



# Analysis and observations on the proposed CAMT regulations

October 4, 2024

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# Introduction

The U.S. Treasury Department and IRS (collectively, “Treasury”) on September 12, 2024, released proposed regulations ([REG-112129-23](#)) relating to the corporate alternative minimum tax (CAMT) created by Pub. L. No. 117-169 (commonly called the “Inflation Reduction Act of 2022” or “IRA”). Read [TaxNewsFlash](#). This proposed regulation package was published in the Federal Registrar on September 13, 2024, more than two years after the passage of the IRA. Concurrent with the release of the proposed regulations, the IRS released [Notice 2024-66](#), providing a waiver of the addition to tax under section 6655<sup>1</sup> for underpayment of estimated income tax with regards to CAMT liability for tax years beginning in 2024. Read [TaxNewsFlash](#).

# Background

CAMT generally imposes a 15% minimum tax on the adjusted financial statement income (AFSI) of corporations who are part of groups whose three-year average annual AFSI exceeds \$1 billion (such corporations, “applicable corporations”). CAMT applies for tax years beginning after December 31, 2022.

The proposed regulations generally follow [Notice 2024-47](#) [PDF 85 KB] (read [TaxNewsFlash](#)), [Notice 2024-33](#) [PDF 82 KB] (read [TaxNewsFlash](#)), [Notice 2024-10](#) [PDF 177 KB] (read [TaxNewsFlash](#)), [Notice 2023-64](#) [PDF 332 KB] (read [TaxNewsFlash](#)), [Notice 2023-42](#) [PDF 90 KB] (read [TaxNewsFlash](#)), [Notice 2023-20](#) [PDF 112 KB] (read [TaxNewsFlash](#)), and [Notice 2023-7](#) [PDF 248 KB] (read [TaxNewsFlash](#)). The [“Bluebook”](#) for the 117<sup>th</sup> Congress, prepared by the staff of the Joint Committee on Taxation, was released on December 21, 2023 (read [TaxNewsFlash](#)). Additionally, the IRS has released [2023 Form 4626 – “Alternative Minimum Tax – Corporations”](#) and accompanying [instructions](#) (read [TaxNewsFlash](#)), updated instructions to [2023 Partnership’s Instructions](#) and [2023 Partner’s Instructions](#) for Schedule K-1 (read [TaxNewsFlash](#)), and updated [instructions to Form 5471](#) – “Information Return of U.S. Persons with Respect to Certain Foreign Corporations.”

# Overview

The proposed regulations address a number of issues regarding the application of CAMT that remained after the guidance provided in previous notices. However, despite the length of the proposed regulation package, many previously identified issues remain unaddressed. Additionally, the proposed regulations continue to increase the complexity of the CAMT regime, as multiple provisions in the proposed regulations will cause enormous administrative and compliance burdens, lend themselves to varied interpretations, and leave many issues unclear. A number of the rules in the proposed regulations could increase the number of applicable corporations or otherwise increase, perhaps materially, an applicable corporation’s CAMT liability. These results may arise in situations that would be surprising to both the Congressional drafters of CAMT and taxpayers.

Furthermore, the proposed regulations would provide exceptionally limited relief from the complexity of CAMT by way of safe harbors and *de minimis* rules. As such, many taxpayers who are not in scope of CAMT as applicable corporations will likely need to expend significant time complying with this novel regime. Taxpayers, both those in scope and those likely out of scope but who still need to “prove the negative” should strongly consider responding to the invitation to comment on the proposed regulations

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<sup>1</sup> Unless otherwise stated, all section references herein are to the Internal Revenue Code of 1986, as amended (hereinafter the “Code”).

(comments are due by December 12, 2024). As explained in detail throughout, there are many key issues that taxpayers may want to comment on, including:

- **Retroactivity relief**, including comments addressing the potential transition year adjustment rule and the retroactive application of certain provisions in the proposed regulations to tax years ending after September 13, 2024 (the date the proposed regulations were published in the Federal Register<sup>2</sup>).
- **Administrability relief**, especially from the proposed requirement to maintain records of entity-level financial statement income (FSI), applicable financial statement (AFS) basis, balance sheet account amounts, and parent-entity financial statements based on the proposed “cracking” and “repacking” rules, as well as suggestions for simplified methods that may prevent the need for systems transformations to cope with the massively complex parallel regime created in the proposed regulations.
- **Complexity relief**, including comments noting the significant complexities introduced by the proposed regulations. These complexities include the determination of a foreign-parented multinational group (FPMG)—a requirement that attaches to corporations eligible for the scope safe harbor, the importation of certain subchapter K principles, and the tracking of a corporation’s cumulative “CAMT earnings.”

