example, a loss recognized on the transfer of property to a foreign related party.[6]

However, because a loss recognized in connection with a property transfer is not deductible "with respect to" an amount paid or accrued, it is not a base erosion payment within

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[4] Section 59A(d)(1). The statutory definition of "base erosion payment" includes three additional categories of payments. Section 59A(d)(2) includes amounts "paid or accrued . . . in connection with the acquisition . . . of property subject to the allowance for depreciation [or amortization]," section 59A(d)(3) includes amounts paid or accrued for certain reinsurance payments, and section 59A(d)(4) includes certain payments made to expatriated entities, as defined in section 7874(a)(2)(B).

[5] Prop. Reg. § 1.59A-3(b)(1)(i).

[6] 83 Fed. Reg. at 65960.

the plain meaning of section 59A(d)(1). This conclusion is also supported by the structure of the statute, its legislative history, and other provisions of the proposed regulations, which all confirm that property losses should not be treated as base erosion payments. Finally, because a gain or loss recognized on the transfer of property simply reflects in taxable income a change in the property's market value regardless of the specific transaction in which such loss is recognized, a property loss does not present the base erosion concerns that the BEAT was intended to address, and there is no policy reason for treating it as a base erosion payment. We thus recommend that the regulations, when finalized, clarify that a loss recognized upon the transfer of property does not give rise to a "base erosion payment" within the meaning of section 59A(d)(1).

II. Definition of a Base Erosion Payment

A. Statutory Language

As noted above, a base erosion payment under section 59A includes "any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under this chapter." Thus, the definition of a base erosion payment imposes two requirements. There must be:

1. an "amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer";
2. "with respect to which a deduction is allowable . . ."

That is, a base erosion payment is (i) an amount paid or accrued to a related foreign person, if (ii) a deduction is allowable with respect to that amount.

B. Applicability to Amounts Paid in Kind

1. *General Tax Treatment of Payments in Kind*

A payment clearly may be made with property that takes the place of cash in a transaction (an "in kind" payment). Thus, a deduction for accrued interest is generally permitted, regardless of the form of the actual payment to the lender, whether in the form of cash, marketable securities, or other property (absent some other limitation, such as section 163(j) or 263A). Thus, for example, if accrued interest were paid using publicly traded stock, any available deduction for the interest would be unaffected by the character of the property used to make the actual payment of the amount owed.

Payments made with property, however, can separately give rise to gains or losses with respect to the property itself, the recognition of which depend on the basis of the property and the value received in the exchange rather than directly on the amount paid. For example, assume a taxpayer owes $100 of interest on its outstanding indebtedness and pays this amount by transferring property with a value of $100 and an adjusted tax basis of $120 (i.e., property with a built-in loss of $20). The taxpayer will be entitled to a $100 interest deduction under section 163, and will have a loss of $20 that is recognized under section 1001 and allowed as a

deduction under section 165. Of course, the $20 loss is not with respect to the $100 interest payment. That interest payment would be separately deductible under section 163 without regard to the type of property used to make the payment. Moreover, the amount of the interest deduction is without regard to the amount of the loss (or gain) recognized in the event the payment is made with property and not cash. This point becomes particularly obvious when the basis of the property greatly exceeds its value: if the basis of the property were instead $20,000,100, the loss on the property would be $20 million and not $20, but the 100 dollar interest deduction would be unchanged.

As another example, assume that the taxpayer above instead transfers property having an adjusted tax basis of $80 to satisfy the same $100 interest obligation. The property would thus have a built-in gain of $20, and the taxpayer would have a gain of $20 recognized under section 1001 and would again be entitled to a $100 interest deduction under section 163. In this example, it is particularly clear that the resulting gain would not alter the amount of the interest payment nor the resulting deduction because the recognition of gain does not affect the amount of the payment made. As in the built-in loss context, the recognition of gain is entirely separable from the interest payment and cannot be part of the payment or the interest deduction.

