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Re: The Treatment of Pre-TCJA NOLs for calculating MTI under REG-104259-18 (Proposed Regulations on Base Erosion and Anti-Abuse Tax)

We are writing to follow up on discussions that we have had with you regarding the appropriate treatment under the base erosion and anti-abuse tax (BEAT) of net operating losses (NOLs) that arose prior to the enactment of the Tax Cuts and Jobs Act (TCJA) and that are allowed to be carried forward for regular tax purposes without the limitations imposed by the TCJA.[1] The preamble to the proposed BEAT regulations (IRS REG-104259-18) discussed two methods for computing modified taxable income (MTI) – the add-back and recomputation methods. While the proposed regulations provide MTI would be calculated under the add-back method, Treasury also requests comments on this method and the practical effects of the recomputation method.

We request the Treasury Department's consideration of a revision to the add-back method for calculating MTI that would be limited to pre-enactment NOLs. This new approach (referred to herein as the "proxy method") provides a transition rule for taxpayers that have pre-enactment NOLs to create parity with taxpayers that do not.   The proxy method is simple to administer and straightforward to enforce. Importantly, the proxy method also avoids any concerns about double benefits or double deductions. Finally, the proxy method is consistent with Treasury's view, as indicated in the preamble to the proposed regulations, that pre-enactment NOLs should not have a BEAT impact in post enactment years.

The add-back method in the proposed regulations does not provide an adequate transition for pre-enactment NOLs, causing every base erosion payment to reduce the value of pre-enactment NOLs absorbed in determining regular taxable liability. We observe that the add-back method allows taxpayers without pre-enactment NOLs to make more base erosion payments than taxpayers with pre-enactment

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[1] Section 13302 of the TCJA limited the use of NOLs arising in taxable years beginning after December 31, 2017. NOLs arising in taxable years before January 1, 2018 (pre-enactment NOLs) are not subject to these limitations.

NOLs before being subject to any BEAT liability.[2] Consistent with the treatment under the proposed regulations of pre-enactment NOLs having a base erosion percentage of zero, final regulations should also remove any economic disparity between similarly situated taxpayers simply because one taxpayer has pre-enactment NOLs. The recomputation method was one approach proposed to address the disparity; the proxy method discussed below is another approach, but without the requirement of creating different, parallel attributes that are maintained separately, as the preamble notes would occur under the recomputation approach.

The proxy method provides a simple and straightforward method to preserve the value of pre-enactment NOLs while those NOLs are absorbed under rules prior to the TCJA. Importantly, the proxy method also avoids any concerns about double benefits or double deductions.

Treatment of pre-enactment NOLs under the Proposed Regulations

We commend the Treasury Department for acknowledging in the preamble to the proposed regulations that NOLs that arose prior to the date of enactment have a base erosion percentage of zero "because section 59A applies only to base erosion payments that are paid or accrued in taxable years beginning after December 31, 2017." As a result, there is no add-back to MTI for pre-enactment NOLs. The proxy method, as a revision to the add-back method, provides consistent treatment for pre-enactment NOLs. Without revising the add-back method with the proxy method, the result for taxpayers with pre-enactment NOL will be an increase in MTI that will not result for taxpayers without pre-enactment NOLs, even when those taxpayers have more base erosion payments. A taxpayer that uses pre-enactment NOLs to reduce its regular cash tax loses the value of those NOLs if the add-back method is not revised. Without revision, the add-back method imposes BEAT liability that reduces the value of the pre-enactment NOLs used by the difference between the 21% value of the pre-enactment NOL and the BEAT rate (currently at 10%) that is applied to each dollar of base erosion payment. This creates a retroactive application of the BEAT to pre-enactment NOLs that the proposed regulations seek to avoid in applying a zero base erosion percentage for pre-enactment NOLs. The impact on the value of pre-enactment NOLs from a retroactive application of BEAT can be seen in the following example:

Taxpayer has $300 of taxable income prior to the use of $300 of pre-enactment NOLs. Taxpayer is subject to the BEAT and has $600 of base erosion payments (BEP). With the use of the pre-enactment NOLs, taxpayer's regular tax owed is reduced to $0 ($300 - $300). The value of using the pre-enactment NOL is $63 (21% of the $300 NOL) – the amount of cash tax owed, offset by the use of the NOL. However, the use of the NOL increases taxpayer's BEAT by every dollar of base erosion payment. Taxpayer's MTI is $600 and the BEAT liability is $60 (10% of $600). This results in a reduction of the value of the pre-enactment NOLs to extent of the tax imposed under the BEAT ($63 NOL value less the $60 BEAT liability).

TI before NOLs	300	(includes 600 of BEP)
Less pre-TCJA NOL	(300)	(value of NOL = $63 ($300 x 21%))
= Taxable Income	0	
* 21% = Reg tax	0	
MTI = TI + BEP	600	
* 10%	60	
Less Regular Tax	(0)	
= BEAT liability	60	
Proper Value of NOL (300 @ 21%)	63	
Actual Value of NOL within the BEAT liability (300 @ 10%)	(30)	
NOL lost, due to BEAT (300 @ 11%)	33	

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[2] *See* Example 2 in Appendix.

The Treasury Department expressed a preference for the add-back method for the simplification it provides taxpayers over the recomputation method, explaining that it would require "complex tracking of separate attributes on a BEAT basis . . ." The proxy method, however, would not undermine the simplification associated with the add-back method, but revise the method to ensure the BEAT does not apply retroactively, to reduce the value of pre-enactment NOLs.

