

# CAMTyland Adventures, Part VIII: Notice 2026-7's Rainbow Cards Offer New Moves

by Monisha Santamaria, Jessica Theilken, and Natalie Tucker

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In this eighth installment of their “CAMTyland Adventures” series, the authors explore the intricate game path created by the most recent corporate alternative minimum tax notice, which offers additional interim guidance for navigating the corporate AMT regime.

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Welcome back, CAMTyland players, to the winding and often perplexing world of the corporate alternative minimum tax (CAMT).<sup>1</sup> Just as taxpayers and their advisers thought they had mastered the rules of the game, Treasury and the IRS have released a fresh set of instructions with Notice 2026-7, 2026-11 IRB 637. This latest guidance, issued February 18, doesn't just add a few new game spaces; it fundamentally changes the gameplay, introducing a series of powerful “Rainbow Cards” that offer shortcuts around some of the regime's most frustrating obstacles. It's anticipated that the rules in this notice will inform forthcoming proposed regulations, which promise to further reshape the CAMT landscape.<sup>2</sup>

For anyone who hasn't read the previous adventures, the CAMT imposes a 15 percent minimum tax on applicable corporations — those

<sup>1</sup>For prior installments in this series, see Natalie Tucker et al., “CAMTyland Adventures, Part VII: Will the OBBBA Crack Snow Flake Lake?” *Tax Notes Federal*, Sept. 15, 2025, p. 1755; Monisha Santamaria et al., “CAMTyland Adventures, Part VI: Notice 2025-28 — A Rainbow of Choices but Few Gumdrops,” *Tax Notes Federal*, Sept. 1, 2025, p. 1431; Santamaria et al., “CAMTyland Adventures, Part V: Coping With CAMTyland Grief,” *Tax Notes Federal*, Sept. 16, 2024, p. 2271; Jessica Theilken, Santamaria, and Tucker, “CAMTyland Adventures, Part IV: Retroactive Tax Extenders — Planning for a Move-Backward Card,” *Tax Notes Federal*, Apr. 22, 2024, p. 645; Jonathan Galin, Santamaria, and Tucker, “CAMTyland Adventures, Part III: 2023 Scope Bubble Corporations — Lost in Lollipop Woods,” *Tax Notes Federal*, Feb. 12, 2024, p. 1249; Santamaria et al., “CAMTyland Adventures, Part II: ‘Right-Sizing’ in the Licorice Lagoon,” *Tax Notes Federal*, July 31, 2023, p. 763; Santamaria et al., “CAMTyland Adventures, Part I: How to Play the Game — Corporate Alternative Minimum Tax Basics,” *Tax Notes Federal*, July 24, 2023, p. 569.

<sup>2</sup>Treasury and the IRS, in prior interim guidance, have indicated they intend to issue a notice of proposed rulemaking that revises the proposed regulations issued on September 13, 2024, before releasing final regulations.

with average annual adjusted financial statement income (AFSI) exceeding \$1 billion.<sup>3</sup> AFSI begins with the net income on the correct financial statement (that is, the applicable financial statement or AFS) and layers on a series of adjustments. The adjustments are generally designed to align the CAMT treatment and regular tax treatment of certain items.<sup>4</sup> The collision between financial accounting (that is, book) treatment and tax treatment of items has always been the central challenge of the game. Thus, many applicable corporations with significant differences in the book and tax treatment of various items have found themselves facing a CAMT liability because the regular tax rules don't apply in CAMTyland.

Notice 2026-7 offers relief for taxpayers struggling with some of the most problematic book-tax differences.<sup>5</sup> It introduces five new elective adjustments to liability AFSI, effectively functioning as Rainbow Cards that may be played in certain instances when the book and tax paths diverge to a taxpayer's detriment. Playing one of the following Rainbow Cards generally allows an in-scope player (that is, an applicable corporation) to follow the more favorable tax treatment of certain items.

Importantly, the five Rainbow Cards apply only to liability AFSI. Thus, because of Notice 2026-7, the number of players on the board as applicable corporations will not shrink significantly. Notice 2026-7, however, changes what the CAMTyland board extracts from the applicable corporation players, provided that one or more of these powerful cards are played.

