Recommendations for Administrative Guidance on Issues Arising under Section 10101 (Corporate Alternative Minimum Tax) of the Inflation Reduction Act of 2022

Alliance for Competitive Taxation

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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") for which guidance is requested and recommends approaches for addressing these issues. ACT may submit additional recommendations for guidance as its member companies continue to analyze the legislation and its potential impacts. In view of the substantial financial impact the CAMT can have on corporate investment decisions, timely guidance is essential.

Recommendations II.A6, II.A.19, II.C.3, and part of II.C.1 are transition rules for pre-effective date transactions.

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. Pension and OPEB

Issue:

Section 56A(c)(11) provides that, with respect to any covered benefit plan, adjusted financial statement income (“AFSI”) shall be adjusted to (1) disregard any income, cost or expense included in the taxpayer's AFS, and (2) include any income, cost or expense included in the taxpayer's taxable income. For this purpose, a covered benefit plan means a defined benefit plan, a qualified foreign plan, or any other defined benefit plan that provides post-employment benefits other than pension benefits.

Recommendation:

Clarify that Other Post-Employment Benefit ("OPEB") plans are considered defined benefit plans such that contributions to an OPEB plan are deductible for CAMT tax purposes to the extent deducted from taxable income and impairment adjustments for financial statement purposes are excluded from the calculation of CAMT taxable income similarly to how pension plans and other defined benefit plans are treated. In addition, it should be clarified that a covered plan includes foreign plans which are qualified under local law.

Rationale:

Treasury has been provided authority to include other post-employment benefit adjustments to AFSI, and inclusion of the aforementioned OPEB adjustments and clarifying of the definition of a covered plan would provide certainty when computing AFSI.

2. Federal Income Taxes

Issue:

Section 56A(c)(5) provides that AFSI shall not include any federal income taxes or certain foreign taxes that are taken into account in the taxpayer's applicable financial statement (“AFS”).

Recommendation:

Guidance should be provided to confirm that for purposes of section 56A(c)(5), the adjustment for federal income taxes includes both current and deferred that are taken into account in the taxpayer's AFS.

Rationale:

Section 56A(c)(5) grants Treasury authority to prescribe regulations or other guidance as may be necessary to provide for the proper treatment of current and deferred taxes for purposes of the CAMT, including the time at which such taxes are properly taken into account. For AFS purposes, both current and deferred income taxes are taken into account in determining financial statement income.

3. State Income Taxes

Issue:

Section 56A(c)(5) provides that AFSI shall not include any federal income taxes or certain foreign taxes that are taken into account in the taxpayer's applicable financial statement.

Recommendation:

Guidance should be provided to confirm that current state income taxes that are taken into account in the taxpayer's AFS, are not adjusted in computing AFSI.

Rationale:

Federal and creditable foreign income taxes are not deductible for federal income tax purposes, whereas current state income taxes are deductible in computing federal taxable income. Reducing AFSI for only current state income taxes deducted in the taxpayer's AFS would ensure consistent treatment of state income taxes for both CAMT and federal income tax computational purposes.

4. Foreign Income Taxes

Issue:

Section 56A(c)(5) provides that AFSI shall be appropriately adjusted to disregard any foreign income taxes or certain foreign taxes that are taken into account in the taxpayer's applicable financial statement.

Recommendation:

Guidance should be provided to prevent an adjustment to AFSI for certain foreign income taxes if the taxpayer does not choose to take the benefits of subpart A of part III of subchapter N in the year for which AFSI is calculated.

Rationale:

Section 56A(c)(5) provides:

> “To the extent provided by the Secretary, the preceding sentence [adjustment for profits taxes] shall not apply to income, war profits, or excess profits taxes (within the meaning of section 901) that are imposed by a foreign country or possession of the United States and taken into account on the taxpayer’s applicable financial statement if the taxpayer does not choose to have the benefits of subpart A of part III of subchapter N for the taxable year.”

ACT recommends Treasury clarify that whether an adjustment is required under section 56A(c)(5) is determined by reference to the year in which AFSI is being calculated, and not the year in which the CAMT liability is being determined.

5. Income Reported Net of Tax

Issue:

Certain items in a taxpayer's income statement may be presented on an "after-tax" or "net of tax" basis. This may include, but is not limited to, income (or loss) from discontinued operations.

Recommendation:

ACT recommends providing guidance with respect to the treatment of income taxes that are presented on an income statement line item "net of tax" in the AFS. Specifically, such amounts should be accounted for on a gross of tax basis, with a separate corresponding tax expense adjustment.

Rationale:

Some income items are reported on the AFS as a single, net of tax item, rather than reported separately as a gross income item and a corresponding tax expense. Taxes reported on a net basis are economically equivalent to those reported on a gross basis and thus should be considered “taken into account” for purposes of the CAMT. For the same reason, ACT has made a similar recommendation with respect to foreign income that is reported net of tax (see section II.C.2, below).

