Baker McKenzie.

Legal Update

September 2023

United States: Notice 2023-64 Supplements CAMT Guidance

IRS and Treasury modify and supplement rules in Notice describing anticipated proposed regulations

In brief

On September 12, 2023, the Treasury Department ("**Treasury**") and the Internal Revenue Service (IRS) released Notice 2023-64 ("**Notice**"), which provides additional interim guidance on the Corporate Alternative Minimum Tax (CAMT). The Notice follows the release of interim guidance issued in Notice 2023-7 (see our client alert on Notice 2023-7: United States: IRS releases initial interim guidance on new corporate alternative minimum tax), Notice 2023-20 (providing guidance related to the insurance industry), and Notice 2023-42 (providing temporary relief from Section 6655 penalties in connection with the application of CAMT).

Contents

Key takeaways

In depth

- Background
- Determining a Taxpayer's AFS (Sec. 4)
- General Rules for Determining AFSI and FSI (Sec. 5)
- Determining FSI, AFSI, and Tax Imposed for Tax Consolidated Groups (Sec. 6)
- Determining AFSI with Respect to Certain Foreign Corporations (Sec. 7)
- AFSI Adjustment for Certain Taxes (Sec. 8)
- AFSI Adjustments for Section 168 Property (Sec. 9)
- AFSI Adjustments for Qualified Wireless Spectrum (Sec. 10)
- AFSI Adjustments to Prevent Certain Duplications and Omissions (Sec. 11)
- Financial Statement Net Operating Losses (Sec. 12)
- Applicable Corporation Status (Sec. 13)
- CAMT FTC (Sec. 14)
- Applicability Dates (Sec. 15)
- Request for Comments (Sec. 16)

Conclusion

Key takeaways

- The Notice provides guidance on many of the fundamental components of CAMT, including
  - determining the taxpayer's Applicable Financial Statement (AFS),
  - defining Financial Statement Income (FSI),
  - how Tax Consolidated Groups should use determine their FSI and calculate the Group's CAMT liability,
  - some adjustments to prevent the duplication or omission of income, and
  - applying the aggregation rules to determine Applicable Corporation status.
- The Notice modifies some of the definitions, rules, and examples related to adjustments for depreciation in Notice 2023-7.
- The CAMT FTC is available for the taxable year in which the foreign income taxes are paid or accrued by the Applicable Corporation (or the CFC for which it is a US shareholder), and the CAMT FTC and FTC Limitation is determined on an aggregate basis for all CFCs.
- The Notice explicitly rejects comments submitted on Notice 2023-7 in a few instances, instead providing that:
  - Domestic corporations that are members of a Foreign Parented Multinational Group (FPMG) may not use any reasonable method to determine its adjusted financial statement income (AFSI), and instead must modify the FPMG's AFS to determine the amounts attributable to the domestic corporation.
  - Timing differences do not result in the duplication or omission of income, even in cases where those timing differences straddle CAMT's effective date.
  - Financial Statement NOLs (FSNOLs) will be applied against AFSI and depleted, even in years before CAMT applies.

- Proposed regulations are expected to be released that will include the rules described in the Notice. While the proposed regulations are expected to apply to taxable years beginning on or after January 1, 2024, taxpayers may rely on the guidance in the Notice for taxable years ending on or before the date the proposed regulations are published in the Federal Register.

In depth

Background

The Inflation Reduction Act (IRA) amended Code section 55 to impose Corporate Alternative Miniumum Tax (CAMT) on applicable corporations (generally, those corporations whose Adjusted Financial Statement Income (AFSI) exceeds $1 billion). CAMT is effective for tax years beginning after December 31, 2022. As a result, taxpayers have already had to take CAMT into account in preparing their financial statements and determining their estimated taxes without the benefit of regulations describing how to make many of the adjustments to financial statement income that calculating CAMT requires. The Notice announces that proposed regulations will be released interpreting CAMT, and those proposed regulations are expected to apply for taxable years beginning on or after January 1, 2024. The Notice also provides that taxpayers can rely on the guidance described in the Notice for taxable years ending on or before the date the proposed regulations are published in the Federal Register and, in any event, taxpayers may rely on the Notice for any taxable year that begins before January 1, 2024.

The Notice provides a detailed explanation of the statutory requirements in section 55 (which imposes CAMT), section 56A (which defines AFSI and describes the adjustments to be made to AFSI for CAMT purposes) and section 59(k) (which defines a corporation to which the CAMT applies (**"Applicable Corporation"**)). The Notice describes the rules that will be included in the forthcoming proposed regulations, including (1) rules for determining a Taxpayer's Applicable Financial Statement (AFS), (2) general rules for determining AFSI, (3) determining Financial Statement Income (FSI), AFSI, and tax imposed for tax consolidated groups, (4) determining AFSI with respect to a controlled foreign corporation (CFC), (5) AFSI adjustment for taxes, (6) AFSI adjustments for section 168 property, (7) AFSI adjustments for Qualified Wireless Spectrum, (8) AFSI adjustments to prevent the duplication or omission of income, (9) rules regarding Financial Statement Net Operating Losses (FSNOLs), (10) rules for determining status as an applicable corporation, and (11) rules for determining the CAMT foreign tax credit ("**CAMT FTC**"). Some of the rules in the Notice, such as those for section 168 property, modify and clarify rules previously described in Notice 2023-7.