**Table 1. CAMT Rainbow Cards**

| Rainbow Card                      | Notice 2026-7 Section | Issue Addressed                                                      |
|-----------------------------------|-----------------------|----------------------------------------------------------------------|
| The Master Mechanic's Wrench Card | Section 3             | Certain tax repairs deductions                                       |
| The Intangible Asset Bridge Card  | Section 4             | Eligible intangibles                                                 |
| The R&E Rewind Card               | Section 5             | Amortization of pre-2025 domestic research and experimentation costs |
| The Hollywood Express Card        | Section 6             | Qualified production costs                                           |
| The Small Dollar Shortcut Card    | Section 7             | Eligible materials and supplies                                      |

Notice 2026-7's revised instructions come with fine print and strategic considerations that every player must understand before making their next move — or risk being mired in the Molasses Swamp. The following is an overview of the key liability AFSI adjustments and other clarifications from Notice 2026-7.

### I. The New Rulebook, Generally

The must-read rules of Notice 2026-7's expansion pack are the rules for playing the Rainbow Cards (discussed in detail below). However, there are other aspects of Notice 2026-7's rulebook that players should familiarize themselves with.

Notice 2026-7's expansion pack provides more cards to the small universe of players who have early adopted sections of the CAMT proposed regulations. Three new cards are available to this small group of players — in particular, the ones navigating financial distress or those with

<sup>3</sup> See sections 55(b)(2), 56A, and 59(k). See also REG-112129-23, KPMG, "Analysis and Observations on the Proposed CAMT Regulations" (Oct. 4, 2024), and KPMG, "Technical Corrections to Proposed Regulations on Corporate Alternative Minimum Tax" (Dec. 23, 2024); Notice 2025-27, 2025-26 IRB 1611, and KPMG, "Notice 2025-27 Provides Additional CAMT Interim Guidance" (June 2, 2025); Notice 2025-28, 2025-34 IRB 316, and KPMG, "CAMT Caution Advised for Applicable Corporations After 'Favorable' OBBB and Notice 2025-28 Changes" (Aug. 5, 2025); Notice 2025-46, 2025-43 IRB 533, Notice 2025-49, 2025-44 IRB 627, and KPMG, "Additional CAMT Interim Guidance and Favorable Early Reliance Rules" (Oct. 2, 2025).

<sup>4</sup> AFSI is computed differently for different purposes. Principally, the computation of AFSI for determining whether a taxpayer is an applicable corporation (scope AFSI) differs from the computation of AFSI for purposes of determining a taxpayer's CAMT liability (liability AFSI).

<sup>5</sup> See KPMG, "Additional Interim CAMT Guidance (Notice 2026-7)" (Feb. 20, 2026).

international squares. Each of these three new cards may be used for both scope AFSI and liability AFSI calculations.<sup>6</sup>

For the vast universe of players who have not early adopted the CAMT proposed regulations, the gatekeeper's test (that is, the rules for determining in-scope status) is unchanged by Notice 2026-7. Think of it this way: There might exist a handful of powerful shortcut cards, but a taxpayer still must reach the gingerbread gate. A taxpayer could easily find itself qualifying as an applicable corporation, required to file Form 4626, "Alternative Minimum Tax — Corporations," and play the game, even if the new Rainbow Cards ultimately mean the taxpayer lands on a "No CAMT Liability" square at the end.

## II. The Master Mechanic's Wrench Card

### A. The Obstacle

For much of CAMT's short life, fixing things has been harder than breaking them. When an applicable corporation repairs tangible property, the tax rules and book rules send the pawn down different paths. For tax, ordinary repair and maintenance costs generally are deductible under section 162. However, many of those same expenditures are capitalized and depreciated as part of the underlying asset for book purposes.<sup>7</sup> The statute — section 56A — provides an AFSI adjustment for depreciation of section 168 property but provides no similar rule for repairs of section 168 property that are deducted for tax

purposes but capitalized and depreciated for book purposes.

Notice 2025-49, 2025-44 IRB 627, tried to address a narrow slice of this mismatch for regulated utilities operating under specific rules of generally accepted accounting principles. But manufacturers, energy producers, retailers, and certain other companies — that spend significant amounts on deductible repairs and maintenance — were left to carry the difference when repair costs were driving CAMT liabilities. Moreover, the compliance burden without parity between the CAMT and the regular tax rules for repairs and maintenance costs was substantial. Taxpayers were required to bifurcate book depreciation on every section 168 asset, isolating the portion attributable to capitalized repairs.

