Comments on
Corporate Alternative Minimum Tax Notice 2023-07

Alliance for Competitive Taxation

March 20, 2023

Contents

I. Introduction

The Alliance for Competitive Taxation ("ACT") is a coalition of leading American companies from a wide range of industries that supports a globally competitive U.S. corporate tax system that aligns the United States with other advanced economies. ACT member companies are listed in Section III.

This submission identifies issues arising under the recently enacted Corporate Alternative Minimum Tax ("CAMT") and Notice 2023-07 and recommends approaches for addressing these issues. ACT may submit additional recommendations as its member companies continue to analyze the potential effects of the legislation and interpretive guidance.

ACT reaffirms its request that the Treasury and the Internal Revenue Service provide guidance on issues identified in ACT's submission of September 30, 2022, that have not yet been addressed.

ACT's policy concerns with the CAMT are not addressed in this submission.

ACT representatives would be pleased to discuss the issues addressed in this submission with the staffs of the Treasury and IRS.

II. Recommendations for Guidance

A. Adjusted Financial Statement Income

1. Depreciation Recovered Via Cost of Goods Sold (“CGS”)

Issue:

Section 56A(c)(13) provides that 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 ("AFSI depreciation rule"). Section 4.03(1) of the Notice provides that depreciation that is capitalized under section 263A into the basis of inventory and recovered through cost of goods sold (“CGS”) as a reduction to gross income under section 61 is a depreciation "deduction" that would reduce AFSI, but only to the extent that the depreciation is recovered through CGS in the current tax year.

Recommendation:

Revise the definition of depreciation “deductions” to include all depreciation that is capitalized under section 263A to CGS, without regard to whether the depreciation has been recovered through CGS in the current tax year. Alternatively, permit computation of the amount of the depreciation that is capitalized to CGS using a method that is consistent with the taxpayer’s section 263A method.

Rationale:

Under the Notice, taxpayers would have the additional burden of determining the amount of ending tax basis in inventory that is attributable to depreciation, which could be a complex computation. Adoption of the revised definition also would make the treatment of depreciation capitalized to CGS for purposes of the CAMT consistent with that of section 163(j).

2. Safe Harbor: Book-Tax Basis Differences

Issue:

Section 56A(c)(13) provides the aforementioned AFSI depreciation rule. Section 4.07 of the Notice provides rules to determine the amount of AFSI adjustments attributable to the disposal of section 168 property. These adjustments require taxpayers to adjust the gain or loss recognized in their AFS by making adjustments to the AFS basis of property for AFSI depreciation and tax depreciation as if the taxpayer had always been subject to CAMT.

Recommendation:

Provide a *de minimis* safe harbor that permits taxpayers to make an annual election to opt out of adjusting AFSI for unadjusted basis differences of section 168 property. This election could be limited to situations in which the cumulative difference between the tax and book basis of all the taxpayer's section 168 property of the same recovery period placed in service during the tax year does not exceed a certain percentage (e.g., 5 percent) of the taxpayer's AFS basis in such property. A taxpayer that makes this election also would be required to treat repairs expenses capitalized on the AFS (but not for tax purposes) as section 168 property.

Rationale:

This safe harbor election would simplify the computation of AFSI adjustments by using the section 168 basis of the property for purposes of both AFSI depreciation and tax depreciation. When the taxpayer disposes of the property, the one-time adjustment for cumulative basis differences will simply add back cumulative book depreciation to the AFS basis of the section 168 property and reduce AFS basis by cumulative tax depreciation to compute the amount of AFSI gain.

3. Safe Harbor: Cost Recovery of "Bonus-Eligible" Property

Issue:

Section 56A(c)(13) provides the aforementioned AFSI depreciation rule. Section 4.04(1)(b)-(c) of the Notice provides that property subject to section 168 includes bonus-eligible property defined in section 168(k), such as certain computer software (as defined in section 167) or a qualified film and television production (as defined in section 181(d)). Section 4.04(2) further provides that section 56A(c)(13)(A) only applies to the portion of depreciation deducted under sections 167 and 168, and if a portion is deducted under another section of the Code, that amount is not included in the adjustment for tax depreciation.

Recommendation:

Clarify that the adjustment for depreciation consists of the entire basis of bonus-eligible computer software, a qualified film, or a television production for which any bonus depreciation deduction has been claimed (including the amount of basis not subject to the special allowance for bonus depreciation). For example, if computer software is placed in service in 2023 and 80% of the basis is recovered under section 168(k) and the remaining 20% under section 167, then the collective depreciation for the year under both sections 168(k) and 167 would be an AFSI tax depreciation adjustment.

Rationale:

Treasury officials have recently affirmed in public statements that the intent of Section 4.04(2) of the Notice aligns with the Recommendation above. Specifically, the depreciation deductions provided by section 167 for bonus-eligible property are more than simply the amounts deducted as bonus depreciation. Accordingly, in a year where the special allowance for bonus depreciation is less than 100%, the full basis of any property for which basis is depreciated under section 168(k) is an eligible AFSI tax adjustment. Forthcoming guidance should clarify the rule consistent with the stated intent.

