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MEMORANDUM

To: Knowledge Base

From: CFO Services

Subject: BEAT Tax and the interaction with the R&D Credit

Date: 2/20/2019

SUMMARY

With 2018 corporate tax return compliance now into full swing, it seemed important to point out a key interaction of the R&D credit (Section 41) with the new BEAT tax (Section 59A). Most everyone knows that the R&D credit is the largest business credit and there are many changing opportunities recently (LBI Directive, small business advantage, eliminate AMT limitation), and the interaction with the BEAT tax will be important for those companies that are subject to it.

ANALYSIS

The BEAT tax (Base Erosion Anti-Abuse Tax) was implemented as an alternative minimum tax that applies when a multinational company reduces its regular tax liability to less than a specified percentage of its taxable income, after adding back deductible base eroding payments and a percentage of tax losses claimed that were carried from another year. The BEAT tax is codified under Section 59A.

Here is how the BEAT tax is calculated[1]:

(1)In General

*Except as provided in **paragraphs (2)** and **(3)**, the term "base erosion minimum tax amount" means, with respect to any applicable taxpayer for any taxable year, the excess (if any) of—*

(A) an amount equal to 10 percent (5 percent in the case of taxable years beginning in calendar year 2018) of the modified taxable income of such taxpayer for the taxable year, over

*(B) an amount equal to the regular tax liability (as defined in **section 26(b)**) of the taxpayer for the taxable year, reduced (but not below zero) by the excess (if any) of—*

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[1] Section 59A(b)(1)

(i) the credits allowed under this chapter against such regular tax liability, over
(ii) the sum of—
*(I) the credit allowed under **section 38** for the taxable year which is properly allocable to the research credit determined under **section 41(a)**, plus*
*(II) the portion of the applicable **section 38** credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this subclause).*

This article is really focused on the relationship between BEAT and the research credit as highlighted in 59A(b)(1)(B)(ii)(I). The research credit is the only credit which allows a 100% offset to the BEAT tax. The other credits available (renewable electricity production credits, low-income housing credits, and investment credits allocable to the energy credit) are only allowed at 80%. In addition, in the absence of a carryover of excess credits, this could eliminate the 20% of those Section 38 credits.

To help understand the interplay of the research credit, here are some examples that demonstrate the interaction.

Company ABC, calculating the regular tax minimum threshold

Taxable Income: $714,285
Regular Tax Liability: $100,000 ($150,000 (tax liability)-$50,000 (total credits)
Total Credits: $50,000 ($25,000 research credit, $0 application Section 38 credit)

Step 1: Increase tax liability by eliminating benefits of tax credits
BEAT step 1: $150,000

Step 2: Reduce for credits against tax liability and add back the research credit and 80% of applicable Section 38 credits
BEAT step 2: $150,000-($50,000) +($25,000+(80% * $0)))=$125,000

Step 3: Determine modified taxable income that triggers BEAT. 10% is the BEAT tax rate on the modified taxable income.
BEATS step 3: $125,000/10%=$1,250,000

Step 4: Determine the amount of BEAT deductions that will trigger BEAT tax. Subtract the regular taxable income from the modified taxable income.
BEAT step 4: $1,250,000-$714,285=$535,715

In this example, Company ABC will have to pay BEAT tax if it deducts more than $535,715 of base erosion tax benefits. Now let's model a few other scenarios by increasing and decreasing the research credit. To create a good comparison let's assume that the items above are consistent and Company ABC will claim $600,000 of base erosion tax benefits to trigger BEAT tax.

Company ABC, tax characteristics
Taxable Income: $714,285
Modified Taxable Income: $714,285+$600,000=$1,314,285
BEAT Tax Amount: $1,314,285*10%=$131,428

Items	Base Research Credit	Larger Research Credit	Smaller Research Credit
Tax Liability	$150,000	$150,000	$150,000
Total Credits	$50,000	$50,000	$50,000
Research Credit	$25,000	$50,000	$0
Regular Tax Liability Adjusted	$125,000	$150,000	$100,000
BEAT Tax Amount	$6,428	$0	$31,428
TOTAL Tax (BEAT + Regular Tax Liability)	$106,428	$100,000	$131,428

The smaller values are used for example purposes, and typically these numbers would be larger because of the threshold of BEAT application. From the example above, even with broad assumptions, the research credit reduces the BEAT tax and is the only credit allowed to provide this insulation. The only difficulty for planning is that after 2025, the add-back to retain the full benefit of the research credit is removed and all credits are subject to the BEAT exclusion.

CONCLUSION

In summary, if a taxpayer is in BEAT and has not captured its research credit because of various reasons, now might be the time to determine the research credit. Even a small amount of research credit could reduce BEAT tax of equal value, providing another valuable reason for calculating the research credit. In addition, with the advantage of the research credit offsetting the BEAT tax, it will be even more important for proper documentation and detailed calculations because under exam it is the only credit that is offsetting the BEAT tax, for now.