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Client Alert

United States: IRS releases initial interim guidance on new corporate alternative minimum tax

In brief

On 27 December 2022, Treasury and the IRS released Notice 2023-7 ("**Notice**"), the first installment of interim guidance on the corporate alternative minimum tax (CAMT), added as part of the Inflation Reduction Act (IRA). The guidance covers what the IRS considers to be "time-sensitive" CAMT issues intended to be addressed in forthcoming proposed regulations. The CAMT is effective for tax years beginning after 31 December 2022 and, therefore, is already effective for calendar-year corporate taxpayers. The Treasury and IRS intend on issuing additional guidance before anticipated proposed regulations, and they also intend on addressing issues not addressed in these series of notices in the proposed regulations.

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Key takeaways

- While limited in scope, the Notice provides useful guidance to corporations in computing their adjusted financial statement income (AFSI) both for purposes of determining their status as an applicable corporation and their CAMT liability (if any). Specifically, the provisions of the Notice:
  - Eliminate the impact (if any) on AFSI of certain transactions that qualify for nonrecognition treatment under sections 332, 337, 351, 354, 355, 357, 361, 368, 721, 731, and 1032 and provide guidance on the applicable corporation status of the parties following such transactions.
  - Eliminate the impact (if any) on AFSI of discharge of indebtedness income in an amount equal to the cancellation of debt income excluded under section 108 (and reduce AFSI tax attributes under the principles of section 108(b)).
  - Increase AFSI by the amount of book cost of goods sold (COGS) depreciation, depreciation expense, and other expenses and reduce AFSI by the amount tax COGS depreciation and deductible tax depreciation.
  - Provide a simplified AFSI test for determining applicable corporation status in which the dollar thresholds of the AFSI tests are halved but many of the more complicated adjustments to AFSI are eliminated.
  - Disregard the impact on AFSI of certain credits under sections 48D, 6417 and 6418.
  - Request comments on a myriad of topics addressed in the Notice and not addressed in the Notice.
- Taxpayers may rely on the Notice pending the release of proposed regulations, which are expected to apply to tax years beginning after 31 December 2022.

In more detail

Background

On 16 August 2022, President Biden signed the IRA, which imposes a CAMT on applicable corporations for any taxable year of such corporations beginning after 31 December 2022. Thus, in the case of a calendar year taxpayer, the first CAMT year began on 1 January 2023. Many of the CAMT provisions enacted by the IRA direct the Secretary to issue regulatory and other guidance that could significantly impact both the scope and the computation of the CAMT.

On 27 December 2022, Treasury and the IRS released the Notice. The Notice: (i) addresses the effects of certain nonrecognition transactions on calculating adjusted financial statement income (AFSI) and an entity or group's status as an applicable corporation subject to tax, (ii) provides for adjustments to AFSI to account for depreciation differences between financial and tax accounting, (iii) provides a safe harbor for calculating the three-year testing period, (iv) provides for adjustments relating to certain tax credits, and (v) provides a rule for determining applicable corporation status when the corporation holds partnership interests. The Notice also includes a five-page list of questions from the IRS requesting comments and input – both on issues addressed in the Notice and those that were not included and that taxpayers hope will be addressed in anticipated future interim guidance or the proposed regulations.

Nonrecognition Transactions

AFSI Adjustments

The Notice generally provides that gain or loss recognized for financial accounting purposes as a result of transactions that are nonrecognition transactions for US federal income tax purposes ("**Covered Nonrecognition Transactions**") will be not be taken into account when calculating AFSI. For this purpose, a Covered Nonrecognition Transaction is a transaction that qualifies for nonrecognition treatment for federal income tax purposes under sections 332, 337, 351, 354, 355, 357, 361, 368, 721, 731, or 1032, and that does not result in any gain or loss being recognized by the corporation or partnership that is the taxpayer party (or a component of the taxpayer group) for US federal income tax purposes. The Notice also addresses transactions, such as a transfer, sale, contribution, distribution, or other disposition of property, which result in gain or loss for US federal income tax purposes ("**Covered Recognition Transactions**").

As a corresponding adjustment, in Covered Nonrecognition Transactions, the party receiving the transferred property will also not take into account any basis adjustments required by the relevant accounting standards as a result of the gain or loss recognized for book purposes. This adjustment applies to the year of the transaction as well as all future years, meaning that the adjustment must be accounted for on a sale or other disposition of the asset in a future tax year. In effect, for purposes of calculating AFSI, the taxpayer must carry the asset with a transferred basis equal to the transferor's basis just prior to the transaction.