4. Safe Harbor: Repairs Expenditures

Issue:

Section 56A(c)(13) provides the aforementioned AFSI depreciation rule. Section 4.05 of the Notice provides that the deduction of an expenditure for a repair for federal income tax purposes does not give rise to section 168 property, so taxpayers must exclude these costs from the computation of the AFSI depreciation rule.

Recommendation:

Permit taxpayers to determine the AFSI depreciation adjustment by including the amount of tax-deductible repairs expenditures incurred during the tax year in tax depreciation if those costs are capitalized for AFS purposes.

Rationale:

Unless a simplified rule is provided, it will be necessary for taxpayers to determine the amount of depreciation expense in its AFS that is attributable to tax-deductible repairs expenditures to compute the AFSI depreciation adjustment. A revised rule should allow taxpayers to include the repairs expenditures in the computation of tax depreciation expense and in the adjustment to book depreciation expense in the tax year those costs are incurred if the repair relates to property that otherwise would meet the definition of section 168 property. Under the recommended approach, there would not be any omission of basis recovery, because the amount of repairs expenditures deducted in the tax year would reduce AFSI and would increase the depreciation allowance on the property that is recognized for AFS purposes.

5. Safe Harbor: Section 263A Timing Differences

Issue:

Section 56A(c)(13) provides the aforementioned AFSI depreciation rule. Section 4.03(1) of the Notice provides that depreciation that is capitalized under section 263A into the basis of inventory and recovered through CGS as a reduction to gross income under section 61 is a depreciation deduction that would reduce AFSI, but only to the extent that the depreciation is recovered through CGS in the current tax year. Differences imposed by the section 263A capitalization rules will result in basis differences that will affect the computation of the AFSI depreciation adjustment.

Recommendation:

Provide a safe harbor that section 263A expenditures that are excluded from CGS on the AFS (i.e., expensed on the AFS) during the tax year are added to the basis of depreciable assets in computing the AFSI depreciation adjustment.

Rationale:

Under the present rules, it will be necessary for taxpayers to determine the amount of depreciation expense related to costs that were expensed on the AFS but capitalized to inventory under section 263A. To reduce administrative burden, taxpayers could avail themselves of a safe harbor to follow the capitalization rules of section 263A for AFS purposes by adding back amounts expensed on the AFS in the computation of tax depreciation expense and making a corresponding adjustment to AFSI. Using this approach would simplify the need to track adjustments and eliminate immaterial timing differences related to CGS.

6. Pre-CAMT "Bonus Depreciation" Assets

Issue:

Section 56A(c)(13) provides the aforementioned AFSI depreciation rule. Section 4.06 of the Notice states that the depreciation adjustment to AFSI provided in section 56A(c)(13) applies to section 168 property placed in service before taxable years beginning before January 1, 2023. The Notice does not include any special rules for property that has been fully depreciated for tax purposes.

Recommendation:

Under a transition rule, permit taxpayers to exclude section 168 property placed in service before enactment of CAMT from the AFSI depreciation adjustment computation if the property is fully depreciated for Federal income tax purposes before the taxpayer's first taxable year beginning after December 31, 2022. As an alternative, provide taxpayers with the ability to make a late/retroactive election out of bonus depreciation for section 168 property placed in service prior to the first tax year beginning after December 31, 2022, if the election is made in the taxpayer's first taxable year beginning after December 31, 2022.

Rationale:

Prior to the CAMT, taxpayers made investments in qualified property in reliance on, and in response to, the bonus depreciation incentive provided by Congress. For some taxpayers, elimination of book depreciation on these investments would retroactively eliminate a portion of the tax incentive originally provided.

7. Other Comprehensive Income ("OCI")

Issue:

In computing financial statement net income, OCI is not included as part of financial statement net income. It is unclear whether OCI is treated as part of AFSI.

Recommendation

Guidance should be provided that confirms that financial statement income, and therefore AFSI, does not include OCI, except to the extent included in taxable income.

Rationale

In a colloquy between Senators Cardin and Wyden, Senator Wyden confirmed that for purposes of the CAMT, OCI is not included in financial statement income. Incorporating this colloquy into forthcoming guidance would clarify its applicability.

8. Net Investment Hedges

Issue:

U.S. corporations with foreign subsidiaries operating in a currency other than the U.S. dollar will often hedge the foreign exchange (“FX”) risk inherent in their equity position (“net investment hedges”). These net investment hedges generally qualify as hedges for GAAP purposes, but not for income tax purposes. For GAAP purposes, any change in the value of foreign subsidiaries' equity due to FX movements is recorded in OCI. The offsetting gain/loss on these net investment hedges is also recorded in OCI. In contrast, for income tax purposes, the change in value of foreign subsidiaries due to FX movements is not currently recognized in taxable income; but gain/loss on the net investment hedges is currently recognized (because net investment hedges roll over regularly and/or are marked to market).

Assuming an exclusion of OCI from CAMT income, the recognition of net investment hedge gain/loss for income tax purposes can lead to a significant mismatch between income for purposes of CAMT and regular tax. As a result, in years in which foreign currencies strengthen against the U.S. dollar, losses recognized for regular income tax purposes on net investment hedges can cause or increase CAMT. Conversely, in years when the U.S. dollar strengthens, gains recognized for regular income tax purposes on net investment hedges can cause a taxpayer to avoid or reduce CAMT.

