



October 14, 2022

The Honorable Lily Batchelder  
Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Mr. William Paul  
Principal Deputy Chief Counsel  
Internal Revenue Service  
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Washington, DC 20224

Mr. Brett York  
Deputy Tax Legislative Counsel  
Department of the Treasury  
1500 Pennsylvania Ave, NW  
Washington, DC 20020

**RE: Corporate Alternative Minimum Tax Immediate Guidance Needed**

Dear Ms. Batchelder, Mr. Paul, and Mr. York:

The American Institute of CPAs (AICPA) respectfully requests immediate guidance on various provisions regarding the Corporate Alternative Minimum Tax (CAMT), which was part of the Inflation Reduction Act of 2022<sup>1</sup> (IRA) enacted on August 16, 2022. These comments are in addition to our letters previously submitted to Congress on October 28, 2021<sup>2</sup> and June 21, 2022.<sup>3</sup>

**GENERAL COMMENTS**

The IRA created many new financial reporting obligations and implications. Taxpayers and practitioners need immediate guidance clarifying the federal income tax treatment of the new provisions to assist companies in determining how to take various issues into account for financial statement purposes.

Immediate guidance is especially needed with respect to the CAMT because companies will struggle with reporting the impact of the minimum tax in financial filings given the number of significant issues delegated to the Department of the Treasury (“Treasury”).

Businesses typically need to include the impact of a new law in the reporting period in which it is enacted. Notwithstanding that the law will not be in effect until 2023, certain companies will need to disclose the anticipated effects in upcoming financial filings. Companies focused on financial statement reporting will face a challenge unless guidance is available by the time the impact will need to be disclosed within the financial statements for the first quarter of 2023. Companies also need immediate guidance to be able to properly make estimated tax payments beginning in April 2023.

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<sup>1</sup> [H.R. 5376, Public Law 117-169.](#)

<sup>2</sup> See AICPA Letter, “[Re: Corporate Profits Minimum Tax in Reconciliation Being Considered](#),” October 28, 2021.

<sup>3</sup> See AICPA Letter, “[Re: AICPA Comments on the Corporate Profits Minimum Tax in Reconciliation Being Considered](#),” June 21, 2022.

The AICPA has highlighted some of the specific areas that need immediate guidance in order for taxpayers and practitioners to make informed decisions to comply with the 2023 financial accounting and federal income tax obligations.

## **SPECIFIC COMMENTS**

Our attached comments include the following recommendations:

### **1. Financial Reporting and Accounting for Income Taxes**

- AFS Prioritization When Statements Issued Under Different Standards
  - Generally, incorporate the additional details contained in the section 451 regulations with respect to determining a taxpayer's AFS for purposes of the CAMT.
  - However, clarify the prioritization rule that should apply to determine the AFS of each member in an aggregated or consolidated group when multiple statements are prepared using different accounting standards. In this instance, it may be more appropriate to use a consistent accounting standard that covers most of the group members even if the statement is a lower priority - i.e., prioritize consistent standards to the extent they exist first, then apply the GAAP, IFRS, etc. priority in accordance with Treas. Reg. § 1.451-3(a)(5) rather than applying priority rules separately to each member of the group.
- Definition of Financial Statement Net Income
  - Provide rules that clarify how discontinued operations income, unusual events, OCI, elimination entries, and income from variable interest entities (VIEs) should be taken into account in computing AFSI. In this regard, it is recommended that AFSI:
    - Include income or loss from discontinued operations or unusual events, and include income or loss that is eliminated in the AFS to the extent the income is not eliminated for federal income tax purposes (e.g., intercompany eliminations) because inclusion of this income will allow the AFSI of a corporation to be comparable to income included in taxable income for that corporation.
    - Exclude OCI and income or loss that is eliminated in the AFS to the extent the income also would be eliminated for federal income tax purposes (e.g., intracompany eliminations) because this type of income would not be reflected in a corporation's taxable income.
    - Adjust for income or loss from VIEs as provided in specific rules applicable to non-consolidated corporations, controlled foreign corporations and partnerships (as discussed in more detail below).

## 2. Passthrough Issues

- Aggregation of S Corporation Financial Statement Income with C Corporation Financial Statement Income
  - Clarify whether the AFSI of an S corporation may be aggregated with that of a C corporation under section 52(a) or (b).
- Partnership Specific Items
  - i. Applicable Corporation Test and Distributive Share Rule Issue #1
    - For purposes of the applicable corporation test for a corporate partner in a partnership, clarify if the “special rules” in section 59(k)(1)(D) turn off the partnership distributive share rule of section 56A(c)(2)(D)(i) in all cases (i.e., an “un-linked read”), or if the partnership distributive share rule of section 56A(c)(2)(D)(i) is turned off only when the corporation and the partnership are aggregated under section 52(b) (i.e., a “linked read”).
  - ii. Applicable Corporation Test and Distributive Share Rule Issue #2
    - For purposes of the applicable corporation test for a corporate partner in a partnership that consolidates the partnership for financial statement purposes but is not aggregated with the partnership under section 52(b) (e.g., the corporation owns 50 percent or less of the capital and profits of the partnership), clarify if the applicable corporation test is based on fully consolidated net income or on net income after backing out noncontrolling interests. We recommend that the full amount of the partnership income should not be included unless the partnership is aggregated under section 52.
  - iii. Reporting Issues
    - Guidance should clarify that partnerships are not required to report out AFSI information unless a corporate partner requests such information in a timely manner. Guidance also should clarify how section 56A(c)(2)(D)(i) and section 56A reporting in general should occur through tiered partnerships.
    - Finally, guidance should allow applicable corporations that own de minimis interests in partnerships to apply a simplified approach to computing AFSI that does not require the partnership to report out AFSI information. For example, it may be reasonable to allow such partners to include their distributive share of the partnership’s taxable income as opposed to a distributive share of the partnership’s AFSI.

iv. The Meaning of the Phrase “Distributive Share” Under Section 56A(c)(2)(D)(i)

- We recommend a flexible approach that allows a partnership to determine its partners’ distributive shares of partnership AFSI using any reasonable method. Guidance should provide examples of methods that may be considered reasonable and not reasonable. Reasonable methods may include, for example, allocating AFSI in accordance with the percentage share of net section 704(b) income or loss, the percentage share of net taxable income or loss, the percentage share of financial statement income (if applicable), in accordance with the principles of section 704(b) but using financial statement amounts instead of section 704(b) amounts, or an allocation method that accounts for special allocations of specific partnership items under the partnership agreement. The method chosen by the partnership should be applied consistently (unless the Secretary expressly permits or requires a change in methodology) for purposes of both computing the CAMT and determining applicable corporation status.

v. Balancing Guidance on Adjustments to AFSI that Carries Out Both the Purposes of CAMT and the Principles of Subchapter K

- Guidance should provide that book income and loss should be excluded from AFSI in cases where such transactions giving rise to book income would not result in a recognition event under the operative rules of subchapter K. Rules that mirror the exceptions to tax-free treatment under subchapter K rules (e.g., section 721(c), section 704(c)(1)(B), section 737, disguised sales under section 707, etc.) should be reflected in this context for CAMT purposes as well.
- Additionally, guidance should address mechanics for income or loss recognition for book purposes at the time such deferred recognition occurs under subchapter K principles. Rules addressing the impact to CAMT of basis adjustments for partnerships with section 754 elections in place (i.e., section 734(b) and section 743(b)) or with substantial built-in losses (i.e., section 734(d) and section 743(d)) should be considered.

### 3. General Concepts and Methods & Periods

- Simplified Method to Determine If a Taxpayer Is an Applicable Corporation
  - Consider introducing an optional simplified method for determining applicable corporation status to relieve ambiguity and complexity associated with AFSI computations and aggregations.
  - A simplified method may be based on other metrics such as by aggregating the net income or loss from the AFS for members of the aggregated group. This rule may stipulate that if the aggregated net income or loss from the AFS (e.g., 10-K or other applicable financial statement) for the three-year period is over

\$1 billion, proceed with computing AFSI for each member. However, if the net income or loss for the three-taxable-year period is less than \$1 billion, the corporation is not an applicable corporation.

- Consider Excluding Extraordinary Items for Purposes of Determining Whether an Applicable Corporation
  - Provide a rule that excludes extraordinary items from the three-year-average AFSI test. This rule may exclude abnormal events such as applicable asset acquisitions, non-taxable transactions, cancellation of indebtedness income, and changes in accounting principles.
  - Even if extraordinary items are taken into account for purposes of computing the three-year average AFSI test, it is recommended at a minimum that a rule be provided to exclude extraordinary items from short-year annualization calculations in circumstances similar to the exceptions provided in Treas. Reg. § 1.1502-76.
- Defining the Term “Predecessor” for Purposes of Determining Whether a Corporation is an “Applicable Corporation”
  - Provide a definition of the term “predecessor” for this specific purpose.
- Impact on “Applicable Corporation” Status of Corporations Undergoing a Change of Ownership
  - Provide guidance on how a corporation’s status as an applicable corporation is impacted by it leaving or joining a consolidated group and how the applicable corporation status of continuing members of a consolidated group is impacted by a member leaving the group. Provide guidance on how deductions for financial statement net operating losses under section 56A(d) are impacted when one or more members of the consolidated group of the departing member have such losses.
  - Consider including a rule that would except a corporation from applicable corporation status upon leaving the aggregate group of an applicable corporation within the meaning of section 52, if the corporation would not be an applicable corporation on its own.
  - Additionally, consider a rule that would except a corporation from applicable corporation status in the event of divestitures. This rule could potentially operate similar to the three-taxable-year average test if a divestiture is made in that applicable corporation status is no longer met if the taxpayer (or aggregate group within the meaning of section 52) fails the average AFSI test for three consecutive years.

