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KPMG report: Initial observations on round 1 of CAMT guidance in Notice 2023-7

January 4, 2023

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Contents

The Treasury Department and the IRS (together, "Treasury") on December 27, 2022, released an advance version of **Notice 2023-7** [PDF 246 KB], providing taxpayers with interim guidance on the corporate alternative minimum tax (the "CAMT"). Notice 2023-7 is the first guidance released from Treasury addressing the CAMT and its many uncertainties. Some of its provisions, such as the extension of regular tax non-recognition principles to the CAMT, appear helpful to taxpayers. Notice 2023-7, however, suggests that the CAMT regime built by Treasury may be complex and administratively burdensome, with numerous CAMT specific attributes—including CAMT specific basis in property—to be tracked.

Background

The CAMT was signed into law on August 16, 2022, as part of the legislation commonly referred to as the Inflation Reduction Act ("IRA") and is effective for tax years beginning after December 31, 2022.

At a very high level, the CAMT is a minimum tax based on financial statement income that applies to "applicable corporations." Whether a taxpayer is an applicable corporation, and thus subject to the CAMT (the "Scope Determination") and the potential CAMT liability of an applicable corporation (the "Liability Determination") are based on adjusted financial statement income ("AFSI"). Importantly, AFSI is not simply financial statement income. Numerous modifications need to be calculated to arrive at AFSI from any number that appears on the face of a financial statement, and these modifications are based both on financial reporting, "regular" tax rules, and CAMT specific rules. Furthermore, AFSI for Scope Determination purposes and Liability Determination purposes may (and often will) differ.

The CAMT contains numerous delegations to the "Secretary" (of the Treasury) and these delegations provide the Secretary with significant discretion. Furthermore, the statute itself can be viewed to contain numerous "gaps." Thus, guidance from Treasury on the implementation of the CAMT was, and remains, much anticipated.

Further background information on the CAMT is available on a dedicated **KPMG website**.

Overview of Notice 2023-7

Notice 2023-7 addresses certain "time-sensitive issues" created by the CAMT. Taxpayers may rely on the interim guidance regarding issues provided in sections 3 through 7 of the notice until the issuance of forthcoming proposed regulations. Section 3 describes rules that address certain issues under the CAMT regarding subchapters C and K of chapter 1 of the Code, troubled corporations, and affiliated groups of corporations that join in filing (or that are required to join in filing) a consolidated return. Section 4 describes rules that address certain CAMT issues with respect to the depreciation of property to which section 168 applies. Section 5 describes a safe harbor method for determining whether a corporation is an "applicable corporation" subject to the CAMT. Section 6 describes rules regarding the treatment of certain federal income tax credits under the CAMT. Section 7 describes rules that address the determination of applicable corporation status in circumstances involving certain partnerships.

Notice 2023-7 states that Treasury intends to issue additional interim guidance to address other CAMT issues prior to the issuance of forthcoming proposed regulations. The additional interim guidance is expected to address, among other issues, certain issues related to the treatment under the CAMT of items that are marked-to-market for financial statement purposes (such as life insurance company separate account assets and certain financial products), the treatment of certain items reported in other comprehensive income ("OCI"), and the treatment of embedded derivatives arising from certain reinsurance contracts. Per the notice, this additional interim guidance would be intended to help avoid substantial unintended adverse consequences to the insurance industry and certain other industries.

Notice 2023-7 contains numerous requests for comments. Treasury requested comments on 16 specific questions regarding the guidance provided in the notice, as well as 20 specific CAMT issues not addressed by the notice. Furthermore, the notice contains requests for general comments, including comments on any

questions arising from the interim guidance set forth in the notice, the CAMT generally, issues that should be addressed in future guidance, the most important issues needing guidance, and where additional guidance is needed most quickly. However, the notice indicates that Treasury anticipates that the forthcoming proposed regulations will be consistent with sections 3 through 7 of the guidance.

KPMG observation

The breadth of requests for comments is noteworthy. It is, however, equally noteworthy that Treasury appears wedded to the general approaches taken in the notice.

Notice 2023-7 contains numerous new defined terms, which are capitalized in the guidance and below. Capitalized terms used but not defined in this report have the definitions provided in the notice.

Nonrecognition conformance rules

Section 3.03 of Notice 2023-7 addresses certain transactions that qualify for nonrecognition treatment for U.S. federal ("Federal") income tax purposes and the impact of these transactions on AFSI. These "nonrecognition conformance rules," at a high level, import tax non-recognition principles into the CAMT in certain circumstances and create a parallel AFSI basis regime.

Background

AFSI generally starts with financial accounting net income or loss ("FSI") reported on an applicable financial statement ("AFS") (e.g., U.S. GAAP statement filed with the SEC). Importantly, certain transactions that are non-recognition events for Federal income tax purposes (including contributions under sections 721 and 351 and distributions under sections 731, 355, and 361) may result in income for financial statement purposes. Under the statutory rules, this income would appear to be included in AFSI—at least in certain cases. The statutory rules, however, give the Secretary authority to adjust AFSI to carry out the principles of certain corporate and partnership non-recognition rules if the Secretary determines the adjustment to AFSI is necessary to carry out the purposes of the CAMT.[1]

Conformance to tax nonrecognition rules in certain cases

Section 3.03 of Notice 2023-7 imports the nonrecognition rules of sections 332, 337, 351, 354, 355, 357, 361, 368, 721, 731, and 1032 into the CAMT if certain conditions are met. Specifically, for certain purposes and subject to certain limitations, FSI recognized by a "Party" to a "Covered Nonrecognition Transaction" is not taken into account solely for purposes of calculating the AFSI of the Party. The rule "applies solely to the AFSI consequences that result directly from the Covered Nonrecognition Transaction for the Party's taxable year in which the AFS of the Party takes into account that transaction."[2]

The term "Covered Nonrecognition Transaction" means "a transaction that, solely with regard to a corporation or a partnership (as appropriate), qualifies for nonrecognition treatment for Federal income tax purposes, respectively, under section 332, 337, 351, 354, 355, 357, 361, 368, 721, 731, or 1032, or a combination thereof, and is not treated as resulting in **any amount** of gain or loss for Federal income tax purposes (that is, solely with regard to the corporation or partnership, as appropriate)."[3]

[1] Section 56A(c)(15).
[2] Notice 2023-7, section 3.02(1)(b).
[3] Notice 2023-07, section 3.02(5)(a) (emphasis added).

KPMG observation

Qualification as a Covered Nonrecognition Transaction has two requirements. First, nonrecognition treatment must be afforded under one of the enumerated Code provisions. Accordingly, a like-kind exchange under section 1031 would not be considered a Covered Nonrecognition Transaction and could result in a significant unanticipated CAMT impact.

