Proposed CAMT rules create reporting and compliance challenges

The recently issued proposed regulations on the corporate alternative minimum tax (REG-112129-23) underscore the complexity of the CAMT regime. The reporting and compliance burdens will fall on a variety of taxpayers, many of which may ultimately fall below the thresholds and not owe any tax.

The proposed regulations were released on Sept. 12, 2024, and follow initial guidance released in a series of notices (Notices 2023-7, 2023-20, 2023-64, and 2024-10). The new comprehensive set of rules provide key definitions and operating rules related to the scope and computation of the CAMT. The proposed regulations largely incorporate the rules provided in the notices, but also provide additional new detailed rules that can be very complex. The reporting and compliance responsibilities may affect a larger group of taxpayers than initially suspected. This article discusses some of the key issues for taxpayers who may be affected.

Background

The CAMT was enacted by the Inflation Reduction Act of 2022 and is effective for tax years beginning after Dec. 31, 2022. The CAMT applies only to certain "Applicable Corporations" as defined under Section 59(k) and imposes a 15% minimum tax on the "adjusted financial statement income" (AFSI) of an Applicable Corporation.

An "Applicable Corporation" means any corporation (other than an S corporation, a regulated investment company (RIC), or a real estate investment trust (REIT)) which has average annual AFSI exceeding $1 billion for a three-taxable-year period ending with that taxable year (the "General AFSI Test").

There is a different two-pronged test for determining Applicable Corporation status for domestic members of a foreign-parented multinational group (FPMG). First, similar to the General AFSI Test, the FPMG member must have average annual AFSI that exceeds the $1 billion threshold (the "FPMG $1 Billion Test"). Then the FPMG member must have average annual AFSI of at least $100 million for the applicable three-taxable-year period (the "FPMG $100 Million Test").

For purposes of determining whether a corporation is an Applicable Corporation, the AFSI of the corporation is aggregated with the AFSI of all persons treated as a single employer with under Sections 52(a), applying to corporations that are members of the same controlled group, or 52(b), applying to trades or businesses that are under common control (the Aggregation Rule).

For the first taxable year beginning after Dec. 31, 2022, Notice 2023-7 provided that a corporation may choose to apply a safe harbor method for determining Applicable Corporation status (the "Simplified AFSI Test").

The Simplified AFSI Test allows a corporation to determine whether it is an applicable corporation with the following modifications:

- The General AFSI Test is applied by substituting $500 million for $1 billion
- The FPMG $1 Billion Test is applied by substituting $500 million for $1 billion
- The FPMG $100 Million Test is applied by substituting $50 million for $100 million

The tax itself applies to the extent that an Applicable Corporation's tentative minimum tax for a taxable year exceeds the sum of regular tax and any base erosion minimum tax (BEAT) under Section 59A. The tentative minimum tax for a taxable year is 15% of AFSI for the taxable year and also includes, if applicable, a foreign tax credit determined under special rules for CAMT purposes (a CAMT FTC).

The AFSI of a taxpayer is defined in Section 56A starting with the net income or loss of a taxpayer set forth on the taxpayer's applicable financial statement (AFS) subject to a number of adjustments provided in Section 56A. The statute provides authority for other adjustments determined by the Treasury Secretary to be necessary to carry out the purposes of Section 56A. AFSI is reduced by a deduction for financial statement net operating loss (FSNOL) pursuant to Section 56A(d).

Computing AFSI

The proposed regulations provide detailed rules related to the computation of AFSI starting with the determination of a CAMT entity's applicable financial statement (AFS) and financial statement income (FSI).

AFS

The proposed regulations provide rules for determining the AFS used for purposes of determining a CAMT entity's FSI based on a hierarchical list. A CAMT entity's AFS will be its financial statement with the highest priority on the IRS's list, which may include:

- GAAP statements that are certified
- IFRS statements that are certified
- An audited financial statement, other than a tax return, that is certified as being prepared in accordance with accepted accounting standards other than GAAP and IFRS
- A financial statement, other than a tax return, that is filed with certain government or government agency or self-regulatory organization, including a state agency that regulates insurance companies
- Unaudited financial statements prepared for an external non-tax purpose using GAAP, IFRS, or any other accepted accounting standards issued by an accounting standards board
- The taxpayer's federal income tax return or information return filed with the IRS

Additional rules in the proposed regulations provide which AFS is used when a taxpayer is included in more than one AFS.

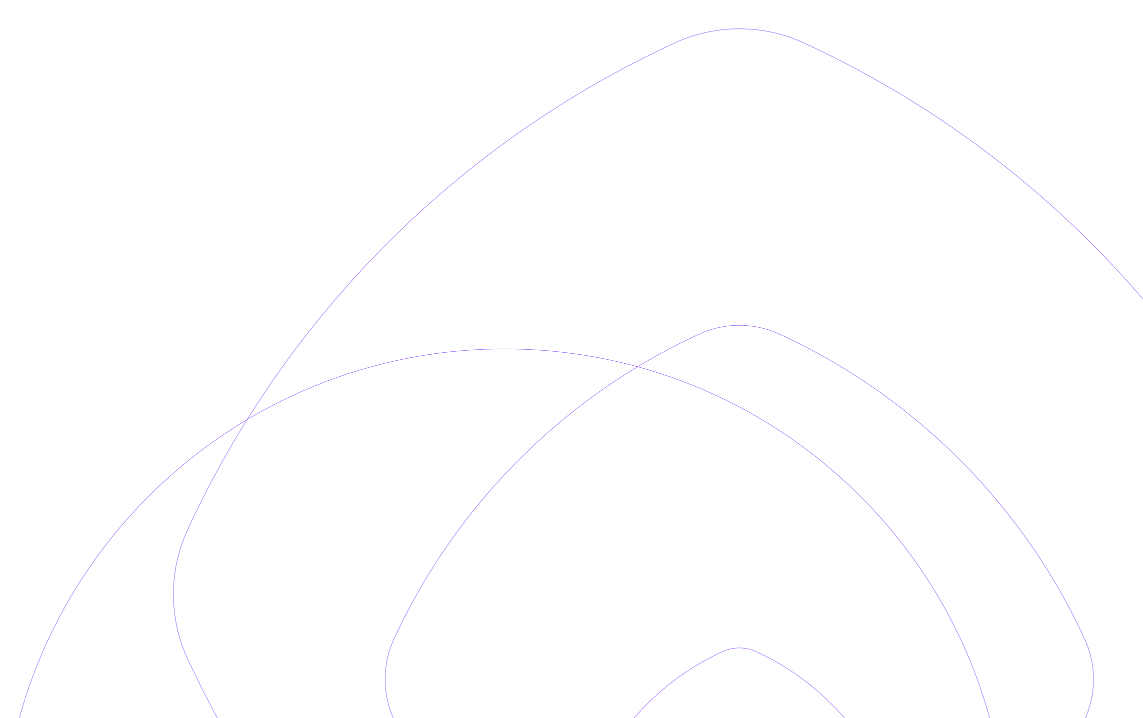
Determining FSI

Generally, FSI includes all of the CAMT entity's items of income, expense, gain and loss reflected in the net income or loss set forth on such income statement for a taxable year, including nonrecurring items and income or loss from discontinued operations. FSI does not include amounts reflected in equity such as retained earnings and other comprehensive income. FSI includes all of the CAMT entity's items regardless of whether the amounts are realized, recognized, or otherwise taken into account for federal income tax purposes.

