Q. What is the TCJA base erosion and anti-abuse tax and how does it work?

A. The BEAT, a new tax under the Tax Cuts and Jobs Act, limits the ability of multinational corporations to shift profits from the United States by making deductible payments to their affiliates in low-tax countries.

Over the past several decades, US multinational corporations have used a variety of techniques to shift profit from the United States to other countries (and, thereby, have eroded the US tax base). A US-based multinational corporation might, for example, pay an affiliate in a lower-taxed country to use patents or other intellectual property in the United States. This would increase the US corporation's costs, thus reducing their reported profits in the United States and increasing their revenue and their reported profits in the lower-taxed country, potentially lowering the corporation's overall tax bill. Prior US tax laws attempted to limit profit shifting, mainly by regulating what are called transfer prices between companies, but the Internal Revenue Service struggled to enforce these laws effectively.

To limit future profit shifting, the Tax Cuts and Jobs Act (TCJA) added a new tax, the BEAT (base erosion and anti-abuse tax). The BEAT targets large US corporations that make deductible payments, such as interest, royalties, and certain service payments, to related foreign parties. The BEAT is a minimum tax add-on: A US corporation calculates its regular US tax, at a 21 percent rate, and then recalculates its tax at a lower BEAT rate after adding back the deductible payments. If the regular tax is lower than the BEAT, then the corporation must pay the regular tax plus the amount by which the BEAT exceeds the regular tax. The BEAT rate is 5 percent in 2018, 10 percent in 2019 through 2025, and 12.5 percent in 2026 and beyond.

For example, suppose, in 2019, a US corporation has $300 million of gross income but pays deductible royalties to a foreign affiliate of $200 million. The corporation’s regular tax liability is $21 million (21 percent of $100 million), but its alternative tax is $30 million (10 percent of $300 million), so the corporation would pay $30 million to the United States (the regular tax of $21 million plus the BEAT of $9 million).

The BEAT applies only to large multinational enterprises, those with gross receipts of more than $500 million (averaged over the prior three years). It also applies only to a corporation that makes more than 3 percent of its total deductible payments to foreign affiliates. However, the BEAT excludes payments that can be treated as cost of goods sold. For example, if a US company properly accounts for interest or royalties as part of the cost of its inventory, the interest or royalties are not added back to the BEAT tax base.
Key Elements of the U.S. Tax System

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Further Reading