2. *Treatment of Amounts Paid in Kind for Purposes of Section 59A*

The case identified in the preamble, a loss recognized on property used to make a base erosion payment, gives rise to two distinct deductions: a deduction for the underlying payment, and a deduction for the loss. The first deduction is clearly an amount paid or accrued to a related foreign party with respect to which a deduction is allowable, and thus that amount meets the two requirements to be a base erosion payment. But the simultaneous recognition of a loss on the property transfer meets neither of those two requirements for the simple reason that the loss deduction is not a deduction for an "amount paid or accrued" to a related foreign party, but rather reflects the difference between the value of the property delivered and its tax basis. Thus, the loss deduction is not an amount allowable "with respect to" any amount paid or accrued to a related foreign person.

Returning to the statutory definition of a base erosion payment, a deduction, therefore, is only allowable "with respect to" a payment to the extent the payment is itself deductible. Put another way, the loss recognized on the property transfer is simply not part of the payment made to the recipient, as confirmed by the fact that if instead a gain were recognized in connection with the property transfer, that gain would certainly not alter the amount of the payment to the recipient or reduce the corresponding deduction. The fact that both the payment and the exchange occur in the context of one transaction should not obscure the fact that two different events are recognized to occur for tax purposes. The separation between deductible payments and gains/losses on property is most obvious when the recognition of gain/loss occurs separately from a transfer of the property. For example, under mark-to-market rules such as those under section 475, taxpayers are required to take into account gains and losses on certain inventory property (and therefore may deduct any losses) on a yearly basis regardless of whether the property was sold or exchanged during the year. It should be obvious, given the absence of any amount paid or accrued to a related foreign party, that mark-to-market losses cannot be

base erosion payments.[7] Therefore, when a property loss arises from an exchange rather than from being marked to market, the fact that the loss and a deductible payment both arise from the same transaction does not transform the property loss into a deductible payment. The property loss is simply not a deduction "with respect to" an amount paid or accrued, and accordingly a loss on property used to make a payment is not a base erosion payment.

The fact that the amount of a base erosion payment is unaffected by the recognition of gain or loss on property used to make the actual payment is reinforced by the statutory definition of a base erosion tax benefit as the deductions allowed "with respect to any base erosion payment." That definition parallels the definition of a base erosion payment: just as a base erosion payment only encompasses an "amount paid or accrued . . . *with respect to which* a deduction is allowable," the definition of a base erosion tax benefit is similarly limited to deductions allowed "with respect to" a base erosion payment. Just as the allowable deduction for a loss on property, even if realized in the same transaction, is not a base erosion payment because it is not a deduction "with respect to" a payment to a related foreign party, by the same token the deduction allowed for a loss on property likewise cannot be a base erosion tax benefit because it is not a deduction with respect to the base erosion payment but rather a loss with respect to an exchange of property. The preamble's reading is at odds with the statute, to the extent that it would result in an amount not constituting a base erosion payment somehow giving rise to a base erosion tax benefit.

Finally, the irrelevance of any gain or loss recognized on property used to make a payment is underlined by the fact that for accrual basis taxpayers, deductions are taken into account when properly accrued, generally without regard to the time or manner of actual payment. For such taxpayers the deduction has little to do with the payment, and thus it seems doubtful that Congress intended the BEAT treatment of a deduction to depend on the manner in which an actual payment is made, as there appears to be no logical basis for creating a BEAT distinction between payments in kind and payment in cash. These considerations become particularly compelling when the taxpayers actually affected by the BEAT are taken into account. In particular, the taxpayers subject to section 59A are by definition large corporations with gross receipts of at least $500 million for the taxable year, and thus virtually all such taxpayers use the accrual method of accounting. As a result, virtually every BEAT taxpayer will be taking its deductions on an accrual basis, which would make it particularly odd to provide for different BEAT results depending on the form of the actual payments made in respect of such accrued deductions.