6. Transition Rule for Depreciation on Investments Made Prior to CAMT Effective Date

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. Since September 2017, section 168(k) has provided an incentive for taxpayers to make capital expenditures and receive an immediate "bonus depreciation" tax deduction for the entire cost basis of qualifying expenditures. However, for financial statement purposes, the cost basis of such property may continue to be depreciated into post-2022 CAMT years.

Recommendation:

Provide that the section 56A(c)(13) depreciation adjustment does not apply for property on which bonus depreciation was claimed in years beginning before January 1, 2023. To avoid the administrative burden of tracking book and tax depreciation on an asset-by-asset basis, this recommendation could be implemented as an optional safe harbor.

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 take away part of the tax incentive originally provided.

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

Issue:

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. CGS is a reduction from gross receipts in computing gross income, whereas depreciation deductions are subtractions from gross income in computing taxable income. Depreciation that is capitalized under section 263A into the basis of inventory and recovered as CGS is not a depreciation "deduction" that would reduce AFSI.

Recommendation:

Clarify that depreciation that is capitalized under section 263A and recovered as CGS is treated as a depreciation "deduction" for purposes of section 56A(c)(13) as a reduction to AFSI.

Rationale:

For purposes of section 163(j), for taxable years beginning before January 1, 2022, adjusted taxable income (ATI) is increased for any deduction allowable for depreciation, amortization and depletion (“DAD”). However, Treasury clarified in Reg. 1.163(j)-1(b)(1)(iii) that, for this purpose, ATI is increased for DAD that is capitalized under section 263A and recovered as CGS. Similarly, for purposes of computing AFSI, all depreciation, regardless of whether recovered as part of CGS or as a deduction, should be taken into account for purposes of section 56A(c)(13).

8. Cost Recovery of Computer Software, Qualified Film and Television Production

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. Although computer software is permitted to be depreciated pursuant to section 167(f)(1), section 168(k)(2)(A)(i)(II) characterizes computer software (as defined in section 167) as qualified property eligible for bonus depreciation (if all requirements are satisfied). Similarly, section 168(k)(2)(A)(i)(IV) characterizes a qualified film and television production (as defined in subsection (d) of section 181) as qualified property eligible for bonus depreciation (if all requirements are satisfied). It is unclear whether computer software or a qualified film or television production that is deducted pursuant to section 168(k) is a reduction to AFSI.

Recommendation:

Clarify that computer software or a qualified film or television production for which any bonus depreciation deduction is claimed under section 167 pursuant to section 168(k) is "property to which section 168 applies".

Rationale:

Qualified property for bonus depreciation includes computer software that is defined in section 167 and a qualified film or television production that is defined in section 181, although the deduction for bonus depreciation is afforded by section 168(k). Because computer software or a qualified film or television production for which bonus depreciation is claimed is qualified property under section 168(k), it is property to which section 168 should apply.

9. 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.

10. 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.

11. Embedded Derivatives Related to Certain Reinsurance Contracts

Issue:

For insurance companies that enter into ”funds withheld” or modified coinsurance (modco) agreements, assets supporting the insurance risks remain with the company that cedes risk. The ceding company marks those assets to market and includes changes in market value in OCI; the ceding company also records a liability to the company assuming risk in an equal amount, and changes in that liability are included in income from operations.

Recommendation: Adjust AFSI to exclude items that are part of AFSI but that correspond to gains and losses that are part of OCI.

Rationale: The mismatch on the financial statement between changes in the market value of assets (OCI) and changes in the corresponding liability (income from operations) creates a distortion that unduly benefits companies with unrealized losses and penalizes companies with unrealized gains.

12. Inclusion of Partnership AFSI for Applicable Corporation Determination

Issue:

Section 59(k)(1)(D) provides that, solely for purposes of determining whether a corporation is an applicable corporation, a partner's share of a partnership's AFSI is determined without regard to section 56A(c)(2)(D)(i), which provides that in the case of a taxpayer that is a partner in a partnership, financial statement income of such taxpayer is "adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership" (the "distributive share limitation"). The scope of this limitation is unclear.

Recommendation:

Treasury should clarify whether the rule of section 59(k)(1)(D) requiring the applicable corporation determination to be made without regard to the distributive share limitation means that (i) all partners determine their AFSI for section 59 purposes based solely on financial accounting rules; (ii) only partners that are treated as part of the same group of trades or business under common control (within the meaning of section 52(b)) should disregard the distributive share limitation; or (iii) all partnership AFSI is excluded or backed out for purposes of determining whether a corporation is an applicable corporation.

