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Re: Comments on Tax Treatment of Pre-TCJA NOLs for Calculating Tax Under Proposed BEAT Regulations (REG-104259-18) and Proposed Modification to the Add-back Computation Method

This letter follows our comment letter of February 15, 2019 and our subsequent meeting on April 4, 2019, regarding the proposed Base Erosion and Anti-Abuse Tax ("**BEAT**") regulations ("**Proposed Regulations**") under Internal Revenue Code ("**IRC**") Section 59A published in the Federal Register on December 21, 2018. In contrast to our previous recommendations, we are now respectfully requesting that the Department of the Treasury and the Internal Revenue Service ("**IRS**") revise the guidance in the Proposed Regulations to include a modification to the add-back method addressing the treatment of pre-enactment net operating losses ("**NOLs**").

In our February 15 comment letter and subsequent meeting, we noted that the proposed add-back method and the alternative recomputation method could produce substantially different tax liabilities for taxpayers and recommended taxpayers be given the option, via an irrevocable election, of choosing which method they could use so as not to disadvantage a taxpayer.

This letter sets forth a means within the proposed add-back method to address the effect of the Proposed Regulations on pre-enactment NOLs (i.e., NOLs arising in tax years beginning before January 1, 2018).

The main concern we have with the Proposed Regulations and the proposed add-back method is the impact on pre-enactment NOLs. As a principle of the Proposed Regulations, and as set forth in other contexts in the Proposed Regulations, it is recognized that pre-enactment NOLs should not be affected by BEAT (i.e., the 0% base erosion percentage for such NOLs). However, the Proposed Regulations do not fully address the retrospective impact of the add-back method on pre-enactment NOLs. If the Proposed Regulations do not fully protect the pre-enactment NOLs, the add back method may result in the taxpayer having significantly higher tax liability as every base erosion payment will reduce the benefit of pre-enactment NOLs utilized in determining regular tax liability.

This adverse impact on pre-enactment NOLs is illustrated in the table below where two nearly identical corporate taxpayers are compared.

Taxpayers A and B each have $300 of taxable income (including $600 of base erosion payments) before NOLs. Taxpayer A also has $300 of pre-enactment NOLs. For Taxpayer A, the $300 of NOLs reduces regular tax to $0 while the $600 of base erosion payments give rise to a BEAT tax of $60 ($600 x 10% BEAT rate). For Taxpayer B, there is $63 of regular tax ($300 x 21% regular tax rate) and $27 of BEAT tax ($90 tentative BEAT tax less $63 regular tax). Taxpayer A pays a total tax of $60 while Taxpayer B pays a total tax of $90, which means Taxpayer A's $300 of NOLs saved it only $30 compared to Taxpayer B. This is the result of the benefit from utilizing pre-enactment NOLs at the 10% rate rather than at the 21% regular tax rate that would have applied absent BEAT.

Add-Back Method Illustrative Example		
	Taxpayer A ($)	Taxpayer B ($)
Taxable Income Before NOL	300	300
Pre-Enactment NOL Used	(300)	0
Taxable Income	0	300
Regular Tax (21% rate)	0	63
Taxable Income	0	300
Base Erosion Payments	600	600
Modified Taxable Income	600	900
Tentative BEAT (10% rate)	60	90
Less: Regular Tax	(0)	(63)
BEAT Liability	60	27

The Proposed Regulations should preserve the benefit of the pre-enactment NOLs. A proposed modified approach ("Proxy Method") for purposes of computing BEAT tax, would effectively increase the taxpayer's regular tax treated as paid by 11% (equal to the difference between the regular tax rate and the BEAT tax rate) of the NOLs utilized in computing regular tax. As illustrated in the table below, a taxpayer utilizing pre-enactment NOLs would not be subject to any higher BEAT tax liability than an otherwise identical taxpayer that did not have pre-enactment NOLs.

Proxy Method Illustrative Example		
	Taxpayer A ($)	Taxpayer B ($)
Taxable Income Before NOL	300	300
Pre-Enactment NOL Used	(300)	0
Taxable Income	0	300
Regular Tax (21% rate)	0	63
Taxable Income	0	300
Base Erosion Payments	600	600
Modified Taxable Income	600	900
Tentative BEAT (10% rate)	60	90
Less: Regular Tax + Proxy	(33)	(63)
BEAT Liability	27	27

The Proxy Method is consistent with the Department of the Treasury and the IRS goal of reducing computational complexity as it avoids any need to recompute tax or maintain separate sets of records to track annual limitations. In addition, the Proxy Method would maintain the principles of the Proposed Regulations to not impact pre-enactment NOLs and would have limited ongoing impact as it will cease to apply when taxpayers have fully utilized their pre-enactment NOLs.

We understand that two other companies - HSBC North America Holdings Inc. ("HSBC") and Rio Tinto - have recommended this Proxy Method. FortisUS supports their positions and joins them in recommending the Proxy Method as an alternative to preserve the principles of the Proposed Regulations. We also note HSBC's February 19, 2019, comment letter suggested simple, straightforward language to implement the proxy method:

> Recommendation - Suggested Final Language (addition in italics) Final Treas. Reg. § 1. 59A-1 (b)(16) Regular Tax Liability. The term regular tax liability has the meaning provided in section 26(b). *For the purposes of calculating the base erosion minimum tax under section 59A(b), regular tax liability shall also include an amount equal to the differential between the current tax rate under section 11(b) and the applicable base erosion tax rate under section 59A(b) times any Section 172 deduction actually used to reduce taxable income for the current year for a net operating loss that arose in a taxable year ending prior to January 1, 2018.*

We appreciate your consideration of our comments. We would be happy to discuss any questions you may have.

Sincerely,

Karen Gosse
Vice President Treasurer
FortisUS Inc.