The Notice provides examples and definitions that are helpful in applying the guidance on nonrecognition transactions. In Example 1, Acquiring AFS (applicable financial statement) Group acquires Target, a member of Target AFS Group solely for stock, merging Target into a member of the acquiring group in an A reorganization. The merger results in financial accounting gain to both Acquiring AFS Group and Target AFS Group, as well as increases to financial accounting basis in the assets received. In determining AFSI, neither the acquiring nor target groups will take into account the financial gain resulting from application of the relevant accounting standards for the year of the merger. The increases or decreases in financial accounting basis of the received assets are also not taken into account for AFSI purposes. Example 2 demonstrates that, when Acquiring AFS Group sells some of the assets acquired in the merger, the Acquiring AFS Group must treat the sale as resulting in financial accounting gain equal to the difference between the value of the assets and the basis as adjusted to not take into account the increase or decrease relating to the merger.

Example 3 describes the consequences of a split-off transaction. Distributing AFS Group contributes property to a new Controlled in exchange for stock, Controlled's assumption of certain liabilities, cash, and securities. As part of the plan, Distributing distributes the stock to certain of its shareholders over the course of the tax year. These transactions qualify for nonrecognition under sections 368(a)(1)(D) and 355, 357, and 361 (to Distributing), and section 1032 (to Controlled). In further pursuance of the plan, Distributing transfers the cash and securities to its creditors in deleveraging transactions that are nonrecognition transactions under section 361 (cash for debt and debt for debt exchange). Each of the transactions results in financial accounting gain to each party and basis increases to the assets Controlled receives under the relevant standards. In determining AFSI, Distributing will not take into account the gain resulting from each of the transaction steps for the year of the split-off because each of the steps qualifies as a nonrecognition transaction. The conclusion is the same even if the creditors were to recognize gain for tax purposes as a result of the transaction.

In evaluating whether a transaction is a Covered Nonrecognition Transaction or a Covered Recognition Transaction, each component transaction of a larger transaction must be reviewed separately to determine whether it is a Covered Nonrecognition Transaction or a Covered Recognition Transaction. This rule is demonstrated by Example 4, which is based on Example 3 except that during the relevant taxable year, Distributing fails to transfer the Controlled securities to Distributing's creditors and the debt for debt exchange is a Covered Recognition Transaction.

When calculating AFSI for the year, Distributing would still not take into account the financial accounting gain resulting from the other steps of the transaction (the initial contribution of property to Controlled, the split-off, the liability assumption, and the cash for debt exchange). It would only have to include in AFSI the financial accounting gain resulting from the debt for debt exchange because only that step is a Covered Recognition Transaction. The inclusion of that financial accounting gain also means that Controlled's financial accounting basis in the assets it receives will be increased for AFSI purposes by the gain resulting from the debt for debt exchange.

> **Observation:** As demonstrated by the outcome in Example 4, distinct component steps in a larger transaction that qualify as Covered Nonrecognition Transactions can give rise to AFSI adjustments even if other distinct component steps are treated as Covered Recognition Transactions for CAMT purposes that do not give rise to AFSI adjustments.

A transaction must also be evaluated as a whole under all applicable Code provisions and general principles (such as step transaction doctrine) in order to determine if the transaction and the individual steps within it qualify as Covered Nonrecognition Transactions or Covered Recognition Transactions. Example 5 demonstrates that if a partner contributes property to an existing partnership and soon thereafter the partnership distributes cash to that partner, the taxpayer cannot solely evaluate each step separately and claim that the contribution is a nonrecognition transaction under section 721 and the distribution is a nonrecognition transaction under section 731. Section 707 and Treas. Reg. § 1.707-3 would apply to recharacterize the two steps as a single part-sale, part-contribution that would be treated for CAMT purposes as a Covered Recognition Transaction.

> **Observation:** Example 5 in the Notice states that the qualification of each component transaction of a larger transaction is determined based on the federal income tax consequences of all other component transactions of such larger transaction and concludes that the larger transaction is a Covered Recognition Transaction warranting no adjustments to AFSI. Example 5 reaches this conclusion notwithstanding that the purported section 721 contribution and the purported section 731 distribution therein only results in recognition of gain or loss in part. There is clearly an inconsistency between treating component steps of a larger Covered Transaction as, in part, a Covered Nonrecognition Transaction and, in part, a Covered Recognition Transaction as in Example 4 while treating a larger Covered Transaction as a Covered Recognition Transaction in whole because gain or loss is recognized in part as in Example 5.