Rationale:

Clarification is necessary for taxpayers to properly determine whether they are subject to the CAMT.

13. Corporate Stock Held Through a Partnership (1/2)

Issue:

The calculation of AFSI in respect of stock of a corporation that the taxpayer holds through a partnership should be clarified.

Considerations:

Section 56A(c)(2)(C) provides that when a corporation is not included in a consolidated return with the taxpayer, the AFSI of the taxpayer with respect to such other corporation is determined taking into account only dividends received from such other corporation and other amounts that 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.

Thus, for example, where the taxpayer marks to market the value of the stock that it owns in a nonconsolidated corporation on its financial statement but does not include the unrealized gain or loss in its taxable income, the taxpayer's AFSI in respect of such stock would exclude such mark-to-market gain or loss.

Section 56A(c)(2)(D) provides that, except as provided by the Secretary, if the taxpayer is a partner in a partnership, AFSI of the taxpayer with respect to such partnership is to be adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership, and that for this purpose, AFSI of the partnership is to be adjusted under rules similar to the rules of section 56A.

13. Corporate Stock Held Through a Partnership (2/2)

Recommendation:

Guidance should be provided to confirm that the AFSI of a taxpayer that indirectly owns stock in a corporation through a partnership should include only the taxpayer's distributive share of the dividends received by the partnership from that corporation (and other amounts described in section 56A(c)(2)(C)) and should not include any mark-to-market gain or loss reported on the partnership's AFSI in respect of that corporation.

Rationale:

The treatment of stock in a nonconsolidated corporation that the taxpayer holds indirectly through a partnership should be consistent with the treatment of a nonconsolidated corporation that the taxpayer holds directly. Treasury is authorized to provide such guidance under section 56A(e) ("The Secretary shall provide for such regulations and other guidance as necessary to carry out the purposes of this section, including regulations and other guidance relating to the effect of the rules of this section on partnerships with income taken into account by an applicable corporation.").

14. Treatment of Intercompany Transactions

Issue:

Section 56A(a) defines a corporation's AFSI for a taxable year as "the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement for such taxable year . . . ." Section 451(b)(3) defines an "applicable financial statement" ("AFS"). Reg. sec. 1.451-3(h)(1)(i) provides generally that "[i]f a taxpayer's financial results are reported on the AFS for a group of entities (consolidated AFS), the taxpayer's AFS is the consolidated AFS." Reg. sec. 1.451-3(h)(3) provides, in relevant part, that "[i]f 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*."

Recommendation:

Guidance should be provided to determine how AFSI is prepared on a separate company or standalone basis where required (e.g., a standalone financial statement separate from the financial statement of the federal consolidated tax filing group), particularly with respect to intercompany transactions.

Rationale:

Section 56A(c)(15) grants Treasury authority to prescribe regulations or other guidance as may be necessary to determine AFSI in a manner consistent with the purposes of section 56A, ". . . including adjustments . . . to prevent the omission or duplication of any item ... ."

15. Distributive Share of Partnership AFSI

Issue:

Section 56A(c)(2)(D)(i) provides that in the case of a taxpayer that is a partner in a partnership, financial statement income of such taxpayer is "adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership." For U.S. federal income tax purposes, a partner's distributive share of partnership items is determined in the first instance by the partnership agreement, but it is subject to the limitations of the rules in section 704 and other provisions of the Code, e.g., section 482 (in the case of partners and partnerships under common control). It is unclear whether and how tax rules should apply for purposes of determining a partner's distributive share of AFSI. Similarly, consideration should be given to book-tax mismatches that result when a partner and partnership have different taxable years. *See* section 706 (providing that for U.S. federal income tax purposes, a partner includes its distributive share of partnership income, gain, loss, deduction, or credit for the taxable year of the partnership ending within or with the taxable year of the partner).

Recommendation:

Treasury should provide guidance regarding the proper application of federal income tax rules for purposes of determining a partner's distributive share of AFSI. In general, deference should be given to federal income tax principles. Treasury should consider a simple rule or safe harbor to permit partnership AFSI to be allocated to partners in proportion to the partners' shares of partnership net income or loss.

Rationale:

The limitations on a partner's inclusion of partnership income for U.S. federal income tax purposes are generally intended to force the partners' distributive shares of partnership items to reflect the actual economic sharing of partnership benefits and burdens.

16. Amounts Received from Subsidiaries (1/4)

Issue

The Inflation Reduction Act of 2022 (“IRA”) does not, by its terms, prevent from increasing a taxpayer’s CAMT liability distributions of earnings from subsidiaries that either (i) already have been included in the calculation of the CAMT, or (ii) have been repatriated and eliminated from taxable income due to the dividends-received deduction (“DRD”) or the exclusion from gross income for previously-taxed earnings and profits (PTEP) .