Recommendation:

Adjustments to OCI related to net investment hedges should be included in CAMT income if included in taxable income.

Rationale:

The accounting for net investment hedges should not push a taxpayer into, or out of, the CAMT based on the volatility of FX exchange rate movements.

B. Corporate Reorganizations

1. Treatment of Partially Taxable Transactions Involving Partnerships (1/2)

Issue:

Notice 2023-7 (the "Notice") provides that in the case of a Covered Nonrecognition Transaction, gain or loss is not taken into account for purposes of calculating AFSI, and corresponding adjustments to the basis of transferred property are required on an AFS. The Notice defines a Covered Nonrecognition Transaction to include, in the case of a partnership, a transaction that qualifies for nonrecognition under section 721 or section 731 that is "not treated as resulting in any amount of gain or loss for Federal Income tax purposes." Example 5 in Notice 2023-7 illustrates that a part-sale/part-contribution to a partnership that is partially taxable under the disguised sale rules of section 707 is not a Covered Nonrecognition Transaction, and all the gain must be recognized for purposes of calculating AFSI. Section 9.01 of Notice 2023-07 requests comments on Covered Transactions in which, for federal income tax purposes, gain or loss is recognized in part.

Recommendation:

In the case of a contribution to a partnership that is partially nontaxable under section 721 or a distribution that is partially nontaxable under section 731, for purposes of calculating AFSI, gain or loss should be recognized in proportion to the to the tax gain or loss recognized.

1. Treatment of Partially Taxable Transactions Involving Partnerships (2/2)

Rationale:

Section 56A(c)(15) provides that the Secretary shall issue regulations or other guidance to "carry out the principles of … part II of subchapter K of this chapter (relating to partnership contributions and distributions)." As evidenced by the statute, legislative history, and voluminous commentary, the principles of Subchapter K include nonrecognition of gain and loss in connection with contributions to and distributions by partnerships to facilitate the joint conduct of business enterprises with minimal tax friction. The cliff effect of the rule in the Notice, requiring the full amount of AFSI to be recognized if there is any gain or loss recognized for tax purposes in connection with a partnership contribution or distribution, is inconsistent with these principles.

2. Treatment of Consolidated Partnerships for Purposes of Determining Applicable Corporation Status (1/2)

Issue:

Notice 2023-7 (the "Notice") clarified that for purposes of determining whether a corporation is an applicable corporation, the AFSI of a partner in a partnership is not limited to its distributive share. In the case of corporations that consolidate with partnerships for financial accounting purposes, it is unclear—in the case of a partnership that is not a trade or business under common control with the corporation within the meaning of Section 52(b)—whether the corporation's AFSI includes all the consolidated partnership's AFSI or the consolidated partnership's AFSI reduced by any noncontrolling interest ("NCI").

Recommendation:

For purposes of determining applicable corporation status, a corporation's AFSI should include any consolidated partnership's AFSI, reduced by any NCI (provided the partnership is not a trade or business under common control with the corporation within the meaning of Section 52(b)).

2. Treatment of Consolidated Partnerships for Purposes of Determining Applicable Corporation Status (2/2)

Rationale:

Reducing a corporation's AFSI for the NCI of a consolidated partnership more accurately aligns the determination of AFSI and applicable corporation status with actual economic returns. Despite the fact that a partner may consolidate with the partnership for financial accounting purposes, the economic gains and losses associated with any NCI belong to other persons. Moreover, in situations in which the corporation and partnership are trades or businesses under common control within the meaning of Section 52(b), the corporation must include all the partnership's AFSI for purposes of determining applicable corporation status. Thus, the proposed rule is limited to those situations in which the partnership is consolidated but not under common control.

3. CAMT Attributes – Definition

Issue:

Section 3.06(2) of Notice 2023-7 provides that "[i]f financial accounting gain resulting from a discharge of indebtedness is not taken into account under section 3.06(1) . . . for purposes of calculating the AFSI of an AFS Group, the AFS Group's CAMT attributes must be reduced to the extent of the Section 108(b) Reduction Amount under the principles of, including taking account the ordering provided by, § 108(b) and § 1017."

Recommendation:

CAMT attributes is neither defined in the statute nor Notice 2023-7. At the very least, CAMT attributes should be defined to include financial statement net operating losses ("NOLs"), CAMT basis in assets, and corporate AMT foreign tax credits ("CAMT FTCs").

Rationale:

Financial statement NOLs, CAMT basis in assets, and CAMT FTCs are all similar in nature to the attributes listed in section 108(b)(2).

4. Allocation of financial statement NOLs

Issue:

A financial statement net operating loss ("NOL") can be carried forward to subsequent taxable years pursuant to section 56A(d). There are no rules that currently address what happens to financial statement NOLs when a member departs its AFS Group.

Recommendation:

Treasury and the Service should provide guidance to taxpayers on how financial statement NOLs should be allocated between a departing member and its AFS Group.

For example, financial statement NOL carryovers should be allocated between a departing member and its AFS Group in the same manner that consolidated NOLs are allocated between a group of corporations filing a consolidated return (a "consolidated group") and a departing member under Treas. Reg. § 1.1502-21(b)(2) with appropriate adjustments, including replacing references to a consolidated group with AFS Group.