The Notice includes a detailed request for comments, both with respect to the rules that are described in the Notice and items that are not addressed in the Notice. Comments are due by October 12, 2023.

Determining a Taxpayer's AFS (Sec. 4)

The Notice provides that for purposes of calculating a corporation’s AFSI, the AFS of a Taxpayer is used. The Notice defines the term “Taxpayer” broadly to include any entity identified in section 7701 and the regulations thereunder (regardless of whether the entity meets the definition of a Taxpayer under section 7701(a)(14)) including disregarded entities. The AFS of the Taxpayer is a financial statement listed in the Notice with the highest priority.

The Notice assigns the highest priority of AFS to certified financial statements prepared based on United States generally accepted accounting principles (GAAP), which are used for the following non-tax purposes: (i) filing with the United States Securities and Exchange Commission (SEC) (i.e., a Form 10-K, or annual statement to shareholders), (ii) for investment related reporting (credit purposes, reporting to owners, or any other substantial non-tax purpose), or (iii) submitted to any Federal agency, other than the SEC or the IRS. The Notice gives the second priority to certified financial statements prepared in accordance with international financial reporting standards (IFRS) and used for similar non-tax purposes. If such financial statements are not available, Taxpayers may use a financial statement (other than a tax return), filed with other government or regulatory bodies, or alternatively, an unaudited financial statement prepared for an external non-tax purpose. As a last priority, AFS may be a Taxpayer’s Federal income tax return or information return filed with the IRS.

The Notice requires an AFS to be certified by an independent financial statement auditor, and where applicable, priority is given to (i) an AFS that reflects restated FSI over the original AFS, (ii) annual financial statements over the periodic financial statements, and (iii) Taxpayer’s separately reported AFS over a consolidated AFS, unless the Taxpayer is either a member of a tax consolidated group, or foreign parented multinational group (FPMG), in which case the consolidated AFS containing the Taxpayer’s results has a higher priority.

Observation: Commenters had requested that, in the case of a domestic corporation that is a member of FPMG, the domestic corporation be permitted to utilize any reasonable method to determine its AFSI, which would include using as its

© 2023 Baker & McKenzie

AFS, the income statement, other financial statement(s) and books and records that it uses to prepare its Form 1120 Schedule M-3 for the taxable year, rather than the consolidated AFS of its foreign parent in which it is included. However, the Notice appears to reject this approach instead requiring such domestic corporation to "break apart" its foreign parent's AFS to determine amounts attributable to it. See discussion of section 5 of the Notice below for guidance in this regard.

General Rules for Determining AFSI and FSI (Sec. 5)

Section 5 of the Notice outlines a series of general rules and adjustments in determining a Taxpayer's AFSI and FSI, including cases where a Taxpayer's financials are reported on a consolidated AFS.

A Taxpayer's AFSI generally is its FSI, adjusted based on section 56A and regulations or other guidance issued under section 56A (including the Notice). A Taxpayer's FSI in turn is the net income or loss set forth on the Taxpayer's income statement included in its AFS, including all recurring and nonrecurring items and net income or loss from discontinued operations, but not equity accounts such as retained earnings and other comprehensive income (OCI).

Observation: Commenters generally recommended that OCI, typically consisting of unrealized revenues, expenses, gains, and losses be excluded from AFSI and Treasury and the IRS apparently agree with this approach.

The Notice emphasizes that, except as provided in section 56A, section 59(k) (as applicable), regulations, or other guidance (e.g., Notice 2023-7), the U.S. federal income tax treatment of an item reflected in AFS is not relevant for FSI and AFSI, and all items of income, expense, gain, and loss of the Taxpayer are taken into account regardless of whether such amounts are realized, recognized, deferred, or otherwise taken into account for purposes of determining the Taxpayer's regular tax liability.

Observation: For example, if a Taxpayer uses a fair value or mark-to-market method of accounting, gain or loss may be included on such Taxpayer's AFSI even if such amounts are not included for tax purposes. As noted below, however, Treasury and the IRS are still considering such questions and request comments on the extent to which adjustments for unrealized gains/losses should be made to AFSI.

Where a Taxpayer's financials are reported on a consolidated AFS, the Notice requires the Taxpayer to segment its portion of net income or loss from the consolidated AFS, supporting this determination by its separate books and records (including trial balances). Thus for purposes of calculating the separate FSI for each member of the consolidated group, the Notice instructs Taxpayers to: (i) not use the losses of one member of the consolidated group to offset another member's income; (ii) add back the journal entries relating to transactions between members of the consolidated group (usually eliminated in determining the consolidated AFS), unless such transactions are between a disregarded entity and its owner or between disregarded entities that have the same owner; (iii) add back FSI of the Taxpayer with respect to its investment in another Taxpayer that is a member of the consolidated group, unless the investment is in a disregarded entity; and (iv) allocate shared expenses and other items that are not reflected in the separate books and records of each member. The Notice provides an example that illustrates how to apply the principles set forth in section 5 of the Notice in determining a Taxpayer's separate FSI from a consolidated AFS.