- For Purposes of Computing AFSI, Clarify How Rules Similar to Section 451(b)(5) Apply to Determine AFSI of a Taxpayer Included in AFS for a Group of Entities
  - Clarify that the rule in section 56A(c)(2)(A) includes the Treas. Reg. § 1.451-3(h), allowing separate source documents that were used to create the consolidated AFS to be used in the computation of AFSI when income has been eliminated in the AFS that must be included in taxable income.
- For Purposes of Computing AFSI, Clarify the Rule for Entities Not Included in the Consolidated Tax Return
  - Clarify that section 56A(c)(2)(C) requires a corporation to remove all items of income or loss in the taxpayer's AFS net income or loss that are attributable to non-consolidated corporations, including (for example) income or loss of the entity accounted for using equity accounting and gain/loss from any mark-to-market adjustments with respect to the corporation recognized in the AFS. Instead, a corporation must include in AFSI only amounts that are recognized as income or loss for taxable income purposes for the taxable year related to such non-consolidated corporation, including (for example) dividends, gain/loss on sale of the corporation's stock, and mark-to-market adjustments if the corporation is marked to market for tax purposes (but not including Subpart F income).
  - Allow dividends received deductions where permissible for tax purposes in order to have parity between taxable income and AFSI with respect to a non-consolidated corporation.
  - See the Passthrough and International sections for recommendations regarding partnerships and CFCs.
- Depreciation Recovered Through COGS
  - Clarify that depreciation that is included in inventoriable costs under either section 471 or section 263A and recovered as COGS is treated as a "deduction" once recovered through COGS for purposes of section 56A(c)(13) adjustments to AFSI.
- Depreciation Within a Consolidated Group
  - Clarify that the excess tax depreciation that is recognized as a result of the intercompany transaction is not treated as depreciation for section 168 purposes, solely for purposes of calculating the CAMT.

- Bonus Depreciation Taken Prior to the Effective Date
  - Provide a transition rule such that the section 56A(c)(13) depreciation adjustment does not apply for section 168 property for which bonus depreciation was claimed in tax years beginning before January 1, 2023.
- Software, Qualified Films or Television Productions Eligibility for Depreciation Special Rule If No Election for Bonus Depreciation
  - Clarify that computer software, qualified films or television productions are property to which section 168 applies if the property is eligible for bonus depreciation and the taxpayer did not elect out of bonus depreciation pursuant to section 168(k).
- Clarify Whether the Depreciation Adjustment to AFSI Applies to Foreign Corporations Not Subject to United States Taxation
  - Clarify for purposes of section 56A(c)(13) that no adjustment to AFSI is made if tax depreciation is not allowed under section 167.

#### **4. International**

- Foreign-Parented Multinational Group (FPMG)
  - We recommend that the regulations provide a definition of a common parent.
  - We recommend that the regulations clarify for purposes of determining whether a corporation is an applicable corporation whether a member of a FPMG group applies only the special rule in section 59(k)(2) and not the general aggregation rule in section 59(k)(1)(D) for purposes of the AFSI test under section 59(k)(1)(B)(ii)(I) (i.e., only including AFSI from members of the FPMG – those on the same AFS) or whether members of a FPMG must apply both the special rule in section 59A(k)(2) and the general aggregation rule in section 59(k)(1)(D).
- CFC AFSI Income Adjustments
  - The dividend inclusion rule provides the Secretary with authority to reduce the amount of dividend inclusion income under that rule. Pursuant to this authority, we recommend that the regulations provide coordination rules. From an administrative perspective, we recommend that the dividend inclusion rule not be applicable in cases where a foreign corporation is a CFC subject to the pro-rata share rule. However, if the IRS determines that a tracking approach is required, we recommend that the regulations provide coordination rules that reduce the inclusion in the AFSI of an applicable corporation under the dividend

inclusion rule to the extent distributed amounts previously were taken into account by the same applicable corporation under the pro rata share inclusion rule. These rules may operate similar to the previously taxed earnings and profits (PTEP) rules provided under section 959.

- We further recommend clarification that “dividends” for purposes of section 56A(c)(2)(C) are dividends as reported on the applicable financial statements (i.e., financial statement dividends and not dividends as defined in section 316). The clarification of book vs. tax dividends is critical to the application of section 338(g) elections, “Fresh Start” accounting, etc.
  - We further recommend that adjustments be made to reduce the inclusion in the AFSI of an applicable corporation under the dividend inclusion rule that relate to either (1) distributions of earnings and profits that were generated in pre-CAMT effective date years or (2) distributions of earnings and profits of a CFC acquired in a transaction or similar situations (e.g., CFCs that changed affiliated groups as a result of a reorganization). With respect to the distributions of earnings and profits of a CFC acquired in a transaction or similar situations, we suggest an attribute (as noted above similar to PTEP) be created for earnings subject to the pro rata share inclusion rule that would allow for future reductions in the dividend inclusion rule adjustment.
- Clarification of the Pro Rata Share Rule
    - We recommend that the regulation clarify and specify what is meant by “as adjusted under rules similar to those that apply in determining adjusted financial statement income.” Specifically, these rules should address whether income is limited to that determined under the principles of section 882, or whether the income is intended to broadly include all AFSI of the CFC irrespective of whether it is effectively connected with a United States trade or business.
- CAMT Foreign Tax Credits
    - We recommend that the regulations clarify that the CAMT allows for all accrued foreign taxes “taken into account” on the AFS as a credit so long as the foreign taxes are eligible credits under section 901 either in a current, prior or future tax year. This will allow for better matching of the credits with the AFS income.
- CAMT Foreign Tax Credits and Partnerships
    - We recommend that the regulations clarify that the CAMT allows for foreign taxes paid or accrued by a partnership for United States federal tax purposes to be treated as paid or accrued by the partners of such partnership.

- Foreign Corporation ASFI and United States Income Tax Treaties
  - We recommend that, as a matter of comity towards the existing network of United States income tax treaty partners, the regulations clarify that in the case of a foreign corporation that determines its net taxable income under an applicable income tax treaty of the United States, such foreign corporation's AFSI as determined under section 56A(c)(4) shall be limited to those items taken into account in determining its net taxable income. Accordingly, if a foreign corporation would have income effectively connected to a United States trade or business for purposes of section 882 and such foreign corporation would avail of United States income tax treaty benefits establishing that none of the foreign corporation's income would be considered business profits attributable to a United States permanent establishment, then such foreign corporation's AFSI should be zero. This clarification would be consistent with the approach adopted in Treas. Reg. § 1.59A-2(d) for purposes of applying the applicable taxpayer gross receipts test under the Base Erosion Anti-Abuse Tax (BEAT), which broadly excludes gross receipts relating to United States income tax treaty protected income.
  
- BEAT and CAMT
  - We recommend that regulations be issued clarifying that sections 59A(b)(1)(B)(ii)(I) and (II) refer to the section 38 credits that would be allowed for regular tax purposes, excluding section 55.

## **5. Mergers & Acquisitions Issues**

- Impact of Nonrecognition Transactions on AFSI
  - We recommend adding rules to address certain transactions where gain or loss recognized for financial statement purposes—but excluded or not recognized for United States federal income tax purposes—should be excluded from the computation of AFSI.
  
- Allocating CAMT Liability Among Members of a Consolidated Group
  - Provide rules for allocating CAMT liability among members of a consolidated group. Rules should include language permitting taxpayers to use a reasonable allocation approach based on the taxpayer's facts and circumstances or provide different allocation methods similar to those currently available to allocate United States federal income tax liability between members of a consolidated group.

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The Honorable Lily Batchelder, Mr. William M. Paul, and Mr. Brett York  
October 14, 2022  
Page 10 of 10

The AICPA is the world's largest member association representing the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact George Manousos, Chair, AICPA Corporate AMT Task Force at (202) 302-0942 or [george.manousos@pwc.com](mailto:george.manousos@pwc.com); Eileen Sherr, Director - AICPA Tax Policy & Advocacy, at (202) 434-9256, or [Eileen.Sherr@aicpa-cima.com](mailto:Eileen.Sherr@aicpa-cima.com); or me at (601) 326-7119 or [JanLewis@HaddoxReid.com](mailto:JanLewis@HaddoxReid.com).

