



Insight

Base Erosion and Anti-Abuse Tax (BEAT) – A Primer

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Executive Summary

- The Base Erosion and Anti-Abuse Tax (BEAT) of the Tax Cuts and Jobs Act (TCJA) serves as a guardrail to reduce the tax benefit of shifting income out of the United States.
- The BEAT serves as a minimum tax for firms that use deductible payments – such as royalties and interest – to shift income from the United States to foreign affiliates abroad.
- While the BEAT is one of a number of policies designed to protect the U.S. base, the base erosion it targets may not be on the scale some estimates suggest, and it may ultimately prove somewhat irrelevant to many global firms.

Introduction

In December 2017, Congress passed the most sweeping set of changes to the federal tax code since 1986. The Tax Cuts and Jobs Act (TCJA) broadly reformed three major elements of the federal tax code: the individual income tax, the corporation income tax, and the tax treatment of international income. The third set of reforms moved the U.S. international tax regime to a nominally territorial system, but this change required a new set of rules to at once improve the tax climate for U.S. firms operating domestically and internationally while preventing the erosion of the U.S. tax base. The Base Erosion and Anti-Abuse Tax (BEAT) is a critical feature of this new regime and is designed to mitigate against U.S. multinational firms shifting income into lower-tax jurisdictions.

What Is BEAT?

A key element of the TCJA, and of many previous tax-reform plans, was to modernize the way the federal government taxes income that U.S. firms earn overseas. Prior to the TCJA, the United States imposed a worldwide tax, which subjected U.S. firms operating abroad to U.S. taxes on their overseas profits, although foreign subsidiaries of U.S. firms could defer those taxes by keeping their related earnings overseas, via a tax practice known as deferral. The old system, particularly when paired with one of the highest corporate tax rates in the world, had a number of drawbacks, not least of which was the incentive for U.S. firms to “invert” and move their headquarters overseas.^[1]

The TCJA contained a number of provisions that upended the old system, including replacing the worldwide tax system with a territorial system whereby the foreign-sourced income of U.S. firms would be exempt from taxation. In so doing, the United States joined 29 of the 34 economies in the Organisation for Economic Co-operation and Development (OECD) that had adopted some form of a territorial system at the time.^[2]

Notwithstanding the deficiencies of the prior U.S. international tax regime and the global trend toward territorial tax systems, territorial systems are not without their own complications. Territorial systems require complex

rules to establish guardrails around a nation’s tax base, as in a territorial system, tax planners have every incentive to shift profits into low-tax foreign jurisdictions. [3] These types of rules, known as “base erosion” provisions, are designed to mitigate the incentives for taxpayers (think large multinational firms) to shift income abroad to avoid U.S. taxes. Accordingly, the international provisions of the TCJA introduced a series of new rules (and acronyms) to tax policy, including the [Global Intangible Low-Taxed Income \(GILTI\)](#), the [Foreign-Derived Intangible Income \(FDII\)](#), and the Base Erosion and Anti-Abuse Tax (BEAT). Each provision was designed to operate in coordination with other international elements and the TCJA more broadly.

With respect to the BEAT, in this instance the acronym describes the policy – the BEAT is a specific tax, whereas FDII and GILTI describe a particular type of income that is uniquely taxed under the TCJA. The operation and intent are straightforward – to reduce the tax benefits of shifting domestic income from U.S. multinationals to lower-taxed jurisdictions overseas through the imposition of a tax on certain kinds of transactions above a threshold level between foreign and domestic corporate affiliates. It operates as a minimum tax by disallowing deductions for certain payments made from domestic corporate entities to foreign affiliates.

Calculating the BEAT Liability

The BEAT is relatively simple in concept but complicated in execution. Only certain U.S. firms are required to determine if they have a BEAT liability. The BEAT only applies to firms with gross receipts in excess of \$500 million and that make payments to foreign affiliates that comprise 3 percent or more of a firm’s total tax deductions. The upshot of these thresholds is to limit the reach of the BEAT to larger multinationals that have something of a critical mass of cross-border transactions with related corporate entities. The basic formula for the BEAT is as follows:

BEAT = (10% of modified taxable income) – adjusted regular tax liability

While straightforward, this formula includes two alternative measures of a given multinational firm’s income, *neither of which* is its regular tax liability. Instead, a firm must first determine its modified taxable income. For the purposes of the BEAT, that is its regular tax liability but with its deductible “base erosion tax benefits” added back. Base erosion payments are any payments made to a foreign corporate affiliate that gives rise to a tax deduction from the domestic corporate entity’s gross income. These payments include royalties, interest payments, reinsurance, and other similar payments.[4] The cost of goods sold is *not* considered a base erosion payment. Firms captured by the BEAT must then calculate their “adjusted regular tax liability,” which is the firm’s tax liability before *most* tax credits are applied. Until 2025, the “adjusted regular tax liability” is reduced by the R&D tax credit, a portion of the low-income housing credit, the renewable energy production credit, and the energy investment credit.[5] Beginning in 2026, “adjusted regular tax liability” is reducible by all credits. The effect, all else equal, of reducing the “adjusted regular tax liability” with credits is to generally increase the applicability of the BEAT. This was done to increase projected revenue collections under the BEAT to comport with Senate budget rules under the [reconciliation process](#).