AFSI Allocations in Reorganizations

Where a taxpayer acquires a target entity from another group that is consolidated for financial accounting purposes, such that it creates a "Test Group" (defined as all persons treated as a single employer for purposes of section 52 or all entities included in a foreign-parented multinational group), AFSI of the target group for the prior three tax years (the testing period for purposes of determining applicable corporation status) must be allocated between the target group and the acquired entity. This allocation is necessary for both Covered Nonrecognition Transactions and Covered Recognition Transactions. The Notice provides that AFSI can be allocated using any reasonable method pending proposed regulations (which will set out a required allocation method). If the target was an applicable corporation prior to the acquisition, that status terminates. The allocated AFSI of the target is then added to the acquiring group's AFSI and covered status of the acquiring group is then determined. The target group never reduces its AFSI for prior years by the amount allocated to the target and thus could remain an applicable corporation potentially subject to CAMT.

Example 6 uses the facts of Example 1 (an A reorganization merger of Target into a member of Acquiring AFS Group solely in exchange for stock) and adds the following: Target AFS Group has AFSI of USD 1.3 billion for 2020, USD 1.2 billion for 2021, and USD 1.1 billion for 2022. Acquiring AFS Group has AFSI of USD 800 million for 2020, USD 900 million for 2021, and USD 1 billion for 2022. Target AFS Group allocates to Target AFSI of USD 50 million for 2020, USD 100 million for 2021, and USD 200 million for 2022. The merger results in Acquiring AFS Group and Target being treated as a Test Group. As a result of being treated as a Test Group, Acquiring AFS Group will be an applicable corporation for its 2023 tax year as it will have an average annual AFSI ("AAAFSI") for the testing period of USD 1.017 billion, which is total AFSI of USD 3.05 billion (USD 850 million for 2020 (USD 800 million + USD 50 million from Target), USD 1.0 billion for 2021 (USD 900 million + USD 100 million from Target), and USD 1.2 million for 2022 (*USD 1 billion + $200 million from Target) divided by 3. Because Target AFS Group does not reduce its AFSI for amounts allocated to Target, it will also be an applicable corporation for 2023.

Where an entire target group is acquired, the same rules apply, except that the entire AFSI of the target group is "transferred" to the acquiring group. The target's status as an applicable corporation (if it was one) terminates and the acquiring corporation will determine its status based on the combined AFSI.

A similar rule applies when a distributing corporation distributes a controlled corporation to its shareholders. If Controlled was an applicable corporation, that status terminates. Controlled must be allocated a portion of the distributing group's AFSI using any reasonable method (pending proposed regulations, which will set out a required method). Distributing will not reduce AFSI for periods prior to the distribution by the amount allocated to Controlled and, therefore, if Distributing was an applicable corporation, it will remain so. Controlled will then determine applicable corporation status based on its allocated AFSI, plus any standalone AFSI from the portion of the year after the distribution.

Example 7 uses the split-off transaction in Example 3 to illustrate the impact of AFSI allocation in a divisive transaction (but not a specific methodology for allocating AFSI). Distributing has AFSI of USD 2.1 billion for 2020, USD 2.0 billion for 2021, and USD 1.9 billion for 2022. Distributing allocates to Controlled USD 950 million of AFSI for 2020, USD 1.2 billion for 2021, and USD 1 billion for 2022. Controlled has AFSI of USD 300 million for 2022 from the post-split standalone period. As a result, Controlled will be an applicable corporation for its 2023 tax year, having an AAAFSI of USD 1.15 billion for the test period, (USD 3.45 billion (USD 950 million in 2020, USD 1.2 billion in 2021 and a total of USD 1.3 billion in 2022) in AFSI divided by 3). Distributing will not reduce its AFSI for 2020, 2021, or 2022, so it will be an applicable corporation for its 2023 tax year.

In calculating AFSI for purposes of both the test for applicable corporation status and for determining CAMT liability, a consolidated group for tax purposes is treated as a single entity.