Second, "any amount of gain or loss" precludes Covered Nonrecognition Transaction treatment. Thus, a single dollar of gain as a result of, for example, "boot" in a section 351 transaction, gain recognition under section 721(c)'s rule for certain partnerships with related foreign partners, the distribution of cash in excess of basis in a section 731 distribution by a partnership or the recognition of ordinary income under section 751's "hot assets" rules, would appear to preclude qualification as a Covered Nonrecognition Transaction and the application of the nonrecognition conformance rules. As a practical matter, this may provide taxpayers with a certain degree of electivity. A taxpayer wishing to avoid the special basis rules with respect to Covered Nonrecognition Transactions (discussed below) could purposely trigger a small amount of gain.

Bifurcation rule

Each component transaction of a larger transaction is examined separately for qualification as a Covered Nonrecognition Transaction.[4] Examples in the notice illustrate the operation of this "bifurcation rule."

KPMG observation

The bifurcation rule raises questions as to how a taxpayer delineates a "component transaction" and when the recognition of gain or loss taints more than one component transaction.

In an example (Example 5), the notice addresses a contribution to and distribution by a partnership, treated as involving the disguised sale of property to a partnership under section 707. The example states that the contribution and distribution are each component transactions and neither qualifies as a Covered Nonrecognition Transaction since the section 707 disguised sale rules "treat them together as a part taxable exchange." It is worth noting that a taxpayer may be unable to determine whether a section 721 contribution to a partnership is part of a section 707 disguised sale and thus a Covered Nonrecognition Transaction until two years after the contribution because of a presumption in the section 707 disguised sale rule. Because of the special basis rules with respect to Covered Nonrecognition Transactions (discussed below), this delay could cause significant practical issues.

The logic of the example raises additional questions as a result of other common subchapter K transactions, including the section 704 and section 737 "mixing bowl" rules and section 708 merger and division rules. For instance, while it would appear that the gain recognized in a mixing bowl transaction is only with respect to the distribution without retroactive impact, significant administrative concerns would be raised if the contribution was "tainted." The section 708 "sale-within-a-merger" rule raises analogous concerns.[5]

The parenthetical in the definition of Covered Nonrecognition Transaction raises additional questions. Specifically, the "solely with regard to the corporation or partnership" limitation raises questions as to exactly

[4] Notice 2023-07, Section 3.02(5)(b).
[5] Similar issues could arise in the subchapter C context. For example, the contribution of stock to a transferee foreign corporation may be subject to a gain recognition agreement, pursuant to which no gain is recognized on the initial contribution but a transfer of the contributed stock by the transferee foreign corporation in the five years following the tax year of the transfer may trigger gain recognition.

when the recognition of gain or loss for Federal income tax purposes is not problematic. An example (Example 3) suggests that the recognition of gain by a creditor as a result of distribution of cash or securities does not preclude Covered Nonrecognition Transaction treatment. While the example is helpful in certain cases, it is worth noting that an instrument's status as debt or equity may be different under Federal income tax and accounting rules.

Definition of "Party"

The term "Party" with regard to a Covered Transaction means Controlled, Distributing AFS Group, a partnership, a "corporate partner transferring to, or receiving property from, a partnership in a Covered Transaction," a Target, a Target AFS Group, or an Acquirer AFS Group. As noted above, the nonrecognition conformance rules only adjust AFSI with respect to a Party to a Covered Nonrecognition Transaction.

KPMG observation

The term Party appears somewhat narrow. For example, it does not appear to generally cover a shareholder contributing appreciated property in a section 351 exchange. To constitute a Party, the transferor would apparently have to constitute an Acquirer AFS Group, and the transferee a Target AFS Group or Target. However, treating both the transferor and transferee as a Party would appear to require that the transferor be treated as acquiring transferee, and that the transferee constitute an "acquiree," for financial statement purposes; this does not seem likely to be the case in many section 351 exchanges. Thus, any FSI recognized by the transferor (and increase in book carrying value recognized by the transferee) could be taken into account despite the nonrecognition conformance rules in the notice.

Additionally, a partner other than the partner transferring property to or receiving property from a partnership ("other partner") generally would not be a Party.

However, it is possible that another partner has FSI as a result of a Covered Nonrecognition Transaction.

For example, assume Corp A and Corp B form a new entity ("LLC") treated as a partnership for Federal income tax purposes. Each of Corp A and Corp B owns 50% of LLC and neither has a controlling financial interest. Therefore, Corp A and Corp B both apply the equity method of accounting for their investments. Assume in the next month, Corp C contributes cash to LLC in exchange for LLC interests decreasing Corp A and Corp B's interests in LLC from 50% to 40% each. For Federal income tax purposes, assuming no exceptions to nonrecognition apply, Corp C generally recognizes no gain or loss for its contribution to LLC in exchange for LLC interests in a tax-free transaction (e.g., a section 721(a) transaction). Under U.S. GAAP, Corp C may recognize no FSI. However, Corp A and Corp B may each recognize FSI as a result of the dilution to their ownership interest in LLC.

As another example, assume Corp A, Corp B, and Corp C are the owners of LLC, an entity treated as a partnership for Federal income tax purposes, and own a 40%, 40%, and 20% interest in LLC, respectively. Further, assume that each investor applies the equity method of accounting to their respective investments. LLC makes a non-pro rata distribution of property to Corp A. For Federal income tax purposes, assuming no exceptions to nonrecognition apply, both Corp A and LLC generally recognize no gain or loss in a tax-free transaction (e.g., a 731 transaction). However, under U.S. GAAP, LLC generally would recognize FSI equal to the difference between the fair value of the property and its carrying value, if the fair value of the non-financial asset distributed is objectively measurable and would be clearly realizable to the distributing entity in an outright sale at or near the time of the distribution. In addition, Corp A, Corp B, and Corp C may recognize FSI if the non-pro rata distribution changes their ownership percentages or degree of influence over LLC.

Based on the definition of Party, the nonrecognition conformance rules do not appear to provide relief to Corp A or Corp B in the first example or Corp B or Corp C in the second example, possibly frustrating the intended extension of Federal income tax nonrecognition treatment to the calculation of AFSI, at least when no gain or loss is recognized for Federal income tax purposes. It is worth noting that while comments are specifically requested on deconsolidation FSI, there is no specific request for comments on dilution FSI (the type of FSI at issue in the examples above).

Furthermore, the narrow definition of Party suggests that the special basis rule (discussed below) could apply with respect to a single shareholder or single partner (i.e., not all shareholders or the corporation itself or not all partners or partnerships). This would suggest that AFSI basis in an asset may be shareholder or partner specific. This raises significant compliance and administrability concerns.

