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It’s Déjà vu All Over Again - The New Book Minimum Tax

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The Tax Reform Act of 1986 Included a Book Minimum Tax

- **Original impetus for the book minimum tax was to tax publicly-traded corporations reporting record profits for financial accounting purposes but were showing tax losses.**
- **The difficulties in administration led to numerous revisions to the 1986 rules.**
- **The 1986 rules required two computations of taxable income – once under the regular tax rules and again under the AMT. The 1986 AMT did not begin with taxable income.**
- **The 1986 rules required the "BURP" (business unreported reported profits) add-back of ½ of the difference between book income & AMTI. Repealed in 1989.**

Impact of 1986 Book Minimum Tax

- **Major impact of 1986 AMT was on depreciation deductions for improvements. Taxpayers were deducting the cost for tax, but spreading the deduction for book purposes.**
- **As a result, manufacturing businesses were the most affected by the 1986 AMT.**
  - **Mining, warehousing and transportation businesses were the most impacted.**
- **In 1993, the adjusted current earnings rules, which also limited depreciation deductions, were repealed.**
- **AMT resulted in a credit that could be claimed against regular taxable income. This credit resulted in a loss of revenue from the AMT.**
- **The 1986 book minimum tax was repealed in 2017 after it was generally agreed that the tax was unworkable.**

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Overview of the New Book Minimum Tax

The Inflation Reduction Act Reintroduced an Alternative Minimum Tax (Book Min Tax)

- **15% tax only applies to US corporations with average financial statement income (called Adjusted Financial Statement Income or AFSI) in excess of $1 billion for any 3-year period ending prior to the current year and after 2021. Tax begins in 2023.**
  - **For 2023, average income will be determined from 2020-2022**
- **Like the 1986 minimum tax, the burden of the new AMT is expected to fall on manufacturing corporations.**
  - **Private equity funds are excluded from aggregation of corporate subsidiaries**
- **Congress (again) was unwilling to repeal tax preferences, so it sought to tax those who took advantage of them**

Determining the Tentative Minimum Tax

- Corporate AMT imposes a 15% minimum tax on the adjusted financial statement income ("AFSI") of an applicable corporation
- An applicable corporation's corporate AMT is:

Corporate AMT = Tentative Minimum Tax ("TMT") − Regular tax (plus any BEAT)

- An applicable corporation's TMT is:

$$\text{TMT} = \left[\text{AFSI} - \text{MIN}\left\{\begin{array}{c}\text{FS NOL,}\\ 80\%\text{ x AFSI}\end{array}\right\}\right] \times 15\% - \text{Corporate AMT foreign tax credit ("AMT FTC")}$$

- AFSI is the net income or loss set forth on the taxpayer's applicable financial statement ("AFS"), subject to certain adjustments
- A corporation is eligible to claim a credit against regular tax (plus any BEAT) for corporate AMT paid in prior years
- General business credits including R&D may generally offset up to approximately 75% of the sum of a corporation's regular tax and AMT

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Applicable Corporation Determination

What is an Applicable Corporation?

Applicable Corporation General rule:

- **An applicable corporation is any corporation (other than an S corporation, a RIC, or a REIT) which meets the average annual AFSI test ("AFSI test") for one or more preceding tax years that end after December 31, 2021.**
- **The AFSI test is met for a tax year if the average annual AFSI (determined without regard to financial statement net operating losses (FSNOL)) for the three-year period ending with such year exceeds $1 billion**

Exception:

- **An otherwise applicable corporation will not be treated as an applicable corporation if:**
  - **it has a change in ownership or a specified number of consecutive tax years (to be determined by the Secretary taking into account the facts and circumstances of the taxpayer), including the most recent tax year, in which the corporation does not meet the AFSI test, and**
  - **the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation.**
- **However, if the corporation meets the AFSI test for a subsequent tax year, then it will again be treated as an applicable corporation.**

What is an Applicable Corporation?

