TaxNewsFlash

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Proposed regulations: Base erosion and anti-abuse tax (BEAT) rules for qualified derivative payments (QDPs) on securities lending transactions

The U.S. Treasury Department and IRS today released proposed regulations (REG-107895-24) regarding how qualified derivative payments (QDPs) in connection with securities lending transactions are determined and reported under the rules governing the section 59A base erosion and anti-abuse tax (BEAT).

The proposed regulations would modify the rules in the existing final section 59A regulations relating to how to determine QDPs in connection with securities lending transactions, including the reporting requirements for such QDPs.

The proposed regulations are proposed to apply to tax years beginning on or after the date that the proposed regulations are finalized. The proposed regulations also contain language that extends the QDP "good faith reporting period" to tax years beginning on or after January 1, 2027, consistent with Notice 2024-43 that was released in May 2024.

Comments on the proposed regulations and requests for a public hearing are due by the date that is 90 days after the proposed regulations are published in the Federal Register, which is scheduled to be January 14, 2025.

KPMG observation

The proposed regulations contain two key rules:

- Under the first rule, a mark-to-market gain or loss on a securities loan entered into with a foreign related party would not give rise to a base erosion payment. As a result, if the taxpayer seeks to satisfy the QDP reporting requirement with respect to a securities loan, mark-to-market gains or losses are excluded from the QDP reporting requirement (i.e., the mark-to-market gains or losses are not taken into account in the BEAT netting rule). Other payments on the securities leg of a securities loan (i.e., substitute payments and borrow fees) are subject to the QDP reporting requirement. The rules also clarify that mark-to-market losses on such intercompany securities loans are included in the denominator of the base erosion percentage.

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- Under the second rule, the Treasury Department and IRS provided a taxpayer favorable rule to determine the recipient of a substitute payment on a securities loan. More specifically, if a payor cannot determine the recipient of its substitute payments, it can apply an alternative method. Under the alternative method, the taxpayer first determines the total amount of substitute payments and other securities lending payments received by all foreign related parties during the tax year. The taxpayer then determines the total amount of substitute payments and other securities lending payments paid by the taxpayer during the tax year. Substitute payments and other securities lending payments are first treated as being paid to foreign related parties of the taxpayer up to the total amount of substitute payments and other securities lending payments received by foreign related parties. Any amount of substitute payments and other securities lending payments paid by the taxpayer that exceed the amount of substitute payments and other securities lending payments received by foreign related parties are treated as paid to unrelated parties.

The preamble to the proposed regulations indicates that the Treasury Department and IRS are considering requiring taxpayers to report additional QDP information on Form 8991 or a supplementary schedule that will assist the IRS in verifying the accuracy of the taxpayer's QDP reporting requirement. This statement was made in a broader context than securities lending transactions and could thus apply to other derivatives entered into with foreign related parties.

The preamble to the proposed regulations also references a comment letter in which the commentor requested that mark-to-market losses on securities lending transactions be excluded from the QDP reporting requirement under the theory that mark-to-market losses are not base erosions payments (i.e., the mark-to-market losses are not payments to a related party). The IRS disagreed with this theory. Rather, the special rule in the proposed regulations is based on the premise that a securities borrower must return the underlying security to close out the securities loan, and the existing BEAT regulations clarify that any loss recognized on the transfer of property (e.g., a security) to a foreign related party is not a base erosion payment. Mark-to-market losses on the outstanding securities loan are merely an acceleration of the expected loss the borrower will recognize to close the securities loan.

The proposed regulations confirm that mark-to-market gains and losses on other derivative contracts that qualify for the QDP exception are subject to QDP reporting.

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