Special basis rule

With regard to any property transferred to a Party as part of a Covered Nonrecognition Transaction, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that Covered Nonrecognition Transaction is not taken into account solely for purposes of computing the AFSI of the Party receiving the transferred property. This means the Party must continue to use the historical financial statement carrying value of the property solely for purposes of computing its AFSI, even if the property is recorded at a different amount (e.g., fair value) for financial reporting purposes.

This rule creates a parallel basis system for CAMT purposes. Any increase or decrease in the carrying value of property transferred in a Covered Nonrecognition Transaction is disregarded. The pre-transaction carrying value of the property is used to compute, for example, AFSI gain upon the sale of the property and the financial statement depreciation included in AFSI if the property is non-section 168 property.

KPMG observation

The creation of a separate, parallel AFSI basis system is expected to create significant administrative complexity and potential reporting burden. While not clear, it appears that the rules for Covered Nonrecognition Transactions shut off book recognition, leaving unadjusted books as the AFSI books, and then waiting for recognition under general book principles or further deferral in the event of a subsequent Covered Nonrecognition Transaction. The practical difficulties in creating and maintaining such a tracing regime appear substantial. In addition, it appears that these rules could be read to require taxpayers to recompute AFSI basis for Covered Nonrecognition Transactions occurring prior to the effective date of the legislation (i.e., throughout the taxpayer's and any predecessor's history). This will require close coordination between an affected taxpayer's financial accounting and tax professionals and may greatly increase tax compliance costs for those taxpayers. Furthermore, one can query whether the IRS will gain the ability to audit such information.

The manner in which this rule works in tiered settings involving partnerships is also unclear. For example, assume Acquirer corporation acquires Target corporation. Target holds significant assets through a partnership. Arguably, Acquirer would not adjust the AFSI basis of the assets acquired (i.e., the assets held by Partnership) under this rule. This is because the special basis rule appears only to apply with respect to transferred property and the assets held by Partnership are not transferred in this example. This result would appear unintended.

Scope Determination in the context of corporate acquisitions and dispositions

Section 3.04 provides rules for applying the Scope Determination in the context of corporate acquisitions and dispositions.

With respect to acquisitions, the rules address the acquisition by an "Acquirer AFS Group" of either a "Target AFS Group" or a "Target." The notice defines an "AFS Group" as one or more entities, the financial results of which are reported on a single AFS. If one or more entities constituting an AFS Group (the Acquirer AFS Group) are treated as acquiring all of the entities in a second AFS Group (the Target AFS Group) or the assets thereof, the rules provide that any pre-acquisition applicable corporation status of the Target AFS Group terminates. However, in general, the pre-acquisition AFSI of both the Target AFS Group and the Acquirer AFS Group are aggregated together for Scope Determination purposes.

Similarly, if an Acquirer AFS Group acquires one or more corporate members of a Target AFS Group (one or more such members, the "Target"), or the assets thereof, but not the entire Target AFS Group, any pre-acquisition applicable corporation status of the Target terminates. However, the Target is allocated a share of the Target AFS Group's total AFSI, with the allocation based on any reasonable allocation method until the issuance of forthcoming proposed regulations. The Target's allocable share of AFSI is then aggregated together with the Acquirer AFS Group's AFSI for purposes of the Scope Determination. Notably, for purposes of the Scope Determination, Target AFS Group's AFSI is **not** reduced by the AFSI allocated to Target.

The rules also address transactions treated under financial accounting rules as a distribution by one corporation as "spinnor" of the stock of a second corporation as "spinnee." In general, any applicable corporation status of the distributed entity and any post-distribution subsidiaries (together, "Controlled") terminates as of the distribution. Controlled's applicable corporation status is instead determined based on Controlled's allocated portion of the "Distributing AFS Group's" AFSI preceding the distribution (with the allocation based on any reasonable allocation method until the issuance of forthcoming proposed regulations). For purposes of the Scope Determination, the AFSI of the Distributing AFS Group is **not** reduced by any AFSI allocated to Controlled.

KPMG observation

Overall, the Section 3.04 rules in the notice are weighted towards treating more corporations as applicable corporations.

Notably, the rules indicate that the acquisition of the assets of a Target or Target AFS Group can require an aggregation of the selling Target's or Target AFS Group's AFSI with the Acquirer AFS Group's AFSI. Read literally, this would appear to apply not only to asset acquisitions (such as reorganizations described in section 368(a)) involving a section 381(a) "successor," but also to any other recognition (or non-recognition) exchange. This aspect of the rules raises several issues. For example, does AFSI aggregation apply if the transferring corporation transfers substantially all, but not all, of its assets? What if the transferring corporation remains legally in existence? What is the treatment if a section 338(g), section 338(h)(10), or section 336(e) election is made for the Target or one or more members of the Target AFS Group?

Section 3.04 of the notice does not explicitly address the potential effect of short tax years on the Scope Determination. For instance, Example 6 includes the acquisition of a Target by an Acquirer AFS Group through a reorganization described in section 368(a). Unless the reorganization

happened on the last day of the tax year, Target generally would have a short tax year ending as of the reorganization. Section 59(k)(1)(E) requires that AFSI for any tax year of less than 12 months be annualized. However, the notice does not mention or appear to contemplate any short year annualization of Target's AFSI.

The notice requires the "double-counting" of AFSI allocated to a Target or Controlled for Scope Determination purposes. In general, this means allocating less AFSI to a Target or Controlled may result in a benefit for the acquirer's Scope Determination (as less AFSI is taken into account by the Acquirer AFS Group or Controlled) without any detriment to the seller's Scope Determination (as the AFSI of the Target AFS Group or Distributing AFS Group is unaffected). The notice specifically provides that the allocation of AFSI to a Target or Controlled does not "reduce" the AFSI of the Target or the Distributing AFS Group, and therefore it is not clear whether an allocation of an adjusted financial statement **loss** to a Target or Controlled corporation also would result in no adjustment to the Target or Distributing AFS Group's AFSI. The notice also does not state whether the parties must agree as to the allocation of AFSI to a Target or Controlled corporation.

Treatment of tax consolidated groups

If a corporation joins in filing a consolidated return for U.S. federal income tax purposes for a particular tax year, AFSI for the group's tax year takes into account items on the group's AFS that are properly allocable to members of the consolidated group.

Section 3.05 of the notice treats a tax consolidated group as a single entity when calculating AFSI for both Scope Determination and Liability Determination purposes.

KPMG observation

The notice does not provide details regarding how the single entity treatment of a tax consolidated group (a "Group") will apply for CAMT purposes.