Determining FSI, AFSI, and Tax Imposed for Tax Consolidated Groups (Sec. 6)

The purpose of this section of the Notice is to provide taxpayers with clarity in determining FSI, AFSI, and amount of CAMT under section 55 in the case of a Taxpayer that is part of an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return for U.S. federal income tax purposes (**"Tax Consolidated Group"**).

In regards to the FSI of a Tax Consolidated Group, the calculation is determined based on the Consolidated AFS of the Tax Consolidated Group taking into account the following considerations:

- if the consolidated AFS comprises only of the members of the Tax Consolidated Group (as defined in Treas. Reg. § 1.1502-1(b)), then the FSI of the Tax Consolidated Group equals the consolidated FSI provided in the consolidated AFS;

- if the consolidated AFS includes all the members of a single Tax Consolidated Group and at least one Taxpayer is not a part of the Tax Consolidated Group, then the FSI must be determined from the consolidated AFS under section 5.02(3)(c) of the Notice, treating the Tax Consolidated Group as the Taxpayer. Doing so does not change the tax classification of an entity that is classified as a partnership. So, the FSI of the Tax Consolidated Group must disregard each AFS consolidation entry and member's investment that includes a transaction between a consolidated AFS member and another Taxpayer. However, each AFS consolidation entry that includes a transaction or investment between consolidated AFS members must be taken into account.

The group's liability under the CAMT is then calculated based on the Tax Consolidated Group's tentative minimum tax, regular consolidated tax liability, and tax imposed by section 59A.

© 2023 Baker & McKenzie

The Notice provides the following example: X, Y, and Z are domestic corporations with one class of stock where X owns 90 percent of the stock of Y and 60 percent of the stock of Z. The rest of the stock is held by an unrelated person. X and Y later file a consolidated tax return with X as the parent. This consolidated group sold an asset to Y for $10 million, which resulted in X having a gain of $2 million. However, this gain was eliminated from consolidated FSI through AFS consolidation entries. Later, Y sold that same asset to Z for $13 million, which resulted in Y having a gain of $3 million. This gain was also eliminated from consolidated FSI through AFS consolidation.

In this example, the XYZ Consolidated group includes Z, who is not a member of the XY Consolidated group. Because of this, the FSI is determined from XYZ Consolidated group AFS, which requires treating XY Consolidated group as a single Taxpayer.

In the first transaction (X's sale to Y), because of the elimination of the transaction between X and Y, the AFS consolidation entries are included. This results in X's $2 million gain not being included in XY Consolidated Group's FSI for that year.

In the second transaction, where the AFS consolidation entries eliminate a transaction between Y and Z, this results in the AFS consolidation entries being disregarded. However, there is still an effect on the asset that must be taken into account. When taking the asset into account, XY Consolidated Group's FSI includes a $5 million dollar gain on the sale of that asset for the year of sale.

> **Observation:** There were also suggestions from commenters that FSNOL 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 and a departing member. However, Treasury and the IRS did not address NOL carryover allocations in the Notice.

Determining AFSI with Respect to Certain Foreign Corporations (Sec. 7)

Section 7 of the Notice provides taxpayers with guidance in determining AFSI of a U.S. shareholder with respect to certain CFCs.

In determining AFSI with respect to a CFC:

(1) A Taxpayer that is a U.S. shareholder must apply section 56A(c)(2)(C) and (c)(3);

(2) any section 56A(c)(3) adjustment is determined by aggregating the adjusted net income or loss of all CFCs owned by a U.S. shareholder.

An additional adjustment is required if a CFC is a partner in a partnership or the owner of any disregarded entity. In that case, the items taken into account when computing the adjusted net income must include the CFC's distributive share of AFSI of the partnership and the FSI of the disregarded entity. As noted below, the Notice requests comments on the manner in which a partner in a partnership determines its distributive share of the partnership's AFSI.

For purposes of determining the AFSI of a foreign corporation, section 56A(c)(4) provides that the principles of section 882, addressing the taxable income of a foreign corporation which is effectively connected with the conduct of a trade or business within the United States, apply. The Notice further specifies that, in case of a foreign corporation that qualifies for and claims the benefits of the business profits provisions of an applicable income tax treaty, the principles of those provisions also apply in determining a foreign corporation's AFSI.

> **Observation:** Many commenters requested that, for purposes of applying section 56A(c)(4), the principles of section 882 be modified to take into account the business profits provision of any applicable income tax treaty in computing a foreign corporation's AFSI. Treasury and the IRS have apparently acquiesced to such request.

AFSI Adjustment for Certain Taxes (Sec. 8)

This section of the Notice provides taxpayers with guidance in determining the AFSI adjustment for certain taxes under section 56A(c)(5).

The appropriate timing for an adjustment to AFSI under section 56A(c)(5) is made during the taxable year where the taxes increase or decrease the Taxpayer's FSI or are included as part of an adjustment to AFSI under other provisions of the Notice. In addition, taxes are taken into account on an AFS if any journal entry has been recorded and used to determine the amounts on the AFS for any year, even if the tax does not increase of decrease the Taxpayer's FSI at the time of the entry. Lastly, income tax that is taken into account on a partnership's AFS is also considered to be taken into account on the partners' AFS.

AFSI Adjustments for Section 168 Property (Sec. 9)

With respect to AFSI adjustments required for section 168 property, section 9 of the Notice adds clarity to previously-released rules.