Considerations

Section 56A(c)(2)(C) provides that when a corporation is not included in a consolidated return with the taxpayer (e.g., a controlled foreign corporation or “CFC”), the AFSI of the taxpayer with respect to such other corporation is determined taking into account only dividends received from such other corporation and other amounts that 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) provides that the AFSI of a taxpayer that is a U.S. shareholder of a CFC is adjusted to account for the taxpayer’s pro rata share of items that are 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 that are funded from earnings included in the U.S. shareholder’s AFSI under section 56A(c)(3) will be double counted for purposes of the CAMT.

Further, in the absence of clarification, the CAMT may tax earnings of a subsidiary that are in excess of its financial statement earnings. This can occur as a result of an intercompany transaction that creates taxable earnings that are eliminated for financial statement purposes and are subsequently repatriated free of U.S. tax (due to the application of section 959 or the DRD).

16. Amounts Received from Subsidiaries (2/4)

Recommendation

ACT recommends that dividends from subsidiaries not be included in AFSI to the extent the dividend is either (i) not includible in the income of a U.S. shareholder or its CFCs (e.g., distributions of previously taxed earnings and profits) or (ii) the dividend is reduced by a DRD 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

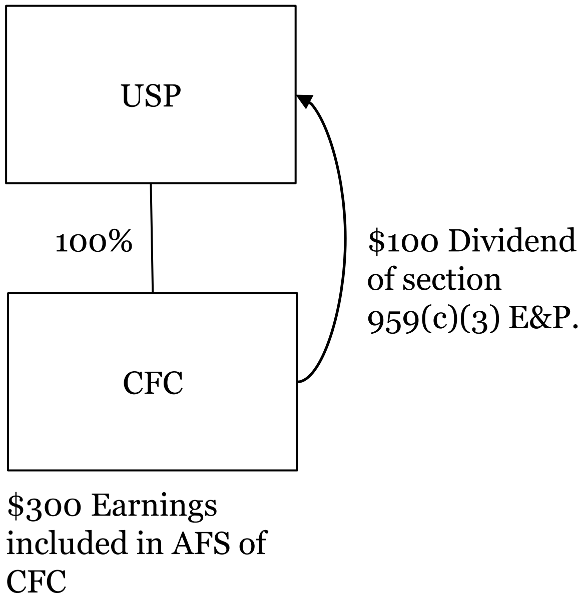
ACT does not believe Congress intended to double count certain earnings from a CFC under sections 56A(c)(2)(C) and 56A(c)(3) when calculating a U.S. shareholder's AFSI. This is evident by the grant of regulatory authority in section 56A(c)(15) (to "prevent the omission or duplication of any item"), as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

Further, in the absence of ACT's recommendation, there are circumstances in which CAMT may be imposed on repatriated earnings despite the allowance of an offsetting DRD for regular tax purposes.

ACT understands there are several options Treasury may choose to address the issues described above. ACT believes its recommendation would be easy to administer and would not allow earnings that otherwise would have been included in AFSI to be exempt from the CAMT. If the repatriation of CFC earnings is subject to taxation via the CAMT, U.S. shareholders of CFCs will be deterred from repatriating such earnings, creating a "lock-out" effect.

16. Amounts Received from Subsidiaries (3/4)

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% DRD under section 245A.

Analysis – Absent ACT's Recommendation

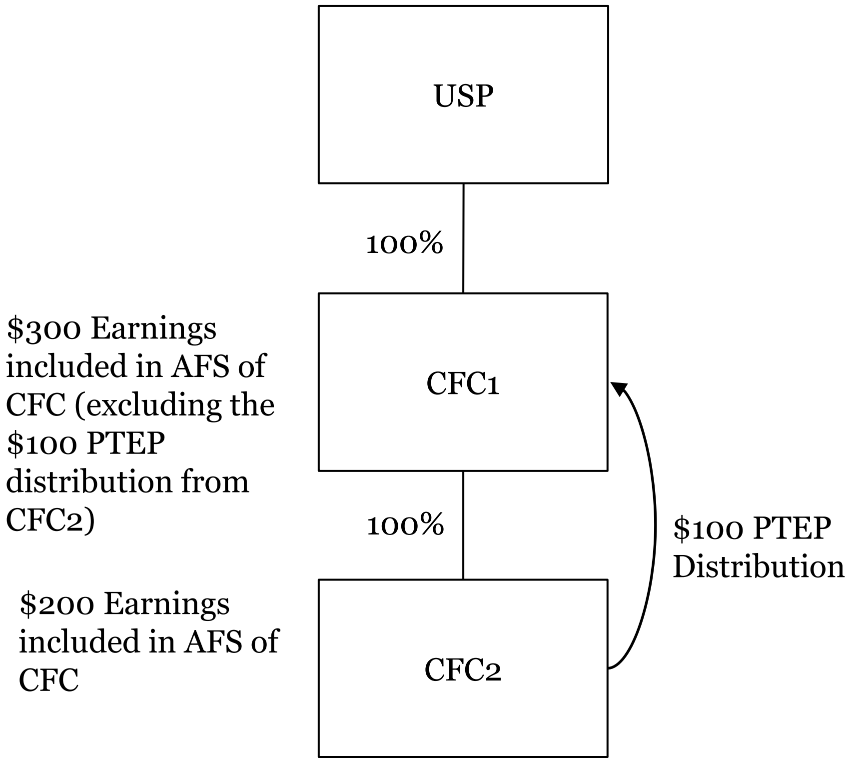
- Under section 56A(c)(2)(C), USP increases its AFSI by the amount of the dividend received from CFC (i.e., $100).
- Under section 56A(c)(3) USP increases its AFSI by the amount of items taken into account in computing the net income or loss set forth on CFC's AFS (i.e., $300).
- Accordingly, as a result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