Sincerely,



Jan Lewis, CPA  
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service  
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
Mr. Timothy Powell, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
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## **AMERICAN INSTITUTE OF CPAs**

### **Corporate Alternative Minimum Tax Immediate Guidance Needed**

**October 14, 2022**

#### **GENERAL COMMENTS**

The IRA created many new financial reporting obligations and implications. Taxpayers and Practitioners need immediate guidance clarifying the federal income tax treatment of the new provisions to assist companies in determining how to take various issues into account for financial statement purposes.

Immediate guidance is especially needed with respect to the CAMT because companies will struggle with reporting the impact of the minimum tax in financial filings given the number of significant issues delegated to the Department of the Treasury (“Treasury”).

Businesses typically need to include the impact of a new law in the reporting period in which it is enacted. Notwithstanding that the law will not be in effect until 2023, certain companies will need to disclose the anticipated effects in upcoming financial filings.

Companies focused on financial statement reporting will face a challenge unless guidance is available by the time the impact will need to be disclosed within the financial statements for the first quarter of 2023. Companies also need immediate guidance to be able to properly make estimated tax payments beginning in April 2023.

The AICPA has highlighted some of the specific areas that need immediate guidance in order for taxpayers and practitioners to make informed decisions to comply with the 2023 financial accounting and federal income tax obligations.

Our comments cover the following issues:

1. Financial Reporting and Accounting for Income Taxes
2. Passthrough Issues
3. General Concepts and Methods & Periods
4. International
5. Mergers & Acquisitions Issues

## SPECIFIC COMMENTS

### 1. Financial Reporting and Accounting for Income Taxes

- AFS Prioritization When Statements Issued Under Different Standards
  - Overview
    - Applicable financial statement (AFS) as defined in section 56A(b)<sup>1</sup> refers to section 451(b)(3) (or as specified by the Secretary in regulations or other guidance).
    - Section 451(b)(3) defines an AFS as:
      - (A) A financial statement which is certified as being prepared in accordance with generally accepted accounting principles (GAAP) and which is (i) a 10-K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the United States Securities and Exchange Commission, (ii) an audited financial statement of the taxpayer which is used for credit purposes, reporting to shareholders, or other substantial nontax purposes, but only if there is no statement of the taxpayer described in clause (i), or (iii) filed by the taxpayer with any other Federal agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii),
      - (B) A financial statement which is made on the basis of international financial reporting standards (IFRS) and is filed by the taxpayer with an agency of a foreign government which is equivalent to the United States Securities and Exchange Commission and which has reporting standards not less stringent than the standards required by such Commission (but only if there is no GAAP statements), or
      - (C) A financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary (but only if there is no GAAP or IFRS statements).
    - Treas. Reg. § 1.451-3(a)(5) provides further clarification on prioritization of financial statements filed in accordance with GAAP, IFRS, etc. In particular, Treas. Reg. § 1.451-3(a)(5)(iii) adds to the definition of an AFS, “A financial statement, other than a tax return, filed with the Federal Government or any Federal agency, a state government or state agency, or a self-regulatory organization including, for example, a financial statement filed with a state agency that regulates insurance companies or the Financial Industry Regulatory Authority.”
    - In addition, with respect to an AFS covering groups of entities, Treas. Reg. § 1.451-3(h)(1)(i) provides that if a taxpayer’s financial results are reported on the AFS for a group of entities (consolidated AFS), the taxpayer’s AFS is the

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<sup>1</sup> Unless otherwise indicated, all references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

consolidated AFS. However, if the taxpayer's financial results are also reported on a separate AFS that is of equal or higher priority to the consolidated AFS under Treas. Reg. § 1.451-3(a)(5), then the taxpayer's AFS is the separate AFS.

- Recommendations

- Generally, incorporate the additional details contained in the section 451 regulations with respect to determining a taxpayer's AFS for purposes of the CAMT.
- However, clarify the prioritization rule that should apply to determine the AFS of each member in an aggregated or consolidated group when multiple statements are prepared using different accounting standards. In this instance, it may be more appropriate to use a consistent accounting standard that covers most of the group members even if the statement is a lower priority - i.e., prioritize consistent standards to the extent they exist first, then apply the GAAP, IFRS, etc. priority in accordance with Treas. Reg. § 1.451-3(a)(5) rather than applying priority rules separately to each member of the group).

- Analysis

- The prioritization rules under section 451 and the Treasury regulations thereunder provide guidance on prioritization of financial statements that appears to require the aggregation of separate statements based on the highest priority for each member of an aggregated group to determine if an applicable corporation, or of the consolidated group to determine adjusted financial statement income (AFSI), without regard to whether a particular statement would cover all members of the group.
- As a result, an interpretation of the current statute and prioritization rules may require GAAP statements to be aggregated with IFRS statements and/or statutory statements filed with regulators even in instances where lower-level consistent financial statements may exist for all or most members of the group. The combination of AFS using different accounting standards could lead to distortions in calculating AFSI due to differing financial accounting methods.

- Definition of Financial Statement Net Income

- Overview

- Section 56A(a) defines the term AFSI as, with respect to any corporation for any taxable year, the *net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement* for such taxable year, adjusted as provided in this section.
- Financial statement income or loss often reports items outside of continuing operating income such as discontinued operations, unusual events, and other comprehensive income (OCI); reports impact of transfer pricing adjustments

and elimination entries; or reports the income (loss) of entities that are not wholly owned by the parent company.

○ Recommendation

- Provide rules that clarify how discontinued operations income, unusual events, OCI, elimination entries, and income from variable interest entities (VIEs) should be taken into account in computing AFSI. In this regard, it is recommended that AFSI:
  - Include income or loss from discontinued operations or unusual events, and include income or loss that is eliminated in the AFS to the extent the income is not eliminated for federal income tax purposes (e.g., intercompany eliminations) because inclusion of this income will allow the AFSI of a corporation to be comparable to income included in taxable income for that corporation.
  - Exclude OCI and income or loss that is eliminated in the AFS to the extent the income also would be eliminated for federal income tax purposes (e.g., intracompany eliminations) because this type of income would not be reflected in a corporation's taxable income.
  - Adjust for income or loss from VIEs as provided in specific rules applicable to non-consolidated corporations, controlled foreign corporations, and partnerships (as discussed in more detail below).

○ Analysis

- Financial statements may reflect income or loss related to discontinued operations, or other items of gain or loss separately stated from net income or loss from continuing operations. Financial statements also typically eliminate intercompany transactions between members of the financial reporting group and intracompany transactions between divisions of a single entity. In these situations, additional guidance may be needed in order to clarify what is intended to be included in the calculation of AFSI.
- Financial statements also may report in OCI certain gains or losses, such as unrealized investment gains, foreign currency translation adjustments, and defined benefit pension adjustments. Senate Finance Committee Chairman Ron Wyden confirmed in a Senate floor colloquy with Senator Ben Cardin that for purposes of the CAMT, OCI is not included in AFSI.<sup>2</sup> Since a colloquy is considered non-authoritative guidance, confirming the colloquy in forthcoming guidance will provide authority to rely on the position expressed in the colloquy.

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<sup>2</sup>168 Cong. Rec. 4165 (2022)

## 2. Passthrough Issues

- Aggregation of S Corporation Financial Statement Income with C Corporation Financial Statement Income

- Overview

- New section 59(k)(1) (A) excludes an S corporation from the definition of an “applicable corporation” subject to the CAMT.
- New section 59(k)(1)(D) provides that, in determining whether a C corporation is subject to the CAMT, “all adjusted financial statement income of persons treated as a single employer with such corporation under subsection (a) or (b) of section 52 shall be treated as adjusted financial statement income of such corporation....”
  - As a result, it appears that the AFSI of an S corporation and of a C corporation may be aggregated under section 52(a) as a parent-subsiary group, a brother-sister group, or a controlled group, and that if the combined AFSI of the aggregated group exceeds the threshold, the C corporation will become subject to the CAMT.

- Recommendation

- Clarify whether the AFSI of an S corporation may be aggregated with that of a C corporation under section 52(a) or (b).

- Analysis

- Guidance is necessary to resolve the ambiguity on whether S corporation activity is included in any CAMT computation.

- Partnership Specific Items

- i. Applicable Corporation Test and Distributive Share Rule Issue #1

- Overview

- Section 59(k)(1)(D) (Special rules for determining applicable corporation status) provides that solely for purposes of determining whether a corporation is an applicable corporation under section 59(k)(1), all AFSI of persons treated as a single employer with such corporation under subsection (a) or (b) of section 52 shall be treated as AFSI of such corporation, and AFSI of such corporation shall be determined without regard to paragraphs (2)(D)(i) and (11) of section 56A(c).