Special rule for determining applicable corporation status:

- **Solely for purposes of determining whether a corporation is an applicable corporation:**
  - **All AFSI of persons treated as a single employer with such corporation under section 52(a) or (b) are treated as AFSI of such corporation and**
  - **AFSI of such corporation shall be determined without regard to:**
    - **Section 56A(c)(2)(D)(i) (i.e., rule providing if the taxpayer is a partner in a partnership, AFSI of the taxpayer shall be adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership), or**
    - **Section 56A(c)(11) (i.e., rule providing for adjustments with respect to defined benefit pensions)**

Controlled group of corporations under section 52(a)

- **Controlled group of corporations is defined by reference to section 1563(a), except the ownership threshold for parent-subsidiary groups is reduced from at least 80% to more than 50% vote or value**
- **Under these rules, constructive ownership rules may apply, and taxpayers may be required to aggregate as a parent-subsidiary controlled group, a brother-sister controlled group, or a combined group of corporations**

Determining the Corporations to Include in the AMT

Common control of trades or businesses under section 52(b)

- Section 52(b) provides that, under regulations provided by the Secretary, all employees of trades or business (whether or not incorporated) which are under common control shall be treated as employed by a single employer
- Treas. Reg. section 1.52-1(b) provides that the term “trades or businesses that are under common control” means any group of trades or businesses that is either a “parent-subsidiary group under common control” as defined in Treas. Reg. section 1.52-1(c), a “brother-sister group under common control” as defined in Treas. Reg. section 1.52-1(d), or a “combined group under common control” as defined in Treas. Reg. section 1.52-1(e)
- In general, these rules apply to “organizations conducting trades or businesses,” consisting of sole proprietorships, partnerships, trusts, estates and/or corporations
- An organization can be a member of only one group of trades or businesses under common control. Current regulations include a tie-breaker rule providing that an organization that could be a member of more than one group can indicate the group in which it is included on a timely filed return (otherwise, the IRS may make this determination)
- Very generally, under rules prescribed by Treasury, the aggregation rules under section 52(b) are based on similar principles to those under section 52(a), with certain modifications, notably, the common control requirement and a constructive ownership rule

Determining the Corporations to Include in the AMT

- **Step 1 – Determine the relevant group of corporations and entities to include for 2023 and after using more than 50% ownership threshold.**
- **Step 2 – Redetermine the relevant group for prior 2 years, taking into account companies that entered and left controlled group.**
- **Partnerships are aggregated under Code § 52(b), but are not included under Code § 52(a).**

Foreign-Parented Groups

Corporation in a foreign-parented multinational group (FPMG) subject to modified Income Test:

Average aggregate group AFSI (ECI and non-ECI income from related entities, including related partnerships and CFCs) for 3-year period exceeds $1 billion, and

Average AFSI for 3-year period is $100 million or more (i.e., Using 882 principles, US ECI-related adjusted financial statement profits of foreign corporations and AFSI of domestic corporations, including CFC income).

For purposes of both prongs of the modified Income Test, disregard adjustments for partnership flow-through income and defined benefit plans, as well as the existence of any FSNOL carryforwards.

AFS is defined by reference to Section 451(b)(3), which defines an AFS in the following order of priority:

A GAAP financial statement prepared in connection with a 10-K or successor form or other annual statement to shareholders required to be filed with the SEC

An audited financial statement certified as being prepared in accordance with GAAP that is used for credit, shareholder/partner/beneficiary reporting or other substantial nontax purposes

An audited financial statement certified as being prepared in accordance with GAAP that is filed with any other federal agency for purposes of other than federal tax purposes

An IFRS financial statement filed with an SEC-equivalent foreign agency

Determining the $1 Billion Annual Income Threshold

- **Loss years prior to the application of the Book AMT are ignored.**
- **For example, if 2020 was a loss year, but the average book income for 2021 and 2022 was in excess of $1 billion, the group would be considered to have met the threshold.**
- **Statute seems predicated on the assumption that each includible entity will have its own AFS.**
- **Consolidated financial statements could have entities included that are not included in the AMT group.**
- **Corporations not in existence for three years will determine AFSI based on period during which corporation was in existence.**

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Determination of Applicable Financial Statement Income

Determining Applicable Financial Statement Income

- **Starting point is Form 10-K financial statement.**
  - **Income in any year is not reduced by NOL carryovers**
- **AMT incorporates Code § 451 definition of applicable financial statement (AFS).**
- **Code § 451 regulations provide an extensive definition of AFS:**
  - **GAAP financial statements**
  - **IFRS financial statements**
  - **Financial statements filed with certain regulators**
- **Aggregate members of consolidated group to determine if $1 billion threshold is exceeded.**
- **Once a corporation is in the new corporate AMT, it remains there until a change of ownership or its income has remained below the $1 billion threshold for a period of time and, in either case, IRS permits withdrawal.**
  - **Private equity funds are excluded from aggregation of corporate subsidiaries**