Analysis – Under ACT's Recommendation

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

16. Amounts Received from Subsidiaries (4/4)

Example 2 – PTEP Distribution



<u>Facts</u>

- USP, an applicable corporation under section 55(k), wholly owns CFC1, which wholly owns CFC2.
- CFC2 has $200 of net income in its AFS. CFC1 has $400 of net income in 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).

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

- USP increases its AFSI by $600 ($400 from CFC2 (including the distribution of PTEP from CFC1), and $200 from CFC2), even though CFC1 and CFC2 jointly earned 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 or CFC1 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).

17. Life Insurance Separate Accounts (1/2)

Issue

For purposes of computing AFSI, section 56A(c)(2)(C) provides that when a corporation is not included in a consolidated return with the taxpayer, the AFSI of the taxpayer with respect to such other corporation is determined by taking into account only dividends received from such other corporation.

Considerations

This provision would create inappropriate results for life insurance companies with respect to insurance separate accounts that invest in stocks. Income from those separate accounts reflected in financial statements will include both stock appreciation or depreciation and a corresponding increase or decrease in reserves or liabilities to policyholders. If section 56A(c)(2)(C) applies to exclude unrealized gains or losses on equities from AFSI, then income for CAMT purposes from insurance separate accounts will be distorted as only changes in reserves or liabilities to policyholders will be accounted for.

Recommendation

This issue could be addressed by either (1) preventing the rule in section 56A(c)(2)(C) from applying to equities held in insurance company variable contracts under section 817, or (2) providing that AFSI should be adjusted to prevent the omission or duplication of any item when there is a mismatch for CAMT purposes between asset appreciation or depreciation and related insurance reserves or liabilities in respect of certain insurance products or transactions.

17. Life Insurance Separate Accounts (2/2)

Rationale

This is an example of the sort of "omission or duplication" that section 56A(c)(15) grants the Secretary the authority to correct. In the furtherance of sound tax policy, guidance should be provided to avoid a mismatch in AFSI between changes in insurance reserves and unrealized appreciation or depreciation on assets that produce those changes in reserves.

18. Aggregate Treatment of CFCs (1/2)

Issue:

Clarification is requested that the adjustment in section 56A(c)(3) is based on the aggregate activity of all CFCs for which the taxpayer qualifies as a U.S. shareholder and is not an adjustment calculated on a CFC-by-CFC basis.

Considerations:

Section 56A(c)(3) provides an adjustment to increase the AFSI of a U.S. shareholder by its pro-rata share of items taken into account in computing the net income or loss set forth on the AFS of a CFC (i.e., the AFSI of the CFC). If this amount would result in a negative adjustment to the U.S. shareholder's AFSI, no adjustment is made, and the negative amount is carried forward to the succeeding taxable year.

Recommendation:

ACT recommends issuing regulations, consistent with the legislative history to section 56A(c)(3) in the Rules Committee summary, providing that the adjustment related to net income or loss of a CFC is an aggregate adjustment taking into account the activity of all CFCs for which the taxpayer is a U.S. shareholder. Further, when a CFC has multiple U.S. shareholders within one consolidated tax group, ACT recommends clarifying that the aggregation occurs at the top-tier U.S. shareholder level.

18. Aggregate Treatment of CFCs (2/2)

Rationale:

The Rules Committee summary of section 56A of section 56A(c)(3) provides:

> "In the case of a U.S. shareholder of a CFC, AFSI includes the pro rata share of the AFSI of such CFC. **The AFSI of CFCs are aggregated globally, and losses in one CFC may offset income of another CFC**. Overall losses of CFCs may not reduce AFSI of a U.S. corporation, but may be carried forward and used to offset CFC income in future years."[1] [Emphasis added]

ACT's recommended clarification is consistent with the global aggregation discussed in the Rules Committee summary.