Providing parity between cash tax and pre-TCJA NOLs

The proxy method ensures that taxpayers do not lose the economic benefit provided under section 172 as it applied prior to the TCJA through the application of the BEAT to pre-enactment NOLs. The proxy method is a refinement to the add-back method in the Proposed Regulations that retains the value of pre-enactment NOLs. A taxpayer's BEAT liability would be determined by increasing the amount of deemed regular tax paid by a percentage of the pre-enactment NOL used in the current year. The percentage would be measured as the difference between the U.S. corporate tax rate of 21% (which is the proper value of the pre-enactment NOL) and the BEAT rate of 10% (which is the reduced value that pre-enactment NOL's obtain under the Proposed Regulations). The proxy method would not remove BEAT liability in all cases because only a percentage of the pre-enactment NOL would be taken into account in determining BEAT liability.

The result of revising the add-back method with the proxy method can be compared with the results using the facts above. Based on those facts, the amount of deemed regular tax paid would be increased by 11% of the pre-enactment NOL used in the current year.

TI before NOLs	300	(includes 600 of deductions for BEPs)
Less pre-TCJA NOL	(300)	(value of NOL = $63 ($300 x 21%))
= Taxable Income	0	
* 21% = Reg tax	0	
MTI = TI + BEPs	600	
* 10%	60	
Less Regular Tax + Proxy Adjustment	33	(0 regular tax + 11% of 300)
= BEAT liability	27	
Proper Value of NOL @ 21%	63	
Actual Value of NOL within BEAT Calculation	(63)	
Value of NOL lost, due to BEAT	0	

The proxy method prevents the result under the recomputation method, where the starting point for MTI could be less than zero. Furthermore, the proxy method would not change the amount of the NOL deduction determined in the Proposed Regulations for purposes of adding the base erosion percentage to MTI. For this purpose, the NOL deduction also would not be less than zero.

The additional examples included in the Appendix compare the impacts of the add-back method on taxpayers with and without pre-enactment NOLs. These examples illustrate how the proxy method ensures the BEAT is not applying retroactively to taxpayers with pre-enactment NOLs without the complexity and potential for double counting of NOL economic benefits that some have suggested might exist under the recomputation approach

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Rio Tinto

We very much appreciate your consideration of these comments and look forward to discussing with you the approach described in this letter. Please contact Michael Gardner, Vice President of Rio Tinto America and U.S. Tax Leader at michael.gardner@riotinto.com if you have any questions regarding this submission.

Respectfully,

Michael Gardner

Appendix

Example 1: comparing taxpayers with and without pre-enactment NOLs

	Taxpayer with Pre-TCJA NOLs			Taxpayer without NOLs		
Taxable Income Before NOL	300	300	300	300	300	300
Pre-TCJA NOL	(300)	(300)	(300)	0	0	0
Base Erosion Payments	600	300	0	600	300	0
BEAT rate	10%	10%	10%	10%	10%	10%

(a) Calculation under the Proposed Regulations' add-back method

	Taxpayer with Pre-TCJA NOLs			Taxpayer without NOLs		
Taxable Income Before NOL	300	300	300	300	300	300
Pre-TCJA NOL Utilized	(300)	(300)	(300)	0	0	0
Taxable Income	0	0	0	300	300	300
Regular Tax (@21%)	**0**	**0**	**0**	**63**	**63**	**63**
Taxable Income	0	0	0	300	300	300
Base Erosion Payments	600	300	0	600	300	0
Modified Taxable Income	600	300	0	900	600	300
Tentative BEAT (@10%)	**60**	**30**	**0**	**90**	**60**	**30**
Less Reg Tax	(0)	(0)	(0)	(63)	(63)	(63)
BEAT liability	**60**	**30**	**0**	**27**	**0**	**0**

(b) Calculation under the Proposed Regulations' add-back method (revised for the proxy method)

	Taxpayer with Pre-TCJA NOLs			Taxpayer without NOLs		
Taxable Income Before NOL	300	300	300	300	300	300
Pre-TCJA NOL Utilized	(300)	(300)	(300)	0	0	0
Taxable Income	0	0	0	300	300	300
Regular Tax (@21%)	**0**	**0**	**0**	**63**	**63**	**63**
Taxable Income	0	0	0	300	300	300
Base Erosion Payments	600	300	0	600	300	0
Modified Taxable Income	600	300	0	900	600	300
Tentative BEAT (@10%)	**60**	**30**	**0**	**90**	**60**	**30**
Less: Reg tax + [Proxy]	(33)	(33)	(33)	63	63	63
BEAT liability	**27**	**0**	**0**	**27**	**0**	**0**

Example 2: comparing taxpayers with and without pre-enactment NOLs that have disparate base erosion payments

    (a) Calculation under the Proposed Regulations' add-back method

	Taxpayer with Pre-TCJA NOLs	Taxpayer without NOLs
Taxable Income Before NOL	300	300
Pre-TCJA NOL utilized	(300)	0
Taxable Income	0	300
Regular Tax (@21%)	**0**	**63**
Taxable Income	0	300
Base Erosion Payments	**300**	**600**
BEAT rate	10%	10%
MTI	300	900
* 10%	30	90
Less Reg Tax	(0)	(63)
BEAT liability	30	27

    (b) Calculation under the Proposed Regulations' add-back method (revised for the proxy method)

	Taxpayer with Pre-TCJA NOLs	Taxpayer without NOLs
Taxable Income Before NOL	300	300
Pre-TCJA NOL	(300)	0
*** 21% US rate**	0	63
Base Erosion Payments	300	600
BEAT rate	10%	10%
MTI	300	900
*** 10%**	30	90
Less Reg Tax + 11% NOL	(0 + 33)	(63 + 0)
BEAT liability	**0**	**27**