### B. The Rainbow Card

Notice 2026-7 hands in-scope players the Master Mechanic's Wrench Card. Applicable corporations may now align the CAMT treatment with their regular tax treatment by reducing liability AFSI for deductible repair and maintenance costs attributable to section 168 property — even when those costs are capitalized and depreciated for book purposes. Specifically, under Notice 2026-7, any applicable corporation may reduce liability AFSI by deductible tax repairs for eligible repair assets (essentially, costs to repair section 168 property that are capitalized for book purposes but deducted under reg. section 1.162-4 or recovered in another manner, such as cost of goods sold for tax purposes). The corresponding book items, such as depreciation expense, impairment losses, and impairment loss reversals for the property, are then disregarded in determining AFSI.

This new AFSI adjustment considers certain section 481(a) adjustments related to eligible repair assets to the extent those amounts are considered in regular taxable income for the year. Further, AFSI must be adjusted to account for any differences in cumulative AFSI adjustments for eligible repair assets that result from a taxpayer making an accounting method change that changes the characterization of eligible repair assets (for example, a change from capitalizing and depreciating a repair cost to deducting the tax repair, or vice versa) in a tax year succeeding the

<sup>6</sup> See Notice 2026-7, sections 8-10. First, for taxpayers emerging from financial distress, Notice 2026-7 provides more favorable attribute reduction rules (applicable in the context of book cancellation of debt income) and provides that fresh start accounting and related AFSI basis adjustments should simply be disregarded for CAMT purposes (applicable in the context of bankruptcy emergence). Second, the antiavoidance pitfall involving covered asset transactions now operates as a rebuttable presumption rather than an automatic penalty: If a taxpayer engages in certain nonrecognition transactions with foreign corporations and basis is used in AFSI within two years, the taxpayer is presumed to have a tax avoidance purpose but may escape the penalty by demonstrating a valid business purpose and attaching a statement to their return, addressing concerns about the previous rule's overly broad reach. Third, the double toll on section 367(d) outbound intangibles transfers is eliminated for taxpayers relying on Notice 2026-7's Rainbow Card. If a U.S. transferor recognizes CAMT deemed royalty income, the foreign transferee taxpayer is now allowed a corresponding reduction to its own adjusted net income or loss, preventing double taxation and aligning with the statute's deemed royalty scheme.

<sup>7</sup> See Accounting Standards Codification (ASC) 360, "Property, Plant, and Equipment"; and International Accounting Standard 16, "Property, Plant, and Equipment."

first tax year in which the taxpayer adopts this section of the notice.

### C. The Fine Print

The Master Mechanic's Wrench Card requires that the repair relates to section 168 property (that is, generally modified accelerated cost recovery system or bonus-depreciation-eligible property). As such, a repair deduction in relation to property that was acquired and placed in service before 1987 (for example, a pipeline placed into service in 1985) is not eligible for this Rainbow Card. This is meaningful to many in the utilities and railroad industries. Further, the Master Mechanic's Wrench Card only works once you're in the game (that is, the taxpayer is an applicable corporation). Said differently, the elective tax repair adjustment may be used to reduce liability AFSI, not scope AFSI. Moreover, once an applicable corporation plays this card, it must consistently apply the adjustment in future years, subject to further guidance, and must comply with annual computational and reporting requirements.

## III. The Intangible Asset Bridge Card

### A. The Obstacle

Intangible assets play by two very different rulebooks. Consider the following scenario: A corporation acquires a target company, and the purchase price exceeds the fair value of the target company's identifiable assets. The difference is generally related to goodwill and does not appear on any balance sheet until a buyer decides what it is worth. For regular tax purposes, acquired goodwill is generally amortizable over 15 years under section 197. For GAAP, goodwill generally remains on the balance sheet indefinitely, tested annually for impairment, recoverable only when the business is sold or the value demonstrably declines.<sup>8</sup> Financial statement income (FSI) is higher than taxable income for every year that goodwill is amortized for tax but is not impaired or sold for book purposes. Without a CAMT adjustment, AFSI is higher than taxable income as well. For large acquirers — and in today's deal

environment that describes a substantial portion of applicable corporations — this divergent treatment of section 197 assets may drive significant CAMT liabilities. Arguably, CAMT should not discourage mergers and acquisitions activity.