The Notice sets out a number of modifications to the guidance provided in section 4 of Notice 2023-7 concerning elements of the adjustments for depreciation expenses. The modifications are made to the definitions in section 4.02 of Notice 2023-7, the

© 2023 Baker & McKenzie

adjustments set out in sections 4.03 and 4.07, and the examples in section 4.08. To the extent a Taxpayer chooses to rely on Notice 2023-7 after September 11, 2023, the Taxpayer must apply the guidance as modified by Notice 2023-64. The modifications cover several issues:

- Taxpayers that must recognize an adjustment under section 481(a) after a change in accounting method related to depreciation of an item of section 168 property will be required to make adjustments to AFSI in order to prevent the duplication or omission of depreciation deductions under section 56A(c)(13). Positive section 481(a) adjustments will increase AFSI and negative section 481(a) adjustments will decrease AFSI. However, in both cases, the AFSI adjustment is limited to the amount taken into account in computing taxable income. An addition to the examples makes clear that this means that, where a section 481(a) adjustment will be taken into account ratably over the allowable period, the AFSI adjustments must also be made over that period.

- Where a Taxpayer capitalizes tax depreciation and recovers the capitalized amounts through other deductions allowed in computing taxable income, the Taxpayer will reduce AFSI by the amount of the amortization even if the deduction is allowed by provisions of the Code other than section 167. So, for example, if a Taxpayer amortizes capitalized tax depreciation under section 174(a)(2), AFSI would be reduced by the amortization deductions allowed in computing taxable income under that section.

- For tax depreciation that is capitalized to section 1221(a)(1) property that is not inventory property and for which the capitalized amounts are only recovered via the computation of taxable gain or loss on a sale or exchange of the property, the Notice provides for concomitant AFSI reductions equal to the recovered amounts.

- In a case where a disposition loss on section 168 property is taken for financial statement purposes in an earlier year than the disposition event occurs for regular tax purposes, taxpayers are required to adjust AFSI in the earlier year to disregard the financial statement loss and must wait until the year of the tax disposition to take the loss for AFSI purposes. The modifications provide for upward adjustments to AFSI in the earlier year and downward adjustments to AFSI in the later year to carry out this rule and clarify section 4.07 of Notice 2023-7 to make it applicable only in the year of the disposition for tax purposes while providing additional rules for re-determining FSI gain or loss from the disposition.

The modifications also aim to make explicit that adjustments to AFSI required upon disposition of the property include all amounts, including amounts attributable to taxable years before the CAMT became effective. In addition, the modifications make clear that adjustments will also take into account relevant amounts even if all or a portion of the amount has not yet been taken into account in AFSI through other required adjustments (for example, the entirety of a section 481(a) adjustment would be included in AFSI adjustments even if the property is disposed of before the 4-year recognition period has expired).

In addition to the modifications to Notice 2023-7, the Notice lays out additional rules to provide clarity regarding the treatment of section 168 property for purposes of calculating AFSI. First, it makes explicit that AFSI is not adjusted under section 56A(c)(13) with respect to property that is not subject to depreciation under section 167 and section 168 for regular tax purposes. That result does not change under the rules for determining whether members of a FPMG are Applicable Corporations under section 59(k)(2)(A). This is likely in response to comments submitted asking Treasury and the IRS to provide for AFSI adjustments for depreciation and amortization deductions on property, such as films or goodwill, that are depreciated or amortized under other sections of the Code (e.g., section 181 or section 197).

Second, the Notice makes clear that AFSI will include all items of income, expense, gain, and loss reflected in FSI, whether or not those amounts are recognized or otherwise taken into account for tax purposes. In other words, section 56A(c)(13) does not provide for any AFSI adjustments as a result of nonrecognition or deferral provisions such as the like-kind exchange rules of section 1031 or the installment method of gain recognition under section 453. Treasury and the IRS do note that other provisions of section 56A or regulations and guidance issued by the Treasury and the IRS may provide additional adjustments (such as those provided in Notice 2023-7 for Covered Nonrecognition Transactions). However, in the absence of such express allowance under statute, regulations, or other guidance, gain or loss on a disposition of section 168 property will be recognized for AFSI purposes even if the Code allows for nonrecognition or deferral of such gain or loss.

AFSI Adjustments for Qualified Wireless Spectrum (Sec. 10)

AFSI must generally be adjusted so that the Taxpayer only takes into account tax amortization deductions related to qualified wireless spectrum. The Notice provides further specificity on book/tax adjustments related to qualified wireless spectrum and expands on adjustments that are required with respect to a change in method of accounting under section 481. Treasury and the IRS also modified the statutory definition of qualified wireless spectrum. Adjustments are not required for taxpayers that do not amortize wireless spectrum property under section 197. Finally, the Notice requires certain adjustments to AFSI as a result of a disposition of qualified wireless spectrum.

AFSI Adjustments to Prevent Certain Duplications and Omissions (Sec. 11)

In numerous comment letters, commenters pointed out to Treasury various instances where, absent an adjustment, the inclusion or exclusion of certain items in AFSI would result in duplications or omissions, respectively. For example, one commenter pointed out a transitional issue whereby certain loss reserves may have been taken into account in book income in a pre-CAMT year but have not yet become deductible for tax purposes. If such reserves crystalize into tax losses in a later year when CAMT is in effect, a Taxpayer may fall into CAMT. In response to such comments, Treasury intends to propose regulations to address three types of "duplication/omission" situations, although notably not with respect to the types of items raised by this commenter.