Cancellation of Debt Income

Under applicable financial accounting standards, cancellation of debt can result in financial accounting gain even where section 108 would allow for exclusion of any cancellation of debt (COD) income for tax purposes. The Notice includes adjustments to account for these mismatch situations along with other nonrecognition transactions such as bankruptcy reorganizations (under section 368(a)(1)(G)).

If a debt discharge gives rise to COD income that is excluded from taxable income under section 108, but results in financial accounting gain on the taxpayer's AFS under the relevant accounting standards, the financial accounting gain, up to the amount of income excluded for tax purposes, will not be taken into account when calculating AFSI for the year of the debt discharge. Where such financial accounting gain is not taken into account under this rule, the taxpayer's CAMT attributes must be reduced by the amount of attribute reduction required under section 108(b) in light of the COD exclusion (noting that the amount excluded from income under section 108 may be greater than the amount of such attribute reduction under section 108(b)). The CAMT attribute reduction must take account of the ordering principles set forth in sections 108(b) and 1017.

In Example 8, Parent is the common parent of a consolidated group for tax purposes that is also a consolidated group for financial accounting purposes. In 2022, Parent emerges from a bankruptcy proceeding in which all members of the group were under bankruptcy court jurisdiction. As a result of the reorganization, USD 10 million of Parent group debt is discharged, all of which is excludible for tax purposes under section 108. However, the Parent group also must reduce its attributes by USD 8.5 million under section 108(b). Former creditors of Parent now own 100% of Parent's stock, but none controls Parent such that the group would be consolidated with another group for financial accounting purposes after the bankruptcy. The relevant accounting standard requires the Parent group to take into account the full USD 10 million of discharged debt as financial accounting gain. In determining AFSI for 2022, the Parent group would disregard the financial accounting gain taken into account under the relevant accounting standard. The Parent group would also reduce its CAMT attributes (accounting for sections 108(b) and 1017 ordering) by the amount (USD 8.5 million) required under section 108(b).

The Notice also addresses the situation where the relevant accounting standards result in a taxpayer having financial accounting gain (and corresponding adjustments to the financial accounting basis of its assets) as the result of an emergence from bankruptcy even in the absence of a section 108 exclusion. In such a situation, the resulting financial accounting gain will not be taken into account for purposes of determining AFSI for the tax year the taxpayer emerges from bankruptcy. In addition, any corresponding increases or decreases to the financial accounting basis of its assets (other than adjustments required as part of a COD exclusion resulting in section 108(b) attribute reductions) are not taken into account in determining AFSI for any tax year of the that party (i.e., the party must carry the assets with an AFSI basis equal to the asset's basis immediately prior to the emergence from bankruptcy and use that basis in calculating AFSI for future years).

Depreciation Deductions

Depreciation expense recorded for financial statement purposes may differ substantially from depreciation deductions allowed for US federal income tax purposes due to differences in, among other things, the depreciation method, the recovery period (or useful life), and the salvage value of an asset. For example, depreciation expense for financial statement purposes is calculated using the straight line method for many assets while section 168 allows deductions based on the use of the modified accelerated cost recovery system, including 80% of the adjusted basis of qualified property placed in service before 1 January, 2024 (and declining 20% per year for property placed in service thereafter) for purposes of section 167. Section 56A(c)(13) attempts to eliminate this difference by adjusting AFSI to take into account depreciation computed under section 168 rather than depreciation computed for financial statement purposes.

First, section 56A(c)(13)(A) provides that the taxpayer's AFSI is reduced by depreciation deductions allowed under section 167, with respect to property to which the accelerated cost recovery system of section 168 applies, to the extent such amounts are allowed as deductions in computing the taxable income of the taxpayer for the taxable year. Second, section 56A(c)(13)(B)(i) requires that AFSI be "appropriately" adjusted to disregard any amount of depreciation expense that is taken into account on the taxpayer's applicable financial statement with respect to such property. Third, section 56A(c)(13)(B)(ii) requires that AFSI be "appropriately" adjusted, "to take into account any other item specified by the Secretary in order to provide that such property is accounted for in the same manner as it is accounted for under this chapter." The Notice confirms and expands on the statutory language by providing that, for purposes of section 56(c)(13)(A), AFSI is: (i) reduced by tax depreciation that is capitalized to inventory and recovered as part of cost of goods sold (COGS), (ii) reduced by depreciation deductions allowed by section 167 with respect to section 168 property, (iii) adjusted to disregard book COGS depreciation, depreciation-related deductions and related expenses, and (iv) adjusted for other items as provided in guidance published in the Internal Revenue Bulletin.