If a CAMT entity's AFS is a consolidated AFS, it must determine the amount of net income on the consolidated AFS that is its own FSI. Generally, a CAMT entity's FSI is determined without regard to the financial results of other CAMT entities that are members of the same financial statement group; for example, the loss of one CAMT entity may not offset the income of another CAMT entity for purposes of determining each entity's FSI.

In addition, a CAMT entity's FSI is determined without regard to certain consolidation entries that either: (i) eliminate the effect of transactions between the CAMT entity and another CAMT entity that is a member of the same AFS group; or (ii) eliminate income, loss, expense, asset, liability or other item of the CAMT entity with respect to its investment in another CAMT entity that is a member of the same financial statement group.

Other consolidation entries that are not reflected in the separate books and records of a CAMT entity must be allocated, or pushed down, and taken into account in the FSI of each CAMT entity to which they relate.



AFSI adjustments

The proposed regulations clarify that AFSI includes all of the CAMT entity's items regardless of whether the amounts are realized, recognized, or otherwise taken into account for federal income tax purposes and that a CAMT entity may not make adjustments in determining AFSI other than those provided in the proposed regulations under Section 56A.

The proposed regulations introduce the concept that gain and loss in FSI may need to be redetermined for AFSI purposes. Generally, unless provided otherwise by specific rules, a gain or loss in FSI with respect to an item that has a different basis for CAMT purposes (CAMT basis) than for FSI purposes (AFS basis), must be redetermined for AFSI purposes by refence to the CAMT basis of the item if that gain or loss is otherwise recognized for AFSI purposes under the Section 56A regulations.

AFSI must be expressed in U.S. dollars, and a CAMT entity with an AFSI that is not already in U.S. dollars must translate AFSI to U.S. dollars using a specified weighted average exchange rate after all applicable adjustments.

The proposed regulations include specific rules under Section 56A for adjustments for the following:

- Differences in an AFS year and taxable year
- Foreign corporations
- A partner's distributive share of partnership AFSI
- Controlled foreign corporations
- Certain federal and foreign income taxes
- Disregarded entities or branches
- Cooperatives
- Alaska Native Corporations
- Certain tax credits
- Covered benefit plans
- Tax exempt entities
- Section 168 property
- Qualified wireless spectrum property
- Preventing certain duplications and omissions
- Certain corporate transactions and certain corporate reorganizations and organizations
- Applying certain subchapter K principles
- Troubled companies
- Certain insurance companies and other specified industries
- FS NOLs and other attributes
- Hedging transactions and hedged items
- Mortgage servicing income
- Certain related party transactions and CAMT avoidance transactions
- Foreign governments

Below is a summary of notable rules relating to certain adjustments.

Federal and foreign income tax

The proposed regulations would mandate an adjustment to disregard applicable income taxes consistent with the statute. The adjustment would apply to federal income taxes and foreign income taxes taken into account in a CAMT entity's AFS as current tax expense, deferred tax expense, or through increases or decreases of AFS accounts of the CAMT entity. There are special rules for an Applicable Corporation that chooses not to credit foreign income taxes. The proposed regulations also provide requirements for when an applicable income tax is considered to be taken into account.

Section 168 depreciation

Section 56A(c)(13) provides that taxpayers can generally use Section 168 tax depreciation to reduce AFSI while disregarding any related depreciation expense included in computing FSI.

The proposed regulations under Prop. Reg. Sec. 1.56A-15 provide relevant definitions, adjustments (including timing), and examples for the AFSI adjustments required for Section 168 property. While the proposed regulations are generally consistent with the prior notices, they add new definitions, adjustments and examples that will impact the computation of AFSI for affected taxpayers.

The proposed regulations define Section 168 property to be any property "depreciable" under Section 168, including property placed in service (PIS) in taxable years ending on or before Dec. 31, 2019. This definition would include items not yet PIS for regular tax purposes and certain intangible property that is eligible for bonus depreciation, even if the taxpayer elects out of bonus depreciation. The definition of Section 168 property continues to exclude amounts that are deductible under another provision (e.g., Section 179 or the portion of certain intangibles recovered under Section 181) and does not apply to deductible expenditures for regular tax purposes (e.g., repairs and maintenance).

Grant Thornton Insight: The modified definition in the proposed regulation simplifies the identification of Section 168 property by including all property "depreciable" under Section 168, regardless of PIS date, but still distinguishes between depreciable property and property that is expensed (e.g., repairs expense), which requires tracking on an asset-by-asset level. Further, by referencing the bonus depreciation regulations (which include a PIS date requirement), certain intangible property like computer software would cease to be Section 168 property if it is PIS after Dec. 31, 2026, which means similar property may be treated differently for AFSI purposes.

The required adjustments to compute AFSI remain similar to those in the notices, with some modification for the newly defined terms in the proposed regulations. AFSI is generally (1) reduced by tax COGS depreciation and deductible tax depreciation; (2) adjusted to disregard covered book COGS depreciation, covered book depreciation expense, covered book expense and any AFS basis recovery with respect to property that was previously disposed of for regular tax purposes; and, (3) increased or decreased, as appropriate, for any tax depreciation Section 481(a) adjustment or tax capitalization method change AFSI adjustment.

Grant Thornton Insight: The adjustments required for Section 168 property are complex and may be difficult to compute and track. Effectively, taxpayers will need to have another set of books and records to track Section 168 property for AFSI purposes because the adjustments required by the proposed regulations create differences from both a taxpayer's AFS depreciation and its depreciation for regular tax purposes.

The proposed regulations provide three new definitions that were not previously included in the Notices: covered book inventoriable depreciation, tax capitalization method change, and tax capitalization method change AFSI adjustment.

In addition to modifying the definition of Section 168 property, the proposed regulations would modify the definition of a tax depreciation Section 481(a) adjustment to clarify that it includes both a depreciation method change Section 481(a) adjustment as well as an adjustment for any other change in method of accounting (other than a tax capitalization method change) that impacts timing of depreciation (e.g., a change under Section 263A, which would have an impact on tax COGS depreciation).

Generally, a taxpayer would be required to use the same methods of accounting under Sections 471, 472 and 263A, as applicable, to identify and value inventories and determine tax COGS depreciation, and separately use the AFS methods to determine book COGS depreciation. The proposed regulations also include a special rule that is meant to simplify the determination of both the tax COGS depreciation and covered book COGS depreciation adjustments.