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[7] Because section 475 applies only to securities, which may not give rise to depreciation deductions, we need not address the theoretical circumstance of a mark-to-market loss reducing the value of property purchased from a related party and thus the value of depreciation deductions that would constitute base erosion tax benefits under section 59A.

III. Legislative History of the BEAT and the Statutory Structure of Section 59A

A. Legislative History

The legislative history of section 59A strongly suggests that Congress did not intend property losses to be subject to the BEAT. The House bill, which introduced the provision that eventually became the BEAT, explained that it imposed a tax on "*certain amounts paid* by U.S. payors to certain foreign recipients *to the extent the amounts are deductible* by the U.S. payor."[8] This language is consistent with the natural reading of section 59A(d)(1) outlined above, which is that the amount of a base erosion payment is limited to the amount of the deduction allowable with respect to the amount paid or accrued to a related foreign party. The Senate Finance Committee confirmed the adoption of this framework in designing the BEAT, explaining the aim of the statute as follows:

> Foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent or foreign affiliates. This can erode the U.S. tax base if the payments are subject to little or no U.S. withholding tax. Foreign corporations often take advantage of deductions from tax liability in their U.S. affiliates with payments of interest, royalties, management fees, or reinsurance payments. [Section 59A] aims to tax payments of this kind.[9]

Thus, although the language of the Senate Amendment, which was adopted in what became the BEAT, is modified slightly from the House's original proposal, there is clear evidence, consistent with the plain language of the provision, that Congress intended to include only "deductible payments" in what became the BEAT. Because losses resulting from transfers of property are not themselves deductible payments, including them within the BEAT would also be contrary to Congressional intent.

B. Structure of Section 59A

The preamble's position regarding property losses is contradicted by several aspects of the structure of section 59A. To begin with, treating losses on property used to make payments as falling within the deductible payment rule would result in that rule operating inconsistently with the other three categories of base erosion payments, which cannot apply to such losses. The additional categories of base erosion payments are: (i) purchases of depreciable or amortizable property from related foreign parties (the "depreciable property rule"), (ii) reinsurance payments to related foreign parties, and (iii) certain payments to expatriated

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[8] H.R. Rep. (Conf.) No. 115-466, 115th Cong., 1st Sess. 524 (2017) (emphasis added).

[9] Senate Finance Committee Explanation of the Bill, Committee Print, *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. 115-20, at 391 (Dec. 2017). *See also* H.R. Rep. No. 115-409, at 400 (Nov. 13 2017) ("[U]nder the current system, companies have been able to base erode by making outbound, related-party deductible payments.").

entities. It is clear from the language of each of these categories that none of those types of base erosion payments, if paid for with loss property, would give rise to a base erosion payment in the amount of the loss.

In the case of an acquisition of depreciable property, the amount of base erosion tax benefit is limited to depreciation on the *acquired* property, and there is no reading of the statute that would include losses recognized on property used to acquire the depreciable property as base erosion payments. Similarly, the scope of a base erosion payment for a reinsurance payment is specifically tied to the amounts taken into account under sections 803(a)(1)(B) and 832(b)(4)(A). Again, if an insurance company made a reinsurance payment to a related foreign reinsurer using publicly traded stock with a built-in loss, that loss would clearly not be included as part of the reinsurance premium and thus as part of a base erosion payment. Finally, in the case of an inverted company, which is required to include as a base erosion payment any reduction in gross receipts (e.g., cost of goods sold), it is clear that a loss on property used to acquire inventory would not be treated as a cost of goods sold. Indeed, because the loss on the property gives rise to a section 165 deduction, it would never be a reduction in gross receipts under any circumstances. Accordingly, treating losses on property as falling within the deductible payment rule would produce the anomalous result that losses arising from the use of property to make a base erosion payment would themselves be treated as base erosion payments in one of the four cases but not in the other three.