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[1]*See* Build Back Better Act – Rules Committee Print 117-18, Section-by-Section Summary, pg. 160, November 3, 2021.

19. Transition Rule for Financial Statement Deductions in pre-CAMT Years

Issue:

Financial statement accruals and reserves (collectively "reserves") that are deducted for financial statement purposes are frequently not deductible for federal income tax purposes until a later year when the item is incurred under section 461.

Considerations:

Significant reserves may have been deducted for financial statement purposes in pre-CAMT years but the commensurate federal income tax deduction for the reserve may be deducted in a CAMT year, thereby creating a permanent book-tax mismatch.

Recommendation:

ACT recommends issuing regulations ensuring that AFSI is only impacted for reserve deductions if the deduction for financial statement and federal income tax purposes both occur in CAMT years.

20. Mark-to-Market Accounting for Tax Purposes

Issue:

Some taxpayers mark to market ("MTM") positions for tax purposes. This accounting method may be required (e.g., in the case of section 1256 contracts) or be elective (e.g., in the case of taxpayers electing under section 475(e) or (f)). In situations where there is MTM accounting for tax but not book purposes, CAMT could be created or increased for corporations with MTM tax losses and avoided or reduced for corporations with MTM tax gains.

Recommendation:

Positions that are MTM for tax purposes should be included in CAMT income if they are not otherwise MTM for book purposes.

Rationale:

The mandatory or elective MTM method of tax accounting should not push a taxpayer into, or out of, the CAMT.

B. Corporate Reorganizations

1. Impact of Split-offs (and other transactions) on AFSI (1/2)

Issue:

Should gain or loss under ASC 845-10-30-12 resulting from a "Split-off" (defined below), as well as certain debt-for-equity exchanges, be excluded from the computation of AFSI?

Recommendation:

Financial reporting gain or loss under ASC 845-10-30-12 resulting from a Split-off, as well as gain or loss for certain debt-for-equity exchanges described in section 361(c), should be excluded from the computation of AFSI.

Rationale:

Generally, if the various requirements of IRC section 355 are satisfied, no gain or loss is recognized on the pro-rata distribution of stock of a controlled corporation ("SpinCo") by a distributing corporation ("Distributing") to its shareholders ("Shareholders") (a "Spin-off"), or on the exchange of Distributing's SpinCo stock for Shareholders' Distributing stock (a "Split-off").

Under ASC 845-10-30-10, a Spin-off does not result in the recognition of gain or loss for financial statement purposes; however, under ASC 845-10-30-12, a Split-off may result in the recognition of gain or loss (generally measured by determining whether the fair market value of SpinCo's stock is more or less, respectively, than its book value).

1. Impact of Split-offs (and other transactions) on AFSI (2/2)

Rationale (cont'd):

Including gain or loss under ASC 845-10-30-12 from a Split-off in the computation of AFSI would treat Spin-offs and Split-offs differently for purposes of determining AFSI, which is contrary to their treatment for U.S. federal income tax purposes. Moreover, certain debt-for-equity exchanges described in section 361(c) that are effected pursuant to a divisive reorganization may result in gain or loss for financial reporting purposes, contrary to outcomes for U.S. federal income tax purposes.

The practical implications of including gain under ASC 845-10-30-12 from a Split-off in the computation of AFSI is to potentially eliminate the ability to undertake a tax-free Split-off, which is contrary to Congress's intent in allowing corporate tax-free separations under section 355. *See S. Rep. No. 781 (1951)*.

Inclusion of these one-off extraordinary items arising from Split-offs in the computation of AFSI can cause a corporation that otherwise would never constitute an applicable corporation to become an applicable corporation within the meaning of section 59(k)(1)(A), subjecting such corporation to the corporate AMT in perpetuity absent the Secretary's determination that it is inappropriate to treat such corporation as an applicable corporation.

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 Split-off under ASC 845-10-30-12 as well as certain accounting gains or losses from debt-for-equity exchanges.

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

2. Impact of Acquisitions Achieved in Stages on AFSI (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.

2. Impact of Acquisitions Achieved in Stages on AFSI (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 own a minority equity interest in a corporation that acquires control of such corporation with those that own only a minority equity interest in a corporation.

2. Impact of Acquisitions Achieved in Stages on AFSI (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

C. Corporate AMT Foreign Tax Credits

1. Timing of Tax Accrual Differences (1/3)

Issue

In many circumstances, the timing of accrual of foreign income taxes will differ for financial statement and U.S. federal income tax purposes. It is unclear when these taxes are taken into account in calculating the CAMT foreign tax credit.