Notice 2025-49 offered limited relief, allowing a liability AFSI adjustment for certain goodwill acquired on or before October 28, 2021 (the date early CAMT legislation first became public). Corporations that made acquisitions after that received no relief for those post October 28, 2021 acquisitions. For many taxpayers, the bridge stopped short of where they needed to go, and many comments were submitted to Treasury indicating as much.

### B. The Rainbow Card

Notice 2026-7 modifies and expands the previous guidance provided by Notice 2025-49 to allow a liability AFSI adjustment for amortization deductions under section 197 attributable to any eligible intangible — defined broadly to include any goodwill (regardless of when acquired), as well as other section 197 intangibles that are not amortizable for AFS purposes (that is, the costs are only recoverable for AFS purposes upon impairment or disposition) (the section 197 intangibles AFSI adjustment). The section 197 intangibles AFSI adjustment generally operates as a targeted replace book with tax mechanism. Liability AFSI is reduced by the amount of deductible tax amortization attributable to eligible intangibles, but only to the extent that those amounts are recovered through COGS or otherwise allowed as a deduction in computing taxable income for the year. At the same time, AFSI is adjusted to disregard covered book amortization and other book expenses associated with those same intangibles, effectively neutralizing the GAAP impairment-only model for CAMT purposes.

### C. The Fine Print

The Intangible Asset Bridge Card comes with pages of fine print. First, there is a complex formula for calculating the amount of the adjustment, which taxpayers may be inclined to overlook. For taxpayers playing the Intangible Asset Bridge Card, liability AFSI is:

<sup>8</sup> See ASC 350, "Intangibles — Goodwill and Other," and IAS 38, "Intangible Assets."

- reduced by deductible tax amortization for eligible intangibles (but only to the extent of the amount recovered as COGS or otherwise allowed as a deduction in computing taxable income for the tax year);
- adjusted to disregard covered book intangible amortization expense, covered book intangible COGS amortization, and covered book intangible expense (including impairment losses) for eligible intangibles; and
- adjusted to consider certain section 481(a) adjustments related to eligible intangible amortization to the extent taken into account in computing taxable income for the tax year.

Second, an additional AFSI adjustment applies upon the tax disposition of an eligible intangible. The adjustment appears directed at avoiding the duplication of basis recovery and may significantly claw back the benefits of this Rainbow Card for eligible intangibles. The adjustment upon disposition (and potential AFSI increase) occurs if the applicable corporation disposes of an eligible intangible for regular tax purposes. The amount is dependent on the CAMT basis of the eligible intangible and, in cases in which the CAMT basis of the eligible intangible is negative, the applicable corporation is required to include the negative amount in AFSI. Computing the CAMT basis of an eligible intangible is complicated, and the formula can be summarized as shown in Table 2.

Third, a special rule applies if an eligible intangible is disposed of for regular tax purposes before it is treated as disposed of for AFS purposes. In that situation, any AFS basis recovery reflected in FSI after the tax disposition date is disregarded in determining AFSI.

Fourth, this Rainbow Card requires a detour for partnership-held eligible intangibles. When an eligible intangible is held through a partnership, special allocation and reporting rules apply to ensure that CAMT entity partners properly reflect basis adjustments — mirroring the partnership mechanics used elsewhere in the CAMT regime. When a CAMT entity partner applies other CAMT partnership adjustments, corresponding modifications must be reflected in computing the section 197 intangible AFSI adjustment.