Rationale:

Because financial statement NOLs can be carried forward to offset future AFSI, it is imperative to have a rule that addresses how such attributes are allocated, if at all.

5. Party – Expand Definition

Issue:

Under section 3.03(1) of Notice 2023-7 only a "Party" to a Covered Nonrecognition Transaction is eligible to exclude financial accounting gain or loss resulting directly from that Covered Nonrecognition Transaction. As currently defined, a "Party" does not include an applicable corporation that does not consolidate for book purposes with a corporation to which it contributes property in a section 351 transaction.

Recommendation:

Treasury and the Service should expand the definition of "Party" to include an applicable corporation that does not consolidate for book purposes with a corporation to which it contributes property in a section 351 transaction.

Rationale:

Expanding the definition of "Party" to a Covered Nonrecognition Transaction will ensure that transfers to wholly owned corporations and partially owned corporations that qualify for tax-free treatment under section 351 are treated the same under the CAMT regime.

6. Acquisitions Achieved in Stages (1/3)

Issue:

Should gain or loss recognized under ASC 805-10-25-10 from a business combination wherein the acquirer obtains control of an entity through a series of transactions be excluded from the computation of AFSI?

Recommendation:

Gain or loss recognized under ASC 805-10-25-10 from a business combination wherein the acquirer obtains control of an entity through a series of transactions should be excluded from the computation of AFSI.

Rationale:

ASC 805-10-25-10 provides that

> "[i]n a business combination achieved in stages, the acquirer shall 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. In prior reporting periods, with respect to its previously held equity method investment, the acquirer may have recognized amounts in other comprehensive income in accordance with paragraph 323-10-35-18. If so, the amount that was recognized in other comprehensive income shall be reclassified and included in the calculation of gain or loss as of the acquisition date. If the business combination achieved in stages relates to a previously held equity method investment that is a foreign entity, the amount of accumulated other comprehensive income that is reclassified and included in the calculation of gain or loss shall include any foreign currency translation adjustment related to that previously held investment."

An example illustrating the application of ASC 805-10-25-10 is described below.

6. Acquisitions Achieved in Stages (2/3)

Rationale (cont'd.):

Example of ASC 805-10-25-10:

Facts: On December 31, 2031, Corporation A purchases a 40-percent noncontrolling interest in Corporation B for $20 million. On December 31, 2032, Corporation A purchases the remaining 60-percent interest in Corporation B for $300 million, which gives it control of Corporation B. Corporation B had a total value of $500 million on that date.

Application: Among other acquisition accounting considerations, under ASC 805-10-25-10, Corporation A must remeasure its previously held 40-percent equity interest in Corporation B at the December 31, 2032, fair market value ($200 million) and recognize the resulting $180 million of gain in earnings ($200 million less the $20 million book carrying value).

Under the Internal Revenue Code, Corporation A recognizes no gain or loss with respect to its 40-percent interest in Corporation B because there has been no realization event involving Corporation A's 40-percent interest in Corporation B. Thus, to include gain or loss arising under ASC 805-10-25-10 in the computation of AFSI would have the practical implications of creating artificial gains or losses for taxable income purposes.

Excluding gain or loss recognized under ASC 805-10-25-10 from the computation of AFSI would create parity among taxpayers that do and do not own a minority equity interest in a corporation prior to acquiring control of such corporation and with those that own only a minority equity interest in a corporation.

6. Acquisitions Achieved in Stages (3/3)

Rationale (cont'd.):

Section 56A(c)(2)(C) provides that

> "[i]n the case of any corporation which is not included on a consolidated return with the taxpayer, adjusted financial statement income 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."

Under this provision, it appears that gain or loss recognized under ASC 805-10-25-10 from a business combination is intended to be excluded from AFSI. If this is the intended result, the Treasury Department should provide regulations that explicitly address this issue.

If section 56A(c)(2)(C) would not by its terms apply to exclude gain or loss recognized under ASC 805-10-25-10 from the computation of AFSI, Congress recognized that circumstances may exist in which the determination of AFSI under general accounting principles would need to be adjusted to "… carry out the principles of part III of subchapter C of this chapter [IRC chapter 1] (relating to corporate organizations and reorganizations) …"[1] Thus, the Treasury Department has the authority to issue regulations that exclude from the computation of AFSI gain or loss arising from a transaction governed by ASC 805-10-25-10, as business combinations are often effectuated in a manner that implicates provisions governing corporate organizations and reorganizations under IRC subchapter C.

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[1]*See* section 56A(c)(15) of the Internal Revenue Code

7. Adjusted Financial Statement Income ("AFSI") – Exclusion of Other Amounts

Issue:

Section 56A(c)(15) gives Treasury and the IRS authority to issue regulations or other guidance to provide adjustments to AFSI. Because section 56A (defining AFSI) is a new provision, there may be adjustments to AFSI that are consistent with the purposes of section 56A that have not been identified in the Code or other guidance ("Unidentified Adjustments").

Recommendation:

ACT recommends the Treasury and IRS craft a rule that provides the Commissioner discretion to determine whether a private letter ruling request for an Unidentified Adjustment is consistent with the purposes of section 56A.