Accounting Principle Change Adjustment. AFSI must be adjusted to take into account any cumulative adjustment to the retained earnings of the Taxpayer on its AFS if such adjustment results from a change in financial accounting principle (**"Accounting Principle Change Adjustment"**). Such adjustment (including as further adjusted) must generally be taken into account in the Taxpayer's AFSI during the period specified in the "adjustment spread period rule." The adjustment spread period rule provides different periods depending on the type of item:

- In the case of an Accounting Principle Change Adjustment that is necessary to prevent a *duplication*, such adjustment must generally be taken into account in AFSI ratably over the four-taxable-year period beginning with the taxable year for which the change in principle is implemented in the Taxpayer's AFSI.
- In the case of an Accounting Principle Change Adjustment that is necessary to prevent an *omission* and results in an *increase* in AFSI, such adjustment must be taken into account in AFSI ratably over the four-taxable-year period beginning with the taxable year for which the change in financial accounting principles is implemented in the Taxpayer's AFSI.
- In the case of an Accounting Principle Change Adjustment that is necessary to prevent an *omission* and results in a *decrease* in AFSI, such adjustment must be taken into account in AFSI in full in the taxable year for which the change in financial accounting principle is implemented in the Taxpayer's AFSI.

If, in any taxable year, a Taxpayer ceases to engage in a trade or business that is the subject of an Accounting Principle Change Adjustment, the Taxpayer must take into account in AFSI for such taxable year any portion of the adjustment not taken into account in AFSI for a previous taxable year.

> **Observation:** In crafting the adjustment spread period rule, Treasury and the IRS appear to be relying on section 481(a) principles, which similarly provide a 4-year spread for unfavorable (positive) adjustments and same-taxable-year inclusions for favorable (negative) adjustments. In addition, the remaining balance of a section 481(a) adjustment is accelerated in certain situations, including if a Taxpayer ceases to engage in a trade or business. Thus, in the event of an ambiguity in the adjustment spread period rule, a Taxpayer presumably can look to section 481(a) for analogous guidance.

Restatement Adjustment. If a Taxpayer restates an AFS and, as a result, the Taxpayer's FSI for a taxable year is restated after the Taxpayer filed its original U.S. federal income tax return for such taxable year, the Taxpayer must account for the restatement by adjusting its AFSI for the first taxable year after such taxable year for which the Taxpayer has not filed an original return as of the restatement date (**"Restatement Adjustment"**). The Restatement Adjustment must take into account the cumulative effect of the restatement on FSI. If, after restating an AFS for a taxable year, a Taxpayer files an amended return or an administrative adjustment request for such taxable year to adjust taxable income as a result of the restatement, the Taxpayer must use the restated AFS for purposes of determining AFSI instead of making the Restatement Adjustment.

Auditor's Opinion Adjustment. AFSI must be adjusted to take into account amounts disclosed in certain auditor's opinions to the extent such amounts would have increased FSI had they been reported in the Taxpayer's AFS (**"Auditor's Opinion Adjustment"**). No such adjustment is required, however, to the extent the disclosed amounts were included in FSI for a prior year. If FSI for a subsequent year includes amounts included in AFSI pursuant to an Auditor's Opinion Adjustment, AFSI for the subsequent years must be adjusted to prevent any duplication of income.

Notwithstanding requests received from several commenters, Treasury takes the view that "timing differences" do not give rise to duplications or omissions that require adjustment to AFSI, "even if the timing difference originated before the effective date of the CAMT and reversed after such effective date."

> **Observation:** Although Treasury views such items as mere timing differences, by not allowing any adjustments to AFSI, such timing differences—especially in the transitional context—can become permanent differences.

© 2023 Baker & McKenzie

Financial Statement Net Operating Losses (Sec. 12)

A FSNOL is defined as the amount of net loss (if any) set forth on the corporation's AFS for taxable years ending after December 31, 2019. CAMT, however, applies to tax years beginning after December 31, 2022, with a three-year look-back period for testing Applicable Corporation status. Commenters raised concerns that older FSNOLs could be "soaked up" against AFSI even before a Taxpayer becomes an Applicable Corporation subject to CAMT in a later year.

Treasury, however, did not agree with such concerns and intends to propose rules clarifying that the amount of an FSNOL carried forward to the first taxable year a corporation is an Applicable Corporation (and subsequent taxable years) is determined without regard to whether the Taxpayer was an Applicable Corporation for any prior taxable year.

> ***Observation:*** Commenters had specifically observed that there apparently was no way to "reserve" such FSNOLs for later use. With the proposed clarification, Treasury has foreclosed any such possible reservation by regulation, and taxpayers will need to be mindful that NOLs are being applied against AFSI (and depleted) even prior to the Taxpayer becoming subject to CAMT.