Lastly, the proposed regulations provide special rules related to basis adjustments to property held by a partnership. In general, the required AFSI adjustments described above include amounts resulting from a basis adjustment under Section 734(b) that is treated as tax depreciation or a tax depreciation Section 481(a) adjustment. Basis adjustments under Section 743(b) or Treas. Reg. Sec. 1.1017-1(g)(2) are not included in the AFSI adjustments. Rather, such amounts are separately stated to the CAMT partners and are then taken into account by those partners as described elsewhere in the proposed regulations.

Section 168 dispositions

The proposed regulations are generally consistent with the computations required to redetermine gain or loss on the disposition of Section 168 property in computing AFSI. If the CAMT basis is negative as a result of the required adjustments, then a gain is recognized. The gain or loss on property that is disposed of in an intercompany transaction is deferred until FSI includes the gain or loss to the selling member.

The determination of CAMT basis is a complex calculation that requires a number of adjustments to AFS basis before computing gain or loss. The calculation includes adjustments from all taxable years, including those beginning on or before Dec. 31, 2019, which simplifies the need to bifurcate AFSI adjustments between a pre-CAMT year and a CAMT year. If property was received in a Section 168(i)(7) transaction, only post-transaction adjustments are taken into account, and taxpayers should treat property that was subject to a method change as though the Section 481(a) adjustment has been fully recognized (regardless if it has remaining years on its Section 481(a) spread period).

The computation begins with AFS basis as of the disposition date and then makes adjustments to: (1) reduce it by the full amount of tax depreciation (including amounts capitalized and not yet recovered, e.g., under Sections 263A or 174); (2) increase it by the full amount of book depreciation (including amounts attributable to AFS basis increases that are disregarded for AFSI and CAMT purposes); (3) decrease it by certain CAMT basis adjustments under Prop. Reg. Sec. 1.56A-21(c)(4) and (5) and for basis reductions due to tax credits; and (4) increase or decrease it by adjustments to AFS basis that were disregarded for AFSI and CAMT purposes.

Similar to the calculation of depreciation adjustments described above, there are special rules for basis adjustments to property held by a partnership. They are similar and require the inclusion of amounts attributable to Section 734(b) adjustments, and separate reporting of amounts attributable to basis adjustments under Section 743(b) or Treas. Reg. §1.1017-1(g)(2).

The proposed regulations follow the prior notices for property disposed of in a nonrecognition or deferral transaction for regular tax purposes (e.g., installment sales under Section 453 and like-kind exchanges under Section 1031). They indicate that that Section 56A(c)(13) does not allow a deferral for these transactions unless specified in the statute or other guidance. Therefore, if a taxpayer disposes of property and recognizes gain or loss for FSI purposes, an adjustment is required for AFSI – regardless of the treatment for regular tax.

Grant Thornton Insight: The IRS provided over 20 examples to illustrate the rules proposed under Section 56A(c)(13) for Section 168 property. While many of them provide insight to the operation of the rules and computation of the required adjustments, they also highlight the complexity of the adjustments — from tracking and identifying property, to computing current-year depreciation adjustments and carrying that through to dispositions. Taxpayers will need to be diligent to maintain appropriate records for Section 168 property.

Foreign corporations

Section 56A(c)(2)(C) provides adjustments for determining the AFSI of a taxpayer that has an interest in another corporation that is not included on the taxpayer's consolidated return. This adjustment takes into account only the dividends and other amounts (as determined under U.S. federal income tax principles) that are includible in gross income (or deductible as loss) with respect to such corporation.

Section 56A(c)(3) adjusts the taxpayer's AFSI related to a controlled foreign corporation (CFC) to take into account its pro rata share of certain items included in the CFC's AFS. As a result, a U.S. shareholder in a CFC must include dividend inclusions (and potentially other amounts) under Section 56A(c)(2)(C) as well as its pro rata share of the AFSI items of the CFC. The statute provides that the pro rata share is determined under rules similar to the pro rata share rules within the Subpart F rules under Section 951(a)(2).

The proposed regulations provide rules in determining AFSI regarding certain foreign corporations. Under these proposed regulations, a U.S. shareholder of a CFC must apply the adjustments contained in both Sections 56A(c)(2)(C) and 56A(c)(3) when determining the AFSI of a CFC.

The interaction of Section 56A(c)(2)(C) and (c)(3) raises double-counting issues with respect to distributions by CFCs and transfers of stock of CFCs. To address these issues, the proposed regulations would require taxpayers to rely on existing regular tax rules with respect to CFCs within CAMT. Because the regular tax rules apply to both distributions by CFCs and transfers of stock of CFCs, the proposed regulations would require taxpayers to rely on certain regular tax rules for determining both the earnings and profits of foreign corporations and the basis of the stock of foreign corporations. The preamble provides two useful examples to explain the impact of the rule on a corporation's AFSI.

- In one example, the AFSI of a CAMT entity that is a domestic corporation would not include any amount related to a dividend received from a foreign corporation if the CAMT entity qualifies for a dividends-received deduction under Section 245A. This is because the FSI from the dividend would be ignored, and the regular taxable income related to the dividend would be offset by the deduction for the dividend.
- In another example, the AFSI of a CAMT entity that is a domestic corporation would typically not include any amount related to a distribution of previously taxed earnings and profits (PTEP) from a foreign corporation. This is because the FSI from the PTEP distribution is disregarded, and Section 959(a) excludes the PTEP distribution from the entity's regular taxable income.

Both examples illustrate how certain foreign income items are excluded from the AFSI under these rules.

The adjusted net income or loss of a CFC must be translated into U.S. dollars using the weighted average exchange rate for the year if the CFCs functional currency for U.S. tax purposes is not the U.S. dollar. Adjusted net income or loss of a CFC is generally defined as the FSI of the CFC, inclusive of all AFSI adjustments, except as provided in Prop. Reg. Sec. 1.56A-6(c)(2) through (5), which includes adjustments for the ownership of stock of a foreign corporation, CFCs engaged in a U.S. trade or business, adjustments for foreign income tax expense, and FSNOL carryovers.

In cases where a U.S. shareholder owns multiple CFCs, the net loss of a CFC may offset the net income of another CFC for purposes of calculating an adjustment under Section 56A(c)(3). If a U.S. shareholder's total pro rata amount is negative, the negative amount is carried forward to the succeeding year.

The proposed regulations also address domestic partnerships that own CFCs. For purposes of determining inclusions of subpart F income and global intangible low-taxed income under Sections 951 and 951A, a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of Section 958(a) and therefore has no inclusions under Section 951 or 951A with respect to any stock of a CFC it owns. Accordingly, because a CAMT entity's pro rata share of the adjusted net income or loss of a CFC is determined under the principles of Section 951(a)(2), the proposed regulations provide that a domestic partnership would have no pro rata share concerning the adjusted net income or loss of any stock of a CFC it owns, and no adjustment would be made to the partnership's modified FSI under proposed Prop. Reg. Sec. 1.56A-6(b)(1). However, if a partner in the partnership is a U.S. shareholder with respect to the CFC, the partner would determine its own pro rata share of the CFC's adjusted net income or loss and would make an appropriate adjustment to its AFSI directly under proposed Prop. Reg. Sec. 1.56A-6(b)(1).