Most taxpayers generally do not need to revisit their 2023 tax return positions and may generally continue relying on the statute<sup>3</sup> or some combination of statute and guidance from the notices for 2023 tax returns. However, fiscal year taxpayers with tax years ending after September 13, 2024, may need to consider certain provisions for their 2023–2024 tax years. Moreover, the preamble to the proposed regulations (the “preamble”) contemplates an AFSI adjustment in the year of transition to implement the final regulations if a taxpayer took a position under CAMT that is inconsistent with the final regulations (*i.e.*, a transition year AFSI adjustment, discussed further below). This may cause certain taxpayers to reconsider certain 2023 CAMT positions while simultaneously submitting comments highlighting the administrative challenges and impracticalities of applying the final CAMT regulations retroactively.

Taxpayers—whether or not they expect to be applicable corporations—should carefully study the proposed regulation package, determine if they want to submit comment letters, and plan for the additional resources their tax (and non-tax) departments will need to comply with the CAMT regime on a go-forward basis. Tax departments should keep their C-suites apprised as to the potential costs—both from an administrative and potential liability standpoint—of the CAMT regime. Such costs of this massively complex and parallel regime have the potential to be significant.

The below sections summarize a number of key issues from the proposed regulations and provide certain KPMG observations.

# Applicability dates and reliance

## Applicability dates

The applicability dates in the proposed regulations are complex, with different applicability dates proposed to apply to different provisions. Specifically:

- Several provisions, referred to as the “specified regulations,” are proposed to apply to taxable years ending after September 13, 2024 (*i.e.*, the date the proposed regulations were published in the Federal Register). The specified regulations include a significant portion of the proposed regulations, including

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<sup>2</sup> See [REG-112129-23](#), 89 Fed. Reg. 75062 (Sept. 13, 2024).

<sup>3</sup> See sections 55(b)(2), 56A, and 59(k) and (l).

rules relating to identification of the AFS, determination of AFSI, applicable corporation status (including the single-employer and FPMG rules, as well as the simplified safe harbor), international provisions, adjustments to prevent duplications and omissions, and CAMT avoidance transactions.

- The consolidated return provisions are proposed to apply to consolidated return tax years for which the due date of the consolidated return (without extensions) is after the date final regulations are published in the Federal Register.
- The provisions other than the specified regulations and consolidated return provisions, such as rules relating to certain tax credits, partnership distributive share computations, section 168 property, various corporate and partnership transactions, and adjustments for troubled companies, are proposed to apply to tax years ending after the date final regulations are published in the Federal Register.

### KPMG observation

Because the specified regulations are proposed to apply to tax years ending after September 13, 2024, calendar year-end taxpayers would generally not be required to apply those rules to 2023 tax years. If finalized with these applicability dates, however, the specified regulations will apply to taxpayers that have a fiscal or short tax year ending after September 13, 2024.

## Reliance

Different standards of reliance are also available for different provisions of the proposed regulations. In general, taxpayers may apply any provision of the proposed regulations to a tax year ending on or before September 13, 2024, but only if the taxpayer and each member of its test group (*i.e.*, its section 52 group and/or FPMG) consistently apply that provision as well as the specified regulations in their entirety to that year and any subsequent year until the first tax year in which the final regulations are applicable.

### KPMG observation

The regulations contain a number of taxpayer-favorable provisions, particularly the rule for dividends from foreign corporations, that may cause taxpayers to want to early adopt. However, a taxpayer, in consultation with its section 52 group and FPMG members, should consider the impact of early adoption holistically.

