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In this article, Giordano and Santamaria examine real estate investment trusts and the Inflation Reduction Act's corporate alternative minimum tax, pointing out that while the tax does not apply directly to REITs, their subsidiaries may be within its scope.

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A 2020 *Tax Notes* article began by describing the inapplicability of the base erosion and antiabuse tax to real estate investment trusts as a truism — something too obvious to mention. The rest of that COVID-era literary triumph explained why that might be just a touch too simplistic.[1]

The term "truism" might also describe the following assertion: The new corporate alternative minimum tax does not apply to REITs. REITs do not have to pay the corporate AMT. Period. But, as with the BEAT, that statement, while entirely accurate, does not tell the whole story.

The corporate AMT enacted in 2022 succeeds the prior iteration of the corporate AMT, which was repealed by the Tax Cuts and Jobs Act of 2017. REITs were sometimes subject to the old corporate AMT, most frequently when they sought to use net operating loss carryovers.[2] One can quibble with whether the new corporate AMT constitutes a sequel to or a remake or reboot of the old corporate AMT, but it is, like the BEAT, another attempt to prevent what is perceived as the overly successful navigation of the American tax system by big businesses and investors (and their advisers). More specifically, the corporate AMT is intended to create a second, alternative tax base for large corporations — and corporations that are members of large groups or have large affiliates. This second tax base starts, but does not end, with book net income (generally, a generally accepted accounting principles or "GAAP" number reflected on a financial statement). This is ostensibly to ensure that those corporations pay their — frequently and readily invoked, but never quite defined — fair share of tax.[3]

In short, the corporate AMT may impose a tax of 15 percent on the adjusted financial statement income (AFSI) of those taxpayers that are caught in its net.[4] AFSI is derived, generally, from the

[1] *See* Stephen J. Giordano and Joshua S. Kaplan, "A Few Thoughts on REITs and the BEAT," *Tax Notes Federal*, Apr. 20, 2020, p. 427.

[2] *See* section 59(d)(1)(A) and reg. section 1.58-6(a).

[3] *See, e.g.*, the March 25, 2021, release by Sen. Elizabeth Warren, D-Mass., about comments made before the Senate Finance Committee: "A small tax on profits — like the number that CEOs like to brag about: their book profits — would ensure that even the companies that are most skilled at gaming the tax code would have to contribute a fair share." For an interesting take on this general topic, see Scott L. Semer, "The Redistributive Myth of Progressive Taxation," *Tax Notes Federal*, Oct. 18, 2021, p. 365.

[4] *See* section 55(b)(2).

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taxpayer's book net income as reflected on its "correct" financial statement.[5] For purposes of distilling AFSI from the pulp of book net income, there are, well, lots of adjustments. And, as we examine in greater detail below, the way those adjustments are used differs depending on the purpose of the calculation of AFSI (that is, whether the computation is to determine if a corporation is caught in the corporate AMT's net as an applicable corporation or to determine the potential corporate AMT liability of an applicable corporation).[6]

The corporate AMT's net appears intended to capture only the biggest fish.[7] And REITs are clearly exempted.[8] But those two statements may offer false comfort. A REIT's subsidiaries may be subject to the corporate AMT — though whether there would be any corporate AMT for those subsidiaries to pay is another question, one that we hope to shed some light on.[9]

I. The Basics

The corporate AMT applies only to "applicable corporations," a rather prosaic term for what is intended to be an exclusive club whose members are the world's corporate behemoths.[10] An applicable corporation is defined as a corporation (other than a REIT, a regulated investment company, or an S corporation) that meets an annual AFSI test for the three years preceding the relevant tax year.[11] This "scope determination" test requires that the average AFSI of the corporation, along with certain related entities, for the three-year period ending with the relevant tax year exceeds $1 billion.[12] Importantly, the AFSI of taxpayers that are treated as a single employer under section 52(a) or 52(b) generally is combined for purposes of determining whether any of those taxpayers exceeds the $1 billion threshold.[13] If a corporation is found to be an applicable corporation, it must compute its corporate AMT liability (the "liability determination"). The corporate AMT liability of an applicable corporation is capped at 15 percent of its AFSI minus any corporate AMT foreign tax credits. This generally would affect the corporation's cash outlay and create a real liability only to the extent that the corporation's regular tax liability is less than the corporate AMT liability.