A foreign corporation engaged in a U.S. trade or business is subject to the CAMT on its taxable income that is effectively connected (ECI) with the conduct of a U.S. trade or business under Section 882. Prop. Reg. Sec. 1.56A-7(b) provides that the AFSI of a foreign corporation is adjusted to include only amounts and items of FSI that would be included in ECI or allowable as a deduction by such corporation for purposes of Section 882(c) if such amount or item accrued for regular tax purposes in the taxable year.

Partnerships

The proposed regulations in Prop. Reg. Sec. 1.56A-5 provide guidance on AFSI adjustments to a partner's distributive share of partnership AFSI. In order to avoid duplication of amounts included in AFSI, Section 56A(c)(2)(D)(i) provides that the AFSI of a taxpayer who is a partner in a partnership is adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership. Notice 2023-7 did not provide significant detail on how a taxpayer who is a partner in a partnership is supposed to determine its distributive share of AFSI of a partnership. The proposed regulations provide robust guidance on how a taxpayer is required to calculate the distributive share of a partnership's AFSI, including the calculation in a tiered partnership structure.

While several approaches for computing a taxpayer's distributive share of partnership AFSI were considered for the proposed regulations, the IRS ultimately determined a "bottom-up" method was consistent with the statute and more conducive to taking into account various adjustments. Under the bottom-up method, a partnership calculates its AFSI and provides its AFSI and other certain information to its CAMT entity partner when requested. The CAMT entity partner determines its distributive share percentage using the computation provided in the proposed regulations, and then uses the information provided by the partnership to determine its total distributive share of partnership AFSI.

Grant Thornton Insight: The computation of a partner's distributive share of AFSI for a partnership investment is not the amount reported for financial reporting purposes, but it also does not consider the normal Subchapter K adjustments typically used to determine a partner's distributive share (for example, Sections 704(b) and 704(c) principles). There are many separately stated items that the partnership will need to report to a CAMT entity partner in order for the CAMT entity partner to determine its distributive share of partnership AFSI. Additionally, the partnership will need to separately state certain items the CAMT entity partner will take into account in determining its AFSI that is separate from the amount included in the CAMT entity partner's distributive share of partnership AFSI.

For purposes of determining the distributive share of partnership AFSI, there is an exception from the general rule if a partnership uses its federal income tax return as its AFS. Under this exception, the CAMT entity partner's distributive share amount is equal to the amount that the CAMT entity partner includes in its FSI for the taxable year, subject to some adjustments.

Grant Thornton Insight: A partnership that uses its Federal Income Tax return as its AFS could arise in certain tiered-partnership scenarios. The exception for using the amount recorded in FSI as the distributive share of partnership AFSI deviates from the bottom-up approach otherwise provided for in the proposed regulations. CAMT entity partners should consider understanding situations in which lower-tier partnerships in the tiered structure are using a federal income tax return as their AFS and potential implications this deviation may have on their overall CAMT situation.

For tiered partnerships, the proposed regulations provide that each partnership in the structure is a CAMT entity with respect to the partnership in which it is a partner (lower-tier partnership) and is required to compute its distributive share of AFSI with respect to its interest in the lower-tier partnership.

A CAMT entity partner that cannot determine its distributive share of the partnership's AFSI without receiving information from the partnership must request the information it needs by the 30th day after the close of the taxable year of the partnership to which the information request relates. Under the proposed regulations, a partnership is required to retain a copy of the request for information in its books and records.

Corporate transactions

The proposed regulations preserve principles in Subchapter C for transactions related to a corporation and its shareholders.

If a CAMT entity owns stock of a corporate subsidiary, the stock is treated as an asset directly held and the shareholder is not treated as holding the assets in the subsidiary.

Under the proposed regulations, if a CAMT entity holds stock in a domestic corporation, and that domestic corporation is not a member of its tax consolidated group, the CAMT entity generally disregards the FSI from holding the stock (e.g., FSI from the equity method or fair value method) and generally disregards adjustments to AFS basis and adjustments to AFS retained earnings. However, an exception applies to gain or loss in FSI from the remeasurement (to fair value) of existing, or remaining, stock in a domestic corporation when the CAMT entity acquires, or disposes, some (but not all) stock in that domestic corporation in a covered recognition transaction.

Specific rules would also apply to certain non-liquidating stock and property distributions, transactions with a Section 336(e) election, certain liquidating distributions, certain stock sales, certain asset sales, and certain corporate reorganizations and organizations.

Acquisitions

If an acquiror corporation acquires stock of a target corporation in a covered transaction, purchase accounting and push-down accounting adjustments reflected in AFS basis, balance sheet accounts, or FSI are disregarded for purposes of determining the acquiror corporation's AFSI, CAMT basis, and CAMT earnings.

If an acquiror corporation acquires assets of a target corporation in a covered recognition transaction, purchase accounting and push-down accounting adjustments reflected in AFS basis, balance sheet accounts, or FSI are generally regarded.

If an acquiror corporation acquires assets of a target corporation in a covered nonrecognition transaction, purchase accounting and push-down accounting adjustments reflected in AFS basis, balance sheet accounts, or FSI are generally disregarded.

Non-liquidating distributions

In a non-liquidating distribution, the proposed regulations provide that a distributing corporation disregard gain or loss in its FSI and applies Section 311(a) to a distribution of stock or other property that would qualify for treatment under Section 311(a) using CAMT basis. CAMT earnings of the distributing corporation are adjusted under Section 312.

In contrast, a distributing corporation would redetermine gain or loss in FSI by reference to CAMT basis for a distribution of property in which Section 311(b) would apply and adjust the distributing corporation's CAMT earnings based on its AFSI. Similarly, a distributing corporation would redetermine gain or loss in FSI by reference to CAMT basis of a distribution of appreciated property under Section 355(c)(2) and adjust CAMT earnings based on its AFSI.

The distribution recipient disregards any gain or loss in FSI resulting from the distribution and applies relevant Code sections (e.g., Sections 243, 301, 302, 305, 306, and 1059) to determine: the amount and characterization of the distribution, its CAMT basis in the stock of the distributing corporation, its CAMT basis in the property received, and its CAMT current earnings resulting from the distribution.

The shareholder of a distributing corporation, or a target corporation, generally determines the character of any distribution from such distributing corporation (e.g., a non-liquidating distribution), or target corporation, using such corporation's regular tax earnings and profits. However, other specific rules apply for certain shareholders that own at least 25% (by vote and value) of the stock of the distributing corporation or target corporation immediately before the transaction.