**Table 2. CAMT Basis of an Eligible Intangible**

|                                                |                                                                                                                                                                                                |
|------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Starting basis of an eligible intangible:      | Start with AFS basis of the eligible intangible as of the disposition date and make adjustments to determine CAMT basis under rules similar to prop. reg. section 1.56A-16(e)(2)(ii)           |
| Decreased by:                                  | Eligible intangible tax amortization as of disposition date (regardless of capitalization or AFSI adjustment)                                                                                  |
| Increased by:                                  | Covered book intangible expense                                                                                                                                                                |
| Increased by:                                  | Covered book intangible amortization and covered book COGS amortization that reduced AFS basis                                                                                                 |
| Decreased by:                                  | Reductions to the CAMT basis under prop. reg. section 1.56A-21 (including modifications from Notice 2025-46, if taxpayer elects into notice modifications)                                     |
| Increased or decreased by:                     | Adjustments to AFS basis disregarded for AFSI and CAMT purposes under the proposed CAMT regulations (including modifications from Notice 2025-46 if taxpayer elects into notice modifications) |
| <i>Source:</i> Notice 2026-7, section 4.07(2). |                                                                                                                                                                                                |

Fifth, this Rainbow Card applies only for purposes of determining liability AFSI and does not affect the calculation of scope AFSI.

Sixth, as with the other elective adjustments introduced by Notice 2026-7, the election must be applied consistently across all eligible intangibles and across future tax years, unless and until further guidance provides otherwise.

Seventh, taxpayers playing the Intangible Asset Bridge Card are subject to annual reporting requirements designed to support transparency and consistency.

## IV. The R&E Rewind Card

### A. The Obstacle

The R&E Rewind Card responds to a new problem — one that did not exist when the CAMT was enacted but was created by a generally

taxpayer-favorable change in the One Big Beautiful Bill Act (P.L. 119-21).<sup>9</sup>

Under section 174 before amendment by the OBBBA, taxpayers were generally required to capitalize research and experimental expenditures paid or incurred in tax years beginning after December 31, 2021, rather than deduct them immediately. Taxpayers were required to capitalize and amortize R&E expenditures over a five-year period if incurred in the United States (domestic R&E expenditures) or over a 15-year period if incurred outside the United States (foreign R&E expenditures). The result was a forced deferral for tax (that is, regular tax), even when book accounting generally allows immediate expensing (although there are special rules for certain types of costs, such as the development of internal-use software).<sup>10</sup>

Section 56A, as enacted, did not contain any special AFSI adjustments for R&E costs and, thus, the financial accounting treatment of R&E costs controlled for determining AFSI. As a result of the requirement to capitalize and amortize R&E costs for regular tax purposes, a taxpayer's FSI, and thus AFSI, was generally expected to be lower than taxable income. This typically created a CAMT cushion and decreased the chances of an applicable corporation paying CAMT.

For amounts paid or incurred in tax years beginning after December 31, 2024, section 174A, as enacted by the OBBBA, restores immediate deductibility of domestic R&E expenditures.<sup>11</sup> The relief is real — but confined to the regular tax land. Moreover, the OBBBA provides transition relief, once again only in the regular tax context, whereby taxpayers may elect in their first tax year beginning after 2024 to accelerate over one or two tax years the recognition of any unamortized domestic R&E costs that were paid or incurred in

tax years beginning after 2021 and before 2025 (that is, those that were capitalized under section 174 before amendment by the OBBBA), the “section 174 transition adjustment.”<sup>12</sup>

The OBBBA, however, offered no release valve in the CAMT context. Neither the statute nor prior guidance allowed AFSI to follow these tax only recoveries; thus, applicable corporations could experience AFSI that is higher than taxable income beginning in 2025 largely as a result of the elections they make related to unamortized domestic R&E costs (or even the continued amortization of those costs coupled with current-year expensing). The result was arguably perverse: The very incentives designed to restore domestic research threatened to inflate CAMT liabilities for applicable corporations.

## B. The Rainbow Card

Notice 2026-7 introduces the R&E Rewind Card, a targeted adjustment that allows the CAMT treatment to get closer to the regular tax treatment for certain domestic R&E costs. For tax years beginning after 2024, applicable corporations may reduce liability AFSI by amortization deductions attributable to domestic R&E costs that were capitalized under former section 174 from 2022 through 2024, provided those deductions reduce regular taxable income in the year and subject to certain adjustments. Thus, the R&E Rewind Card allows an applicable corporation to reduce AFSI for either its section 174 transition adjustment or, if the taxpayer elects not to accelerate its unamortized domestic R&E costs, the amortization of that amount to the extent deducted for regular tax purposes in determining taxable income for the tax year.