There is one method, under a series of rules, to compute AFSI for the scope determination — that is, for purposes of whether a taxpayer is an applicable corporation that might owe corporate AMT. A different series of adjustments is used to compute AFSI for purposes of the liability determination. We note that many of these rules have not been given form by regulations or other guidance and that Treasury has discretion to add additional adjustments, so there are many important technical questions that remain unresolved.

This basic test is modified for corporations that are part of a foreign-parented multinational group. A member of a foreign group is an applicable corporation if the corporation satisfies two tests.[14] First, the taxpayer must satisfy a $1 billion test for its AFSI that includes the AFSI of all members of the group. Unlike the generally applicable $1 billion test described earlier, and although it's not entirely clear, it appears that, based on the language in the statutory provisions and the available guidance, for purposes of this

[5] *See* section 56A(a).

[6] *See generally* sections 56A and 59(k).

[7] The Biden administration has described the corporate AMT as applying "to only the very largest corporations." *See* the White House, "Fact Sheet: The American Jobs Plan" (Mar. 31, 2021).

[8] *See* section 59(k)(1).

[9] This article generally will not address the myriad questions about how various commercial situations are treated for purposes of determining a corporation's AFSI, whether for purposes of determining if the corporation is an applicable corporation or to determine the amount of the corporation's liability for corporate AMT.

[10] *See* sections 55(b)(2), 59(k). The Joint Committee on Taxation estimated that approximately 150 corporations were subject to a prior proposed version of the corporate AMT. JCT, "Memorandum: Proposed Book Minimum Tax Analysis by Industry" (July 28, 2022). One commentator has identified only 90 corporations that are subject to the corporate AMT. Martin A. Sullivan, "Tax Credits and Depreciation Relief Slash Burden of New Corporate AMT," *Tax Notes Federal*, Aug. 22, 2022, p. 1185. It is possible, however, that many more than 150 corporations are in scope and subject to the corporate AMT and, of course, will need to expend time and money to determination whether the tax applies to them, along with fulfilling any required reporting.

[11] *See* section 59(k)(1).

[12] *See* section 59(k)(B)(i). But see note 15 *infra* for how the section 52 aggregation rule is applied to foreign groups.

[13] *See* section 59(k)(1)(D).

[14] *See* section 59(k)(1)(B).

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first prong the section 52 single employer rules do not apply.[15] Second, a different — and narrower — calculation of the taxpayer's AFSI must exceed $100 million.[16] For this $100 million test, generally, only U.S.-nexus AFSI is taken into account. But unlike the first $1 billion test, the section 52 single employer rules apply.[17] The idea here is that for corporate AMT to apply to a member of a foreign group, that group must have a fairly significant footprint (exceeding $100 million) in the United States, along with a large global footprint (exceeding $1 billion).

II. Tell Us More

As with the BEAT, REITs are not subject to the corporate AMT. But a REIT's regarded, taxable corporate subsidiary (known as a taxable REIT subsidiary, or more commonly a TRS) may be subject to the corporate AMT.

A. What's a TRS?

Stated very generally, a TRS is used to do things that a REIT cannot, or should not, do. Likewise, TRSs are used to hold assets that a REIT cannot, or should not, hold. As the name suggests, TRSs are subject to corporate tax on their income and are not eligible for the dividends paid deduction available to REITs.

The use of TRSs is common for businesses that undertake significant (or even relatively insignificant) activities that, absent the use of the TRS or some other solution, would generate nonqualifying income for purposes of the REIT gross income tests. For example, REITs operating in the timber industry typically use TRSs for certain bad income-generating activities; REITs might also undertake homebuilding or other dealer-type activities through TRSs, which are also an integral part of the tax structure for many REITs in the hospitality and healthcare industries.[18]

Importantly, a TRS is often viewed from a commercial standpoint as part of the same business enterprise as its parent REIT. For financial accounting purposes, a TRS typically, but not always, is consolidated (that is, book consolidated) by its REIT parent.[19] It is common, though not universal, for both public and private REITs to own all (or substantially all) their TRSs' equity. It thus follows that it is common, though again not universal, for REITs and their TRSs to constitute a single employer under section 52(a) or 52(b). Perhaps more importantly, under the single employer rule, a TRS often will be combined for these purposes not only with its parent REIT but also the REIT's other affiliates. This might include partnerships in which the REIT owns a direct or indirect interest, indirect owners, and certain sibling or cousin entities.