Additional rules apply to preserve the tax principles in determining the AFSI of the distributing corporation, their shareholder or security holders, and the target corporation with respect to distributions with a Section 336(e) election.

Liquidating distributions

For tax-free liquidating distributions subject to Section 337 (i.e., no gain or loss to the liquidating corporation), the liquidating corporation's gain or loss in FSI resulting from the distribution is disregarded, no AFSI is recognized, and CAMT retained earnings adjusted according to Section 312. Accordingly, the liquidation recipient's gain or loss in FSI resulting from a tax-free distribution under Section 332 would be disregarded, Section 332 would apply with no AFSI recognized to the recipient, the recipient's CAMT basis in property received would be determined under Section 334, and its CAMT retained earnings and other attributes adjusted under Section 381.

In contrast, the liquidating corporation's FSI gain or loss resulting from a taxable liquidating distribution under Section 336 would be redetermined by reference to CAMT basis and CAMT retained earnings adjusted accordingly. The liquidation recipient's AFSI on a taxable liquidating distribution would be redetermined by reference to its CAMT basis in the stock of the liquidating corporation, its CAMT basis in the property received would be equal to its AFS basis, and its CAMT earnings would be adjusted.

Stock sales

The proposed regulations provide CAMT consequences when a target corporation shareholder (target shareholder) transfers target corporation (target) stock to an acquiror corporation (acquiror) in a transaction that results in recognition of gain or loss in Section 304 or 1001.

For such a covered recognition transaction, the target shareholder must: (i) redetermine its resulting gain or loss in its FSI by reference to its CAMT basis, in lieu of AFS basis, of the transferred stock; (ii) determine its CAMT basis in the property received from the acquiror to be equal to the target shareholder's AFS basis in that property; and (iii) adjust CAMT current earnings (in lieu of AFS retained earnings) based on the target shareholder's AFSI. For CAMT purposes, Section 304 does not apply to any acquisition of stock of a corporation.

In general, no AFSI consequences result to the target. However, if the stock sale is subject to an election under Sections 336(e), 338(g), or 338(h)(10), the target corporation redetermines gain or loss reflected in its FSI to be equal to the gain or loss that would result for regular tax purposes determined by using the CAMT basis of the target's assets and the new target determines its CAMT basis in the property deemed to be received to be its regular tax basis.

For this type of transaction, the acquiror must: (i) redetermine its resulting gain or loss reflected in its FSI by reference to its CAMT basis in lieu of AFS basis in its transferred property; (ii) determine its CAMT basis in the target stock to be equal to the acquiror's AFS basis in the transferred property; and (iii) adjust its CAMT current earnings (in lieu of AFS retained earnings) based on the acquiror's AFSI.

Asset sales

The proposed regulations also provide the AFSI consequences when a target corporation transfers property to an acquiror corporation in a transaction that results in gain or loss under Section 1001 to the target corporation.

For such a taxable asset sale, the target corporation must: (i) redetermine its resulting gain or loss reflected in in its FSI by reference to its CAMT basis in lieu of AFS basis in its transferred property; (ii) determine its CAMT basis in the property received from the acquiror corporation to be its AFS basis in that property; and (iii) adjust its CAMT current earnings (in lieu of AFS retained earnings) based on its AFSI.

The acquiror corporation then must: (i) redetermine any resulting gain or loss reflected in its FSI by reference to its CAMT basis of the transferred property; (ii) determine its CAMT basis in the property received from the target corporation to be equal to its AFS basis in that property; and (iii) adjust its CAMT current earnings (in lieu of AFS retained earnings) based on its AFSI.

Corporate reorganizations and organization

The proposed regulations provide rules for determining a corporation's AFSI, CAMT basis, and CAMT earnings consequences with respect to certain reorganization and Section 351 exchanges. The rules include particular rules for determining AFSI, CAMT basis, and CAMT earnings for a reorganization defined in Section 368(a)(1)(B) (B reorganizations), acquisitive reorganizations defined in Sections 368(a)(1)(A), (C), and (D), certain divisive reorganizations qualifying for nonrecognition under Sections 355, recapitalizations under Section 368(a)(1)(E) when a recapitalizing corporation transfers solely stock, a mere change of form reorganization defined Section 368(a)(1)(F), and certain Section 351 exchanges.

The general theme for the CAMT treatment of these transactions disregards gain or loss in FSI resulting from such transactions and then applies principles for regular tax purposes. Differences between CAMT and regular tax remain (e.g., CAMT basis and CAMT earnings).

Partnership transactions

Notice 2023-7 provided guidance on certain partnership transactions between a partnership and a CAMT entity partner, including contributions governed by Section 721(a) and distributions governed by Section 731(a). As provided in the notice, any FSI resulting from these transactions for AFS purposes are not taken into account in the partnership's or the partner's AFSI.

The proposed regulations deviate from the previous guidance due to an effort to prevent shifts of built-in gain and loss away from the contributing partner without requiring taxpayers to incorporate the complexity and administrative burden of Subchapter K principles into CAMT computations.

Generally, the proposed regulations provide for a "deferred sale approach" with respect to contributions governed by Section 721(a) and a "deferred distribution gain or loss approach" for distributions governed by Section 731(a).

Deferred sale approach

The deferred sale approach requires the gain or loss reflected in the contributor's FSI resulting from the contribution of property to be included in AFSI ratably on a monthly basis over a certain applicable recovery period beginning on the first day of the month of the contribution. Prescribed acceleration events would increase the rate of inclusion in AFSI in certain taxable years.

Deferred distribution gain or loss approach

The deferred distribution gain or loss is the amount of gain or loss reflected in the partnership's FSI resulting from the distribution of deferred distribution property. The amount of deferred distribution gain or loss that is to be included in each CAMT entity partner's distributive share amount is determined ratably, on a monthly basis over an applicable recovery period beginning on the first day of the month in which the distribution occurs. Similar to the deferred sale approach, prescribed acceleration events increase the rate of deferred distribution gain or loss in a CAMT entity's AFSI.

Tiered partnerships

Another departure from traditional Subchapter K principles occurs in the application of the deferred sale and deferred distribution gain or loss approaches to tiered partnerships. The proposed regulations provide that for both deferred sale gains or losses and deferred distribution gains and losses, the respective amounts are included in the distributive share amounts of the partners of the contributor partnership or distributing partnership (whether or not the partners were partners in the partnership at the time of the distribution) in proportion to their distributive share percentages for the taxable year.

Basis considerations

The proposed regulations provide new rules for determining and adjusting the basis assets in a partnership and the basis of an interest in a partnership investment with respect to contributions governed by Section 721(a) and distributions governed by Section 731(a). The new CAMT basis rules require partnerships and partners to have a third set of books to track the partnership's CAMT basis of assets and the partner's CAMT basis of a partnership interest.