For example, an important issue for purposes of the Scope Determination is the effect (if any) that members' joining or leaving a Group will have on the calculation of the Group's average AFSI. Section 3.05 specifies that a Group is treated as a single entity for Scope Determination purposes, but it is not clear how that single entity treatment interrelates to the rules in section 3.04 addressing the Scope Determination in the context of acquisitions and dispositions. Treating a Group as a single entity could mean that a member that joins or leaves the Group is not treated as a separate entity for purposes of calculating the Group's AFSI, and accordingly that a member joining or leaving a Group is treated effectively as an asset acquisition or disposition. This approach, if intended, would appear similar to the treatment of Groups for purposes of the gross receipts test of the base erosion and anti-abuse tax ("BEAT") in section 59A. However, as noted above, the notice appears to provide that an asset acquisition may also result in the inheritance by the acquirer of the AFSI history of the former owner of the assets. Thus, it may be that the single-entity treatment prescribed by the notice simply is of limited relevance in the context of acquisitions and dispositions of members.

It would appear that, to the extent an applicable corporation joins a Group that is not itself an applicable corporation on a single-entity basis (e.g., a small subsidiary of a very large affiliated group joins a smaller Group), the joining corporation would lose its applicable corporation status based on the single-entity treatment of the acquiring Group (in many cases, the acquired entity's applicable corporation status may terminate in any event under the rules described above). It would be helpful if this was clarified in future guidance.

The treatment of a Group as a single entity does not mean that CAMT "attributes" (e.g., financial statement net operating losses ("NOLs"), minimum tax credits) of the Group are not apportioned between Group members and potentially carried into or from a Group when a member joins or leaves. The notice specifically requests guidance on the allocation and use of CAMT attributes within a Group.

COD income

Background

In general, regular tax gross income includes income from the discharge of indebtedness ("COD income").[6] However, regular tax gross income generally does not include COD income arising from the discharge of indebtedness as part of a bankruptcy case of the debtor or to the extent a debtor is insolvent (in either case, "excluded COD income").[7] Any amount of excluded COD income generally is applied to reduce the tax attributes of the debtor in the order specified in section 108(b)(2) (unless the taxpayer makes an election pursuant to section 108(b)(5) to first reduce basis in depreciable property). To the extent the amount of excluded COD income exceeds the amount of attributes subject to reduction under section 108(b), that excess ("black hole COD income") is still excluded COD income and generally has no further regular tax consequences.

Under financial accounting rules, the extinguishment of indebtedness may also give rise to FSI reported on the AFS of the debtor. However, we know of no concept equivalent to excluded COD income in financial accounting rules. Therefore, a financially distressed company that restructures and reduces its indebtedness often will have significant gains or losses from debt extinguishment reported on its AFS that, absent guidance, would appear to be included in AFSI.

Additionally, under financial accounting rules, a company's emergence from bankruptcy often results in the application of "fresh start" accounting, pursuant to which the book value of a company's assets is increased or decreased to reflect the fair market value of each asset as of the emergence. Further, under "fresh start" accounting the excess (if any) of the fair market value of the assets over their prior book value generally is reported as gain on the financial statements.

Thus, absent guidance to the contrary, the AFSI of a company emerging from bankruptcy or otherwise restructuring its indebtedness could include significant gain from both (1) the extinguishment of indebtedness and (2) in the case of a bankruptcy emergence, the "step-up" of assets from book value to fair market value. As a consequence, bankruptcy or other troubled company restructurings could effectively cause a corporation to become an applicable corporation and/or create or significantly increase an applicable corporation's CAMT liability.

Treatment of discharges of debt

Sections 3.06 and 3.07 of the notice ameliorate some of the otherwise significant CAMT consequences of many debt restructuring transactions.

First, section 3.06 generally provides that, to the extent a discharge of indebtedness (a "discharge") results in excluded COD income for an AFS Group, that AFS Group excludes from AFSI an amount of financial statement gain resulting from a discharge ("book discharge gain") equal to the amount of excluded COD

[6] Section 61(a)(11).
[7] Section 108(a)(1)(A), (B).

income. This exclusion applies for purposes of calculating the AFSI of the AFS Group for the tax year in which the discharge occurs.

KPMG observation

The relief provided by section 3.06 arguably requires that the book discharge gain and the excluded COD income occur in the same tax year. However, there potentially could be differences between the timing of book discharge gain and excluded COD income. For example, a debtor may potentially realize significant excluded COD income in one tax year as a result of a "significant modification" under Treas. Reg. § 1.1001-3 causing a deemed exchange of "old" debt for "new" debt. The debt may give rise to book discharge gain and no (or limited) taxable income (i.e., COD income) in a subsequent year. This rule may not provide relief in such a situation.

If an AFS Group excludes book discharge gain under the provision described above, the AFS Group's "CAMT attributes" must be reduced by the amount of excluded COD income that results in a reduction of tax attributes for regular tax purposes (the "Section 108(b) Reduction Amount"). The term CAMT attributes is not defined, and the notice specifically requests comments on what items should be considered CAMT attributes subject to reduction. Section 3.06 does specify that in reducing CAMT attributes, the principles of sections 108(b) and 1017, as well as the ordering rules provided thereby, are taken into account.

KPMG observation

The reduction in CAMT attributes is based on the Section 108(b) Reduction Amount, which in turn is based on the attributes reduced under the general rules of section 108(b). This provision limits the reduction in CAMT attributes based on the attributes available to be reduced under section 108(b). For example, if a debtor had $100 of excluded COD income, only $10 of which reduced regular tax attributes (meaning the remaining $90 constituted black hole COD income), the notice provides that the debtor would apply $10 to reduce its CAMT attributes, regardless of whether the debtor had more than $10 of CAMT attributes.

This approach would appear to result in a whipsaw in certain fact patterns. Assume a corporation has $100 in regular tax excluded COD income, but only $10 in book discharge gain. For regular tax purposes, $100 of attributes are reduced. The notice appears to provide that $10 of book discharge gain is excluded from AFSI, but that **$100** of CAMT attributes are reduced.

As stated above, section 3.06 does not define what constitutes a "CAMT attribute" and requests comments on the issue. It appears that financial statement NOLs, book "basis" in assets, and potentially CAMT foreign tax credits as provided by section 59(l) could constitute CAMT attributes. In contrast, the CAMT minimum tax credit presumably should not be a CAMT attribute, as it is already subject to reduction under section 108(b) and further represents a potential future reduction of regular tax (and not CAMT) liability.