B. TRSs and the Corporate AMT

As a general matter, taxpayers that are treated as a single employer under section 52(a) or section 52(b) are combined for purposes of determining whether the taxpayer exceeds the general $1 billion test (that is, the scope determination test, at least as applied outside the context of foreign groups). Thus, in some cases, both the REIT's AFSI and that of an entity in which the REIT holds an interest of greater than 50 percent in capital or profits (and certain other affiliates) will be included for determining whether the REIT's TRS meets the $1 billion test.

For example, assume REIT owns a 92 percent interest in Partnership, which in turn owns a 100

[15] *See* section 59(k)(1)(B)(I). As of now, the single employer aggregation rule appears to apply for purposes of the second prong of the scope determination for foreign groups — the $100 million test. In sum, then, the section 52 single employer aggregation rule appears to apply (1) for purposes of the general scope determination *outside* the context of foreign groups, and (2) for purposes of the $100-million-test prong of the scope determination for foreign groups, but appears not to apply (3) for purposes of the $1-billion-test prong of the scope determination for foreign groups. Note, however, that section 59(k)(2)(D) gives the IRS authority to determine, among other things, "the entities to be included in a [foreign group]."

[16] *See* section 59(k)(1)(B)(II).

[17] *See* section 59(k)(2)(A). In section 5 of Notice 2023-7, 2023-3 IRB 390, Treasury and the IRS provided a simplified method, with lower AFSI thresholds and other modifications relative to the statutory rules, for determining whether a taxpayer is an applicable corporation subject to the corporate AMT (the simplified scope determination). The simplified scope determination appears to retain the application of the section 52 single employer rules for purposes of the generally applicable $1 billion test and $100 million test for foreign groups.

[18] See generally section 856(d)(8)(B), housing the so-called REIT Investment Diversification and Empowerment Act or "RIDEA" structure used by many REITs that own hospitality and healthcare properties.

[19] Note that the criteria for determining whether entities are consolidated for financial statement purposes (that is, book consolidated) differ from those governing eligibility for the formation of a consolidated group for U.S. federal income tax purposes. Note that REITs and their TRSs cannot be members of the same consolidated group for U.S. federal income tax purposes. *See* section 1504(b)(4).

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percent interest in Subsidiary, a TRS of REIT. Subsidiary operates a manufacturing business, and has no significant intercompany transactions (aside from the payment of dividends) with its affiliates. For the period covering 2020, 2021, and 2022, the combined average AFSI (as measured for scope determination purposes) of REIT, Partnership, and Subsidiary is $1.1 billion, and Subsidiary's average AFSI (as measured for scope determination purposes, but on a hypothetical single-entity basis) is $50 million. Because REIT, Partnership, and Subsidiary constitute a single employer, Subsidiary will be an applicable corporation, subject to the corporate AMT, in 2023 and beyond — despite the fact that Subsidiary's own average AFSI during that period is a mere $50 million. Perhaps, then, it is not quite so easy to say that REIT is not subject to the corporate AMT, at least if its relationship to Subsidiary causes Subsidiary to be an applicable corporation. Now, as a practical matter, Subsidiary's status as an applicable corporation may not matter very much. In our facts, Subsidiary's AFSI — as measured for purposes of the liability determination — would likely be in the ballpark of $50 million.[20] As a result, TRS's corporate AMT liability could not exceed $3 million, or 15 percent of that $50 million, even assuming that Subsidiary was to owe no regular corporate income tax. It is possible, though, that this $3 million may not exceed, by a significant amount or at all, Subsidiary's regular U.S. federal corporate income tax liability. In other words, being subject to the corporate AMT might have little or no additional bottom-line effect on Subsidiary.