Applicable Corporation Status (Sec. 13)

Section 13.02 of the Notice provides guidance in applying the aggregation rules of section 59(k)(1)(D) in determining whether a corporation is an Applicable Corporation. Section 59(k)(1)(D) provides that, 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) is treated as AFSI of that corporation **("Section 52 Aggregation"**). Section 52(a) provides that corporations that are members of a controlled group of corporations, within the meaning of section 1563 (with certain modifications including the substitution of "more than 50%" for "at least 80%" in section 1563(a)(1)), are treated as a single employer. Section 52(b) provides that trades or businesses that are partnerships, trusts, estates, corporations, or sole proprietorships under common control (determined by applying similar principles to those of section 52(a)) are members of a controlled group and are treated as a single employer. The stock ownership rules of section 1563(d) and the constructive ownership rules of section 1563(e) apply for purposes of section 52(a) and section 52(b).

Section 13.02(2)(c) of the Notice clarifies that section 52(a) applies to members of a controlled group, not to component members of the controlled group as defined in section 1563(b). Therefore, sections 1563(b)(1)(A) and (b)(2) do not apply to exclude certain corporate members, such as foreign corporations, from the controlled group for purposes of section 52(a). Similarly, an organization that is a foreign entity (such as a foreign partnership or foreign trust) may be aggregated under section 52(b) in determining whether it is a member of a controlled group that is treated as single employer under section 52(b) for purposes of applying section 59(k)(1)(D). In addition, because section 52 and the regulations thereunder do not exclude S corporations, RICs, or REITs, these organizations are taken into account in determining whether members of a controlled group are treated as a single employer under section 52 for purposes of applying section 59(k)(1)(D) (even though S corporations, RICs and REITs cannot themselves be an Applicable Corporation).

Section 13.03 of the Notice addresses certain issues with respect to the aggregation rules applicable to an FPMG. An FPMG is defined as two or more entities if (i) at least one entity is a domestic corporation and another entity is a foreign corporation, (ii) the entities are included in the same AFS for the year, and (iii) either the common parent of the entities is a foreign corporation or, if there is no common parent, the entities are treated as having a common parent that is a foreign corporation. Section 13.03(1) provides that, for purposes of determining whether a Taxpayer meets the FPMG $1 Billion Test, the AFSI of a Taxpayer being evaluated for Applicable Corporation status (the **"Tested Corporation"**) that is a member of a FPMG includes both (i) the AFSI of all other members of the FPMG (**"FPMG Aggregation"**), and (ii) the AFSI of all persons treated as a single employer with the Tested Corporation by reason of Section 52 Aggregation to the extent such AFSI is not AFSI of a member of the FPMG. Finally, in applying both Section 52 Aggregation and FPMG Aggregation for purposes of determining whether a Tested Corporation meets the FPMG $1 Billion Test, AFSI of all relevant persons is determined without regard to sections 56A(c)(2)(D)(i) (adjustment to take into account partner's distributive share of AFSI), (c)(3) (adjustment to take into account pro rata share of CFC's items of net income and loss), (c)(4) (adjustment for effectively connected income), and (c)(11) (adjustment with respect to defined benefit plans).

> **Observation:** Commenters had noted the absence of any coordination rule between the Section 52 Aggregation rules and the FPMG Aggregation rules and suggested that the FPMG Aggregation rules incorporate the Section 52 Aggregation rules to place U.S. multinational groups and FPMGs on a similar footing. Treasury and the IRS have largely adopted this suggestion in the Notice.

Notice 2023-7 provides that the adjustment in section 56A(c)(2)(D)(i), the increase to take into account partner's distributive share of the AFSI of a partnership, is inapplicable in all circumstances in determining whether a corporation that is a partner in a partnership (whether directly or indirectly) is an Applicable Corporation. Instead, as noted previously, a Taxpayer that is a partner

in a partnership includes in its AFSI the FSI amount it reports with respect to its partnership investment (for example, under the fair value method or equity method). On the other hand, if a Taxpayer is a partner in a partnership and all of the AFSI of a partnership is treated as the AFSI of the Taxpayer under section 59(k)(1)(D) or section 59(k)(2)(A), then solely for purposes of section 59(k), such FSI amount related to the partnership investment is excluded from the Taxpayer's AFSI in order to avoid duplication of income or loss from such investment.

CAMT FTC (Sec. 14)

Section 14 of the Notice clarifies several critical aspects of the CAMT FTC in section 59(l) and related provisions. Under the Notice, a Foreign Income Tax (i.e., an income, war profits, or excess profits tax within the meaning of section 901 with respect to a foreign country or possession of the United States) is eligible to be claimed as a credit for purposes of the CAMT in the taxable year in which it is paid or accrued for US federal income tax purposes by an Applicable Corporation or a CFC with respect to which it is a U.S. Shareholder. In order to be eligible, the Foreign Income Tax must also have been taken into account in the AFS of an Applicable Corporation or a CFC. Under section 8.02(2) of the Notice, a Foreign Income Tax is taken into account if any journal entry has been recorded in the journal used to determine the amounts on the AFS of the Applicable Corporation of CFC for any year to reflect the Foreign Income Tax even if it does not increase or decrease FSI at the time of the journal entry.