The reference to section 1017 in the notice makes it clear that financial reporting carrying value (or "book basis") is a CAMT attribute subject to reduction. Similar to the rules in the notice for non-recognition transactions, a reduction of AFSI basis under this provision will effectively require the maintenance of a separate set of books to track AFSI basis for purposes of calculating AFSI. For certain, generally tangible property, "tax" depreciation deductions are substituted for "book" depreciation (see below), and thus the basis available for CAMT attribute reduction should be the remaining basis resulting from tax depreciation, not from book depreciation. In certain cases, it appears that the notice could result in negative AFSI basis. For example, assume that a debtor has $100 of excluded COD income that for regular tax purposes reduces regular tax NOLs, but for CAMT purposes, given the absence of any financial statement NOLs, reduces the AFSI basis in a depreciable asset from $100 to $0. In the following year, the taxpayer takes a regular tax depreciation deduction that (under section 56A(c)(13)) is also taken into account for purposes of calculating AFSI. The AFSI basis in the depreciable asset is already $0, but arguably would be reduced to a negative

amount to reflect the fact that the positive tax basis in the depreciable asset is still creating depreciation deductions taken into account in calculating AFSI. One can query whether negative AFSI basis is consistent with the idea of a parallel system and overall CAMT policy.

The notice provides for the reduction of CAMT attributes under the principles of, including taking into account the ordering provided by, sections 108(b) and 1017. However, it is not clear to what extent the principles of these sections incorporate the specific rules that apply for purposes of attribute reduction for regular tax purposes. For example, taxpayers may elect to reduce basis in depreciable property before other attributes under section 108(b)(5), and also may elect to treat certain stock held by a member of an affiliated group in another member of that group as depreciable property for purposes of attribute reduction. It is not clear to what extent these elections would be followed for CAMT attribute reduction purposes.

Further, Treas. Reg. § 1.1502-28 sets forth detailed rules addressing attribute reduction in the context of tax consolidated groups, including the potential for excluded COD income of one tax consolidated group member to reduce the tax attributes of other members through "look-through" or "fan out" attribute reduction. It is not clear whether the notice considers Treas. Reg. § 1.1502-28 to reflect the "principles" of sections 108(b) and 1017 and to likewise apply for purposes of the reduction of CAMT attributes. Further, with respect to financial statement NOLs and CAMT foreign tax credits, it is not clear how these attributes are allocated within a consolidated group, adding further uncertainty to CAMT attribute reduction in the tax consolidated group context.

In all events, the rules set forth in, and contemplated by, this section, and the notice as a whole, suggest that guidance will build out a complex and parallel CAMT regime. This regime may be viewed to impose significant compliance and administrative burdens.

Next, section 3.07(1) provides that, to the extent that the emergence from bankruptcy of an AFS Group results in gain or loss on that group's AFS, the gain or loss is not taken into account for purposes of calculating AFSI in the tax year of emergence. Section 3.07(2) further provides that, for any "Party" emerging from bankruptcy in a transaction described in section 3.07(1), any increase or decrease in book basis resulting from the emergence from bankruptcy (other than as resulting from CAMT attribute reduction under section 3.06 of the notice) is not taken into account for purposes of computing AFSI with regard to any tax year of that Party.

KPMG observation

The rule in section 3.07(1) is intended to disregard FSI arising from the application of "fresh start" accounting on an emergence transaction.

The rule in section 3.07(2) appears intended to provide that, consistent with disregarding FSI on emergence, any increase or decrease in book basis arising from the application of fresh start accounting is also disregarded in computing the future AFSI of the AFS Group. This represents another instance in which an affected taxpayer would be required to maintain a separate set of books for purposes of calculating AFSI.

Literally, however, section 3.07(2), unlike section 3.07(1), only applies to a "Party" (a defined term under the notice) emerging from bankruptcy. This limitation seemingly would not include all taxpayers that potentially may be subject to fresh start accounting on an emergence transaction. Indeed, it may capture no such taxpayers. For example, a corporation that emerges from bankruptcy without transferring its assets to another corporation seemingly would not be a Party, because it would not be defined as a Target or as a Target AFS Group. And if the bankrupt corporation transfers all of its assets to another corporation, the transferring corporation would be a Party, but section 3.07(2) applies only to tax years of that Party, seemingly not to tax years of the acquiring corporation. Accordingly, a non-Party or a Party other than an entity emerging from bankruptcy would arguably attain what could be considered a double-benefit (or detriment) of (1) disregarding the FSI on

emergence arising from fresh start accounting but (2) taking into account fresh start accounting in calculating its book basis for CAMT purposes.

While many bankruptcy restructurings involve regular tax non-recognition transactions, others are purposely structured as taxable transactions (often referred to as "Bruno's transactions") in which the debtor's assets are sold in a taxable transaction and much of the debtor's excluded COD income may be treated as black hole COD income. The provisions in sections 3.06 and 3.07 appear intended to more closely align with the treatment of regular tax non-recognition transactions by exempting gain and denying basis step-ups, but could seemingly lead to significant mismatches between the regular tax and CAMT treatment of taxable restructuring transactions, if there is gain and a step up for regular tax purposes, but none for CAMT purposes. The notice specifically requests comments on whether the treatment of bankruptcy reorganizations that constitute recognition events for regular tax purposes should differ from the rules set forth in sections 3.06 and 3.07.

Depreciation adjustment rules

Section 4 of the notice contains interim guidance to facilitate the application of the depreciation adjustment rules in section 56A(c)(13).

Background

At a high level, section 56A(c)(13) provides certain adjustments for depreciation, generally meant to have AFSI reflect tax, rather than financial statement, depreciation. This remove-book-and-replace-with-tax rule is generally limited to depreciation with respect to certain, generally tangible, property. Specifically, 56A(c)(13)(A) provides that AFSI is reduced by depreciation deductions allowed under section 167 with respect to property to which section 168 applies to the extent of the amount allowed as deductions in computing taxable income from the year. Section 56A(c)(13)(B)(i) provides that AFSI is appropriately adjusted to disregard any amount of depreciation expense that is taken into account on the taxpayer's AFS with respect to such property. The Secretary is given authority to make further appropriate adjustments with respect to the property.

In general

The rule regarding reductions to AFSI in section 56A(c)(13)(A) has been bifurcated by the notice into two components: Tax COGS Depreciation and Deductible Tax Depreciation (collectively referred to below as "Covered Tax Adjustments"). The notice also breaks the "appropriately adjusted" rule in section 56A(c)(13)(B)(i) into three categories of book expenses (i.e., reflected on the taxpayer's AFS) that are to be disregarded: Covered Book COGS Depreciation, Covered Book Depreciation Expense, and Covered Book Expense (collectively referred to below as "Covered Book Adjustments").