Considerations

The CAMT has two timing requirements for foreign taxes to qualify for the foreign tax credit, the tax must be: (1) “taken into account” on the AFS of the CFC, and (2) paid or accrued for U.S. federal income tax purposes. In many fact patterns, these two events will not occur within the same U.S. taxable year (including the first taxable year the CAMT is effective).

Recommendation

ACT recommends taxes be eligible for the CAMT foreign tax credit during the latter tax year of which both (i) the tax has been taken into account for financial statement purposes and (ii) the tax has accrued for U.S. federal income tax purposes.

ACT's recommendation ensures that foreign taxes will be creditable despite differences in foreign tax, U.S. tax, and U.S. financial statement year-ends. Further, ACT's recommendation ensures that redetermined foreign taxes are creditable for CAMT purposes.

ACT also recommends that foreign tax that has accrued for U.S. federal income tax purposes and has been included on the balance sheet of the taxpayer’s AFS, be deemed to have been “taken into account” for purposes of the CAMT. For example, if U.S. GAAP eliminates taxes paid on intercompany transactions for sales of inventory between related parties, such that the taxes accrue on the corporation’s balance sheet (but are not recognized in the income statement until the inventory is sold to a third party), the taxes nevertheless would be creditable for purposes of the CAMT foreign tax credit.

1. Timing of Tax Accrual Differences (2/3)

Rationale (cont'd)

If the CAMT required the accrual of foreign taxes in the same tax year for financial statement and tax return purposes, many foreign taxes would never be creditable under the CAMT. As indicated by the colloquy between Senators Wyden and Menendez, below, Congress did not intend to deny the CAMT foreign tax credit ("FTC") due to a difference in foreign tax, U.S. tax, and U.S. financial statement year-ends:

> "**Mr. Menendez**: Mr. President, I rise to engage in a colloquy with my colleague, the chairman of the Senate Finance Committee. In the corporate alternative minimum tax, there is some question as to whether companies that operate in foreign countries with standard tax years that are different from the U.S. could lose foreign tax credits strictly because of these nonconforming years. This may especially be an issue in the very first year of the corporate alternative minimum tax's application. Does Treasury have authority to issue regulations dealing with potential issues with foreign income taxes relating to nonconforming foreign tax years and how that impacts foreign tax credits in the corporate alternative minimum tax? This would include fair rules for the utilization of foreign tax credits in the law's first year.
>
> **Mr. Wyden**: Yes, regulations such as these would be in line with the legislative text and our intent for companies to be able to appropriately utilize foreign tax credits in the corporate alternative minimum tax."

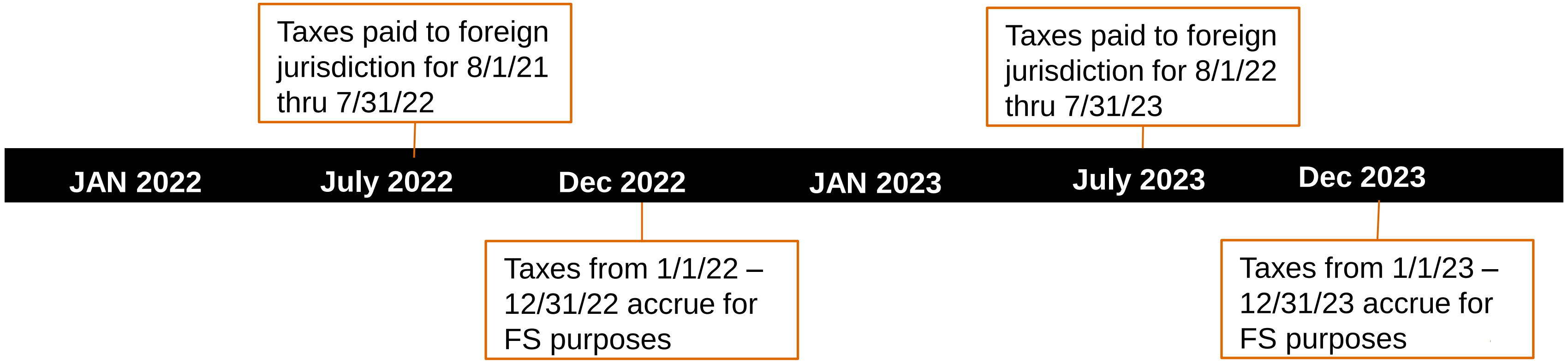
In certain countries (e.g., Japan), some companies are required to have a fiscal year end for local tax purposes that differs from the U.S. tax year required for U.S. tax purposes under section 898, and there can be a difference between both foreign and U.S. tax years and U.S. GAAP reporting periods. Regulations should ensure that U.S. shareholders of these CFCs receive a full 12 months of foreign tax credits for CAMT purposes, including in the first year of the CAMT's application. ACT's recommendation applies to a broad set of fact patterns (e.g., foreign tax redeterminations).