Rationale:

Because it is difficult to envision all the adjustments to AFSI necessary to carry out the purposes of section 56A, a rule that gives the Commissioner discretion to identity additional adjustments to AFSI is appropriate.

8. AFSI adjustments for non-Covered Nonrecognition Transactions (1 of 3)

Issue:

Section 3.02(5) of Notice 2023-7 defines a Covered Nonrecognition Transaction as a transaction that, solely with regard to a corporation or a partnership (as appropriate), qualifies for nonrecognition treatment for Federal income tax purposes, respectively, under §§ 332, 337, 351, 354, 355, 357, 361, 368, 721, 731, or 1032, or a combination thereof, and is not treated as resulting in any amount of gain or loss for Federal income tax purposes (that is, solely with regard to the corporation or partnership, as appropriate).

Section 3.03(1) of Notice 2023-7 provides that "any financial accounting gain or loss resulting from the application of the accounting standards used to prepare the AFS of a Party to the Covered Nonrecognition Transaction is not taken into account solely for purposes of calculating the AFSI of the Party for the one or more taxable years in which the AFS of the Party takes into account the Covered Nonrecognition Transaction."

Section 3.03(2) of Notice 2023-7 provides that with regard to any property transferred to a Party as part of a Covered Nonrecognition Transaction described in section 3.03(1)(a) of Notice 2023-7, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that Covered Nonrecognition Transaction is not taken into account solely for purposes of computing the AFSI of the Party receiving the transferred property with regard to any taxable year of that Party.

8. AFSI adjustments for non-Covered Nonrecognition Transactions (2 of 3)

Recommendation:

ACT's recommended approach is to clarify that in that case of a Covered Nonrecognition Transaction where the AFS gain or loss from the transaction is not taken into account for purposes of the application of the CAMT for any taxpayer, the AFS basis of assets is not adjusted and the book depreciation on any AFS basis adjustments continues to be accounted for in computing AFSI.

Alternatively, if ACT's recommended approach is not amenable, then, as a matter of administrative convenience, ACT requests that forthcoming guidance permit taxpayers to make, for their first CAMT year that will begin on or after January 1, 2023, a one-time, irrevocable election to disregard for all AFSI purposes all Covered Nonrecognition Transactions that occurred in tax years beginning before January 1, 2023. That is, the election would disregard all transactions that were regarded for all AFS purposes (i.e., gain/loss recognition and/or a basis adjustments recognized for AFS purposes) and that were not recognized for federal income tax purposes (i.e., no gain/loss recognition and/or basis adjustments for federal income tax purposes) that occurred in tax years beginning before January 1, 2023.

Rationale:

Although Section 3.03(2) generally provides that AFS basis adjustments are disregarded in the case of a Covered Nonrecognition Transaction, there is some confusion as to whether this approach applies where the financial statement gain or loss from the transaction is not included in the CAMT calculation for any taxpayer. ACT's recommendation is to adopt a consistency approach -- in the case of a Covered Nonrecognition Transaction that does not result in gain or loss that is relevant to the CAMT calculation for any taxpayer, the AFS basis of assets (and resulting book depreciation and amortization) continues to be taken into account in determining AFSI.

8. AFSI adjustments for non-Covered Nonrecognition Transactions (3 of 3)

Rationale (continued):

Alternatively, if ACT's recommended approach is not amenable, then, to alleviate the administrative burden that sections 3.03(1) and (2) would impose on taxpayers due to the need to adjust for AFS basis differences on all historic Covered Nonrecognition Transactions that a taxpayer has ever entered into, as a matter of administrative convenience, forthcoming guidance should permit taxpayers to make, for their first CAMT year that will begin on or after January 1, 2023, a one-time, irrevocable election to disregard for all AFSI purposes all Covered Nonrecognition Transactions that occurred in tax years beginning before January 1, 2023. As a result, the election would disregard all basis adjustments made for AFS purposes in tax years beginning before January 1, 2023, that did not have a corresponding basis adjustment for federal income tax purposes. The election would not apply to non-Covered Nonrecognition Transactions, whereby any basis adjustments made for AFS and/or federal income tax purposes (and resulting depreciation expense, etc.) would continue to be respected and taken into account for AFSI purposes.

9. AFSI Adjustments – Spin-off with retained interest (1 of 2)

Issue:

In a typical tax-free spin-off, a distributing corporation ("Distributing") will distribute 100 percent of the stock of a controlled corporation ("Controlled") pro-rata to its shareholders. In some instances, rather than distributing 100 percent of the stock of Controlled to its shareholders, Distributing will retain up to 20 percent of the stock of Controlled (the "Retained Stake") and distribute the balance to its shareholders (the "Retention Scenario"). Under the Retention Scenario, Distributing must dispose of the Retained Stake within 5 years after the spin-off for the transaction to be tax-free.

GAAP requires that a parent corporation recognize a gain or loss in net income when a subsidiary is deconsolidated (the "mark-to-market adjustment"). A parent corporation deconsolidates a subsidiary on the date that the parent ceases to have a controlling financial interest (a greater than 50% voting interest) in such subsidiary. If a parent corporation retains a noncontrolling equity investment in the subsidiary after deconsolidation, that investment is measured at its fair value. The mark-to-market adjustment is measured using the fair value of the noncontrolling equity investment and does not occur until after the divestiture of the controlling interest. For as long as the parent corporation continues to own the retained noncontrolling equity investment in its deconsolidated subsidiary, the parent corporation will recognize book income or book loss each quarter to reflect changes in the fair value of the retained noncontrolling equity investment.