Taxpayers in certain disaster areas located in the U.S., Puerto Rico, and the U.S. Virgin Islands have additional time to evaluate whether or not to early adopt the proposed regulations, as the IRS previously announced affected taxpayers have additional time to file their 2023 returns (the extended deadline is February 3, 2025, or May 1, 2025, for some).<sup>4</sup>

The preamble provides that taxpayers may continue to rely on the provisions of Notice 2023-7, Notice 2023-20, Notice 2023-64 (as amended by Notice 2024-10), and Notice 2024-10 for tax years ending on or before September 13, 2024. This level of reliance on the notices is narrower than that outlined in Notice 2023-64, which generally permitted taxpayers to rely on the notices for any tax year beginning before January 1, 2024. Therefore, under the proposed regulations, a fiscal-year taxpayer with a tax year ending after September 13, 2024, is precluded from applying any rule in the notices to such tax year, including the simplified safe harbor for determining applicable corporation status (discussed in further detail below). As a result, if the proposed regulations are not finalized

<sup>4</sup> See the [IRS Tax Relief in Disaster Situations website](#) for details as to affected taxpayers, affected areas, and the applicable extended filing deadline.

expeditiously, such a taxpayer may have to choose whether to early adopt the specified regulations for its 2024 tax year or risk filing a return that is inconsistent with the regulations (once finalized) applicable to that tax year.

In contrast to reliance on the proposed regulations, reliance on the notices does not have a consistency requirement—in other words, taxpayers can continue to “pick and choose” which provisions of the notices to rely on for tax years ending on or before September 13, 2024.

## Impact on accounting for income taxes

The impact of the proposed regulations within a taxpayer’s financial statements generally depends on whether the taxpayer expects to early adopt the proposed regulations (or portions thereof) prior to the issuance of final regulations, which may depend on whether the application of such guidance results in a benefit or a detriment.

There is a presumption that beneficial tax positions (based on present tax law) will be claimed even if they are not claimed (or expected to be claimed) in the original filing of a tax return. Similarly, there is a presumption that detrimental tax positions will not be taken until required. Hence, for accounting for income taxes purposes, taxpayers should assess whether they expect to apply the proposed regulations (or portions thereof) based on the status of tax laws and regulations at the balance sheet date (*i.e.*, taxpayers should assess what filing position they would take if the proposed regulations were never finalized). Those expected filing positions would then be analyzed under the guidance on uncertainty in the tax law.

When evaluating uncertainty in the tax law, depending on the exact reliance language and other factors, the existence of the proposed regulations may or may not affect the assessment of the taxpayer’s ability to sustain the benefit of a tax position. In addition, the issuance of the proposed regulations may influence a taxpayer’s assessment of the effect of the taxing authority’s practices, (*e.g.*, such as a practice of not challenging tax positions consistent with its own proposed rulemaking).

Accordingly, a taxpayer may expect to take a favorable filing position permitted in the proposed regulations even if the regulations were never finalized. As part of assessing the expected filing position under the guidance on accounting for uncertainty in income taxes, if the taxpayer would not expect the IRS to challenge the position in the proposed regulations, the taxpayer may be able to avoid recording an unrecognized tax benefit for the tax position.

Conversely, a taxpayer may expect to take a position inconsistent with the proposed regulations and may be able to recognize a benefit for the tax position based on an assessment that the position would be sustained. The entity would then reassess the position if and when retroactive final regulations are issued that would cause the taxpayer to change either its filing position or assessment of sustaining the position.

In summary, in order to apply the appropriate accounting for income taxes effects of the proposed regulations, taxpayers will need to understand what their expected filing positions would be based upon facts, circumstances, and enacted tax laws as of each reporting date, including an assessment of the taxpayer’s ability to sustain those positions. Not recognizing benefits in the first period in which an expected filing position is recognizable may later result in an error for financial reporting purposes if (or when) that benefit is subsequently recognized.

## Transition guidance

As noted above, the proposed regulations continue to permit taxpayers to choose between reliance on the proposed regulations, the notices, or the statute for 2023 tax years. The proposed regulations do not

provide a definitive set of transition rules that will apply once the regulations are final but do preview rules Treasury is considering implementing to address situations in which a taxpayer accounted for and reported AFSI in a pre-applicability date year in a manner inconsistent with the final regulations (e.g., if a taxpayer took a position under the statute or notices in a prior year that is inconsistent with the final regulations or if the taxpayer did not apply a provision in the proposed regulations that is in the final regulations). These rules would apply to a taxpayer's first tax year for which a particular final rule is applicable (such year, the "transition year").