Liabilities

The proposed regulations make another departure from normal Subchapter K rules on the treatment and impact of liabilities for contributions and distributions of property. The treatment of partner and partnership liabilities for purposes of determining a CAMT entity partner's or partnership's AFSI is based on the liability treatment for AFS purposes and not under normal Subchapter K principles (including Section 752).

Grant Thornton Insight: The deferred sale approach and the deferred distribution gain or loss approach is a departure from not only Notice 2023-7, but also from normal Subchapter K principles. Diligence should be exercised to understand the operation of the proposed guidance and careful consideration of the impact on AFSI is warranted when determining whether to apply the proposed regulations before they are finalized.

Partnership reporting and record-keeping requirements

The proposed regulations provide for additional record-keeping requirements for a partnership and each CAMT entity that is a partner in a partnership in order to comply with the partnership rules contained in the regulations.

Grant Thornton Insight: The adjustments to apply Subchapter K principles to CAMT are not entirely intuitive. There are numerous examples the IRS has provided to help clarify and assist in the application of the proposed regulations. Partnerships should be aware of the additional reporting and record-keeping requirements of the proposed regulations and should consider having a process in place to compute and provide the required information in case a request for the information is made by a CAMT entity partner.

Related party transactions

The proposed regulations provide an adjustment to defer losses that are included in FSI from certain dispositions of property between or among related entities. If AFSI of a CAMT entity otherwise reflects a loss from a sale, exchange, or other disposition of property between the CAMT entity and a CAMT entity (or entities) that is related, the loss is deferred until no member of the CAMT entity's related group holds that property. There is an anti-abuse rule that would apply to arrangements entered into with a principal purpose of avoiding the CAMT rules. An additional rule requires appropriate adjustments to CAMT basis to reflect the principles of Section 482 and its regulations with respect to a controlled transaction or a controlled transfer between two or more members of the same group of controlled taxpayers (as defined in Treas. Reg. Sec. 1.482-1(i)(8)).

Hedging transactions

The proposed regulations provide special rules for a CAMT entity to determine AFSI for certain hedging transactions (an AFSI hedge) or the underlying hedged item. The rule provides that a fair value measurement adjustment for an AFSI hedge or a hedged item is disregarded for determining a CAMT entity's AFSI if either: (i) there is a fair value measurement adjustment with respect to an AFSI hedge, but not the hedged item, and neither the AFSI hedge nor the hedged item is mark-to-market; or (ii) there is a fair value measurement adjustment with respect to the hedged item, but not the AFSI hedge, and neither the AFSI hedge nor the hedged item is mark-to-market. The rules then provide how gain or loss is included after a fair value measurement is disregarded.

The special hedging transaction rule applies to AFSI hedges which include a hedging transaction under Treas. Reg. Sec. 1.1221-2(b), a hedge under Treas. Reg. Sec. 1.1275-6, a hedging transaction under Section 1256(e), a hedging transaction under Section 988(d) that is integrated under Reg. § 1.988-5, or a position that is a hedge under Section 475(c)(2)(F).

Additional rules apply to net investment hedges, which are defined as certain assets or liabilities entered into by a CAMT entity to manage foreign currency exposure of a net investment in a foreign operation.

Troubled companies

The Proposed Regs include special adjustments to AFSI for financially troubled companies.

First, the proposed regulations provide a regime similar to provisions in Sections 108(a) and (b) with respect to the AFSI consequences of discharge of indebtedness income ("COD Income). The proposed regulations provide that a CAMT entity may disregard COD Income included in its FSI for purposes of determining its AFSI if the CAMT entity is under the jurisdiction of the bankruptcy court and the discharge was granted by the court or pursuant to a plan approved by the court. The proposed regulations also provide that a CAMT entity may disregard COD Income included in FSI up to the amount that such CAMT entity is insolvent. If either COD Income exclusion applies, the proposed regulations would require that the CAMT entity reduces CAMT attributes. CAMT attributes subject to reduction include CAMT basis in covered property, FS NOL, CFC adjustment carryovers, CAMT basis of property that is not depreciated or amortized for AFS purposes, and CAMT FTCs.

The proposed regulations would also require adjustments for fresh-start accounting from the emergence of bankruptcy by: (i) disregarding such gain or loss reflected in FSI; (ii) determining the CAMT basis of any assets by disregarding adjustments to AFS basis of those assets resulting from the emergence from bankruptcy; and (iii) adjusting the CAMT entity's earnings resulting from the emergence from bankruptcy by applying Section 312.

The proposed regulations provide special rules for a CAMT entity that is a partner in a partnership if the partnership realizes COD Income.

Finally, AFSI does not include any financial accounting gain attributable to federal financial assistance any earlier than when the gain is included for purposes of Section 597.

Financial statement NOL (FSNOL)

The proposed regulations expand upon financial statement net operating loss (FSNOL) rules that are similar to those for tax NOLs.

The rules under Prop. Reg. Sec. 1.56A-23(b) define a FSNOL as negative AFSI for a corporation after application of the other AFSI adjustments. The FSNOL is then carried forward indefinitely and is used to the lesser of the FSNOL or 80% of AFSI (much like a tax NOL). Thus, if an Applicable Corporation has a first-year FSNOL of, for example, $3,000,000 and the following year has an AFSI of $900,000, then a FSNOL of up to $720,000 is used in that year to reduce AFSI.

The proposed regulations expand upon the rule from the statute to address entities acquired by the corporation (or tax consolidated group) that import FSNOLs or assets with a net unrealized built-in loss based upon CAMT basis (CAMT-NUBIL). The proposed regulations apply concepts analogous to the separate limitation return year (SRLY) rules under the tax consolidated group rules in Treas. Reg. Secs. 1.1502-21 and 1.1502-15 to FSNOL and CAMT-NUBIL. The rules include subgrouping provisions as well.

Taxpayers will have to compute and maintain a tracked register to determine if FSNOLs are available. For example, consider a target has $100,000 of FSNOL when it is acquired by a CAMT taxpayer. In the following year, if the target has $25,000 of separately tracked AFSI, then $20,000 of its FSNOL will be available to offset that AFSI. The tracked register will be at zero dollars heading into the next year.

Tax consolidated groups

A consolidated group for federal income tax purposes (a tax consolidated group) is generally treated as a single CAMT entity for purposes of determination of AFSI, Applicable Corporation status, and tentative minimum tax.

For the determination of AFSI, the tax consolidated group will need each AFS that covers one or more members of the group.

There are separate rules if AFS is comprised solely of tax consolidated group members (total co-extensivity) or the AFS is comprised of both tax consolidated group members and non-members (non co-extensivity).