Determining Applicable Financial Statement Income

- **Starting point is Form 10-K financial statement.**
- **Adjustments for the following:**
  - **Disregard any federal and foreign income taxes**
    - **State taxes are not adjusted from AFS and includes both current and deferred taxes as well as changes in UTBs**
    - **Foreign taxes are only adjusted out of AFSI if a taxpayer elects to claim a tax credit**
  - **Take into account the taxpayer's pro rata share of items taken into account in computing the net income/loss set forth on a CFC's applicable financial statements**
    - **AFSI of CFCs aggregated globally and a loss by one CFC may offset income of another CFC**
    - **Net overall losses of CFCs may not reduce AFSI of a US Corporation**
  - **Take into account the taxpayer's distributive share of AFSI of a partnership**
  - **Exclude related to corporations that are not included in a consolidated return of the taxpayer. Include dividends received from non-consolidated corporations and other amounts which are includible in gross income**
  - **Reduce by depreciation deduction allowed under section 167 and disregard any amount of depreciation expense that is taken into account on the taxpayer AFS with respect to such property**
  - **Other miscellaneous adjustments**

NOLs and Tax Credits

- **AFSI may be reduced by NOLs incurred in 2020 and after but NOLs are capped at 80% of AFSI.**
- **AMT Foreign Tax Credit can be taken only if taxes are taken into account on an applicable financial statement and is limited to the 15% rate times foreign subsidiary's income included in AFSI.**
- **Other tax credits can reduce AMTI by up to 25%.**
- **AMT can be applied as a regular tax credit in future years to the extent that the corporation's regular tax liability exceeds the BMT.**

Determining The Minimum Tax Foreign Tax Credit

- **Tax is 15% of AMTI minus:**
  - **AMT foreign tax credit**
  - **Base erosion anti-abuse tax (BEAT)**
- **AMT FTC is the lesser of:**
  - **foreign taxes paid by the domestic corporation and**
  - **Foreign taxes paid by CFCs**
- **CFC foreign taxes is itself the lesser of:**
  - **(a) The parent's Code § 951(a) share of the foreign taxes paid by the CFC & taken into account in the parent's AFSI**
  - **(b) 15% of the CFC's income included on the shareholder's AFSI**
  - **But if (a) is greater than (b), the excess increases 15% of CFF's income for the next 5 years (until taken into account)**
- **CFC foreign taxes include creditable foreign taxes paid directly by US applicable corporations.**

The Book AMT Is Fully Creditable Against Regular Tax

- **Congress recognized that it is very likely that many book-tax differences relate to timing differences.**
  - **Expensing versus depreciation**
- **For this reason, if a taxpayer falls into the Book AMT, the AMT liability, that is, the excess of the AMT liability over the regular tax liability, may be claimed as a credit in a subsequent year in which the regular tax liability (plus BEAT liability) exceeds the AMT liability.**

Other Minimum Tax Rules

- **Income from CFCs is added to book income.**
- **US taxes do not reduce AFSI, so are add-backs in determining AFSI.**
- **Regular tax credits can reduce 75% of AMT.**
- **BMT rate is 15%.**
- **Tax only applies to the extent that AFSI times the 15% rate exceeds the amount of regular tax imposed at the corporate rate of 21% plus BEAT.**
  - **15% tax is reduced by the corporate AMT foreign tax credit**
  - **Foreign taxes imposed on CFCs may also be credited**
- **BMT is not compliant with OECD proposed global minimum tax (Pillar 2).**
- **GILTI tax (10.5%) could result in application of BMT.**

Tax Credit Transactions

- **The Corporate AMT generally requires partners in partnerships to take into account in its AFSI its distributive share of AFSI of the partnership (the partnership's net income or loss on such partnership's applicable financial statements).**
  - **Tax credit partnerships may not have applicable financial statements.**
  - **Tax credit partnerships may be accounted for on a taxpayer's AFS under various financial accounting methodologies.**
  - **An investor that accounts for its investment in a LIHTC partnership under the proportional amortization method must reflect the amortization of the investment's cost as a component of income tax expense. AFSI is adjusted to disregard any Federal income taxes. While the amortization of the investment's cost is reflected as a component of income tax expense in the financial statements, it would seem inappropriate for an investor to increase its AFSI by the amortization. More specifically, the 'book' amortization is not a part of the investor's Federal income taxes.**
  - **Investments in partnerships that generate investment tax credits may be accounted for under the deferral method. Under the deferral method, the benefit from the credit may be reflected in the financial statements in a year other than the year the credit is claimed on the tax return. In addition, the credit's benefit may be netted with other items of income and expense associated with the investment.**