Taxpayers using this Rainbow Card must increase AFSI by any book amortization expense of domestic R&E costs reflected in the taxpayer's AFS in the current year if those amounts were subject to capitalization and amortization under former section 174 in 2022 through 2024. Thus, the notice seems to attempt to prevent duplications in AFSI of domestic R&E costs amortized in the current year when both book and regular tax capitalized the same costs in prior years.

<sup>9</sup> While P.L. 119-21 initially had the “One Big Beautiful Bill Act” short title when passed by the House and received in the Senate (see section 1 of H.R. 1 (119th Cong., 1st sess.) as placed on the Senate calendar on June 28, 2025), that short title was struck as part of the budget reconciliation process in the Senate (commonly referred to as the “Byrd bath”), hence the official name of the bill is “An Act to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14” (popularly known as the “One Big Beautiful Bill Act” or “OBBBA”).

<sup>10</sup> See ASC 730, “Research and Development”; and IAS 38, “Intangible Assets.” See also KPMG, “Handbook: IFRS Compared to US GAAP” (Dec. 2025).

<sup>11</sup> See section 70302 of the OBBBA. Section 174A(c) also provides an election to capitalize and amortize these costs.

<sup>12</sup> See section 70302(f)(2) of the OBBBA.

However, Notice 2026-7 does not require taxpayers to claw back any portion of this AFSI adjustment that corresponds to book expenses that reduced FSI and AFSI in a prior year (for example, 2023 or 2024).

### C. The Fine Print

The most important fine print is that the R&E Rewind Card is limited to domestic R&E costs that were capitalized under former section 174 that are still being amortized for regular tax purposes after 2024 (that is, this AFSI adjustment does not apply to either foreign or domestic R&E costs paid or incurred in tax years beginning after 2024 subject to amended section 174 or new section 174A).

Taxpayers should also take care not to overlook the complexity of the requirement to unwind any book amortization reflected in FSI that relates to domestic R&E costs capitalized from 2022 to 2024. Because the rules for what costs must be capitalized under financial accounting principles differ from the section 174 rules, taxpayers may need to undergo a complex series of steps to identify the amount of the adjustment that increases AFSI.

Like the other Rainbow Cards, this adjustment applies only for purposes of determining liability AFSI and does not affect scope AFSI. Consistency requirements apply, but no separate election statement or special reporting is required when an applicable corporation plays this card.

## V. The Hollywood Express Card

### A. The Obstacle

Players in the film, television, live theater, and music industries can use a section 181 express lane to expense certain production costs for regular tax purposes. In particular, section 181 permits taxpayers to elect to immediately deduct the costs of certain qualified film, television, live theatrical, and sound recording productions in the year paid or incurred, subject to production-specific dollar limitations, with the remaining amount capitalized and depreciated once the

production is released.<sup>13</sup> For financial accounting purposes, however, those same costs are generally capitalized into a single production asset and depreciated or amortized using an income forecast type method.<sup>14</sup> This divergence creates a familiar CAMT mismatch — taxable income reflects a current deduction, while AFSI reflects only book depreciation or amortization spread over multiple years.

The problem is compounded when production costs exceed the applicable section 181 dollar limitation. In those cases, the excess costs are treated as section 168 property for tax purposes, while the entire production remains a single capitalized asset for book purposes. The result is a bifurcated asset for CAMT purposes — partly governed by the section 181 framework (and therefore subject to book treatment absent Treasury relief), and partly eligible for the section 168 depreciation adjustment (and therefore reflective of regular tax treatment). This mirrors the compliance and tracking burdens that motivated the Master Mechanic's Wrench Card.

### B. The Rainbow Card

Notice 2026-7 introduces a new elective liability AFSI adjustment for qualified production costs related to any qualified production owned by a CAMT entity that are allowed as a deduction under section 181(a). Like the Intangible Asset Bridge Card and the R&E Rewind Card, the Hollywood Express Card generally functions as a targeted replace book with tax rule, allowing CAMT to follow the same recovery path taken for regular tax for qualified film or television productions, live theatrical productions, or sound recording productions.

<sup>13</sup> Section 181, as amended by section 70434 of the OBBBA, permits taxpayers to elect to deduct the cost of qualified film or television productions and qualified theatrical productions commencing before 2026, up to \$15 million per production (\$20 million for productions in certain geographic regions) or any qualified sound recording productions for sound recordings commencing in tax years ending after July 4, 2025, that commence before 2026, up to \$150,000 in the aggregate. Section 70434 of the OBBBA also added qualified sound recording productions as a new category of qualified property eligible for 100 percent bonus depreciation once a production is initially released or broadcast (for capitalized production costs exceeding the amount expensed under section 181 and without regard to the dollar limitation or expiration of section 181).