An important question not answered directly by section 59(l) is whether the amount of Foreign Income Taxes paid or accrued by the CFCs of an Applicable Corporation (**"CFC Taxes"**) and any limitation on the ability of the Applicable Corporation to claim a credit for such Foreign Income Taxes (the **"CFC FTC Limitation"**) are determined for each CFC separately or by aggregating all such CFCs. Section 14.02(4) of the Notice clarifies that, "[f]or purposes of the CAMT FTC, a Taxpayer determines the amount of CFC Taxes * * * and the CFC FTC Limitation * * * for a taxable year on an aggregate basis with respect to all CFCs in which it is a U.S. Shareholder."

> **Observation:** The determination of CFC Taxes and the CFC FTC Limitation on an aggregate basis is consistent (and likely necessary) in light of section 7.02(2) of the Notice which requires a Taxpayer to make a single section 56A(c)(3) adjustment based on the aggregate of the Adjusted Net Income or Loss of all of its CFCs. These aggregation provisions suggest a mechanism that, in some ways, resembles the GILTI regime of section 951A, albeit based on Adjusted Net Income or Loss (rather than Tested Income and Loss) and, importantly, with a 5-year carryover of excess CAMT FTCs under section 59(l)(2).

Section 14.02(5) of the Notice provides that, if an Applicable Corporation or CFC is a direct or indirect (through another partnership or pass-through entity) partner in a partnership, then the Foreign Income Taxes paid or accrued by such partner includes its share of any Foreign Income Taxes paid or accrued by the partnership. This clarification in the Notice is critical to avoid double taxation because, while section 56A(c)(2)(D)(ii) requires a partner to take into account its distributive share of a partnership's net income or loss set forth in the partnership's AFSI, the statute does not explicitly state that the partner may take into account its share of the Foreign Income Taxes of the partnership.

> **Observation:** Commenters had requested that Treasury and the IRS provide in proposed regulations that the principles of section 704(b) apply when allocating foreign taxes that a partnership has paid or accrued to a partner for purposes of the CAMT FTC or at least specify that applying section 704(b) would be accepted as a reasonable method for determining such partner's share of Foreign Income Taxes of the partnership. However, Treasury and the IRS did not address how to determine a partner's share of the Foreign Income Taxes of a partnership though applying the principles of section 704(b) would seem to nevertheless be reasonable. As noted below, the Notice indicates that Treasury and the IRS are still considering the question and welcome further comments.

Finally, section 14.02(3) of the Notice provides that a Foreign Income Tax paid or accrued as a result of a foreign tax redetermination (as defined in section 1.905-3(a)) is eligible for a CAMT FTC only if the Taxpayer is an Applicable Corporation in the taxable year to which the foreign tax redetermination relates ("**Relation-Back Year**"). The Notice further provides such tax may be claimed as a CAMT FTC only in the Relation-Back Year, even if the tax is reflected in a journal entry on an AFS within a taxable year that is later than the Relation-Back Year (notwithstanding the journal entry rule in section 8.02(2) of the Notice described above).

> **Observation:** Section 905(c) was amended by the Tax Cuts and Jobs Act of 2017 to provide that the impact of a foreign tax redetermination for a CFC is taken into account in the prior year or years the credits were taken (rather than through adjustments to foreign tax credit pool of such CFC). The Relation-Back Year rule of section 14.02(3) of the Notice is consistent with this change.

© 2023 Baker & McKenzie

Applicability Dates (Sec. 15)

The Notice states that the forthcoming proposed regulations are expected to apply for taxable years beginning on or after January 1, 2024. Those proposed regulations will contain rules consistent with the guidance provided in (1) sections 3 through 7 of Notice 2023-7 (as modified by the Notice), (2) sections 3 through 5 of Notice 2023-20, and (3) sections 3 through 14 of the Notice.

Taxpayers may rely on the interim guidance in the specified sections of the Notices described above for taxable years ending on or before the date the proposed regulations are published in the Federal Register. Regardless of the date that the proposed regulations are published in the Federal Register, taxpayers may rely on the interim guidance for any taxable year that begins before January 1, 2024.

> ***Observation***: The statement that the forthcoming proposed regulations are expected to apply to taxable years beginning on or after January 1, 2024 suggests that Treasury and the IRS intend to issue those proposed regulations around the end of 2023 or very early in 2024. If this expectation is accurate, it puts more pressure on taxpayers to submit their comments on the Notice quickly.

Request for Comments (Sec. 16)

The Notice requests comments on a variety of topics addressed in the Notice, as well as topics that are not addressed in the Notice but which continue to be considered by Treasury and IRS. Comments are due by October 12, 2023, which is a very short comment period. Although the Notice indicates that Treasury and IRS will consider comments received after that deadline, as long as considering late comments will not delay issuing the proposed regulations, taxpayers would be well-advised to submit their comments as close to the deadline as possible.

For topics addressed by the Notice, the Notice requests general comments, as well as comments to address the following specific items:

- Whether simplified methods or safe harbors should be provided for applying the depreciation adjustment rules in section 56A(c)(13)
- How should a change in the treatment of an item that involves the proper time for taking such item into account for AFSI purposes be treated for AFSI purposes when such change is not otherwise treated as a change in a method of accounting for Regular Tax purposes because it does not affect taxable income (AFSI only change)?
- If a Taxpayer changes its method of accounting for Regular Tax purposes from deducting amounts paid or incurred to capitalizing and depreciating such amounts under sections 167 or 168, or vice versa, how should such change be taken into account for AFSI purposes?
- Should the term "wireless telecommunication carrier" in section 56(c)(14)(B)(i) be defined and, if so, should the NAICS classification for Wireless Telecommunications Carriers (except Satellite) be used?
- With respect to AFSI adjustments to prevent duplication or omission of income, can Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments (as defined in the Notice) be traced to a separate trade or business (as defined in Treas. Reg. § 1.446-1(d))?
- With respect to AFSI adjustments to prevent duplication or omission or income, what events should be considered a cessation of a trade or business for purposes of accelerating inclusion of an Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment? Should rules similar to those in section 7.03(4) of Rev. Proc. 2015-13 apply?