There are other rules on how to account for AFS consolidating entries. These rules are analogous to the intercompany transaction rules under Treas Reg. Sec. 1.1502-13 including acceleration-style events when property ceases to be held by the group and when a party ceases to be a member of a group. For example, an asset is sold intra-group for a $2,000 gain that is eliminated on the AFS, and then sold to a AFS-non-consolidated group member (e.g. a corporation owned more than 50% but less than 80%) for a further $3,000 gain that is also eliminated in the AFS. The first elimination entry is taken into account for purposes of AFSI determination of the tax consolidated group, but upon the second sale, the elimination entry is not taken into account and all $5× of gain is now reflected in the AFSI of the tax consolidated group.

The proposed regulations also provide special rules for determining gain or loss from the disposition of member stock by another member (e.g., a sale of a subsidiary's stock).

The usage of FSNOLs in a consolidated group likewise builds upon the principles described under FSNOL with additional provisions on usage, apportionment, and carryover. The proposed regulations apply the same core principles of Treas. Reg. Sec. 1.1502-21 such that FSNOL are used by oldest year first for any member in the group and pari passu when more than one member has a FSNOL for a given year. Of particular note, the proposed regulations retain the same operation for FSNOLs of a departing member as for regular NOLs. For example, if a member has an apportionable FSNOL of $100,000 that would otherwise carry into its first post-departure year, the consolidated group would have a last chance to use the FSNOL for AFSI for the group, including AFSI attributable to post-member-departure periods.

Applicable corporation status

The rules for determining the Applicable Corporation status of a corporation in the proposed regulations are consistent with the statute and the notices.

The proposed regulations provide that the average annual AFSI test is applied to the period during which a corporation was in existence if it was not in existence for three years. The test is also applied by annualizing AFSI of a short period of less than 12 months by multiplying by 12 and dividing by the number of months. However, the amount annualized does not include extraordinary items under Treas. Reg. Sec. 1.6655-2(f)(3)(ii)(A) and such items are included after the AFSI is annualized.

Other noteworthy provisions in the proposed regulations include an example applying the aggregation rule, the extension of the Simplified Method, and the circumstances when Applicable Corporation status would be terminated.

Aggregation rule

The aggregation rule under Section 59(k)(1)(D) may require a corporation to include the AFSI of an entity that is not included in either the corporation's federal income tax return or AFS.

The proposed regulations clarify the application of the aggregation rule for a controlled group of corporations under Section 52(a) and trades or businesses under common control under Section 52(b). The proposed regulations provide an example with the following facts:

> X is a corporation that owns 80% of the capital and profits of a partnership, PRS. PRS owns 80% of the total combine voting power of all classes of stock entitled to vote of Y, a corporation.

The conclusion in the example provided that X is deemed to own 64% of the total combined voting power of all classes of stock entitled to vote of Y (the product of 80% of PRS and 80% of Y) and that X was a common parent of a parent-subsidiary controlled group under Section 52(a), but that PRS was not included because it was not a corporation. The example also states that PRS may be a member of a group of trades or business under common control under section 52(b) if PRS is engaged in a trade or business.

Joining or leaving a test group

A corporation generally includes in its AFSI for a taxable year the AFSI of all persons related (e.g., under the aggregation rule) to the corporation at any point of its taxable year. However, the corporation includes the AFSI of a person for the portion of the taxable year in which there is a relevant relationship. If a corporation has a change of ownership that results a person no longer being related to the corporation for purposes of including such other person's AFSI, the corporation does not include that person's AFSI in its AFSI for any period prior to the change in ownership in order to determine whether the corporation is an Applicable Corporation for the taxable year of the change in ownership and subsequent years. For this purpose, a change in ownership has three requirements: (i) the corporation is not a test group parent; (ii) the corporation is treated as related to a test group parent as of the first day of the taxable year; and (iii) the corporation and the test group parent no longer satisfy the relevant relationship as of the last day of the taxable year.

If a corporation has a change in ownership that results in it joining a new tax consolidated group that is an Applicable Corporation in the first year, then the corporation is treated as an Applicable Corporation in the first year.

Simplified method for determining Applicable Corporation status

The proposed regulations provide a simplified method safe harbor that a corporation may choose to apply for purposes of determining whether it is an Applicable Corporation. The Simplified AFSI test under the Notice could only be applied to the first taxable year beginning after Dec. 31, 2022. The simplified method in the proposed regulations is consistent with the safe harbor in Notice 2023-7 and allows a corporation to determine whether it is an Applicable Corporation with the following modifications:

- The General AFSI Test is applied by substituting $500 million for $1 billion
- The FPMG $1 Billion Test is applied by substituting $500 million for $1 billion
- The FPMG $100 Million Test is applied by substituting $50 million for $100 million

If a corporation exceeds the relevant thresholds using the simplified test, it must compute full AFSI under General AFSI test or the FPMG AFSI tests to determine if it is and Applicable Corporation.

Termination of applicable corporation status

The proposed regulations provide a mechanism for a corporation to terminate its status as an Applicable Corporation, which was not provided in the statute. The proposed rules would terminate Applicable Corporation status for a corporation as of the first day of the first taxable year that: (i) the corporation experiences a change of ownership; or (ii) satisfies a termination test. To meet the termination test for a taxable year, the corporation must fail the applicable average annual AFSI test for five consecutive taxable years ending with the taxable year.

If a corporation joins another consolidated group that has Applicable Corporation status, the corporation is still an Applicable Corporation for that taxable year and subsequent tax years.

CAMT foreign tax credit

Prop. Reg. Sec. 1.59-4 provides rules under Section 59(l) for determining the amount of the CAMT FTC. The proposed regulations apply various FTC rules for regular tax purposes within the context of the CAMT FTC, including the FTC disallowance and suspension rules for determining "eligible taxes" and the deemed-paid FTC rules under Section 960 for determining an applicable corporation's pro rata share of CFC taxes.

The proposed regulations also introduce special rules for CAMT FTC purposes. For example, the CAMT FTC is determined based on the earnings of a CFC, regardless of the character of those earnings for regular tax purposes, as all the earnings of the CFC are considered for CAMT purposes under Section 56A(c)(3). For example, the proposed regulations would allow a CAMT FTC with respect to taxes imposed on the residual earnings of a CFC because such earnings of the CFC are included in AFSI of the U.S. shareholder of the CFC. Additionally, certain limitations, such as those under Section 960(d) and Section 904, do not apply for CAMT FTC purposes. The proposed regulations also allow the carryover of unused CFC taxes, but only for the five succeeding taxable years in chronological order.

Prop. Reg. Sec. 1.59-4(c) provides rules for determining the amount of the CAMT FTC that an applicable corporation can claim if it chooses to claim the foreign tax credit under Section 901. Generally, a domestic applicable corporation claiming an FTC under Section 901 will determine its CAMT FTC for the taxable as the sum of 1. the lesser of total pro rata share of CFC taxes, or 15% of the Section 56A(c)(3) adjustment to AFS, and 2. eligible taxes paid on AFS, if the applicable corporation is a domestic corporation.