<sup>14</sup> See ASC 926, "Entertainment — Films"; ASC 928, "Entertainment — Music"; IAS 39, "Intangible Assets"; and IAS 2, "Inventories."

If an applicable corporation plays the Hollywood Express Card, liability AFSI may be (1) reduced by qualified production costs, but only to the extent those amounts are recovered through COGS or otherwise allowed as a deduction in computing taxable income for the year; (2) adjusted to disregard book COGS depreciation and other book expenses reflected in the AFS for the qualified production; and (3) adjusted to take into account certain section 481(a) adjustments related to qualified production costs, to the extent those adjustments are taken into account in computing taxable income for the year.

Moreover, liability AFSI must be adjusted to reflect any differences in cumulative AFSI adjustments arising from an accounting method change that alters the amount of costs treated as qualified production costs in a tax year following the first year the CAMT entity adopts this section of the Notice 2026-7 (for example, a change from capitalizing and depreciating production costs to deducting them under section 181<sup>15</sup>). As with the other Rainbow Cards, these rules appear designed to prevent duplicative or omitted basis recovery for CAMT purposes.

### C. The Fine Print

While the new AFSI adjustment offers meaningful relief and administrative simplification — particularly for taxpayers with significant production activity — careful modeling is required to evaluate its interaction

with the relevant section 181 dollar limitations (that is, the treatment of excess costs<sup>16</sup>) and future disposition or abandonment of productions.

Further, the qualified production cost adjustment applies solely in determining liability AFSI and does not affect scope AFSI — a limitation shared by all five Rainbow Cards. Taxpayers playing the Hollywood Express Card are subject to consistency requirements and associated annual reporting obligations, like those imposed for the Master Mechanic's Wrench Card and the Intangible Asset Bridge Card.

## VI. The Small Dollar Shortcut Card

### A. The Obstacle

Regulations under section 162 provide detailed rules governing the tax treatment of materials and supplies, generally defined to include a unit of property with an acquisition or production cost of \$200 or less.<sup>17</sup> For regular tax purposes, amounts paid to acquire or produce incidental materials and supplies are generally deductible in the year paid or incurred, while the costs of nonincidental materials and supplies are generally deductible in the year first used or consumed. For financial accounting purposes, however, these same low-cost or short-lived items may be capitalized and depreciated over a period of years, particularly when they are pooled, tracked as part of a larger asset group, or embedded within inventory or other balance sheet accounts.<sup>18</sup>

This divergence creates a familiar CAMT mismatch — regular taxable income reflects a current deduction, while AFSI reflects deductions over time. Moreover, taxpayers with significant volumes of small dollar materials and supplies purchases may be disadvantaged relative to

<sup>15</sup> An election to expense qualified production costs under section 181 is generally required to be made by the due date, including extensions, of a taxpayer's tax return for the tax year in which the costs of the production are first incurred. See section 181(c) and reg. section 1.181-2. Section 181 is a temporary provision that has been extended multiple times and now sunsets for productions commencing after 2025. The provision had expired for productions commencing after 2016 when it was retroactively extended in 2018 to apply to productions commencing before 2018, and then again in 2020 to apply to productions commencing before 2021. It has since been extended to apply to productions commencing before 2026. In response to the retroactive extension of the provision, the IRS issued Rev. Proc. 2022-23, 2022-18 IRB 1052, providing a limited-time opportunity for taxpayers to treat a late section 181 election as a change in method of accounting for qualified production costs incurred in 2018 or 2019. Taxpayers selecting the method change option were required to file a Form 3115, "Application for Change in Accounting Method," with their first or second timely filed original tax return that was filed after April 19, 2022, under Rev. Proc. 2022-23. That method change is no longer available.