Similarly, treating property losses as falling within the deductible payment rule would ignore the fact that Congress specifically addressed base erosion issues related to acquired property, but did not provide a rule addressing dispositions of property. In the depreciable property rule, Congress addressed depreciation deductions that are treated as base erosion tax benefits related to property acquired from a related foreign person. That rule clearly applies only to the *acquisition* of property from a related foreign person, not to any *disposition* of property, even to a related person. Thus, the fact that Congress wrote a specific rule addressing related-party property acquisitions, while it drafted no such rule applicable to related-party property dispositions, strongly suggests that, consistent with the statutory language limiting base erosion payments to payments, it had no intention to apply the BEAT to losses realized on property dispositions.

C. Relationship between the amount of a "base erosion payment" and the amount of a "base erosion tax benefit"

As noted above, section 59A defines a base erosion tax benefit as the allowed deduction for a base erosion payment. The need to separately define base erosion payments and base erosion tax benefits arises because of the statute's coverage both of direct base erosion payments under section 59A(d)(1) and "indirect" base erosion payments in the form of amounts paid to purchase assets that give rise to depreciation/amortization deductions, as discussed above, that are spread over multiple taxable years. The definition of a base erosion tax benefit thus encompasses both types of deductions that could arise from a payment to a related foreign person, whether directly as a result of the payment or indirectly based on the asset purchased with that payment. The statute is therefore clear that base erosion tax benefits are simply the allowed deductions arising from base erosion payments.

As discussed above, because a deductible loss is not a deduction with respect to an "amount paid or accrued," it is not a base erosion payment. And by the same token, a deductible loss cannot be a base erosion tax benefit because it is not a deduction with respect to a base erosion payment. If the preamble was meant to suggest that a property loss could nevertheless be a base erosion tax benefit, the result would be to measure the payment and the base erosion tax benefit differently. That is, by claiming that the amount of a base erosion tax benefit – apparently including under this view a loss resulting from the property transfer – could greatly exceed the amount of any amount paid or accrued to a foreign related party. The natural reading of the statute forecloses such a logical disconnect by preserving the relationship between the amount paid or accrued and the amount of the tax benefit associated with that payment, which will as a matter of course be ensured by limiting the amount of the base erosion tax benefit to the amount of the deduction arising from a base erosion payment, consistent with the plain language of the statute.

Accordingly, excluding losses on transferred property from treatment as base erosion payments is supported by the structural relationships among the definitions of base erosion payments in section 59A(d) and the definition of a base erosion tax benefit in section 59A(c)(2).

D. Relationship between the BEAT and Withholding Tax

As noted in the legislative history to section 59A, Congress recognized that base erosion concerns do not arise in the case of payments of deductible amounts to foreign related persons that are subject to U.S. withholding tax. The BEAT therefore excludes from the definition of a base erosion payment amounts that are subject to withholding tax at the statutory 30 percent rate. Withholding taxes, of course, apply to the gross value of any amount for which withholding is required without regard to the amount of gain or loss on property used to make a payment in kind. It is clear that the withholding tax due when, for example, a corporation pays a dividend or interest to a foreign person with property (instead of cash), the withholding tax due is based on the value of the property and is not adjusted for any losses (or gains on the property). Taking the example above, if $30 were withheld on the $100 interest payment to a related party on which a $20,000,000 loss were otherwise recognized, no amount of the $100 payment or the $20 million loss would be included as base erosion tax benefits. This same exclusion would apply regardless of whether the loss were only $20 (as in the original form of the example) or if there were gains on the transferred property. But, under the preamble's reading, a different result would apply if full withholding were not made on the interest payment. If the $30 were not withheld on the underlying payment amount, not only would the $100 payment become a base erosion tax benefit, the entire $20,000,000 loss would become a base erosion tax benefit as well.