In the Notice, Treasury and the IRS clarify that, for purposes of section 56A(c)(13), property to which section 168 applies consists of: (i) modified accelerated cost recovery system property, as defined in Treas. Reg. § 1.168(b)-1(a)(2), that is depreciated under section 168; (ii) computer software that is qualified property as defined in Treas. Reg. §§ 1.168(k)-1(b)(1) or 1.168(k)-2(b)(1), as applicable, and depreciated under section 168; and (iii) other property depreciated under section 168 that is both qualified property as defined in Treas. Reg. § 1.168(k)-2(b)(1) and described Treas. Reg. § 1.168(k)-2(b)(2)(i)(E), (F), or (G).

Section 56A(c)(13) applies only to the portion of the cost property that is depreciated under section 167 and section 168. For example, if a portion of the cost of property is deducted under section 181, that portion is not subject to adjustments. Additionally, if a taxpayer elects out of the additional first year depreciation deduction under section 168(k) for property otherwise qualifying as described in (ii) or (iii) above, then AFSI is not adjusted under section 56A(c)(13) with respect to such property because section 168 would not apply to such property. Further, if a taxpayer deducts an expenditure as a repair for tax purposes but capitalizes the expenditure as an improvement for AFS purposes, section 56A(c)(13) would not apply because the expenditure does not give rise to section 168 property.

Similar to the nonrecognition rules described above, AFSI adjustments are necessary for dispositions to reconcile any adjustments made in prior years to AFSI. If a taxpayer disposes of section 168 property, the taxpayer must adjust AFSI to redetermine any gain or loss taken into account in the net income or loss on the taxpayer's AFS with respect to such disposition by adjusting the AFS basis of the property to take into account all current and prior section 56A(c)(13) adjustments, including those that would have been made in taxable years prior to the effective date of the CAMT had the CAMT applied in those years.

The Notice illustrates these rules through the following example. Taxpayer is an applicable corporation for the calendar year ending 31 December 2023. On 1 January 2018, taxpayer purchased and placed in service Property A, a section 168 property, at a cost of $1,000x. Property A qualified for, and taxpayer claimed, the 100% additional first year depreciation deduction allowable under section 168(k) for its taxable year ending 31 December 2018. For AFS purposes, taxpayer depreciates Property A over 40 years on a straight-line method and recognized USD 25x (USD 1,000x cost / 40 years) of expense for AFS purposes in 2018 and each year thereafter until it sold Property A on 1 January 2024 for USD 900x. For 2024, Taxpayer takes into account USD 50x of net gain for the sale of Property A in the net income or loss set forth on its AFS (USD 900x proceeds - USD 850x of AFS basis (USD 1,000x cost - USD 150x accumulated depreciation expense as of 1 January 2024)). In determining AFSI for the taxable year ending 31 December 2023, taxpayer does not have any deductible tax depreciation or tax COGS depreciation in computing taxable income with respect to Property A, and thus, the adjustment would be zero. In addition, taxpayer would adjust AFSI to disregard the USD 25x of depreciation expense with respect to Property A. To determine the AFSI adjustment for the gain or loss from the sale of Property A, taxpayer must adjust the AFS basis to take into account the cumulative section 56A(c)(13) adjustments, starting from the date Property A was placed-in-service. Accordingly, the adjusted basis of Property A for AFSI purposes is zero ($850x AFS basis + USD 150x accumulated depreciation expense - USD 1,000x of accumulated tax depreciation). Thus, the redetermined gain on the sale of Property A for AFSI purposes is USD 900x (USD 900x proceeds - USD 0 adjusted AFSI basis).

> **Observation:** It should be noted that the delegation of authority to the Secretary in section 56A(c)(13)(B)(ii) is quite broad and limited only "to take into account any other item specified by the Secretary in order to provide that such property is accounted for in the same manner as it is accounted for under this chapter." It remains to be seen what other adjustments, such as salvage value, date placed in service, etc., Treasury and the IRS believe are appropriate or necessary in this regard.