<sup>16</sup> For example, if a taxpayer claims 100 percent bonus depreciation for the excess costs once a qualified production is initially released or broadcast, the taxpayer would need to ensure it is not adding back any book amortization or depreciation expense twice (*i.e.*, as part of the section 181 AFSI adjustment and the AFSI adjustment for the depreciation of section 168 property under section 56A(c)(13)). Rather, the book basis and applicable depreciation or amortization should be bifurcated, as appropriate.

<sup>17</sup> See reg. section 1.162-3.

<sup>18</sup> See ASC 360, "Property, Plant, and Equipment"; ASC 330, "Inventory"; IAS 16, "Property, Plant, and Equipment"; and IAS 2, "Inventories." See also KPMG, "Handbook," *supra* note 10.

taxpayers investing in larger section 168 assets that benefit from the statutory depreciation adjustment. This outcome mirrors the book-tax disconnect addressed by the Master Mechanic's Wrench Card and the Hollywood Express Card.

## B. The Rainbow Card

Notice 2026-7 introduces a new elective liability AFSI adjustment for eligible materials and supplies, defined as tangible property with an acquisition cost of \$200 or less that is deductible under section 162 for regular tax purposes but capitalized and depreciated for AFS purposes. Like the other Rainbow Cards introduced in the Notice 2026-7, this elective adjustment generally operates as a replace book with tax rule.

Under Notice 2026-7, liability AFSI may be (1) reduced by eligible materials and supplies tax COGS and deductible eligible materials and supplies costs, but only to the extent those amounts are recovered through COGS or otherwise allowed as a deduction in computing taxable income for the tax year; (2) adjusted to disregard eligible materials and supplies book COGS depreciation and eligible materials and supplies book expense reflected in the applicable financial statement for those capitalized items; and (3) adjusted to take into account certain section 481(a) adjustments related to eligible materials and supplies, to the extent those adjustments are taken into account in computing taxable income for the year.

Further, if the Small Dollar Shortcut Card is played, liability AFSI must be adjusted to reflect any differences in cumulative AFSI adjustments for eligible materials and supplies that arise from an accounting method change in a tax year succeeding the first tax year in which the applicable corporation plays this card. This includes, for example, a change recharacterizing an item previously treated as inventory or depreciable property as eligible materials and supplies, or vice versa.

## C. The Fine Print

While the Small Dollar Shortcut Card offers meaningful relief for applicable corporations with significant volumes of small dollar materials and supplies, careful coordination with inventory

methods, capitalization policies, and future accounting method changes may be required.

As with the four other Rainbow Cards, the eligible materials and supplies adjustment applies solely in determining liability AFSI and is expressly disregarded for purposes of determining scope AFSI and applicable corporation status.

Moreover, taxpayers playing the Small Dollar Shortcut Card are subject to consistency requirements and associated annual reporting obligations.

## VII. Planning Your Next Move

With knowledge of what's in the new rulebook, taxpayers will need to carefully consider their CAMT game plan going forward. Applicable corporations facing CAMT liabilities should now:

- *Update the game board:* Immediately model the effect of playing the Rainbow Cards. Taxpayers should model how playing one or more of the Rainbow Cards affects current-year and future-year CAMT liabilities. This is crucial for forecasting cash needs, including estimated tax payments, and the provision for income tax computations.<sup>19</sup>
- *Choose the path wisely:* The decision to play a Rainbow Card is binding until Treasury issues repropounded CAMT regulations. The consistency rules in the fine print for all the Rainbow Cards mean that an applicable corporation won't be able to unwind a play in a future tax year if the adjustment results in an increase to AFSI (for example, if a taxpayer elects to play the Intangible Asset Bridge Card in 2025 and deducts its qualified tax amortization for CAMT purposes but then has a large impairment in its AFS in 2026, it must increase AFSI by that amount in 2026).
- *Prepare the player pieces:* If an applicable corporation decides to play one or more Rainbow Cards, that corporation must start

<sup>19</sup> While the IRS and Treasury previously provided relief from underpayment of estimated tax regarding a taxpayer's CAMT liability for tax years beginning in 2023 through 2025 (see, e.g., Notice 2025-27), as of the date of this article, they have not provided similar relief for tax years beginning in 2026.

building the compliance machine now. The applicable corporation will need robust systems to track eligible costs, calculate the adjustments, and prepare the new required disclosure statements for the tax return.<sup>20</sup> ■

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<sup>20</sup> The information in this article 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 authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

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