- Recommendation
    - For purposes of the applicable corporation test for a corporate partner in a partnership, clarify if the “special rules” in section 59(k)(1)(D) turn off the partnership distributive share rule of section 56A(c)(2)(D)(i) in all cases (i.e., an “un-linked read”), or if the partnership distributive share rule of section 56A(c)(2)(D)(i) is turned off only when the corporation and the partnership are aggregated under section 52(b) (i.e., a “linked read”).
  - Analysis
    - The plain language of section 59(k)(1)(D) appears to be written in a manner that turns off the distributive share rule in all cases for purposes of the applicable corporation test, such that the section 52 aggregation rule and the rule disregarding section 56A(c)(2)(D)(i) operate separately in an “un-linked read.” However, regulations should clarify whether the “linked read” or the “un-linked read” is the appropriate application of section 59(k)(1)(D). This clarification also impacts the analysis in the following issue.
- ii. Applicable Corporation Test and Distributive Share Rule Issue #2
- Overview
    - Certain corporations may own an interest in a partnership and consolidate the partnership for financial statement purposes. If the corporation and the partnership are aggregated under section 52(b), then it seems clear that under section 59(k)(1)(D) all AFSI of the group is included in the applicable corporation test.
    - However, it is less clear what should occur if the corporation and the partnership are not aggregated under section 52(b). For example, it is common in umbrella partnership-corporation (“UP-C”) structures for a publicly traded corporation to own less than 50 percent of the capital and profits of an operating partnership, but the publicly traded corporation still consolidates the partnership for financial statement purposes. It is possible that full consolidated AFSI is above \$1 billion, but that AFSI after backing out noncontrolling interests (i.e., the other partners of the operating partnership) is less than \$1 billion.
  - Recommendation
    - For purposes of the applicable corporation test for a corporate partner in a partnership that consolidates the partnership for financial statement purposes but is not aggregated with the partnership under section 52(b) (e.g., the corporation owns 50 percent or less of the capital and profits of the partnership), clarify if the applicable corporation test is based on fully consolidated net income or on net income after backing out noncontrolling interests. We

recommend that the full amount of the partnership income should not be included unless the partnership is aggregated under section 52.

○ Analysis

- If guidance applies the “linked read” in the first issue above, the corporation would presumably only take into account its distributive share of the partnership’s AFSI under section 56A(c)(2)(D)(i). However, if guidance applies the “un-linked read,” then the corporation presumably needs some other mechanism so as to not include net income attributable to noncontrolling interests (i.e., the other partners in the partnership) in testing whether the corporation is an applicable corporation.
- One reasonable mechanism could be an adjustment under section 56A(c)(2)(A) and its reference to using rules similar to section 451(b)(5) when multiple entities are included on the same financial statement. Section 451(b)(5) and Treas. Reg. § 1.451-3(h) include rules for apportioning revenue between entities included on the same consolidated financial statement. Applying these principles to apportion AFSI in this fact pattern seems reasonable. Another approach to reducing consolidated net income for net income attributable to noncontrolling interests could be based on the section 56A(a) AFSI definition and its reference to net income or loss “of the taxpayer.” However, if section 56A(a) is read in this manner, it is unclear what the purpose of section 56A(c)(2)(A) is.
- In any event, guidance should clarify what mechanism (if any) a corporation could use to exclude AFSI attributable to noncontrolling interests for purposes of the applicable corporation test. As this AFSI is not attributable to the corporation, absent section 52 aggregation applying it does not appear appropriate or consistent with section 56A for the corporation to ultimately take this income into account in the applicable corporation test.

iii. Reporting Issues

○ Overview

- Certain partnerships will need to report out AFSI information to corporate partners that are applicable corporations. Because only a small percentage of very large corporations are intended to be treated as applicable corporations, most partnerships will not have any direct or indirect corporate partner who needs any AFSI information.

○ Recommendation

- Guidance should clarify that partnerships are not required to report out AFSI information unless a corporate partner requests such information in a timely manner. Guidance also should clarify how section 56A(c)(2)(D)(i) and section 56A reporting in general should occur through tiered partnerships.



- Analysis
  - Although the phrase “distributive share” is a familiar term in connection with section 704(b), its use in the CAMT rules raises questions regarding its meaning in this context. For example, it is not clear whether section 704(c) principles, which were designed to prevent shifting of taxable gains and losses between partners in a partnership, should be taken into account in determining a partner’s distributive share of partnership AFSI. Reasonable arguments can be made for both applying or disregarding section 704(c) principles. On the one hand, section 704(c) was designed with a view of taxing the beneficiary of property appreciation instead of allowing such tax to be spread amongst partners. On the other hand, allocations of taxable income under section 704(c) are not representative of a partner’s economic allocations.
  - In the absence of legislative history or any indication from Congress as to the intent of the phrase “distributive share” in the context of CAMT, a broad interpretation encapsulated under an umbrella of reasonableness will allow partnerships to make appropriate allocations of AFSI.
- v. Balancing Guidance on Adjustments to AFSI that Carries Out Both the Purposes of CAMT and the Principles of Subchapter K
  - Overview
    - Section 56A(c)(15) directs Treasury to provide guidance on adjustments to AFSI that Treasury determines necessary to carry out both the purposes of CAMT and the principles of Part II of Subchapter K (relating to partnership contributions and distributions). Definitive guidance clarifying what the directive intends for in certain situations is needed, e.g., when transactions that are otherwise tax-free under section 721(a) and section 731(a) result in financial statement income or loss.
  - Recommendation
    - Guidance should provide that book income and loss should be excluded from AFSI in cases where such transactions giving rise to book income would not result in a recognition event under the operative rules of subchapter K. Rules that mirror the exceptions to tax-free treatment under subchapter K rules (e.g., section 721(c), section 704(c)(1)(B), section 737, disguised sales under section 707, etc.) should be reflected in this context for CAMT purposes as well.
    - Additionally, guidance should address mechanics for income or loss recognition for book purposes at the time such deferred recognition occurs under subchapter K principles. Rules addressing the impact to CAMT of basis adjustments for partnerships with section 754 elections in place (i.e., section 734(b) and section 743(b)) or with substantial built-in losses (i.e., section 734(d) and section 743(d)) should be considered.

- Analysis
  - We believe the directive is clear in acknowledging a need for Treasury to incorporate special rules adjusting AFSI in certain situations where AFSI inclusions or exclusions, as determined after the adjustments normally made under section 56A(c), would contradict the purpose and principles of certain subchapter K provisions. Providing special rules that align AFSI recognition with taxable income or loss recognition in a manner consistent with subchapter K principles ensures that AFSI is ultimately recognized for CAMT purposes while keeping the integrity of subchapter K principles intact.

### **3. General Concepts and Methods & Periods**

- Simplified Method to Determine If a Taxpayer Is an Applicable Corporation

- Overview
  - Section 59(k)(1)(A) defines an applicable corporation as meaning, with respect to any taxable year, a corporation (other than an S corporation, regulated investment company (RIC), or real estate investment trust (REIT)) that meets the average annual AFSI test for one or more taxable years prior to the taxable year and ending after December 31, 2021.
  - Section 59(k)(1)(B) states that a corporation meets the average annual AFSI test if the average annual AFSI of the corporation (determined without regard to financial statement net operating loss (NOL) carryovers) for the three-taxable-year-period ending with the taxable year exceeds \$1 billion. Additional rules exist for foreign-parented multinational groups, under which the corporation meets the average AFSI test for a taxable year if (1) the corporation meets the \$1 billion test (determined after application of section 59(k)(2)) and (2) the average AFSI (determined without regard to section 59(k)(2) and financial statement NOL carryovers) for the three-taxable-year-period ending with the taxable year is \$100 million or more for the United States consolidated group.
  - The tests for determining if a taxpayer is an applicable corporation are complicated due to the reliance on aggregated AFSI for reasons stated elsewhere in this comment letter.

- Recommendations
  - Consider introducing an optional simplified method for determining applicable corporation status to relieve ambiguity and complexity associated with AFSI computations and aggregations.
  - A simplified method may be based on other metrics such as by aggregating the net income or loss from the AFS for members of the aggregated group. This rule may stipulate that if the aggregated net income or loss from the AFS (e.g., 10-K or other applicable financial statement) for the three-year period is over \$1 billion, proceed with computing AFSI for each member. However, if the net

income or loss for the three-taxable-year period is less than \$1 billion, the corporation is not an applicable corporation.