The Notice requests comments on topics that are not addressed in the Notice, and notes that Treasury and IRS are continuing to study (1) the scope of section 56A(c)(2)(C), (2) the extent to which any unrealized mark-to-market gains and losses that are recognized in the Taxpayer's FSI should be adjusted in determining the Taxpayer's AFSI, and (3) the manner in which a partner in a partnership determines its distributive share of the partnership's AFSI. The Notice states that these issues will be addressed in the proposed regulations. In addition, the Notice requests comments on the following:

- Are there circumstances where adjustments to AFSI are required to clearly reflect income?
- The scope of the definition of Covered Benefit Plan in section 56A(c)(11)(B)(iii), including whether certain plans described in the Pension Excise Tax Regulations qualify as a Covered Benefit Plan,

© 2023 Baker & McKenzie | 9

- What is the appropriate treatment of dividends received from, and gains or losses from dispositions of stock of, foreign corporations for purposes of computing a Taxpayer's AFSI? In particular, what approach(es) should be considered to address the potential duplication of income with respect to a CFC by reason of the application of section 56A(c)(2)(C) and (c)(3)?
- Should a branch that is not a disregarded entity be treated the same as a disregarded entity when applying the rules described in section 5.02(3)(c)(iii) of the Notice? Specifically, can a branch be treated as a member of the AFS Group separate from its owner for financial accounting purposes? If so, how does a financial accounting branch differ from (or compare to) a branch for US tax purposes?
- Is the rule in section 5.02(3)(c)(iii) of the Notice to eliminate transactions with a disregarded entity and investments in a disregarded entity appropriate in the cross-border context?

Observation: Given the tight deadline for comments and the clear signal that Treasury and IRS intend to issue proposed regulations around the end of the year, we strongly encourage taxpayers to meet the October 12th deadline for comments on their highest-priority issues. While taxpayers will obviously have another opportunity to provide comments on the proposed regulations, this appears to be the last opportunity to engage with Treasury and IRS on the contents of the proposed regulations before their release. Taxpayers would be well-advised to take advantage of that opportunity.

Conclusion

The Notice provides additional guidance on many of CAMT's fundamental components, but many significant questions--including how a partner determines its distributive share of partnership AFSI--remain outstanding and will be addressed in forthcoming guidance. While the Notice largely does not respond to comments previously submitted on Notice 2023-7, it is clear that Treasury and IRS have read and considered those comments and, in the case of timing differences and FSNOLs, have rejected those comments without explanation. Despite this, taxpayers should consider reiterating comments previously submitted and unaddressed and, in the case of comments that were explicitly rejected in the Notice, consider whether there are additional legal or policy rationales that would support the original request.

© 2023 Baker & McKenzie

Contact Us

Tom May
Partner
thomas.may@bakermckenzie.com

Daniel Stern
Partner
daniel.stern@bakermckenzie.com

Alexandra Minkovich
Partner
alexandra.minkovich@bakermckenzie.com

Sahar Zomorodi
Partner
sahar.zomorodi@bakermckenzie.com

Reza Nader
Partner
reza.nader@bakermckenzie.com

Brooke Radford
Associate
brooke.radford@bakermckenzie.com

Dominick Schirripa
Knowledge Lawyer
dominick.schirripa@bakermckenzie.com

© 2023 Baker & McKenzie. **Ownership:** This site (Site) is a proprietary resource owned exclusively by Baker McKenzie (meaning Baker & McKenzie International and its member firms, including Baker & McKenzie LLP). Use of this site does not of itself create a contractual relationship, nor any attorney/client relationship, between Baker McKenzie and any person. **Non-reliance and exclusion:** All information on this Site is of general comment and for informational purposes only and may not reflect the most current legal and regulatory developments. All summaries of the laws, regulation and practice are subject to change. The information on this Site is not offered as legal or any other advice on any particular matter, whether it be legal, procedural or otherwise. It is not intended to be a substitute for reference to (and compliance with) the detailed provisions of applicable laws, rules, regulations or forms. Legal advice should always be sought before taking any action or refraining from taking any action based on any information provided in this Site. Baker McKenzie, the editors and the contributing authors do not guarantee the accuracy of the contents and expressly disclaim any and all liability to any person in respect of the consequences of anything done or permitted to be done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this Site. **Attorney Advertising:** This Site may qualify as "Attorney Advertising" requiring notice in some jurisdictions. To the extent that this Site may qualify as Attorney Advertising. PRIOR RESULTS DO NOT GUARANTEE A SIMILAR OUTCOME. All rights reserved. The content of the this Site is protected under international copyright conventions. Reproduction of the content of this Site without express written authorization is strictly prohibited.