The preamble includes the following three different possible approaches for taxpayers to transition to the final regulations:

- 1 **Transition year adjustment approach:** A cumulative AFSI adjustment would be determined as of the beginning of the transition year as if the taxpayer had applied the final regulations in its first tax year beginning after December 31, 2019. Any difference in the redetermined cumulative AFSI and cumulative AFSI as reported in prior tax years would be an adjustment to AFSI in the transition year. Treasury is considering allowing taxpayers to take the adjustment into account using rules similar to those provided for accounting method changes for regular tax purposes.
- 2 **Cut-off basis transition approach:** No transition year adjustment to AFSI would be made and CAMT attributes would not be redetermined.
- 3 **Fresh start transition approach:** No transition year adjustment to AFSI would be made but CAMT attributes would be redetermined as if the entity had first applied the final regulations in the first tax year beginning after December 31, 2019.

The preamble mentions the possibility of multiple transition rules being adopted in final regulations, such that different transition approaches may be applied to different items of AFSI and in specified circumstances. Further complications in determining any transition adjustment may arise due to the fact that, as discussed above, different provisions of the proposed regulations have different effective dates.

### KPMG observation

The transition rules proposed by Treasury in the preamble may result in increased AFSI for taxpayers that filed 2023 tax returns with a position for computing AFSI that is not consistent with the proposed (or final) regulations. However, while not explicitly stated, the transition year adjustment approach would appear to have the potential to decrease AFSI in the transition year (and later years) in cases where a taxpayer may have overreported AFSI in 2023 (e.g., by taking conservative positions). Furthermore, both the transition year adjustment approach and fresh start approach outlined by Treasury would require taxpayers to essentially apply the final regulations to years prior to the issuance of the proposed regulations. This could create undue burdens on taxpayers who filed tax returns relying on the limited guidance available at the time of filing.

Treasury has made eleven different requests for comments on the proposed transition guidance. Given the potential for unnecessary complexity of a multi-transition rule approach and the potential for the transition year adjustment approach to result in the retroactive application of final regulations, taxpayers should consider providing comments to Treasury highlighting the issues with the proposed transition guidance and suggesting a reasonable approach.

## Methods of accounting

The preamble indicates that Treasury is considering implementing rules and procedures similar to those for regular tax accounting method changes that would apply for AFSI-only method changes (e.g., if a taxpayer

consistently does not make a required AFSI adjustment under section 56A(c)(13)).<sup>5</sup> For tax years beginning after a taxpayer's transition year to the final regulations, proposed AFSI-only method change procedures would potentially apply to a change in the treatment of an item for AFSI purposes as a result of a change in determining either the proper timing for taking the item into account or the proper amount of the item taken into account. The proposed AFSI-only change rules being contemplated would institute a parallel accounting method change regime, potentially incorporating the existing accounting method change rules and procedures which taxpayers must follow for changes in accounting methods implemented for regular tax purposes, including consent procedures requiring a Form 3115 (or similar form), the computation of a cumulative adjustment to AFSI similar to that computed under section 481(a) with similar adjustment recognition periods, and audit protection (in certain circumstances). Alternatively, Treasury is considering providing blanket consent to taxpayers requesting an AFSI-only method change with the change being implemented by the filing of a statement in the taxpayer's tax return for the year of the AFSI-only change.

### KPMG observation

The potential for an AFSI-only change regime that mirrors the current accounting methods rules and procedures applicable for regular tax purposes<sup>6</sup> may exponentially increase the administrative burden of taxpayers attempting to comply with CAMT (but such burden could be worthwhile in some cases if final regulations provide audit protection rules similar to those afforded taxpayers for regular tax purposes). Furthermore, many questions arise when considering how AFSI-only method change procedures would and should operate. For example, it is unclear how or when a taxpayer establishes the consistent treatment of an AFSI-only item. In addition, with the varied proposed transition approaches for a taxpayer's transition year to the final regulations, it is unclear how a section 481(a)-type regime would operate in the CAMT context (e.g., whether cut-off or modified cut-off adjustments would be permitted<sup>7</sup>).