Moreover, the statute's careful calibration of base erosion tax benefits to take into account the reduction of withholding taxes under tax treaties further confirms this point and demonstrates that Congressional focus on whether an amount paid or accrued actually has a base eroding effect was limited to the amount of the payment. In particular, section 59A(c)(2)(B)(ii), by cross reference to former section 163(j)(5)(B), provides that the amount of a base erosion tax benefit not taken into account by reason of U.S. withholding tax must be reduced pro rata to take into account withholding rate reductions under applicable tax treaties.

Congress' careful adjustment of base erosion treatment to take precise account of the rate-reduction impact of applicable treaties makes it particularly implausible that Congress intended base erosion tax benefits to be increased by potentially significant property losses, only to have that treatment reduced or eliminated as a result of a withholding tax computed without regard to the amount of such increase.

IV. Policy Considerations

A. Base Erosion

1. *Purpose of the BEAT*

For the reasons discussed above, property losses are not base erosion payments, and they do not give rise to base erosion tax benefits. While those conclusions are required by the plain language of the statute, and supported by its legislative history and statutory structure, they are also fully consistent with sound tax policy. The operative language of section 59A makes clear that Congressional policy concerns were focused on payments that erode the U.S. tax base. For example, the rule's application is triggered when "base erosion payments" give rise to "base erosion tax benefits." While those terms are both given basic definitions in the statute, the regulatory implementation of those definitions should apply them in a manner that rationally distinguishes between deductible payments that are what the statute seeks to tax – base erosion payments – and those that are not. And indeed, the proposed regulations adopt precisely that approach by providing regulatory exceptions for amounts that might otherwise fall within the statutory definition of a base erosion payment, presumably based on determinations by Treasury and the IRS that the excepted payments do not in fact present base erosion concerns.

Recognition of the Congressional focus on base erosion is supported by the legislative history's focus on base erosion as the particular abuse targeted by the provision. As mentioned above, the Senate Finance Committee, which introduced the BEAT as an alternative to a House provision addressing similar concerns, framed its explanation of the reasons for a change in law as follows:

> Foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent or foreign affiliates. This can erode the U.S. tax base if the payments are subject to little or no U.S. withholding tax. Foreign corporations often take advantage of deductions from tax liability in their U.S. affiliates with payments of interest, royalties, management fees, or reinsurance payments. [Section 59A] aims

> to tax payments of this kind. This type of base erosion has corroded taxpayer confidence in the U.S. tax system.[10]

The legislative history thus made clear, consistent with the language of the statute itself, that the Senate Finance Committee's focus in drafting section 59A was to combat base erosion, as measured by the amount of deductions allowable for amount paid or accrued to related foreign parties.

2. *Losses on Property*

The fact that the operative rules of the statute do not treat property losses as base erosion payments is fully consistent with the fact that property dispositions present no substantial base erosion concerns, and are thus outside the intended scope of the statute. The hallmark of "base erosion" involves shifting profits out of the United States. A deductible interest payment to a foreign related corporation obviously results in a U.S. deduction and a foreign inclusion, and may have the result of lowering the U.S. tax on the group's U.S. economic activities.

The transfer of loss property to a related party, however, has no such effect. When a U.S. corporation owns property that declines in value, that economic loss is appropriately reflected in the group's U.S. tax base; indeed, failure to recognize that loss when realized would overstate the group's economic income. But, as noted above, that loss has nothing to do with the deductible payment. Further, as discussed in more detail below, the U.S. tax system has long disciplined the recognition of losses in related-party transactions, applying restrictions that may defer or deny the loss on such transactions, including section 267. Thus, if a related-party property transfer otherwise gives rise to a recognized loss for U.S. tax purposes, there is assurance that the timing and amount of that loss represent a genuine economic loss properly taken into account for U.S. tax purposes. Moreover, there is no transfer of that attribute to the related foreign transferee, which will ordinarily take the transferred property at fair market value basis with no built-in gain or loss. Accordingly, transferring loss property results in no inappropriate erosion of the U.S. tax base, any more than any other economic loss realized by a U.S. taxpayer.