- Analysis
  - A taxpayer may struggle with the complicated rules of determining AFSI for its aggregated group only to conclude that it is not an applicable corporation.
  - An optional simplified rule for determining applicable corporation status could alleviate some of the burdens of AFSI computations and aggregations.
  - It is expected that the net income or loss reported in an AFS for a group is likely to exceed AFSI for the group, especially due to the fact that AFS income likely includes all of the income of non-consolidated corporations and partnerships as opposed to the taxable income or distributive share that would be included in AFSI.
- Consider Excluding Extraordinary Items for Purposes of Determining Whether an Applicable Corporation
  - Overview
    - Section 59(k)(1)(A) defines an applicable corporation as meaning, with respect to any taxable year, a corporation (other than an S corporation, RIC, or REIT) that meets the average annual AFSI test for one or more taxable years prior to the taxable year and ending after December 31, 2021. A similar test exists for foreign-parented multinational groups.
    - Section 59(k)(1)(B) describes the average annual AFSI test as average AFSI over a three-taxable-year period ending with such taxable year (exceeding thresholds separately defined for domestic and foreign-parented corporations).
    - Section 59(k)(1)(E)(ii) provides a special rule for short taxable years, where AFSI for any taxable year of less than 12 months shall be annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months in the short period.
    - AFSI may include items that are extraordinary in nature such as one time sales of businesses or other nonrecurring transactions.
  - Recommendations
    - Provide a rule that excludes extraordinary items from the three-year-average AFSI test. This rule may exclude abnormal events such as applicable asset acquisitions, nontaxable transactions, cancellation of indebtedness income, and changes in accounting principles.
    - Even if extraordinary items are taken into account for purposes of computing the three-year average AFSI test, it is recommended at a minimum that a rule be provided to exclude extraordinary items from short-year annualization calculations in circumstances similar to the exceptions provided in Treas. Reg. § 1.1502-76.

- Analysis
  - AFSI may include items that are extraordinary in nature, such as one-time sales of businesses or other nonrecurring transactions. Including these items in AFSI for purposes of three-taxable-year test may not be informative in determining a consistent expectation of financial statement income that exceeds \$1B. This concern is exacerbated by the fact that once a corporation is an applicable corporation, that corporation always is an applicable corporation (absent guidance excluding them).
  - Similarly, including extraordinary items in AFSI when annualizing income of a short period is likely to be distortive and not reflect the true financial results of the corporation.
  - It is common for extraordinary items to be excluded when inclusion could be distortive, such as when annualizing income for purposes of estimated tax payments under Treas. Reg. § 1.6655-1(f)(2)(ii), when prorating income when a corporation leaves a consolidated group under Treas. Reg. § 1.1502-76(b)(2)(ii), or when allocating items between the aggregate group period and the pre-group period for BEAT purposes in Treas. Reg. § 1.59A-2(c)(4)(iii).
  - A rule that removes extraordinary items from the average annual test, and from a short period annualization calculation, would normalize AFSI. Normalization provides a more accurate average as extraordinary items within the test period or for a short period could skew results either toward or away stipulated thresholds.
- Defining the Term “Predecessor” for Purposes of Determining Whether a Corporation is an “Applicable Corporation”
  - Overview
    - Section 59(k)(1)(E)(iii), which is part of the definition of the term “applicable corporation,” states that “Any reference in this subparagraph to a corporation shall include a reference to any predecessor of such corporation.”
  - Recommendation
    - Provide a definition of the term “predecessor” for this specific purpose.
  - Analysis
    - The term “predecessor” is used in several places in the Code and the regulations thereunder (e.g., sections 59A, 448, and 1502), sometimes with different meanings. Given the importance of determining whether a corporation is an applicable corporation, it will be critical to understand when a corporation may be treated as a “predecessor” for this purpose.

- Impact on “Applicable Corporation” Status of Corporations Undergoing a Change of Ownership
  - Overview
    - Section 59(k)(1)(C) provides that a corporation can cease to be treated as an applicable corporation if (i) it either has a change in ownership or has a specified number of consecutive taxable years, including the most recent taxable year, in which the corporation does not meet the average annual adjusted financial statement income test, and (ii) the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation.
  - Recommendations
    - Provide guidance on how a corporation’s status as an applicable corporation is impacted by it leaving or joining a consolidated group and how the applicable corporation status of continuing members of a consolidated group is impacted by a member leaving the group. Provide guidance on how deductions for financial statement net operating losses under section 56A(d) are impacted when one or more members of the consolidated group of the departing member have such losses.
    - Consider including a rule that would except a corporation from applicable corporation status upon leaving the aggregate group of an applicable corporation within the meaning of section 52, if the corporation would not be an applicable corporation on its own.
    - Additionally, consider a rule that would except a corporation from applicable corporation status in the event of divestitures. This rule could potentially operate similar to the three-taxable-year average test if a divestiture is made in that applicable corporation status is no longer met if the taxpayer (or aggregate group within the meaning of section 52) fails the average AFSI test for three consecutive years.
  - Analysis
    - Transactions in which a corporation joins or leaves a consolidated group are common transactions that have a variety of consequences for United States federal income tax purposes with respect to both the corporation and the other members of the consolidated group. Rules to address issues - such as whether a departing member continues to be treated as an applicable corporation even if it does not satisfy the relevant tests on a separate-company basis, and conversely whether continuing members continue to be treated as applicable corporations even if they no longer satisfy the tests after a member departs - would help prevent the application of the CAMT from spreading to factual situations where it may be inappropriate.

- Similarly, changes in ownership of a corporation(s) not in a consolidated group (but in a section 52 controlled group) also are common transactions for which exceptions should be provided to retest the new aggregate group following change in ownership transactions.
- For Purposes of Computing AFSI, Clarify How Rules Similar to Section 451(b)(5) Apply to Determine AFSI of a Taxpayer Included in AFS for a Group of Entities
  - Overview
    - Section 56A(c)(2) provides special rules for determining AFSI. Section 56A(c)(2)(A) states that rules similar to those in Section 451(b)(5) shall apply if the financial results of a taxpayer are reported on applicable financial statement for a group of entities.
    - Section 451(b)(5) provides, for purposes of paragraph (1), if the financial results of a taxpayer are reported on the AFS (as defined in paragraph (3)) for a group of entities, such statement shall be treated as the AFS of the taxpayer.
    - Treas. Reg. § 1.451-3(h) provides clarity around additional applicable financial statement issues. These rules include guidance specific to taxpayer's financial results being reported on the AFS for a group of entities, rules dealing with separately listed items, non-separately listed items, and computation of AFS revenue for the taxable year when the AFS covers mismatched reportable periods. For example, Treas. Reg. § 1.451-3(h)(3) provides, if a consolidated AFS does not separately list items for the taxpayer, the portion of the AFS revenue allocable to the taxpayer is determined by relying on the taxpayer's separate source documents that were used to create the consolidated AFS and includes amounts subsequently eliminated in the consolidated AFS.
    - It is unclear how section 451(b)(5) operates in the case of non-separately listed items for the taxpayer (e.g., a member of the group that was eliminated in the AFS) if the rules in Treas. Reg. § 1.451-3(h)(3) are not applicable.
  - Recommendation
    - Clarify that the rule in section 56A(c)(2)(A) includes the Treas. Reg. § 1.451-3(h), allowing separate source documents that were used to create the consolidated AFS to be used in the computation of AFSI when income has been eliminated in the AFS that must be included in taxable income.
  - Analysis
    - It is unclear how the section 56A(c)(2)(A) reference to section 451(b)(5) operates in the case of income of a corporation that is eliminated in a consolidated AFS.
    - Treasury Reg. § 1.451-3(h) addresses certain additional AFS issues that would provide clarity. In particular, adjustments to AFS income or loss must be made

for book only eliminations to create parity between tentative minimum tax and regular tax.

- For Purposes of Computing AFSI, Clarify the Rule for Entities Not Included in the Consolidated Tax Return
  - Overview
    - Section 56A(c) provides general adjustments to the net income or loss set forth in the AFS of a taxpayer for purposes of computing AFSI.
    - Section 56A(c)(2) provides special rules for related entities. In the case of “dividends and other amounts” when a corporation is not included on a consolidated return with the taxpayer, section 56A(c)(2)(C) provides that AFSI of the taxpayer with respect to such other corporation shall be determined by only taking into account the dividends received from such other corporation (reduced to the extent provided by the Secretary in regulations or other guidance) and other amounts which are includible in gross income or deductible as a loss under this chapter (other than amounts required to be included under sections 951 and 951A or such other amounts as provided by the Secretary) with respect to such other corporation.
    - Additional rules adjust the AFSI of a corporation that is a partner in a partnership under section 56A(c)(2)(D) or a shareholder in controlled foreign corporation (CFC) under section 56A(c)(3).
  - Recommendations
    - Clarify that section 56A(c)(2)(C) requires a corporation to remove all items of income or loss in the taxpayer’s AFS net income or loss that are attributable to non-consolidated corporations, including (for example) income or loss of the entity accounted for using equity accounting and gain/loss from any mark-to-market adjustments with respect to the corporation recognized in the AFS. Instead, a corporation must include in AFSI only amounts that are recognized as income or loss for taxable income purposes for the taxable year related to such non-consolidated corporation, including (for example) dividends, gain/loss on sale of the corporation’s stock, and mark-to-market adjustments if the corporation is marked to market for tax purposes (but not including Subpart F income).
    - Allow dividends received deductions where permissible for tax purposes in order to have parity between taxable income and AFSI with respect to a non-consolidated corporation.
    - See the Passthrough and International sections for recommendations regarding partnerships and CFCs.