## General scope determination

### Determining applicable corporation status

In general, a corporation becomes an applicable corporation (and is thus "in scope" of CAMT) in a covered tax year if the corporation's average annual AFSI in the three tax years ending before the tested tax year exceeds \$1 billion (the "general test"). However, if a corporation is a member of an FPMG, its relevant income must exceed each of two thresholds during the three-year tested period to be in-scope: (i) \$1 billion of average annual AFSI, but solely for this purpose including FSI that is non-effectively connected income ("ECI") of foreign corporations ("global AFSI" and the "global AFSI test"), and (ii) \$100 million of average annual AFSI, determined under the normal rules for computing AFSI ("U.S. AFSI" and the "U.S. AFSI test").

<sup>5</sup> Section 446 requires a taxpayer who changes the method of accounting on the basis of which they regularly compute their taxable income to secure the consent of the Secretary prior to computing taxable income under the new method. Section 481(a) generally requires a taxpayer to make any adjustment necessary to prevent amounts from being duplicated or omitted that may result from a taxpayer computing taxable income for a tax year using a method of accounting for an item of income or expense that is different from the method used in the preceding tax year. Generally, a section 481(a) adjustment is required to be recognized in taxable income entirely in the year of change for an adjustment that decreases taxable income and over four taxable years (beginning with the taxable year of change) in the case of an adjustment that increases taxable income. Rev. Proc. 2015-13 provides procedures whereby taxpayers may request consent of the Secretary to change a method of accounting. See also Rev. Proc. 2024-23, as modified by Rev. Proc. 2024-30 and Rev. Proc. 2024-34 (providing procedures for obtaining automatic consent for numerous accounting method changes). <sup>6</sup> See sections 446 and 481(a), Rev. Proc. 2015-13, and Rev. Proc. 2024-23, as modified by Rev. Proc. 2024-30 and Rev. Proc. 2024-34.

<sup>7</sup> See sections 446 and 481(a), Rev. Proc. 2015-13, and Rev. Proc. 2024-23, as modified by Rev. Proc. 2024-30 and Rev. Proc. 2024-34.

<sup>7</sup> When a change in accounting method is made on a cut-off basis for regular tax purposes, there generally is no section 481(a) adjustment and only items arising on or after the beginning of the year of change are accounted for under the new method. Under a modified cut-off approach, items arising on or after a specified operative date are generally accounted for under the new method.

By statute, both the general test for non-FPMG members and the U.S. AFSI test for FPMG members are based on the aggregated AFSI of all persons treated as a single employer with the tested corporation under section 52(a) and (b) (a “section 52 group”). For purposes of the global AFSI test for FPMG members, the proposed regulations would, consistent with the notices, require the aggregation of both (i) the AFSI of all members of an FPMG, and (ii) the AFSI of all persons in the same section 52 group to the extent such AFSI is not AFSI of a member of the FPMG.

The aggregation rules described in this section would apply solely for purposes of determining whether a corporation is an applicable corporation (the “scope determination”), and not for purposes of determining an applicable corporation’s CAMT liability (the “liability determination”).

## Section 52 group

An entity can be a member of a section 52 group through either the application of section 52(a) or (b). Section 52(a) describes controlled groups of corporations, whereas section 52(b) describes trades or businesses (whether or not incorporated) under common control. Section 52(a) and (b) each have separate rules for parent-subsidiary, brother-sister, and combined common control groups.

Under the current regulations, the constructive ownership rules for a parent-subsidiary control group under section 52(a) differ from those under section 52(b). In particular, while section 52(a) relies on the broader rules under section 1563(d) and (e) (which attribute ownership from options, partnerships, estates and trusts), the regulations addressing the application of section 52(b) rely on narrower constructive ownership rules in section 414 (which attribute ownership only from options). The CAMT proposed regulations would adopt, through cross-reference, a proposed revision to the regulations under section 52 that would allow for attribution from partnerships.<sup>8</sup>

Additionally, the CAMT proposed regulations contain an example where X is a corporation that owns 80% of the capital and profits interest in PRS, a partnership. PRS owns 80% of the total combined voting power of all classes of stock entitled to vote of Y, a corporation. The example finds a section 52(a) group and, with respect to the operation of section 52(b), states that “if PRS is engaged in a trade or business, it may be a member of a group of trades or businesses under common control under section 52(b) that includes X and Y.”