9. AFSI Adjustments – Spin-off with retained interest (2 of 2)

Section 56A(c)(2)(C) provides that for any corporation a taxpayer owns that is not included on a consolidated return with the taxpayer, AFSI of the taxpayer with respect to such corporation shall be determined by only taking into account: (1) the dividends received from such corporation (reduced to the extent provided by the Secretary in regulations or other guidance); and (2) other amounts which are includible in gross income or deductible as a loss under Chapter 1 (relating to normal taxes and surtaxes) of the Code (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 corporation.

In the Retention Scenario the initial mark-to-market adjustment arising from Distributing's Retained Stake appears to occur on the date of the spin-off while Controlled is still included in the Distributing consolidated return. Therefore, it appears that section 56A(c)(2)(C) may not exclude the initial mark-to-market adjustment from Distributing's AFSI. However, mark-to-market adjustments subsequent to the initial mark on the Retained Stake appear to be excluded from Distributing's AFSI under section 56A(c)(2)(C).

Recommendation:

Provide guidance that excludes from Distributing's AFSI all mark-to-market adjustments arising from the Retained Stake.

Rationale:

Congress enacted section 355 to allow Distributing to engage in tax-free spin-offs. Recognizing the importance of Congress's intent in enacting section 355 and consistent with the authority granted by Congress under section 56A(c)(15), Treasury and the IRS issued Notice 2023-7, in particular, section 3.03(1)(a), to ensure that tax-free spin-offs would not give rise to accounting gain or loss that would be included in AFSI. Consistent with the rationale above, mark-to-market adjustments resulting from the Retained Stake, which is part of the overall spin-off transaction, should be similarly excluded from AFSI.

10. Transition Rule for pre-CAMT gain recognized for Tax

Issue:

Taxable transactions engaged in amongst subsidiaries of a consolidated financial statement group ("Internal Taxable Transaction") do not give rise to book gain or loss on a consolidated financial statement basis, but may give rise to a taxable gain or loss. Generally, a subsequent disposition of the assets received in an Internal Taxable Transaction to an acquirer outside of the consolidated financial statement group ("External Transaction") will result in book gain or loss. If the Internal Taxable Transaction (and associated taxable gain or loss) occurs in a pre-CAMT year and the External Transaction (and associated book gain or loss) occurs in a CAMT year, then the recognition of the book gain or loss in AFSI has the potential effect of being double counted for federal income tax purposes. Neither section 56A nor Notice 2023-7 includes any special rules to account for the Internal Taxable Transaction.

Recommendation:

Under a transition rule, permit taxpayers to exclude from AFSI any book gain or book loss arising from an External Transaction attributable to assets acquired in an Internal Taxable Transaction prior to the enactment of CAMT ("pre-CAMT year") to the extent of the amount taken into account for tax purposes in a pre-CAMT year.

Rationale:

This recommendation will alleviate the potential double counting issue resulting from Internal Taxable Transactions undertaken by taxpayers in pre-CAMT years.

C. International Issues

1. Amounts received from subsidiaries (1/6)

Dividends and similar amounts

Issue

The IRA does not, by its terms, prevent earnings from subsidiaries which have either (i) already been included in the calculation of the CAMT or (ii) have been repatriated and subjected to a dividends received deduction (“DRD”) from increasing a taxpayer's CAMT liability.

Considerations

Section 56A(c)(2)(C) provides that when a corporation is not included on a consolidated return with the taxpayer (e.g., a controlled foreign corporation (“CFC”) or a 10% owned foreign corporation (a “10/50 Company”), the AFSI of the taxpayer with respect to such other corporation is determined by only taking into account dividends received from such other corporation and other amounts which are included in the gross income or deductible as a loss (other than amounts required to be included under sections 951 and 951A) with respect to such other corporation.

Section 56A(c)(3) subsequently provides that the AFSI of a taxpayer, that is a U.S. shareholder of a CFC, is adjusted to take into account the taxpayer’s pro rata share of items taken into account in computing the net income or loss set forth on the CFC’s applicable financial statement. Accordingly, unless an adjustment is made, dividends received by a U.S. shareholder, funded from earnings that are added back to the U.S. shareholder’s AFSI under section 56A(c)(3), will be double counted for purposes of the CAMT.

Further, the CAMT may apply when the tax earnings of a subsidiary are in excess of its financial statement earnings (e.g., through an intercompany transaction which created tax earnings that are eliminated for financial statement purposes), despite those earnings never being subject to U.S. tax due to a DRD.

1. Amounts received from subsidiaries (2/6)

Dividends and similar amounts (cont'd.)

Recommendation

ACT recommends that dividends from subsidiaries (e.g., CFCs and 10-50 Companies) not be included in AFSI to the extent the dividend is either (i) not includible in the income of a U.S. shareholder (e.g., distributions of previously taxed earnings and profits) or (ii) the dividend is reduced by a dividends received deduction contained in Chapter 1, Subchapter B, Part VIII of the Internal Revenue Code. For the avoidance of doubt, ACT recommends that regulations provide that a deemed dividend by reason of section 78 does not increase the AFSI of a U.S. shareholder.