Indeed, the proposed regulations already provide a rule recognizing that property losses, even if otherwise subject to treatment as base erosion payments, may appropriately be excepted

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[10] Senate Finance Committee Explanation of the Bill, Committee Print, *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. 115-20, at 391 (Dec. 2017). *See also* H.R. Rep. No. 115-409, at 400 (Nov. 13 2017) ("[U]nder the current system, companies have been able to base erode by making outbound, related-party deductible payments."); 163 Cong. Rec. S8107 (Dec. 19, 2017) (statement of Sen. Lindsey Graham) ("[B]ase erosion payments do not include amounts paid to a foreign affiliate that are subject to U.S. income tax . . . [t]he income has not been shifted offshore, and there has been no erosion of the tax base."); Ways & Means Committee Majority Tax Staff, Tax Cuts & Jobs Act H.R. 1 Section-by-Section Summary, at 73 (*hereinafter*, the "House Section-by-Section Summary") ("Multinational enterprises, and particularly foreign-parented multinational enterprises, can erode the U.S. tax base by shifting profits to foreign affiliates . . .").

from such treatment. In particular, the proposed regulations provide an exception for section 988 losses, which are losses on certain transactions denominated in nonfunctional currency.[11] Such losses might in the first instance constitute base erosion payments (without regard to the position stated in the preamble), because under section 988(a)(2) losses on section 988 transactions are treated as interest expense for certain purposes under the regulations. Such exchange losses resulting from a section 988 transaction with a foreign related party might therefore be treated as a payment or accrual to a foreign related party with respect to which a deduction is allowable, and would thus fall within the definition of a BEAT payment.

Yet even though the statute would by its terms apply to such losses (unlike other property losses that are not treated as interest payments), the preamble to the proposed regulations states that section 988 losses "do not present the same base erosion concerns as other types of losses" and exempts them from the definition of base erosion payments.[12] Presumably this regulatory exception reflects a determination by Treasury and the IRS that section 988 losses are not as susceptible to base erosion abuses (such as aggressive profit shifting) as other types of related party transactions. While the basis for this exception is not addressed in detail in the preamble, it is notable that many nonfunctional currency transactions arise as a natural result of conducting cross-border business activities. Further, many such transactions are intended to hedge the currency risk on underlying business transactions, and as a result such offsetting transactions are cash-flow neutral. Moreover, section 988 transactions are subject to the unpredictable market risk of exchange-rate fluctuations. Thus, such transactions would not generally be a natural means of engaging in base erosion, such that there is ordinarily little incentive to enter into section 988 transactions for base erosion or profit shifting purposes.

While other property losses are not within the statutory scope of section 59A to begin with because they are not amounts paid or accrued, it is notable that they resemble section 988 transactions in that they do not present the type of base erosion concerns that section 59A addresses. In particular, transferring loss property to a related party presents negligible base erosion opportunity, since the same genuine economic loss would be recognized if property with a built-in loss were sold to an unrelated party. Indeed, as noted above, section 267 and other Code rules may defer or deny losses on related-party transactions. For example, if a U.S. corporation sought to trigger built-in losses on marketable securities, it could simply sell those securities to an unrelated party for cash and recognize the losses. If the corporation instead used those securities to repay an obligation to a member of its corporate group, the timing of its recognition of that loss may be deferred under section 267(f), and the related-party transaction would not otherwise provide any tax benefit as compared with a sale to an unrelated party. Thus, recognizing a genuine economic loss in respect of property by transferring that property to

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[11] Prop. Reg. § 1.59A–3(b)(3)(iv).