Prop. Reg. Sec. 1.56A-8(c) provides that an applicable corporation that does not choose to claim a foreign tax credit for the taxable year would reduce its AFSI by the amount of foreign income taxes which the applicable corporation deducts for regular tax purposes under Section 164 (taking into account all other relevant provisions) for the taxable year. This includes foreign income taxes of a disregarded entity of which the applicable corporation is the owner for regular tax purposes and any creditable foreign tax expenditures allocated to the applicable corporation as a partner or indirect partner in a tiered partnership or other type of pass-through entity.

Recordkeeping and reporting

Corporations

A corporation that is an Applicable Corporation must maintain books and records sufficient to demonstrate how it complies with Section 56A and the regulations thereunder including: (i) the identification of AFS; (ii) the determination of FSI; (iii) the substantiation of AFSI adjustments; and (iv) the substantiation of AFS basis and CAMT basis.

A corporation that is an Applicable Corporation for any taxable year must make an annual return on Form 4626. Form 4626 must be filed with a corporation's federal income tax return.

A corporation (other than an S corporation, a RIC, or a REIT) that exceeds the thresholds in the simplified method must provide information to demonstrate whether it is an Applicable Corporation on Form 4626 required to be filed on its federal income tax return.

Partnerships

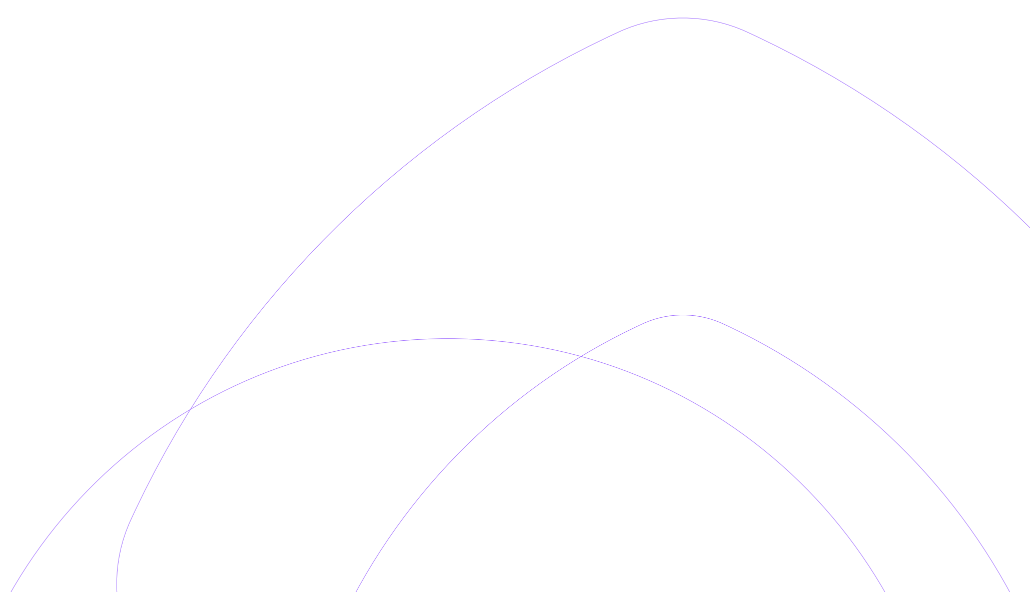
A partnership is required to file the information the CAMT entity requests with the IRS and provide the information to the CAMT entity as required in forms, instructions, or other guidance. Partnerships are required to provide any requested information on or before the day the partnership tax return is required to be filed. Failure to provide the information requested by the CAMT entity may subject the partnership to a penalty for failing to furnish correct payee statements under Section 6722. A partnership is required to continue to provide information to a CAMT entity partner each subsequent year until the CAMT entity partner provides written notification that the information is no longer available.

If a partnership fails to provide the requested information to the CAMT entity, the CAMT entity can use a good-faith estimate based on whatever information it can reasonably obtain in order to compute its distributive share of partnership AFSI.

The proposed regulations provide additional guidance on reporting and filing requirements for tiered partnerships. An upper-tier partnership (UTP) must request required information from a lower-tier partnership (LTP), and the LTP must file the information with the IRS and furnish the information to the UTP as required in forms, instructions, or other guidance. A UTP must request any necessary information by the later of 1. The 30th day after the close of the taxable year of the partnership to which the information request relates; or 2. 14 days after the date the UTP receives a request for the information from another UTP.

Information requested by a CAMT entity that is required to be filed with the IRS is subject to the Bipartisan Budget Act of 2015 (BBA) for partnerships subject to that regime. If a partnership has already filed its partnership return, and if the due date for filing the partnership return has passed, a BBA partnership must file an Administrative Adjustment Request in order to furnish information to a CAMT entity that is a partner in a partnership.

Grant Thornton Insight: While not directly impacted by the CAMT regulations, partnerships may be burdened significantly with the requirement to provide Partnership AFSI and other information prescribed in the proposed regulations when requested by a CAMT entity partner. Partnerships should be ready to provide information a CAMT entity may request and should not wait until a request arises before becoming familiar with the CAMT proposed regulations. The IRS provided several examples to help clarify the complex rules for the partnership computations required by the proposed regulations.



Applicability dates

A significant portion of the regulations (the "specified regulations") are proposed to apply to taxable years ending after Sept. 13, 2024. Certain other rules are proposed to be effective for taxable years ending after the publication date of final regulations, including most rules pertaining to partnerships, as well as the rules for AFSI adjustments to Section 168 property, corporate reorganizations, Subchapter K principles, troubled companies, and FSNOL and other attributes. Specific rules pertaining to consolidated returns are proposed to apply to consolidated return years for which the income tax return is due after the publication of final regulations.

Taxpayers may rely on the specified regulations for any taxable year ending on or before Sept. 13, 2024, provided that the taxpayer and each member of its test group meet a consistency requirement to consistently apply the specified regulations in their entirety to the taxable year and each subsequent taxable year until the first year that final regulations are applicable.

Taxpayers may rely on one or more of the other sections for any taxable year ending before the publication of final regulations so long as the consistency requirement is met with respect to such proposed regulations and the specified regulations.

Certain rules that apply to transfers may be applied to transfers on or before Sept. 13, 2024 provided the taxpayer and each member of its test group consistently follow such rules for transfers on or before Sept. 13, 2024, and if such transfers occur in taxable years ending on or before Sept. 13, 2024, the taxpayer must rely on the specified regulations for such taxable years.

Notwithstanding any other rules permitting applicability dates, the proposed regulations designate certain rules that may not be relied upon unless the taxpayer and each member of its test group relies on such section in its entirety.

Next steps

The proposed regulations may be applied immediately, but they are extremely complex. Taxpayers subject to the CAMT and/or the CAMT reporting requirements should assess the proposed regulations to determine whether any of the rules materially impacts their circumstances related to CAMT. Comments on the proposed regulations are due to the IRS by Dec. 12, 2024.

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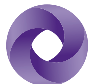

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