- Analysis
  - Clarity is needed with respect to the meaning of “other amounts” in section 56A(c)(2)(C). A non-consolidated corporation may give rise to a variety of book income or loss events that are not treated as includible in gross income or deductible as a loss for taxable income purposes (e.g., income related to investments accounted for under the equity accounting method, mark to market on investments done under generally accepted accounting principles not eligible for similar federal income tax treatment, income recognized for VIE’s, etc.).
  - A rule stating that parity must exist for AFSI and taxable income with respect to these income or loss items from non-consolidated corporations also would help to clarify what is meant by “other amounts” in section 56A(c)(2)(C).
- Depreciation Recovered Through COGS
  - Overview
    - Section 56A(c)(13) provides that AFSI shall be reduced for depreciation “deductions” for property subject to section 168 and increased for depreciation expenses that are taken into account in the taxpayer’s AFS with respect to such property.
    - Cost of goods sold (COGS) is a reduction from gross receipts in computing gross income, not a deduction subtracted from gross income in computing taxable income.
    - Depreciation that is capitalized under section 471 or section 263A into the basis of inventory and recovered as COGS may not be considered a depreciation “deduction” that would reduce AFSI.
  - Recommendation
    - Clarify that depreciation that is included in inventorable costs under either section 471 or section 263A and recovered as COGS is treated as a “deduction” once recovered through COGS for purposes of section 56A(c)(13) adjustments to AFSI.
  - Analysis
    - Similar to Treasury’s clarification in Treas. Reg. § 1.163(j)-1(b)(1)(iii) that ATI is increased for depreciation that is capitalized under section 263A and recovered as COGS, all depreciation, regardless of whether recovered as part of COGS or as a deduction, should be taken into account for purposes of section 56A(c)(13).

- Depreciation Within a Consolidated Group
  - Overview
    - Section 56A(c)(13) provides that AFSI shall be reduced for depreciation deductions for property subject to section 168 and increased for depreciation expenses that are taken into account in the taxpayer's AFS with respect to such property.
    - When members of a consolidated group engage in an intercompany transaction, Treas. Reg. § 1.1502-13 applies. Traditionally, when depreciable property is sold, the buyer has a step up in the basis of the property and the seller recognizes its income as the buyer recognizes the depreciation on the basis step-up.
  - Recommendation
    - Clarify that the excess tax depreciation that is recognized as a result of the intercompany transaction is not treated as depreciation for section 168 purposes, solely for purposes of calculating the CAMT.
  - Analysis
    - Because the seller's income on sale is not included in the calculation of AFSI, it appears that the Treas. Reg. § 1.1502-13(c) matching rule would not be able to apply with respect to the CAMT, but it would be able to apply for purposes of the regular income tax liability. Therefore, any adjustments made should be solely with respect to the CAMT.
- Bonus Depreciation Taken Prior to the Effective Date
  - Overview
    - AFSI shall be reduced for depreciation “deductions” allowed under section 167 for property subject to section 168 and increased for depreciation expenses that are taken into account in the taxpayer's AFS with respect to such property.
    - Section 168(k) has provided an incentive for taxpayers to invest in capital expenditures and receive an immediate “bonus depreciation.”
    - The financial statement cost basis of such property may continue to be depreciated into post-2022 CAMT years.
  - Recommendation
    - Provide a transition rule such that the section 56A(c)(13) depreciation adjustment does not apply for section 168 property for which bonus depreciation was claimed in tax years beginning before January 1, 2023.

- Analysis
  - For assets on which bonus depreciation was claimed in pre-CAMT years, increasing AFSI for book depreciation without a commensurate reduction to AFSI for tax depreciation would be counter to the policy intent of the AFSI depreciation adjustment and would eliminate the tax incentive originally provided by bonus depreciation.
- Software, Qualified Films, or Television Productions Eligibility for Depreciation Special Rule If No Election for Bonus Depreciation
  - Overview
    - AFSI shall be reduced for depreciation deductions allowed under section 167 with respect to property to which section 168 applies and increased for depreciation expenses that are taken into account in the taxpayer's AFSI with respect to such property.
    - Section 168(k)(2)(A)(i)(II) states that qualified property eligible for bonus depreciation includes computer software (as defined in section 167).
    - Section 168(k)(2)(A)(I)(IV) states that qualified property eligible for bonus depreciation includes a qualified film or television production (as defined in subsection (d) of section 181) for which a deduction would have been allowable under section 181.
    - It is unclear whether computer software, qualified films, or television productions that claimed bonus depreciation and that are deducted pursuant to section 168(k) are a reduction to AFSI because that type of property is amortized under section 167 if the taxpayer does not claim bonus depreciation or to the extent the bonus depreciation percentage is less than 100% of the cost.
  - Recommendation
    - Clarify that computer software, qualified films, or television productions are property to which section 168 applies if the property is eligible for bonus depreciation and the taxpayer did not elect out of bonus depreciation pursuant to section 168(k).
  - Analysis
    - Despite computer software, qualified films and television productions generally being amortized under section 167, because bonus depreciation for these properties is provided under section 168(k), they are property to which section 168 applies and their cost recovery satisfies the requirements of section 56A(c)(13) to constitute a reduction to AFSI.

- Clarify Whether the Depreciation Adjustment to AFSI Applies to Foreign Corporations Not Subject to United States Taxation
  - Overview
    - Section 56A(c)(13) provides that AFSI shall be reduced by depreciation deductions allowed under section 167 with respect to property to which section 168 applies to the extent of the amount allowed as deductions in computing taxable income for the taxable year, and appropriately adjusted to disregard any amount of depreciation expense that is taken into account on the taxpayer's applicable financial statement with respect to such property, and to take into account any other item specified by the Secretary in order to provide that such property is accounted for in the same manner as it is accounted for under this chapter.
    - Entities in a foreign-parented multinational group may have property where deductions are not allowed under section 167 (e.g., property not connected to a United States trade or business).
    - Although foreign-parented multinational groups have property where deductions are not allowed for purposes of section 167, they may be considered to have property to which section 168 applies.
    - This disparity could have the result of an illogical one-sided adjustment whereas a taxpayer does not reduce AFSI for tax depreciation deductions allowed under section 167 but adds back AFS depreciation expense for property to which section 168 applies.
  - Recommendation
    - Clarify for purposes of section 56A(c)(13) that no adjustment to AFSI is made if tax depreciation is not allowed under section 167.
  - Analysis
    - Adding back financial statement depreciation expense to AFSI without a corresponding reduction for tax depreciation is contrary to the legislative intent of the adjustment in section 56A(c)(13) (i.e., to not take away the benefit of accelerated cost recovery).

#### **4. International**

- Foreign-Parented Multinational Group (FPMG)
  - Overview
    - Section 59(k)(1)(B)(i) generally provides a corporation meets the average annual AFSI test for a taxable year if the average annual AFSI of such

- corporation for the 3-taxable-year period ending with such taxable year exceeds \$1,000,000,000 (the “general requirement”).
- Section 59(k)(1)(B)(ii) generally provides, in the case of a corporation that is a member of a foreign-parented multinational group (FPMG), such corporation meets the average annual AFSI test for a taxable year if — (I) the corporation meets the general requirement (determined after the application of section 59(k)(2)) (the “FPMG general requirement”), and (II) the average annual AFSI of such corporation for the 3-taxable-year-period ending with such taxable year is \$100,000,000 or more.
  - Section 59(k)(1)(D) provides that for purposes of determining whether a corporation is an applicable corporation, all AFSI of all persons treated as a single employer under sections 52(a) or (b) are treated as AFSI of such corporation.
  - Section 59(k)(2) provides a special rule for purposes of satisfying the FPMG general requirement. The special rule states that the AFSI of such corporation for such taxable year shall include the AFSI of all members of the FPMG, which include such corporation.
  - Section 59(k)(2)(B) defines a FPMG as “two or more entities if (i) at least one entity is a domestic corporation and another is a foreign corporation, (ii) such entities are included in the same applicable financial statement with respect to such year, and (iii) either (A) the common parent of such entities is a foreign corporation, or (B) if there is no common parent, the entities are treated as having a common parent which is a foreign corporation ....”
- Recommendations
    - We recommend that the regulations provide a definition of a common parent.
    - We recommend that the regulations clarify for purposes of determining whether a corporation is an applicable corporation whether a member of a FPMG group applies only the special rule in section 59(k)(2) and not the general aggregation rule in section 59(k)(1)(D) for purposes of the AFSI test under section 59(k)(1)(B)(ii)(I) (i.e., only including AFSI from members of the FPMG – those on the same AFS) or whether members of a FPMG must apply both the special rule in section 59A(k)(2) and the general aggregation rule in section 59(k)(1)(D).
  - Analysis
    - When the CAMT was originally proposed in the House as part of the Build Back Better legislation, the phrase “common parent” was defined with a cross reference to section 163(n), which was a proposed amendment of the Code. Proposed section 163(n) was not enacted and the cross-reference to proposed section 163(n) was removed; however, the reference to “common parent” was retained in the CAMT without any definition.