1. Timing of Tax Accrual Differences (3/3)

Example

Example:

Financial Statement Year-End: 12/31; U.S. Federal Income Tax Year-End: 12/31; and Foreign Income Tax Year-End: **7/31**



Analysis

CAMT is first effective for the U.S. tax year ended 12/31/23. For purposes of the CAMT FTC, the foreign taxes for the period 8/1/22 through 7/31/23 are taken into account, as these taxes have both been (i) accrued for financial statement purposes[1] and (ii) accrued for Federal income tax purposes[2].

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[1]For financial statement purposes, income taxes with respect to pre-tax earnings from 8/1/22 to 12/31/22 were accrued on the 12/31/22 financial statements, and income taxes with respect to pre-tax earnings from 1/1/23 to 7/31/23 were accrued on the 12/31/23 financial statements.
[2]For Federal income tax purposes, the taxes for the period 8/1/22 to 7/31/23 accrued on the 12/31/23 tax return.

2. Income Reported Net of Tax

Issue:

The CAMT has two timing requirements for foreign taxes to qualify for the CAMT foreign tax credit: (i) the tax must be "taken into account" on the AFS of the CFC and (ii) the tax must be paid or accrued for U.S. federal income tax purposes. However, whether a tax is "taken into account" on the AFS is not defined.

Recommendation:

ACT recommends taxes be considered taken into account in the AFS for CAMT foreign tax credit purposes regardless of whether the taxes are separately stated in the AFS.

Rationale:

Some income items are reported on the AFS as a single, net of tax item (with foreign tax credits associated with such items reflected in the effective tax rate), rather than reported separately as a gross income item and a corresponding tax expense. Taxes reported on a net basis are economically equivalent to those reported on a gross basis and thus should be considered "taken into account" for purposes of the CAMT.

3. Transition Rule for Foreign Tax Credits

Issue:

Section 59(l)(2) provides taxpayers with a CAMT FTC carryover for 5 years for foreign taxes paid by at the CFC level.

Recommendation:

ACT recommends providing taxpayers with an election to calculate the amount of CAMT FTC carryover that would have existed in the preceding five years before the effective date of the CAMT and be given the ability to utilize such foreign tax credits under section 59(l)(2).

Rationale:

Such a transition rule would be consistent with the rule in section 56A(d) which provides for financial statement net operating losses from pre-effective date years to be accounted for in the calculation of AFSI, as well as the rules under Treas. Reg. § 1.904-2(j)(1)(iii) that provide similar transition relief for the implementation of the branch basket in section 904 under the Tax Cuts and Jobs Act. Such regulations also would be consistent with the authority given to Treasury under section 59(l)(3) to provide such regulations or other guidance as is necessary to carry out the purposes of the CAMT's foreign tax credit provisions.

D. Financial Accounting Issues

1. Change in Method of Accounting

Issue:

Under a taxpayer's applicable financial accounting standard (e.g., U.S. GAAP), certain changes in accounting principle(s) may be required by accounting standard setters (e.g., FASB).

Recommendation:

ACT recommends providing taxpayers with guidance on addressing considerations with respect to any changes in accounting principles.

Rationale:

Taxpayers may be subject to certain changes in accounting principle(s) based upon changes or modifications to previously existing accounting standards. In recent year(s), there have been changes to the accounting standards for the recognition of revenue and lease accounting under both U.S. GAAP and International Financial Reporting Standards ("IFRS"). Importantly, how enterprises are required to adopt new accounting standards will differ by the guidance issued for the specific standard and the relevant accounting standard setter.

2. Separate Company Financial Statements

Issue:

For purposes of determining a taxpayer's CAMT liability, there may be a requirement to prepare certain standalone or separate company financial statements for certain entities that are otherwise only included in a consolidated financial statement.

Recommendation:

ACT recommends providing taxpayers with guidance on the preparation and presentation of any required separate company or standalone financial statements.

Rationale:

Absent any requirements under the various provisions of the CAMT system, a consolidated enterprise may not otherwise have a requirement to produce separate company financial statements for entities that are only included in a consolidated financial statement (e.g., Form 10-K). Among other considerations, taxpayers may not currently have internal processes in place to prepare these separate company financial statements.

3. Purchase Price Allocation for Acquired Assets

Issue:

In certain circumstances, there may be differences between financial reporting and tax accounting with respect to the allocation of purchase price among acquired assets.

Recommendation:

ACT recommends providing taxpayers with guidance on considering potential differences between financial reporting and tax accounting with respect to the allocation of purchase price among acquired assets.

Rationale:

Potential differences in the allocation of purchase price to acquired assets between financial reporting and tax could result in inconsistent outcomes.

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.