Potential Financial Crisis Volatility

- **Financial crisis anomalies. For example, assume there is a credit event in Year 1, and a bank must significantly increase its allowance for loan losses. However, such loans are not charged-off for AFS purposes until Year 2 (i.e., the year the bank frequently recognizes bad debt deductions for tax).**
  - **This could result in the bank paying regular corporate tax in Year 1 and paying minimum book tax in Year 2.**
  - **Similarly, if conditions improve in Year 2 and the bank releases a portion of its allowance for loan loss, the release could result in book income exceeding taxable income in Year 2.**
- **• Deferred tax assets arising from minimum book tax carryforwards need to be factored into regulatory capital calculations. These carryforwards may be subject to threshold limitations in a manner similar to other carryforwards.**

IRS Guidance for Insurers Subject to the Corporate Minimum Tax

Notice 2023-20 – Variable Life & Annuity Contracts

- **Mark-to-market gains and losses on segregated account assets are not included in taxable income. Code § 817(a).**
- **Concomitantly, additions to reserves for mark-to-market gains and losses on segregated account assets do not enter into the tax deduction for reserves.**
- **For financial accounting purposes, mark-to-market gains & losses gains generally enter into AFS income and loss.**
- **AFSI for book minimum tax purposes, includes mark-to-market gains and losses on assets but disregards mark-to-market changes to liabilities.**
- **Notice 2023-20 overrides Code § 56A(c)(2)(C) and allows the insurer to exclude the mark-to-market income from the segregated account assets.**

Notice 2023-20 – Funds Withheld Reinsurance

- **In a covered reinsurance transaction, the ceding company continues to hold reserve assets ceded to the reinsurer (as security for payment of claims).**
- **Under insurance accounting rules, the ceding company recognizes mark-to-market gains & losses on the withheld assets through Other Comprehensive Income (OCI), but changes to the payable to the reinsurer are shown on the ceding company's AFS and is not offset by the OCI change.**
- **Notice 2023-20 allows insurers to exclude mark-to-market changes in the withheld assets from AFSI to the extent that the payable to the reinsurer is not included in the AFSI.**
- **The reinsurer deletes any changes to the value of the assets from its AFSI.**

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Merger & Acquisition Implications

Notice 2023-7: Covered Transactions

- Covered nonrecognition transactions
  - Book gain or loss excluded from AFSI
  - Book basis adjustments of property transferred excluded from AFSI
- Covered recognition transactions
  - Book gain or loss included in AFSI
  - Book basis adjustments of property transferred included in AFSI
- Component transaction analysis

Notice 2023-7:
Covered Transactions (continued)

- All covered transactions
  - If an Acquirer acquires a Target in a Covered Transaction that creates a Test Group includes the Target (or the assets thereof):
    - The Target's applicable corporation status terminates
    - The Target is allocated a portion of its historic group's AFSI and is included in the Acquirer's history (for qualification purposes only), and
    - The Target's historical group's AFSI is not reduced.

Book Purchase Accounting Adjustments

- Acquiring company obtains control of a business
  - All assets and liabilities acquired generally adjusted to fair value
  - Valuation methodologies include the income approach, the cost approach and the market approach
- Book transactions
  - Sale by a consolidated group versus non-consolidated group
- CAMT transactions
  - Covered nonrecognition transactions versus covered recognition (stock and asset) transactions

(Certain) Depreciation Adjustments

- Adjustment limited to “section 168” property
- For AFSI calculation purposes
  - Each year: disregard book depreciation and replace with tax depreciation
  - Upon disposition: book adjusted basis + accumulated book depreciation – accumulated tax depreciation
- Impact of Purchase Accounting

Group Issues

- Consolidated Financial Groups
  - If the financial results of a taxpayer are reported on an AFS for a group of entities, such financial statement is treated as the AFS of the taxpayer
  - Transactions involving entities consolidated for book but not tax purposes
- Consolidated Tax Groups
  - Allocation of CAMT attributes
  - Allocation of CAMT liability
  - Consequences of leaving the consolidated tax group

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International Tax Aspects

Controlled Foreign Corporations

- AFSI of U.S. shareholder excludes income of non-consolidated corporations (whether US or foreign) <u>for CAMT base purposes</u>, other than:
  - Dividends received by U.S. shareholder
  - “Other amounts” included in U.S. shareholder’s gross income (other than GILTI/Subpart F)
  - Pro rata share of CFC’s items net income or loss items on CFC’s financial statement
    - If pro rata share is a loss, don’t count currently; carry forward to offset positive adjustment in later year
- Pro rata share is determined under rules similar to § 951(a)(2), <u>but</u>
  - Unlike GILTI, no carve-out for QBAI and, unlike Subpart F income, no E&P limitation
  - 15% tax, compared to GILTI at 10.5% (13.125% after 2025) and Subpart F at 21%
  - CAMT applies after GILTI/Subpart F, since it applies only if > than regular tax & BEAT

– Presumably “other amounts” includes interest, royalties, etc.