- A similar issue can result in double counting of post-effective date AFSI - for example, when a CFC is sold between taxpayers that are both subject to the CAMT. The earnings of the CFC sold may have been subject to the CAMT of selling taxpayer under the pro rata share inclusion rule. If the profits are later distributed, such amounts could again be subject to CAMT of buying taxpayer under the dividend inclusion rule.
    - The same scenario could also arise in the case of a section 355 spin transaction where distributing included the CFC income under the pro rata share inclusion rule and distributee receives a post-spin distribution from the CFC (which is potentially subject to the dividend inclusion rule). Under these circumstances, the interaction between the dividend inclusion rule and the pro rata share inclusion rule may result in the inclusion of income twice without any policy rationale for this result.
  - Recommendations
    - The dividend inclusion rule provides the Secretary with authority to reduce the amount of dividend inclusion income under that rule. Pursuant to this authority, we recommend that the regulations provide coordination rules.
    - From an administrative perspective, we recommend that the dividend inclusion rule not be applicable in cases where a foreign corporation is a CFC subject to the pro-rata share rule. However, if the IRS determines that a tracking approach is required, we recommend that the regulations provide coordination rules that reduce the inclusion in the AFSI of an applicable corporation under the dividend inclusion rule to the extent distributed amounts previously were taken into account by the same applicable corporation under the pro rata share inclusion rule. These rules may operate similar to the previously taxed earnings and profits (PTEP) rules provided under section 959.
    - We further recommend clarification that “dividends” for purposes of section 56A(c)(2)(C) are dividends as reported on the applicable financial statements (i.e., financial statement dividends and not dividends as defined in section 316). The clarification of book vs. tax dividends is critical to the application of section 338(g) elections, “Fresh Start” accounting, etc.
    - We further recommend that adjustments be made to reduce the inclusion in the AFSI of an applicable corporation under the dividend inclusion rule that relate to either (1) distributions of earnings and profits that were generated in pre-CAMT effective date years or (2) distributions of earnings and profits of a CFC acquired in a transaction or similar situations (e.g., CFCs that changed affiliated groups as a result of a reorganization). With respect to the distributions of earnings and profits of a CFC acquired in a transaction or similar situations, we suggest an attribute (as noted above similar to PTEP) be created for earnings subject to the pro rata share inclusion rule that would allow for future reductions in the dividend inclusion rule adjustment.

○ Analysis

- The new rules provide that the AFSI of an applicable corporation is determined by only taking into account the dividends received from any other corporation which is not included on a consolidated return with the applicable corporation and other amounts which are includible in gross income or deductible as a loss (other than amounts required to be included under section 951 and section 951A) (i.e., the dividend inclusion rule).<sup>5</sup> In addition, the new rules also provide that for a United States shareholder of one or more CFCs, the AFSI is adjusted to take into account such United States shareholder's pro rata share of items taken into account in computing the net income or loss set forth on the AFS of each such CFC (i.e., the pro rata share inclusion rule).<sup>6</sup>
- With the application of the two rules above, certain CFCs' earnings included in an applicable corporation's AFSI under section 56A(c)(3)(A) may be included again in the AFSI under section 56A(c)(2)(C) when such CFCs' earnings are distributed as dividends to that applicable corporation.
- The dividend inclusion rule under section 56A(c)(2)(C) applies to dividends received from any other corporation which is not included on a consolidated return with the applicable corporation. This section does not include any additional restrictions on the includible dividends nor define the term "dividend" separately.
- Since the new CAMT rules apply to taxable years beginning after December 31, 2022 (the "Effective Date"),<sup>7</sup> any dividends received by an applicable corporation in its taxable years beginning after December 31, 2022, would be subject to the dividend inclusion rule under section 56A(c)(2)(C), absent an adjustment. Such dividends could be distributions out of the distributing corporation's earnings accumulated before the Effective Date, earnings previously included in the AFSI of another applicable corporation under section 56A(c)(3)(A), or earnings that were acquired from a foreign seller that had not previously been subjected to United States tax.
- As a result, certain earnings accumulated prior to the Effective Date would be subject to the dividend inclusion rule once such earnings are distributed to an applicable corporation after the Effective Date. Certain earnings accumulated during a period when the foreign corporation was foreign-owned, and not a CFC, would also be subject to the dividend inclusion rule once such earnings are distributed to an applicable corporation. In addition, certain CFC's earnings included in an applicable corporation's AFSI under section 56A(c)(3)(A) may still be treated as includible dividends under section 56A(c)(2)(C) when distributed to a different applicable corporation.

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<sup>5</sup> Section 56A(c)(2)(C).

<sup>6</sup> Section 56A(c)(3)(A).

<sup>7</sup> Inflation Reduction Act of 2022, H.R.5376, 117th Congress §10101(f)(2022).

- Clarification of the Pro Rata Share Rule
  - Overview
    - Section 56A(c)(3)(A) provides that when determining the income subject to the pro rata share rule, the net income should be “adjusted under rules similar to those that apply in determining adjusted financial statement income.” There is some ambiguity as to the meaning of this language and whether the net income taken into account is limited to AFSI determined under the principles of section 882.
  - Recommendation
    - We recommend that the regulation clarify and specify what is meant by “as adjusted under rules similar to those that apply in determining adjusted financial statement income.” Specifically, these rules should address whether income is limited to that determined under the principles of section 882, or whether the income is intended to broadly include all AFSI of the CFC irrespective of whether it is effectively connected with a United States trade or business.
  - Analysis
    - Section 56A(c)(3)(A) provides that, for any taxable year, a taxpayer is a United States shareholder of one or more CFCs, the AFSI of such taxpayer with respect to such CFC shall be adjusted to also take into account such taxpayer’s pro rata share (determined under rules similar to the rules under section 951(a)(2)) of items taken into account in computing the net income or loss set forth on the AFS (as adjusted under rules similar to those that apply in determining AFSI) of each such CFC with respect to which such taxpayer is a United States shareholder. When determining AFSI under the general rules referred to in the parenthetical, section 56A(c)(4) limits AFSI to income determined under the principles of section 882. Section 882 subjects a foreign corporation to tax on its taxable income which is effectively connected with the conduct of a trade or business within the United States. Under this reading, if section 56A(c)(4) were to apply in the context of the pro rata share rule, the United States shareholder of a CFC would only include in its AFSI net income of the CFC which is effectively connected with a United States trade or business.
- CAMT Foreign Tax Credits
  - Overview
    - An applicable corporation’s tentative minimum tax equals 15% of the applicable corporation’s current year AFSI over the applicable corporation’s eligible CAMT foreign tax credits. It is unclear whether companies that operate in foreign countries with tax years that differ from the United States could lose

foreign tax credits as a result of these nonconforming years. This is of particular significance in the transition year.

- Recommendation
  - We recommend that the regulations clarify that the CAMT allows for all accrued foreign taxes “taken into account” on the AFS as a credit so long as the foreign taxes are eligible credits under section 901 either in a current, prior or future tax year. This will allow for better matching of the credits with the AFS income.
- Analysis
  - Section 59(l) provides that for purposes of both direct and indirect credits, the foreign taxes available to be credited must be “taken into account” on the AFS and “paid or accrued (for Federal income tax purposes).” As a result of the combination of both book and tax concepts, absent regulatory guidance, certain taxes related to nonconforming foreign tax years may be taken into account in the AFS but not paid or accrued for federal income tax purposes, or vice versa.
- CAMT Foreign Tax Credits and Partnerships
  - Overview
    - Section 59(l) provides CAMT foreign tax credits for certain foreign taxes paid or accrued for United States federal income tax purposes by an applicable corporation or a CFC. There is a lack of clarity as to whether foreign taxes paid or accrued by a partnership (for United States federal tax purposes) may be considered paid or accrued by the partners in such partnership for purposes of section 59(l). Absent clarification, it is unclear whether an applicable corporation may be entitled to CAMT foreign tax credits with respect to any foreign taxes paid or accrued by a partnership for United States federal tax purposes.
  - Recommendation
    - We recommend that the regulations clarify that the CAMT allows for foreign taxes paid or accrued by a partnership for United States federal tax purposes to be treated as paid or accrued by the partners of such partnership.
  - Analysis
    - Section 702(a)(6) generally provides that a partner in a partnership is entitled to its distributive share of taxes paid by such partnership. Section 901(b)(5) provides, in relevant part, that a taxpayer partner shall (subject to limitations under section 904) be entitled to a foreign tax credit in the amount of the

partner's proportionate share of the foreign taxes of the partnership paid or accrued during the taxable year. Although it is clear that a partner is entitled to its proportionate share of the partnership's foreign taxes for section 901 purposes, it is less clear whether the foreign taxes are treated as paid or accrued by the partner (as opposed to the partnership itself) for United States federal income tax purposes.