Section 168 property

The notice clarifies the threshold requirement that, for purposes of section 56A(c)(13) (the required substitution of tax for book depreciation), adjustments to AFSI are only made for "property to which section 168 applies." First, the notice provides that section 168 property for this purpose includes property that is depreciated in whole or in part under section 168. This means generally that all depreciable tangible real and personal property is subject to the Covered Book and Tax Adjustments, including depreciable property of taxpayers such as electing real property trades or businesses, regulated utilities, and property primarily used outside the United States, for which the alternative depreciation system is required to be used or elected. Certain types of intangible property, including computer software, films, and TV programs, are eligible for the Covered Book and Tax Adjustments, but only to the extent the taxpayer claims bonus depreciation and therefore claims all or a portion of the cost under section 168. Assuming no change in the scheduled phase out of bonus depreciation, the Covered Book and Tax Adjustments for these assets will

sunset completely after 2026. In addition, only amounts allowed as a deduction under either section 167 or section 168 are subject to the Covered Book and Tax Adjustments. The notice explicitly mentions deductions for qualified films under section 181, for example, that must be excluded from the Covered Book and Tax Adjustments, but there are others, including the cost of developed computer software, which would be capitalized and amortized under section 174.

Treatment of tax repair deductions

The notice clarifies that expenses treated as currently deductible repairs for regular tax purposes are also excluded from the Covered Book and Tax Adjustments because they do not give rise to depreciable section 168 property.

KPMG observation

For example, a repairs study would allow costs to be deducted as an ordinary expenses under section 162 instead of capitalized to the basis of a section 168 asset and deducted as depreciation. Thus, if an expense is deducted for regular tax purposes under section 162 but capitalized for financial reporting purposes, the expense generally would give rise to a regular tax deduction when incurred and a reduction to AFSI when depreciated on the taxpayer's AFS.

However, the converse is not true, in that an expenditure that is a repair expense for book, but a capital improvement for tax, would be subject to the Covered Book and Tax Adjustments, including adjustments as described below, that prevent double expense recovery, because the improvement would be section 168 property.

Multiple adjustments required for section 168 property

For items of section 168 property, the notice describes two types of adjustments that are required: (1) adjustments for items that originate in the regular tax treatment of the property and reduce AFSI (Covered Tax Adjustments), and (2) items that originate in AFS income and are required to be removed from AFSI (Covered Book Adjustments). For this purpose, Covered Tax Adjustments include both depreciation allowed as a deduction in computing regular taxable income and the amount recovered through cost of goods sold in the current tax year of depreciation allowances initially capitalized to inventory.

KPMG observation

The faster a taxpayer's inventory property turns over during the tax year, the less significant the deferral of this Covered Tax Adjustment will be. For taxpayers using the LIFO inventory method for tax purposes, current capitalized costs associated with a new inventory layer will remain carried on the tax balance sheet in a LIFO layer indefinitely.

The inclusion of COGS-allocable depreciation significantly clears up some uncertainty in the application of the statute given that for regular tax purposes this depreciation is taken into account as a reduction in gross income rather than as a deduction allowed in computing taxable income. Without this clarification, the statute could have been interpreted to preclude a reduction in AFSI for such tax depreciation while requiring the book depreciation to be added back. This is because there is no statutory requirement that the corresponding book depreciation be allowed as a deduction.

Covered Book Adjustments that must be removed from AFSI similarly include amounts expensed in the AFS as depreciation, but this category is expanded to include amounts that are expensed in the AFS as either an impairment loss or impairment loss reversal (collectively, "Covered Book Depreciation Expense"). Similar to the Covered Tax Adjustments, this category also includes depreciation expense, impairment loss, or impairment loss reversal that is taken into account in the AFS as cost of goods sold ("Covered Book

COGS Depreciation"). In contrast to the Covered Tax Adjustments, however, this category also includes amounts that are recognized as an expense in the AFS but are reflected in the unadjusted depreciable tax basis of the section 168 property ("Covered Book Expense").

KPMG observation

In contrast to the treatment of tax repairs, an item that is expensed as a repair in the AFS but capitalized for tax purposes must be added back to AFSI in the year the amount is expensed in the AFSI. Similarly, book and tax differences in cost capitalization that result from the application of the uniform capitalization rules for regular tax purposes, or costs for assets that are classified as being subject to a capital lease for tax but operating lease for books will need to be removed from AFSI. As a result, taxpayers will need to track costs that are charged to general ledger accounts that are unrelated to their fixed assets, such as interest expense, general and administrative expense, and rental expense.

Additional adjustments upon disposition

The notice provides for additional adjustments upon the disposition of section 168 property. These adjustments generally have the effect of preventing a duplication or omission of basis recovery that would otherwise result from either claiming tax depreciation expense faster than book depreciation, or vice versa, or because of a difference between the unadjusted book and tax basis of the property. The mechanism set forth in the notice is a required series of adjustments to the book basis of the asset for purposes of determining gain or loss in the AFS.

KPMG observation

These adjustments are made even if the asset is scrapped, abandoned, or worthless, which will be favorable in some cases, but at the cost of administrative complexity in cases in which assets that are fully written off for book and tax are no longer tracked in the general ledger.

To make this adjustment, the taxpayer starts with an asset's actual book basis, adds back all prior Covered Book Adjustments, and subtracts all prior Covered Tax Adjustments to arrive at the adjusted basis for determining gain or loss for purposes of AFSI. The notice requires the taxpayer to calculate the cumulative amount of prior Covered Book and Tax Adjustments *as if* the taxpayer had always been in the CAMT, even if the taxpayer was not subject to the CAMT in some or any of the prior years. For example, if a taxpayer claims 100% bonus depreciation for section 168 property prior to becoming subject to the CAMT, that depreciation is required to be taken into account even though it had no impact on CAMT liability for a prior year. Similarly, note that prior book impairments are treated the same as book depreciation and therefore are added back to the AFSI basis for gain or loss at the time of disposition. By allowing these impairments to be treated as prior book depreciation even if they occurred in a pre-CAMT year, the notice provides relief in situations in which the tax write off occurs in a CAMT tax year.

KPMG observation

Although disposition adjustments will prevent many sources of potential duplication or omission of basis recovery, there are some situations in which it would not, such as in the case of book-tax differences that were not previously reflected in one of the three types of Covered Book Depreciation Adjustments or in the case of tax deductible amounts under a Code section other than section 167 or section 168 in a non-CAMT year that are deferred and taken into account in the AFS in a CAMT year. For example, prepaid expenses deductible for tax under the 12-month rule could be duplicated. Alternatively, if the book and tax basis of an asset differ upon acquisition of section 168 property, and the cost has not been fully depreciated at the time of disposition, this difference would become permanent. Given the need for these adjustments to be made on a property-by-property basis, it is

unclear how these rules would be applied when a taxpayer uses multiple asset accounting for regular tax depreciation. Also unaddressed is whether the Covered Book and Tax Adjustments to be made each year are based on the taxpayer's existing tax accounting methods in cases where the taxpayer in a later year determines that the method of accounting was impermissible for regular tax purposes.

The rules in section 4 of the notice are mandatory and do not contain simplifying conventions and/or materiality thresholds.