– Does loss carryover rule apply on aggregate basis or CFC-by-CFC basis? Is carryover indefinite until used up?

Double Inclusion Issue with CFCs

- Does § 56A(c)(2)(C) require inclusion of dividends only if they are "includible in gross income?"
  - If so, it seems PTEP distributions would not be covered by § 56A(c)(2)(C) and there is no double inclusion issue regarding distributions of earnings already taxed as GILTI/Subpart F
  - Under that reading, only dividends associated with QBAI would be included in gross income, but should they even be covered given they are not taxable due to § 245A?
- If § 56A(c)(2)(C) requires inclusion of dividends that are not includible in gross income, there is a double inclusion issue. Treasury/IRS have authority "to prevent the omission or duplication of any item," but to date have not provided guidance
- Other questions will arise when addressing the double inclusion issue:
  - Will there be a rule similar to § 951(a)(2) so that buyer of CFC is not taxed on dividends of earnings already taxed to the seller?
  - Will there be transition relief if CFC pays dividend out of earnings taxed as GILTI or Subpart F income in pre-CAMT years?

The CAMT Foreign Tax Credit: Overview

- An applicable corporation's CAMT FTC is sum of:
  1) Lesser of (a) corporation's "pro rata share" (same % used for including CFC's income) of creditable foreign income taxes paid/accrued by CFC for federal income tax purposes and included on its financial statement, and (b) 15% of corporation's income inclusion from CFC, and
  2) Creditable foreign income taxes paid/accrued by corporation that are included on its financial statement

– Excess of (1)(a) over (1)(b) is used to increase (1)(a) amount for next 5 years

– Is "lesser of" rule applied in aggregate, not CFC-by-CFC?

– CAMT FTC is not limited to foreign-source income or other FTC limitations (e.g., no basketing, OFL, ODL, loss recapture, expense apportionment, etc)

The CAMT Foreign Tax Credit: Timing/Other Issues

- Is CAMT FTC allowed upon later of time (a) tax is paid/accrued and (b) tax is included on CFC's financial statement (e.g., they don't occur in same year)?
- Timing difference exacerbated if, pursuant to § 905(c), foreign tax authority's adjustment to foreign taxes relates back to earlier year
- Presumably a CAMT FTC is available for a corporation's distributive share of foreign income taxes paid/accrued by, and shown on financial statements of, foreign corporations owned by a partnership. Rev. Rul. 71-141

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Partnerships

Pressing Issues

- Notice 2003-7 clarified that the distributive share rule is turned off for scoping purposes even where the partnership is not treated as a single employer.
  - If partnership is not single employer with corporation (e.g., corporation owns a 30% interest), does that mean all the partnership's income is excluded from corporation's AFSI?
  - If partnership is single employer with corporation, but significant interests in partnership are owned by third parties (e.g, an Up-C structure), does that mean corporation is unable to exclude the portion of the partnership's financial statement income attributable to the unrelated entities?
- CAMT was modified by Senators Thune and Sinema to ensure that private equity funds structured as partnerships would not be required to aggregate the financial statement incomes of their portfolio company subsidiaries for CAMT testing of the subsidiaries.
  - Does Treasury believe there is regulatory authority to alter that conclusion and if so, is it exploring that possibility?

– Should a distributive share be calculated by reference to partnership tax principles?

Notice 2023-7 Request for Comments

- Notice 2003-7 also included a section requesting comments for further guidance on various issues, including but not limited to:
  - AFSI and applicable corporation status resulting form certain transactions,
  - AFSI adjustments related to depreciation,
  - Other rules requiring clarifying guidance
    - Changes in ownership & predecessor corporation considerations,
    - Allocation of CAMT liability and allocation of CAMT attributes,
    - Other AFSI adjustments (mark-to-market, Section 451, etc.)

Thank You!

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