Fundamentally, the BEAT seeks to capture income that U.S. firms shift overseas through payments to related corporate entities. The canonical example is a major U.S. corporation that pays no federal tax because it ascribes its income to its overseas patents, which are held by a related foreign corporate entity in a low-tax jurisdiction. The U.S. parent makes royalty payments to the foreign affiliate that are deductible against U.S. income. The income is then shifted out of the United States through the royalty payments, and out of the U.S. tax base because those payments are otherwise deductible. The BEAT works by denying those deductions and applying a 10 percent surcharge to that income; if the amount exceeds the firm's regular income (as adjusted), then the firm must pay an additional tax.

BEAT by Example

To illustrate how BEAT works, consider a hypothetical U.S. technology company. For the purposes of this example, assume the company earns \$100 billion per year. Further assume it makes royalty payments to a foreign subsidiary of \$50 billion. It otherwise has \$25 billion in deductible expenses. For the sake of simplicity, we will assume no other credits, net operating losses, or other tax benefits.

Figure 1: Hypothetical Firm

Gross Income	Deductions	Base Erosion Tax Benefits
\$100 Billion	\$75 Billion	\$50 Billion

This firm is clearly captured by the BEAT, with income well in excess of \$500 million, and with base erosion tax benefits totaling well more than 3 percent of deductions.

Recall that the formula for determining FDII is as follows:

$$\text{BEAT} = (10\% \text{ of modified taxable income}) - \text{adjusted regular tax liability}$$

Thus, for this firm, this calculation would reflect the following inputs:

$$\text{Regular Tax Liability} = \$25 \text{ Billion} \times 21 \text{ percent} = \$5.25 \text{ Billion}[6]$$

$$\text{Adjusted Regular Tax Liability} = \text{Regular Tax Liability} - \text{Credits}$$

$$\text{Adjusted Regular Tax Liability} = \$5.25 \text{ Billion} - \$0 = \$5.25 \text{ Billion}$$

$$\text{Modified Taxable Income} = \text{Regular Taxable Income} + \text{Base Erosion Tax Benefits}$$

$$\text{Modified Taxable Income} = \$25 \text{ Billion} + \$50 \text{ Billion} = \$75 \text{ Billion}$$

In this example, the hypothetical firm would normally face a \$5.25 Billion tax bill, somewhat diminished by having shifted \$50 Billion in income through royalty payments to its foreign affiliate. The effect of the BEAT is clear, by adding these royalty payments back into to the tax base for this hypothetical firm.

BEAT = (10% of \$75 Billion) – \$5.25 Billion

BEAT = \$2.25 Billion

In this example, the firm would face a BEAT of \$2.25 billion. Assuming no other considerations, this is an additional tax, bringing the hypothetical U.S. firm's total tax liability to \$7.5 billion.

The BEAT is policy that is responsive to the notion that U.S. firms are shifting substantial amounts of income through deductible payments to foreign affiliates. Indeed, the scale of the “problem” runs into the hundreds of billions according to some estimates. Despite wide variation in these estimates, policymakers, who no doubt have designs on the potential sums that could be raised by reducing profit shifting, reliably cite the highest estimates. The problem is that the high estimates appear to be *inflated by double-counting*. Accordingly, this may be a less significant phenomenon than is thought. The BEAT may be, in turn, more of a policy in search of problem. Some initial data bear this out. According to the Joint Committee on Taxation, only 479 of the more than 6.4 million U.S. corporate taxpayers faced a BEAT liability in 2018. Even among larger firms, a BEAT liability is the exception rather than the rule: only 202 out of the 7,235 firms with assets over \$1 billion faced a BEAT liability in 2018. To be sure, the number of firms is not necessarily all that telling if there is substantial income being captured, but that is also not the case. In 2018, a sample of the largest U.S. corporate taxpayers – reflecting a quarter of all corporate earnings and over a third in corporate assets – showed that such firms paid a total BEAT liability of just *\$70 million*.^[7]

Conclusion

The TCJA was an assemblage of individual, business, and international tax reforms. The international tax reforms are likely the most significant departures from past policy in the law but are somewhat complex and have been subject to prolonged regulatory refinement. The alphabet soup of international tax regimes established under the TCJA are designed to act in concert to balance a number of priorities including preserving the U.S. tax base while improving the climate for investment in the United States. Achieving these goals has required a carrot-and-stick approach – and the BEAT policy is the most conspicuous stick among the major international policies. Despite clearly targeting base erosion payments, it may be more of a policy in search of problem.

[1] <https://www.americanactionforum.org/research/cost-inaction-tax-reform/>

[2] <https://taxfoundation.org/territorial-tax-system-oecd-review/>

[3] See

<https://www.finance.senate.gov/imo/media/doc/The%20International%20Tax%20Bipartisan%20Tax%20Working%20Group> and <https://www.jct.gov/publications.html?func=startdown&id=4656>

[4] <https://www.federalregister.gov/documents/2020/10/09/2020-19959/base-erosion-and-anti-abuse-tax>

[5] <https://www.jct.gov/publications/2019/overview-of-the-base-erosion-and-anti-abuse-tax-se/>

[6] Assumes the current-law corporate rate of 21 percent.

[7] <https://www.jct.gov/publications/2021/jcx-16r-21/>