KPMG observation

The rules in section 4 of Notice 2023-7 could impose significant administrative burdens on taxpayers where the burdens might outweigh the benefits. The need to separately track the cumulative amount of previously recognized book and tax basis differences and book expenses embedded in tax basis for gain and loss purposes, and to do so on a property-by-property basis adds considerable complexity to fixed asset accounting and these differences are not uncommon. Many of these differences occur under the current regular tax system with respect to almost all depreciable property, plant, and equipment due to the uniform capitalization rules. In situations in which tax depreciation is affected by deferred intercompany gain or loss on intercompany transactions, an additional layer of complexity is introduced.

Additional complexities arise if the section 168 property is held by a partnership and, for example, a corporate partner has a section 743(b) basis adjustment attributable to the section 168 adjustment or is entitled to section 704(c) remedial deductions with respect to the section 168 property. It would appear that both section 743(b) depreciation and section 704(c) remedial deductions would affect the computation of AFSI and need to be separately tracked for CAMT purposes.

Safe harbor for Scope Determination

Section 5 of the notice addresses the Scope Determination and provides a safe harbor method for determining whether a corporation is an applicable corporation for the first tax year beginning after December 31, 2022 (the "First Taxable Year").

Background

The CAMT applies to an "applicable corporation," which is (1) a corporation (other than a REIT, RIC or S Corporation) that (2) satisfies the average annual AFSI test. Under the average annual AFSI test, a corporation generally meets the Scope Determination if the AFSI of the corporation (together with certain related entities) in the three tax years ending with any tested tax year exceeds $1 billion (the "General AFSI Test"). A tested tax year is any tax year ending after December 31, 2021.

The Scope Determination also includes two aggregation rules. First, for purposes of the Scope Determination the AFSI of a corporation generally includes the AFSI of any person that is treated as a single employer with that corporation under section 52(a) or (b).

Second, a special aggregation rule applies for purposes of the Scope Determination if the corporation is a member of a foreign-parented multinational group ("FPMG"). The rule for FPMGs (1) modifies the $1 billion AFSI threshold under the general AFSI test to include non-effectively connected income ("ECI") financial statement profits of foreign corporations (which otherwise would not be AFSI) under section 59(k)(2)(A) and (2) adds a $100 million AFSI test that would only take into account the group's actual AFSI (i.e., determined without regard to the rule in section 59(k)(2) and without regard to the adjustment described in section 56A(d)) under section 59(k)(1)(B)(ii)(II) (such additional AFSI test, the "FPMG AFSI test").

The statute directs Treasury to provide a simplified method for determining whether a corporation meets the applicable corporation definition.

In general

Section 5.03(2) of the notice describes a safe harbor method (the "Simplified Method") that a corporation may choose to apply to determine whether it is an applicable corporation for the First Taxable Year.

Section 5.03(4) of the notice addresses the effect of a corporation that fails to meet the safe harbor. If a corporation applies the Simplified Method for its First Taxable Year and fails to meet the safe harbor because it determines that its AFSI exceeds the relevant AFSI thresholds, then the corporation will be an applicable corporation for that year only if it is determined to be an applicable corporation under the statutory rules.

KPMG observation

It appears that the Simplified Method requires a corporation that does not meet its safe harbor to apply the statutory rules.

Simplified Method

In general, under the Simplified Method, a corporation determines whether it is an applicable corporation by applying the rules in the Scope Determination rules in the statute with enumerated modifications.

The notice modifies the amounts used for the AFSI thresholds (in the AFSI Tests), generally halving the thresholds. The General AFSI Test is applied by substituting $500 million for $1 billion and the FPMG AFSI Test is applied by substituting $50 million for $100 million.[8]

The notice also modifies the determination of AFSI.[9] Specifically, certain adjustments used to compute AFSI from FSI are "turned off." Section 5.03(2)(c)(i) of the notice provides that, except as provided in section 5.03(2)(c)(ii) of the notice (discussed below), AFSI is determined without regard to the adjustments set forth in section 56A(c) and (d) other than for the special rules for consolidated financial statements and consolidated returns in section 56A(c)(2)(A) and (B), the adjustments for certain foreign taxes in section 56A(c)(5), and the ECI adjustment in section 56A(c)(4) if the FPMG AFSI Test is applied.

KPMG observation

The notice's modification of the AFSI for safe harbor purposes means that AFSI is determined without regard to, for example, section 56A(c)(2)(C)'s rule for not-consolidated-for-tax corporate investments (such rule is generally meant to have AFSI reflect tax, rather than financial statement, inclusions for certain corporate investments), section 56A(c)(2)(D)(i)'s distributive share only rule for partnership investments (consistent with section 7 of the notice, discussed below) and section 56A(c)(13)'s rule for depreciation (discussed above).

As the modifications in section 56A(c) and (d) generally are taxpayer favorable (i.e., in most cases, such modifications are expected to decrease AFSI), the fact that the modifications in section 56A(c) and (d) generally do not apply would appear to increase AFSI for Safe Harbor purposes, as opposed to Scope Determination purposes, in most cases. This, along with the lower thresholds, would appear

[8] Notice 2023-7, section 5.03(2)(a) and (b).
[9] Notice 2023-7, section 5.03(2)(c).

to make the safe harbor unavailable to a significant number of taxpayers that are not applicable corporations.

Further, under section 5.03(2)(c)(ii) of the notice, AFSI is determined after taking into account AFS Consolidation Entries except those that eliminate transactions between persons not treated as a single employer under section 52(a) or (b). Additionally, the interaction of this rule with the FPMNG rules is unclear. Section 5.02 defines "AFS Consolidation Entries" to mean the financial accounting journal entries that are made for AFS purposes in order to present the financial results of an AFS Group as though all members of the AFS Group were a single company, including journal entries to eliminate transactions between members of the group.

Section 2.01(c)(i) of the notice defines AFS Group with reference to section 56A(c)(2)(A), which states that if the financial results of a taxpayer are reported on the AFS for a group of entities, rules similar to the rules of section 451(b)(5) shall apply.[10]

KPMG observation

The Simplified Method first requires AFS Consolidation Entries to be made for any entity in the AFS Group, and then reverses the consolidation entries of entities that are not part of a single employer group under section 52(a) or (b).

Importantly, the section 52(a) and (b) rules and the U.S. GAAP consolidation rules are not coextensive. At a high level, this is because U.S. GAAP contains two primary consolidation models—the variable interest entity model and the voting interest entity model—which are focused on having a controlling financial interest. In contrast, section 52 may use a standard that is more focused on just economics (e.g., in the case of a partnership, ownership of more than 50% of profits or capital). Thus, entities could be consolidated for financial statement purposes but may not be treated as a single employer under section 52. Conversely, entities could be treated as a single employer under section 52, but not be consolidated for financial statement purposes. Thus, the application of section 5.03(2)(c)(ii) of the notice may require significant analysis. Furthermore, the treatment of entities that are consolidated for financial statement purposes but may not be treated as a single employer under section 52 under the Simplified Method appear both unclear and complicated.