Applicable Corporation Safe Harbor

The Notice provides a safe harbor ("**simplified method**") for corporations to determine whether they are an applicable corporation for the first taxable year beginning after 31 December 2022 in lieu of the rules in section 59(k)(1) and (2). Under the simplified method, a corporation determines whether it is an applicable corporation by applying the rules in section 59(k)(1) and (2) with the following modifications: (i) the AFSI test in section 59(k)(1)(B)(i) is applied by substituting "USD 500,000,000" for "USD 1,000,000,000"; (ii) in the case of a foreign parented multinational group (FPMG), the AFSI test in section 59(k)(1)(B)(ii)(II) is applied by substituting "USD 50,000,000" for "USD 100,000,000"; (iii) with certain exceptions (relating to taxes, effectively connected income, consolidated financial statements, and consolidated tax returns), AFSI is determined without regard to the general adjustments in section 56A(c) and the deduction for financial statement net operating loss in section 56A(d) but taking into account AFS consolidated entries except those that eliminate transactions between persons not treated as a single employer; and (iv) for a corporation that has an AFS that covers a period ("**AFS year**") that differs from its taxable year, the three-year AFSI tests, as modified above, are applied by reference to the AFS years of such corporation ending within its taxable year (e.g., if a calendar year corporation has an AFS year that ends 30 September, in determining whether the corporation is an applicable corporation for its tax year ending 31 December 2023, the corporation uses its 30 September 2020, 30 September 2021, and 30 September 2022 financial statements).

The Notice illustrates the application of the AFS consolidated entries rule described above through the following example. Corporations A, B, and C are US corporations that are members of an AFS Group (ABC group). A and B (but not C) are treated as a single employer under section 52(a). A, B, and C choose to apply the simplified method. During the 2022 taxable year, A provides services to B and C. For purposes of the 2022 AFS for the ABC group, AFS consolidation entries are made to eliminate income and expense from the provision of service transactions between A and B, and between A and C. For purposes of applying the simplified method, the AFSI of A and B for the 2022 taxable year is determined by taking into account the AFS consolidation entries that eliminate the income and expense from the transactions between A and B. However, the AFS consolidation entries that eliminate income and expense from the provision of service transactions between A and C are not taken into account for purposes of determining the AFSI of A, B, and C because A and C are not treated as a single employer under section 52(a).

Even if a corporation does not meet the safe harbor based on application of the simplified method, it will be an applicable corporation only if it is determined to be an applicable corporation under section 59(k)(1).

> **Observation:** The simplified rules of the safe harbor should help certain corporations to avoid performing some of the more complex adjustments necessary to apply the statutory AFSI tests. On the other hand, given that the monetary thresholds have been halved, the safe harbor may be of limited utility to larger corporations.

Other Adjustments

The advanced manufacturing investment credit provided in section 48D, incentivizing semiconductor manufacturing, provides an election under section 48D(d) that allows taxpayers to treat the credit as a direct payment against income taxes (and thus eligible for refund if such payment exceeds the taxpayer's actual tax liability for the applicable year). Generally, this direct payment does not result in an income inclusion for tax purposes, but the relevant accounting standards may result in a gain. A similar situation arises under section 6417, added by the IRA, which allows for an election to treat certain credits (generally "green energy" credits) as direct payments against income tax. Under section 6418, taxpayers may sell certain eligible credits (again, generally "green energy" credits) for cash, with the payment received being excluded from income for tax purposes. However, as with the sections 48D and 6417 elections, these payments can give rise to financial accounting gain.

In order to account for these mismatches, the Notice provides that any amount of financial accounting gain resulting from an election under sections 48D or 6417 to treat the applicable credit as a direct payment of tax will not be taken into account in calculating AFSI unless that amount is already disregarded under section 56A(c)(5) (which generally provides for an adjustment to AFSI to disregard federal income taxes and foreign income, war profits, or excess profits taxes taken into account on the AFS). In addition, amounts received as a payment for the transfer of a credit under section 6418 that are excludible from income for tax purposes under section 6418(b) (or treated as exempt income under section 6418(c)(1)(A)) but result in financial accounting gain are disregarded in determining AFSI unless already disregarded under section 56A(c)(5). Payments received by partners or S corporation shareholders under the provisions of section 48D(d)(2) or section 6417(c) that are treated as tax exempt income are likewise disregarded to the extent those payments are treated as tax exempt income under those sections.