Further, the corporate AMT is intended to tax (or, perhaps more accurately, accelerate taxation of an approximation of) significant differences between an applicable corporation's book income, as reflected on its financial statements, and its taxable income. Of course, intended effect and actual effect are not the same things, and good intentions often pave roads that, even if they don't lead, as some say, to hell, may still have lots of potholes. The generally applicable federal income tax rate for corporations is 21 percent; the corporate AMT rate is 15 percent. As a result, if we can dare to generalize, absent situations in which significant amounts of income are booked without a corresponding inclusion in taxable income or a quirk in the operation of the corporate AMT rules, the corporate AMT would not be expected to have a significant bottom-line effect on the applicable corporation. Thus, the absence of significant book-tax differences at the applicable corporation level might often eliminate the possibility of corporate AMT. In many cases — though not all — the typical TRS[21] is unlikely to have significant book-tax differences. For example, in the hotel and hospitality sector, an operating TRS's book profit will often closely resemble its net cash flow and its (pre-corporate AMT) taxable income. Among other shoes many are waiting to see drop is the treatment of intercompany payments (that, though recognized for federal income tax purposes, are eliminated in consolidation for GAAP purposes). These would include, for example, intercompany payments made by a TRS that is an applicable corporation to a REIT, on whose books the TRS is consolidated. As described earlier, it is not uncommon for a TRS to deduct arm's-length interest or rent payments made to its parent REIT. If final rules were effectively to add back all or some portion of those payments (and the associated deduction) to the TRS's AFSI for purposes of the liability determination, it would arguably be difficult to distinguish that result, at least from a bottom-line standpoint, from an application of corporate AMT to the REIT itself. We suspect that we speak for other tax lawyers unburdened by a CPA license in saying that financial accounting is best left to the accountants and that everyone (accountants included) is still learning how to compute AFSI, for whatever purposes, and waiting for guidance to make that computation possible in many instances.

C. Foreign Investors and a Quirk

An interesting quirk arises when a REIT is owned, and its TRS is indirectly owned, by foreign investors. The use of REITs to provide tax-efficient platforms for investment in U.S. real estate by and for both institutional and foreign

[20] As noted, AFSI measured for scope determination purposes and AFSI measured for liability determination purposes can differ greatly.

[21] Insofar as one could be said to exist.

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investors is increasingly common. A TRS, even those with a public REIT as a parent or that are part of another large investment platform, will often have a relatively small amount of taxable income after taking into account generally deductible payments to the REIT (in the form of rent, a rent substitute, or interest), payments to property managers and intellectual property providers, and ordinary-course business expenses. But once a TRS's income is combined with that of its parent REIT (effectively adding back all or a significant part of what was the TRS's rent and interest paid to the parent REIT) and with the income of other relevant affiliates, the average annual AFSI (for scope determination purposes) of the TRS may reach $100 million.[22] If a TRS's income is combined with not only a REIT but also other entities within an institutional investor's portfolio universe, the $1 billion threshold may be reached, if not readily then perhaps more frequently than expected.

Take the following example. F, a foreign institutional investor (specifically, a qualified foreign pension fund within the meaning of section 897(k)), owns all the common equity of REIT. REIT owns a portfolio of luxury hotels, which it leases to its wholly owned TRS. F also owns majority stakes in multiple private companies operating worldwide, with an aggregate value somewhere in the 12 figures, which are combined on F's applicable financial statement. Assume F, a foreign corporation for U.S. federal income tax purposes, is the head of a foreign group. Assume that TRS's combined AFSI (taking into account the single employer aggregation rule) for the relevant three-year period exceeds $100 million. Assume also that F, along with the group of entities that are members of the foreign group, has AFSI for the relevant three-year period that exceeds $1 billion. TRS is, therefore, an applicable corporation. But as described earlier, the effect of the corporate AMT on TRS's cash outlays (aside from professional fees and compliance expenses) may be insignificant.

III. Conclusion

We came neither to praise the corporate AMT nor, in the context of REITs, to bury it. Instead, we wanted to let it be known that while REITs are not corporate AMT taxpayers, businesses in which REITs own significant interests, with which the REIT forms a single enterprise, and of which REITs form part of a single employer or book-consolidated group, may have a corporate AMT liability. In determining whether those businesses could be subject to the corporate AMT, the REIT's income needs to be considered and may be determinant. And, of course, the mere possibility of corporate AMT applying may increase the compliance burden — and the possibility of mistakes for the businesses and their tax and accounting advisers.[23] ■

[22] We use this smaller number because foreign institutional investors, taken as a whole, are significant investors in U.S. real estate and real estate credit platforms.

[23] The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only and does not necessarily represent the views or professional advice of KPMG LLP.

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