Rationale

ACT does not believe Congress intended to double count earnings from a CFC under sections 56A(c)(2)(C) and 56A(c)(3) when calculating a U.S. shareholder's AFSI. This is evident by the grant of regulatory authority in section 56A(c)(15) (to "prevent the omission or duplication of any item"), as well as the parenthetical in section 56A(c)(2)(C) (which provides that an adjustment for dividends received from, among other entities, CFCs and 10-50 Companies, shall be "(reduced to the extent provided by the Secretary in regulations or other guidance)".

In the absence of ACT's recommendation, there are circumstances where the CAMT may impose tax on earnings which have been repatriated (from either a CFC or 10-50 Company), despite the fact the corporate income tax provides a DRD to offset any tax that otherwise would have been imposed.

Further, ACT recommends Treasury clarify dividends received by a CFC from a 10-50 Company are not included in the adjustments under sections 56A(c)(2)(C) or 56A(c)(3). This recommendation is consistent with the legislative history of section 245A which provides: "a CFC receiving a dividend from a 10-percent owned foreign corporation that constitutes subpart F income may be eligible for the DRD with respect to such income".

1. Amounts received from subsidiaries (3/6)

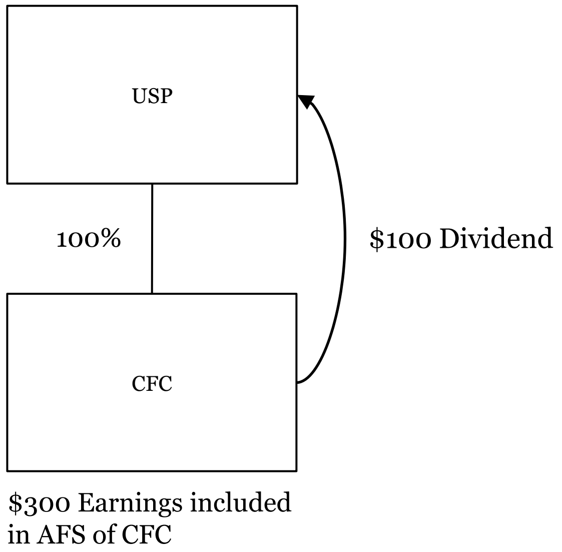
Dividends and similar amounts (cont'd.)

Rationale (cont'd.)

ACT understands there are several options with which Treasury may choose to correct the issues described above. ACT believes its recommendation can be administered easily and does not allow earnings that otherwise would have been included in AFSI to be exempt from the CAMT. If CFC earnings remain subject to taxation via the CAMT (e.g., the double counting of earnings), U.S. shareholders of CFCs will be incentivized to keep offshore earnings abroad, creating a "lock-out" effect.

1. Amounts received from subsidiaries (4/6)

Dividends and similar amounts (Example 1 – Section 245A DRD)



Facts

- USP, an applicable corporation under section 55(k), wholly owns a CFC.
- CFC has $300 of net income on its AFS for the current year and distributes a $100 dividend to USP for which USP takes a 100% dividends received deduction under section 245A.

Analysis – Ignoring ACT's Recommendation

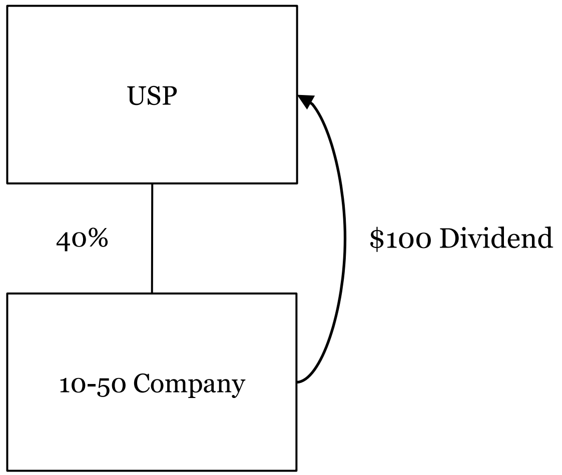
- Under section 56A(c)(2)(C), USP increases its AFSI by the amount of the dividend received from CFC (i.e., $100).
- Under section 56A(c)(3) USP increases its AFSI by the amount of items taken into account in computing the net income or loss set forth on CFC's AFS (i.e., $300).
- Accordingly, as a result of USP's investment in CFC, USP includes $400 of AFSI, despite CFC only earning $300 of AFSI.

Analysis – Under ACT's Recommendation

- No adjustment would be necessary under section 56A(c)(2)(C) as the dividend distributed from CFC received a dividends received deduction under Chapter 1, Subchapter B, Part VIII (i.e., section 245A).
- Under section 56A(c)(3) USP increases its AFSI by the amount of items taken into account in computing the net income or loss set forth on CFC's AFS (i.e., $300). ACT's recommendation prevents the duplication (i.e., the $100 dividend) of earnings being included in USP's AFSI calculation.