[12] 83 Fed. Reg. at 65960.

a related person in a transaction that otherwise gives rise to loss recognition under applicable Code rules does not give rise to base erosion concerns within the intendment of section 59A.[13]

B. Recognition of Losses in Related Party Transactions

We showed above that recognizing economic losses on property does not present the type of base erosion concern that Congress addressed in section 59A. We conclude by noting that section 59A cannot sensibly be read to address broader tax policy concerns that may be presented by losses recognized in related-party transactions, which are already addressed in detail by other Code provisions.

First, as already noted, section 267 has for many decades denied or deferred the recognition of losses in related-party transactions. In particular, in the common-control situations subject to section 59A, section 267(f) will generally apply to defer losses until the property is sold outside the group, obviating any transfer pricing concerns about the related-party sale. Given this discipline, seeking to expand section 59A to further limit losses in such transactions would serve no purpose.

Second, while section 59A could potentially apply to losses in transactions with less-closely related parties that would not be subject to section 267,[14] there is no evidence in either the statute or legislative history that Congress intended section 59A to operate as a stealth expansion of section 267. It is even more difficult to imagine that that Congress' concern with these transactions would not be addressed more directly with an expansion of the scope of related party transactions covered by section 267, but instead would be addressed by applying a completely different mechanism – the BEAT – to impose a completely different set of consequences than the transactions covered by section 267, and without any discussion of this in the legislative history.

Third, the suggestion that Congress intended the BEAT to operate as a sub rosa expansion of section 267 to apply in 25 to 50 percent ownership cases is particularly implausible given that section 267 itself has applied only to majority ownership cases for decades. In the case of entities with more limited common ownership, there is far less reason to doubt the bona fides of the pricing and other terms of their transactions, as any games-playing will be at the substantial economic detriment of the taxpayer. For example, if a taxpayer attempts to overstate a loss on property by understating its selling price to a less than 50 percent owned "related" party, the other owners of that entity will reap most of the benefit of such a bargain purchase.

Finally, seeking to extend the BEAT in an effort to effectively deny a taxpayer's genuine economic loss on property would make no sense as a matter of tax policy, as it would result in a manifest distortion of taxable income. To the extent that an economic loss on the disposition of

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[13] Of course, any deductible payment resulting from that transfer would remain fully subject to treatment as a base erosion payment, in accordance with the plain language of the statute.

[14] Section 59A applies at common ownership levels between 25 and 50 percent, while section 267 applies at the greater than 50 percent level.

property is otherwise permitted to be deducted under the Code, denying such a loss because it is realized in a transaction with a foreign related party would serve no rational tax policy goal, particularly given the random scope of the resulting denial: losses would be effectively denied/subjected to the BEAT in the case of transactions with related foreign persons, but not transactions with related U.S. persons, even though both types of transactions will otherwise be subject to the same treatment under section 267.

For all these reasons, then, a regulatory attempt to turn section 59A into an expanded but randomly applicable version of section 267, even if it were authorized by the statute, would be fundamentally illogical.

Accordingly, the fact that section 59A does not by its terms treat losses on property transfers as base erosion payments is fully consistent with the purpose of the statute. The final regulations should therefore clarify, consistent with the plain language of the statute, that the recognition of a loss upon a transfer of property to a related foreign person does not give rise to a base erosion payment.

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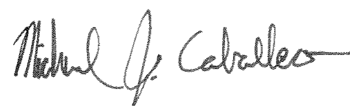
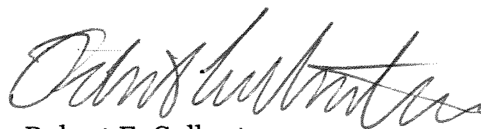
We appreciate the opportunity to submit this letter for your consideration and we would be happy to develop more fully any of the analysis and discussion presented herein or to further consider the application of the analysis to particular scenarios. We would welcome the opportunity to discuss the issues in this submission.

Sincerely,



Michael J. Caballero



Robert E. Culbertson

cc: U.S. Department of the Treasury
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- Douglas L. Poms, International Tax Counsel
- Brian Jenn, Deputy International Tax Counsel
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