Under section 5.03(2)(d) of the notice, where a corporation has an AFS that covers a period ("AFS year") that differs from its tax year, the AFSI Tests are applied by substituting "3-AFS-year period ending during such taxable year" for "3-taxable-year period ending with such taxable year" in each place those phrases appear. Further, section 59(k)(1)(E) is applied by substituting "AFS year" for "taxable year" and "3-AFS years" for "3-taxable years" in each place those phrases appear.

[10] Under section 451(b)(5), for purposes of section 451(b)(1), if the financial results of a taxpayer are reported on the AFS (as defined in section 451(b) (3)) for a group of entities, such statement shall be treated as the AFS of the taxpayer. The definition of AFS under section 451(b)(3) includes a financial statement which is certified as being prepared in accordance with generally accepted accounting principles and which is (1) a 10–K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the SEC, (2) an audited financial statement of the taxpayer which is used for credit purposes; reporting to shareholders, partners, or other proprietors, or to beneficiaries; or any other substantial nontax purpose, but only if there is no statement of the taxpayer described in clause (1), or (3) filed by the taxpayer with any other Federal agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (1) or (2).

Clean energy credits

Background

The IRA included new monetization features for many of the clean energy tax credits. Specifically, the IRA allows for refundability through a direct pay election for certain credits and types of entities under section 6417 and the IRA also allows for taxpayers to sell the clean energy tax credits to unrelated buyers under section 6418. Additionally, the CHIPS Act enacted a new investment tax credit under section 48D for semiconductor manufacturing that is also refundable through a similar direct pay election. The relevant statutory provisions provide that direct payment amounts and amounts received from the transfer of tax credits are not included in taxable income.

In general

The guidance confirms and clarifies the treatment for AFSI purposes of direct payment amounts as well as amounts received from the transfer of credits.

With respect to section 6417 and section 48D, the guidance confirms the application of section 56A(c)(9), which states that AFSI shall not include any amount treated as a payment against tax under a direct pay election.

In the case of partnerships and S Corps, section 6417 and section 48D provide that when a partnership or S Corp holds credit-eligible property, the direct pay election is made by the partnership or S Corp and the resulting payment is made to the partnership or S Corp and that those amounts are treated as tax-exempt income. The guidance further confirms that AFSI does not include amounts received by partnerships and S corps.

Finally, the guidance provides that any amount received from the transfer of a tax credit under section 6418 is excluded from ASFI, including in the case of amounts received by partnerships and S corps.

KPMG observation

The confirmation of the treatment of the direct payments amounts is consistent with the statutory exclusion from AFSI for such amounts in section 56A(c)(9). Section 56A(c)(9) does not, however, include a specific statutory carve-out for amounts received from transfers of tax credits under section 6418. While it seemed logical from a policy perspective to also exclude from AFSI amounts received from transfers of credits, it was unclear how to treat those amounts based on the statute alone. The guidance is a much needed and welcome clarification on that point.

Corporate partners and the Scope Determination

Background

The CAMT statute provides several modifications to FSI to arrive at AFSI. Under one modification, if a taxpayer (e.g., a corporation) is a partner in a partnership (“corporate partner”), the taxpayer generally

would be required to adjust its AFSI to "only" take into account the taxpayer's distributive share of AFSI of the partnership (the "distributive share only" rule). The Secretary has the authority to provide otherwise.

Section 59(k)(1)(D) provides that, solely for purposes of the Scope Determination, a corporation's AFSI includes the AFSI of all persons treated as a single employer with the corporation under sections 52(a) or (b). Additionally, section 59(k)(1)(D) "turns off" the distributive share only rule, although the language and structure of the statute leave unclear the extent to which the distributive share only rule is "turned off." Specifically, the language leaves unclear whether section 59(k)(1)(D)'s rule that "adjusted financial statement income of such corporation shall be determined without regard to [the 'distributive share only' rule]" (1) *only* applies if section 52 treats the partnership and corporation as a single employer and 100% of the AFSI of the partnership has been included in the corporation's AFSI ("Linked Reading") or (2) applies for *all* purposes of the Scope Determination—including when the partnership is not treated as as a single employer with the tested corporation under section 52 (the "Independent Reading").

In general

Section 7 of the notice adopts the Independent Reading, providing that the distributive share only rule is inapplicable for all Scope Determination purposes.

KPMG observation

The notice's approach raises significant questions as to how much partnership AFSI a corporate partner includes for Scope Determination purposes. It is clear that if the partnership and corporate partner are a single employer under section 52(a) or (b), 100% of partnership AFSI is included. If the partnership and corporate partner are not treated as single employer under section 52(a) or (b), a reasonable approach, in the absence of other guidance, would be to use start with the corporation's financial treatment of the partnership investment. This would appear to mean that if the corporate partner consolidates the partnership for financial statement purposes, the starting point would be 100% of partnership FSI and if the corporate partner uses a fair value method with respect the partnership investment, the starting point would be a mark-to-market amount.[11] Such inclusions, arguably inconsistent with the statutory scheme, would appear to make it more likely that corporations in certain UP-C and real estate fund structures are subject to the CAMT. Furthermore, under the notice approach, it is unclear how certain modifications in section 56A(c) would apply with respect to partnership FSI.[12] However, the approach may have been adopted in an effort to provide for a determination that is more easily auditable.

Conclusion

While the notice is fifty pages long, addresses a number of issues and the resolution of certain issues appears generally taxpayer favorable, the notice leaves a number of significant gating issues unaddressed—ones for which comments are requested as well as others. Notably, the manner in which the section 52 aggregation rules operate and numerous international issues are excluded from the issues addressed and the specific requests for comments. Another consideration that is unaddressed is the manner in which necessary information will be reported between taxpayers for purposes of applying the CAMT regime—particularly corporate partners in uncontrolled partnerships. These issues, and many others, will need to be urgently addressed in order to facilitate 2023 compliance.

Perhaps most significantly, the notice suggests that Treasury will build out an extensive CAMT regime—with a parallel basis system and CAMT specific attributes—and it is possible that the scope and complexity of such a regime may dwarf, for example, the consolidated return regulations. One can query as to whether

[11] See Monisha Santamaria and Sarah Staudenraus, *Adventures in CAMTyland: The Partnership 'Distributive Share Only' Rule in the Corporate Alternative Minimum Tax*, 63 TAX MANAGEMENT MEMORANDUM 26 (Dec. 19, 2022).
[12] See *id.*

this is practical—even for large corporations with large tax departments—or is sound tax administration for a regime that generally just accelerates the payment of tax, but may not in its general application change the aggregate tax burden over time.

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