1. Amounts received from subsidiaries (5/6)

Dividends and similar amounts (Example 2 – Section 245A DRD)



<u>Facts</u>

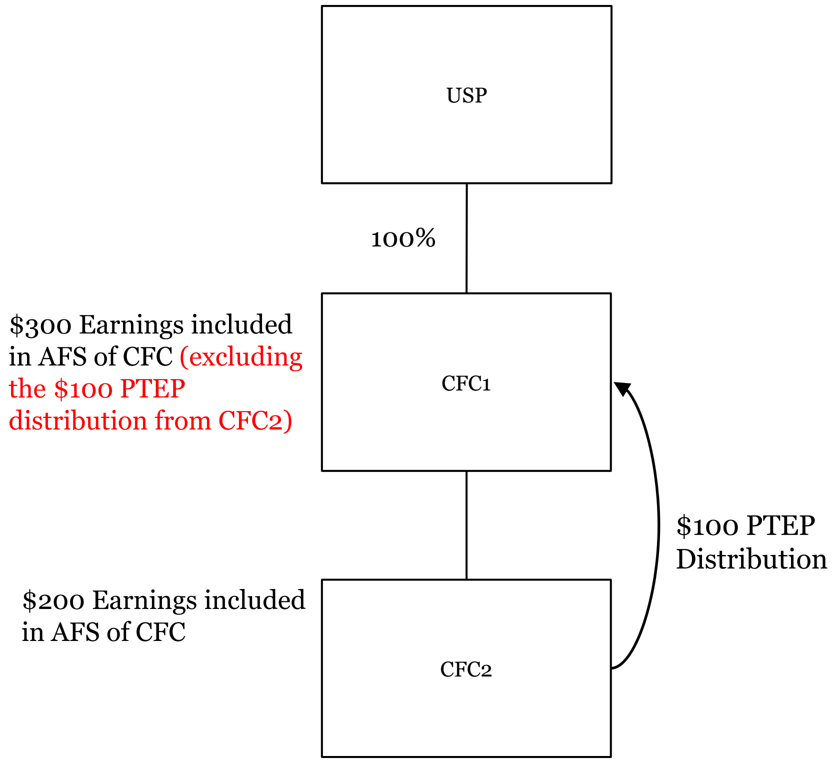
- USP, an applicable corporation under section 55(k), owns 40% of a 10-50 Company
- 10-50 Company distributes a $100 dividend to USP for which USP takes a 100% dividends received deduction under section 245A.
- **<u>Analysis – Ignoring ACT's Recommendation</u>**
- Under section 56A(c)(2)(C), USP increases its AFSI by the amount of the dividend received from 10-50 Company (i.e., $100).
- As the dividend would incur 15% tax under the CAMT, without ACT's recommendation the 100% section 245A DRD could be reduced to an 85% DRD (100% - 15%).

<u>Analysis – Under ACT's Recommendation</u>

- No adjustment would be necessary under section 56A(c)(2)(C) as the dividend distributed from CFC received a dividends received deduction under Chapter 1, Subchapter B, Part VIII (i.e., section 245A).

1. Amounts Received from Subsidiaries (6/6)

Dividends (Example of Double Counting – ACT's Recommendation)



<u>Facts</u>

- USP, an applicable corporation under section 55(k), wholly owns CFC1, which wholly owns CFC2.
- CFC1 has $400 of net income on its AFS for the current year, $100 of which resulted from a distribution from CFC2. For tax purposes, the $100 distribution is excluded from the income of CFC1 under section 959(b). CFC2 has $200 of net income on its AFS.

<u>Analysis – Ignoring ACT's Recommendation</u>

- USP increases its AFSI by $600 ($400 from CFC1 (including the distribution of PTEP from CFC2), and $200 from CFC2).
- Accordingly, as a result of USP's investment in CFC1 and 2, USP includes $600 in AFSI, despite CFC1 and 2 earning only $500 of net income.

<u>Analysis – Under ACT's Recommendation</u>

- The distribution of PTEP from CFC2 to CFC1 would not increase the AFSI of USP because the amount is excluded from income under section 959(b).
- Accordingly, USP would increase its AFSI by $500 ($300 from CFC1 and $200 from CFC2).

III. ACT Member Companies

ACT Member Companies

3M
Abbott Laboratories
ADP
Alcoa Corporation
Alphabet Inc. / Google LLC
American Express Company
Bank of America Corp.
Boston Scientific Corp.
Carrier Global Corp.
Caterpillar Inc.
Cisco Systems, Inc.
The Coca-Cola Company
Corteva Inc.
Danaher Corporation
Dell Technologies, Inc.
The Dow Chemical Company

DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
The Home Depot Inc.
Honeywell International Inc.
IBM Corporation
Johnson & Johnson
Johnson Controls, Inc.
JPMorgan Chase & Co.
Kellogg Company
Kimberly-Clark Corp.
MasterCard Inc.
McCormick & Company, Inc.

Morgan Stanley
Oracle Corporation
Otis Worldwide Corp.
PepsiCo, Inc.
Procter & Gamble Co.
Prudential Financial Inc.
Raytheon Technologies Corp.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Parcel Service, Inc.
Verizon Communications Inc.
Walmart Inc.
The Walt Disney Company
Zoetis Inc.