- If narrowly interpreted, the text in section 59(l) could be construed to exclude from CAMT foreign tax credits any taxes paid or accrued at the partnership level, as it is unclear whether existing United States federal tax law would technically treat such taxes as paid or accrued by a CFC partner or applicable corporation partner in such partnership. Such a result would inappropriately contravene traditional United States foreign tax credit policy, which expressly provides that partners generally shall be entitled to claim credits for the partnership's taxes paid or accrued.
- Accordingly, regulations should clarify that a partnership's foreign taxes paid or accrued shall be considered paid or accrued by the partners of such partnership for CAMT FTC purposes.

- Foreign Corporation ASFI and United States Income Tax Treaties

- Overview

- Section 56A(c)(4) provides that a foreign corporation's AFSI is determined based on the principles of section 882. It is unclear whether the reference to "principles of section 882" would cause a foreign corporation's AFSI to include items that are effectively connected with the foreign corporation's conduct of a United States trade or business, without regard to whether such foreign corporation is otherwise not subject to United States federal income tax on its business profits pursuant to an applicable United States income tax treaty. This issue is relevant for purposes of applying the applicable corporation average annual AFSI test under section 59(k)(1)(B).

- Recommendation

- We recommend that, as a matter of comity toward the existing network of United States income tax treaty partners, the regulations clarify that in the case of a foreign corporation that determines its net taxable income under an applicable income tax treaty of the United States, such foreign corporation's AFSI as determined under section 56A(c)(4) shall be limited to those items taken into account in determining its net taxable income. Accordingly, if a foreign corporation would have income effectively connected to a United States trade or business for purposes of section 882 and such foreign corporation would avail of United States income tax treaty benefits establishing that none of the foreign corporation's income would be considered business profits attributable to a United States permanent establishment, then such foreign corporation's AFSI should be zero. This clarification would be consistent with

the approach adopted in Treas. Reg. § 1.59A-2(d) for purposes of applying the applicable taxpayer gross receipts test under the BEAT, which broadly excludes gross receipts relating to United States income tax treaty protected income.

- Analysis

- Section 56A(c)(4) provides that a foreign corporation's AFSI is determined based on the principles of section 882. As the reference to section 882 seemingly only incorporates the United States federal statutory tax law provision that determines a foreign corporation's net income subject to United States federal income tax, it would appear that, absent regulatory guidance, section 56A(c)(4) may adjust a foreign corporation's AFSI without regard to whether a portion or all of the items would be excluded from United States federal income tax pursuant to an applicable United States income tax treaty.
- As a result, when applying the applicable corporation average annual AFSI test under section 59(k)(1)(B), items that relate to United States income tax treaty protected effectively connected income might be included to cause a taxpayer to be within scope of the CAMT under the aggregation rules, notwithstanding that the United States federal tax system has relinquished its primary taxing rights with respect to such income pursuant to an applicable United States income tax treaty. Accordingly, it would seem inconsistent with United States income tax treaty policy to take the United States income tax treaty protected items into account when determining a foreign corporation's AFSI as well as whether a separate taxpayer could become an applicable corporation for CAMT purposes. As noted above, BEAT's applicable taxpayer gross receipts test presented this same policy issue, and the regulations thereunder clarified that a foreign corporation's gross receipts relating to United States income tax treaty protected income shall be excluded when applying the gross receipts test.

- BEAT and CAMT

- Overview

- An applicable corporation is liable for the CAMT to the extent its "tentative minimum tax" exceeds its regular United States federal income tax liability (including the BEAT under section 59A), prior to taking into consideration general business credits under section 38. Certain issues exist as to how BEAT and the CAMT interact. It is unclear how aspects of the CAMT and BEAT interact and, absent regulations, there also appears to be circularity between the two computations.

- Recommendation

- We recommend that regulations be issued clarifying that sections 59A(b)(1)(B)(ii)(I) and (II) refer to the section 38 credits that would be allowed for regular tax purposes, excluding section 55.

- Analysis
  - Under section 59A(b)(1)(B), the “base erosion minimum tax amount” is computed by comparing 10% of modified taxable income with “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—
    - (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).”
  - Ambiguity exists as to the interaction of this provision with the CAMT. With the enactment of the CAMT, and absent regulations, there is potential circularity because the amounts allowed under section 38 as general business credits for research under section 41(a) and the “applicable section 38 credits” are determined by taking into consideration “the regular tax liability and the tax imposed by section 55.”<sup>8</sup> The tax imposed by section 55(a) now includes the regular tax plus the liability under BEAT. As a result, a CAMT taxpayer would have to know its BEAT liability to determine its section 55 tax, but such a taxpayer cannot determine its BEAT liability without knowing the amount of allowed section 38 credits, which are now are adjusted by CAMT.

## 5. Mergers & Acquisitions Issues

- Impact of Nonrecognition Transactions on AFSI
  - Overview
    - There are a variety of transactions that can result in gain or loss being recognized for financial statement purposes—and therefore presumably included in AFSI absent an adjustment—even though no gain or loss is recognized for United States federal income tax purposes. The following is a non-exhaustive list of such transactions.
    - *Multi-stage acquisitions*: When a corporation eventually acquires control of another corporation after a series of transactions, ASC 805-10-25-10 requires the acquirer to “remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in earnings.” For United States federal income tax purposes, however, the corporation’s eventual acquisition of control does not cause it to recognize gain or loss with respect to stock it had acquired before acquiring control.
    - *Deconsolidations*: If a parent deconsolidates a subsidiary other than through a nonreciprocal transfer to owners (e.g., a spin-off), ASC 810-10-40-5 requires

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<sup>8</sup> Section 38(c).

the parent to recognize a gain or loss in net income attributable to the parent equal to the difference between (i) the aggregate of fair value of consideration received, fair value of the retained noncontrolling investment in the former subsidiary, and the carrying amount of any noncontrolling interest in the former subsidiary, and (ii) the carrying amount of the former subsidiary's assets and liabilities. This calculation can take into account gain or loss not only in the stock disposed of by the parent but also the stock of the subsidiary retained by the parent. For United States federal income tax purposes, no gain or loss is recognized with respect to stock of the subsidiary retained by the parent.

- *Cancellation of debt income*: When a debtor reacquires its debt, ASC 470-50-40-2 requires the debtor to recognize gain or loss equal to the difference between the reacquisition price of the debt and the net carrying amount of the extinguished debt. For United States federal income tax purposes, the debtor may recognize discharge of indebtedness income equal to the excess of the adjusted issue price over the repurchase price. See Treas. Reg. § 1.61-12(c)(2)(ii). However, if the repurchase occurs when the debtor is insolvent or in a title 11 case, the amount of the discharge of indebtedness income is excluded from the debtor's gross income to the extent of its insolvency or, in the case of a title 11 case, entirely. See section 108.
  - *Non-pro-rata split-offs*: Where a corporation (Distributing) exchanges its stock in a subsidiary (Controlled) for Distributing stock held by some but not all of its shareholders, ASC 845-10-30-12 generally requires Distributing to recognize gain or loss to the extent the fair market value of the Controlled stock is more or less than its book value. For United States federal income tax purposes, Distributing does not recognize gain or loss in such non-pro-rata split-off transactions if the requirements in section 355 and its regulations are satisfied.
- Recommendation
    - We recommend adding rules to address certain transactions where gain or loss recognized for financial statement purposes—but excluded or not recognized for United States federal income tax purposes—should be excluded from the computation of AFSI.
  - Analysis
    - Congress recognized that in certain circumstances the determination of AFSI under general accounting principles would need to be adjusted, including to “carry out the principles of . . . part III of subchapter C of [chapter 1 of the Internal Revenue Code] . . . (relating to corporate organizations and reorganizations).” See section 56A(c)(15).
    - By including in AFSI items of gain or loss that are not recognized for United States federal income tax purposes—either due to the application of a nonrecognition provision or the lack of a realization event—the CAMT could have the effect of taxing transactions that Congress specifically intended not to

be immediately taxed. It could also have the effect of causing taxpayers that otherwise would not meet the AFSI threshold to become applicable corporations as a result of an extraordinary event that Congress intended not to give rise to income or gain. Treasury has the authority to issue regulations that exclude such items of gain or loss from AFSI in order to align the CAMT with that Congressional intent.

- Allocating CAMT Liability Among Members of a Consolidated Group
  - Overview
    - Rules for allocating CAMT liability among members of a consolidated group will be important for, among other things, determining stock basis adjustments under Treas. Reg. § 1.1502-32 and earnings and profits adjustments under Treas. Reg. § 1.1502-33 with respect to members of the group.
  - Recommendation
    - Provide rules for allocating CAMT liability among members of a consolidated group. Rules should include language permitting taxpayers to use a reasonable allocation approach based on the taxpayer's facts and circumstances or provide different allocation methods similar to those currently available to allocate United States federal income tax liability between members of a consolidated group.
  - Analysis
    - To acknowledge factual differences among them, consolidated groups should be given some flexibility in determining how to allocate CAMT liability among their members. This is consistent with the flexibility permitted with respect to the allocation of other items and with the various allocation methods permitted for allocating regular United States federal income tax liability among members of a consolidated group.