Section 56A(c)(2)(D)(i) requires an adjustment to AFSI where the taxpayer is a partner in a partnership so that only the taxpayer's distributive share of the partnership's AFSI is taken into account in the taxpayer's AFSI. However, section 59(k)(1)(D) provides that this adjustment is not included when determining whether the taxpayer is an applicable corporation. Treasury and the IRS note their understanding that uncertainty exists about whether this adjustment applies in determining applicable corporation status where the corporation and a partnership in which the corporation is a partner are not treated as a single employer under section 52(a) or (b). The Notice clarifies that the section 56A(c)(2)(D)(i) adjustment does not apply in any circumstance when determining applicable corporation status.

> **Observation:** The Notice does not address whether such credits would be considered to be qualified refundable tax credits for purposes of the OECD's Pillar Two though it seems that they could be.

Request for Comments

Although the Notice addresses several topics of import to taxpayers, it leaves a range of topics uncovered and many questions unanswered. Treasury and the IRS acknowledge as much by requesting comments on numerous topics not included in the Notice as well as comments on the topics that are addressed by the Notice. Comments are due 60 days after publication of the Notice in the Internal Revenue Bulletin, but late comments will be considered so long as consideration would not delay the issuance of proposed regulations. Items not covered in the Notice, but included in the comment requests include:

- The facts and circumstances that are relevant to determining the application of the two exclusions from applicable corporation status under section 59(k)(1)(C)(i), including the transaction that should constitute a "change in ownership," when a corporation should remain an applicable corporation even after a change in ownership, and how many years of failing to meet the AFSI test should be required before applicable corporation status ceases.
- Whether the rules under section 451(b)(5) should be modified in determining the AFSI of a corporation included in a consolidated financial group (which seems particularly important given the preference for US generally accepted accounting principles over international financial reporting standards in the existing section 451 regulations).
- The scope of the section 59(k)(1)(D) exception to the AFSI adjustment in section 56A(c)(2)(D)(i) concerning partnership distributive shares and the interpretation and calculation of "distributive share" itself for purposes of the adjustment.
- Other adjustments that will be necessary to carry about the purposes of part II of subchapter K (partnership contributions and distributions), including the need for exceptions to the rule on Covered Nonrecognition Transactions in the partnership transaction context.
- Situations where AFSI is omitted or duplicated as a result of applying section 52(a) or (b) under section 59(k)(1)(D) (treating AFSI of entities treated as a single employer with the taxpayer as AFSI of the taxpayer) and what guidance is needed to prevent such duplication or omission.
- The precise scope and contours for entities that should be treated as "predecessors" for purposes of the applicable corporation provisions, and to what extent the predecessor concepts should apply to the CAMT beyond applicable corporation status determinations.
- Appropriate rules applicable to FPMGs under section 59(k)(2)(D)(i).
- Adjustments necessary to account for the financial deconsolidation of a member of an AFS group.
- Whether attribute limitation principles such as those in sections 382 and 383 and Treas. Reg. §§ 1.1502-21(c) and 1.1502-15 should apply to CAMT attributes for purposes of calculating the tentative minimum tax.
- The allocation and use of CAMT liability, financial statement NOLs, and CAMT credits among members of a consolidated group, and the allocation of CAMT attributes to a departing member of a tax consolidated group.
- How to account for items included in other comprehensive income on the financial statements for purposes of the AFSI calculation.
- Whether and to what extent adjustments should be provided to address unrealized mark to market gains and losses that are otherwise included (or not included) in AFSI.

In relation to areas covered by the Notice, Treasury and the IRS request comments on several questions, notably:

- What the AFSI consequences should be of transactions resulting in partial gain or loss recognition for tax purposes.
- Should transactions solely between members of a single AFS group result in AFSI adjustments.
- How AFSI allocation to a Target or Controlled should be calculated, and whether there is reason for the allocation methods for a Target and a Controlled to differ.
- What CAMT attributes should be adjusted in the COD exclusion and emergence from bankruptcy contexts and the methodology to be used for such adjustments (including ordering).
- The treatment of bankruptcy reorganizations for purposes of calculating AFSI.
- The method for making adjustments relating to Tax COGS Depreciation.

  Observation: The Notice makes no attempt to address whether and how the CAMT interacts with the rules of the OECD's Pillar Two, which now seem destined to be adopted by the European Union, the United Kingdom, and other major trading partners of the United States. For example, the Notice does not assert that the CAMT is a domestic top-up tax, a controlled foreign corporation tax, or perhaps some combination of the two. However, there is still time to try to address these types of issues as other countries finalize and adopt their rules.

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