### KPMG observation

If finalized, the proposed regulations could change the contours of section 52(b) parent-subsidiary control groups to include trades or businesses indirectly owned through non-trade or business entities. Section 52(a), however, already applies to many, but not all, of the covered fact patterns—as illustrated by the example. Thus, the expansion would appear to only impact certain partnership-parented structures.

## FPMG definition and scope determination

### General FPMG definition

The proposed regulations would provide that an FPMG exists when there are two or more entities (one of which is the corporation) if: (1) at least one of the entities is a domestic corporation and one of the entities

<sup>8</sup> See REG-134420-10, 88 Fed. Reg. 84770 (Dec. 6, 2023), proposing a revision to Treas. Reg. § 1.52-1(c)(1) to be consistent with proposed changes to Treas. Reg. § 1.1563-1(a)(2) (see REG-134420-10, 88 Fed. Reg. 52057 (Aug. 7, 2023)). Such proposed regulations have not yet been finalized.

is a foreign corporation; (2) the entities are included in the same AFS for that tax year; and (3) one of the entities is an “FPMG common parent.” The proposed regulations would provide significant detail on each of these prongs.

## Domestic corporation and foreign corporation requirement

Consistent with section 59(k)(2)(C), the proposed regulations would provide that if a foreign corporation is, or is treated as, engaged in a U.S. trade or business for purposes of section 882 (including through one or more disregarded or pass-through entities), the U.S. trade or business would be treated as a separate domestic corporation (a “deemed domestic corporation”) that is wholly owned by the foreign corporation.

### KPMG observation

It is not clear whether a U.S. trade or business of a foreign corporation that is exempt from tax under section 882 because the foreign corporation qualifies for benefits under an applicable income tax treaty (i.e., the foreign corporation earns only ECI that is treaty-exempt) would still be a deemed domestic corporation.

## Included in the AFS

The proposed regulations would treat an entity and an FPMG common parent as “included on the same AFS” if the FPMG common parent has a “controlling interest” in the entity at any time during the tax year. Under the general rule, an upper-tier entity has a controlling interest in a lower-tier entity if the applicable financial accounting standard requires that a consolidated financial statement of the upper-tier entity reflect the assets, liabilities, equity income and expenses of the lower-tier entity (regardless of whether or not a consolidated financial statement is or is required to be prepared or is prepared correctly). This general rule appears to treat entities that are line-by-line consolidated on the foreign parent’s AFS as “included” in the foreign parent’s AFS. The applicable accounting standard is deemed to be U.S. GAAP unless foreign parent consolidated financials are prepared under another standard.

In addition, the proposed regulations would deem an upper-tier entity to have a controlling interest in a lower-tier entity if the upper-tier entity would be treated as having a controlling interest in a lower-tier entity but for the fact that the lower-tier entity is (or would be, if no financials are prepared) excluded from consolidated financials under the applicable accounting standard because of: (1) size or materiality; (2) being held for sale; (3) the business of the entity ceasing operations, terminating, or being disposed of; or (4) the entity otherwise being permitted (but not required) to be excluded.

### KPMG observation

While the CAMT deemed consolidation rules are similar to those in the Pillar Two GloBE rules, the proposed regulations would go beyond the Pillar Two GloBE rules by treating as included in an AFS an entity that is not consolidated but is *permitted* to be consolidated under the relevant accounting standard. Thus, under the proposed regulations, only an entity that is *forbidden* from being line-by-line consolidated under the applicable accounting standard would be considered not included in the AFS for purposes of the second prong of the FPMG definition.

The proposed regulations would also treat a deemed domestic corporation (a U.S. trade or business of a foreign corporation) as included in an AFS with the foreign corporation, irrespective of whether the applicable accounting standard would permit consolidation.

## KPMG observation

Thus, in general, a single foreign corporation engaged in a U.S. trade or business, or that owns an interest in a disregarded entity or a partnership engaged in a U.S. trade or business, would be treated as included in an FPMG, unless the foreign corporation is a member of a domestic-parented group.

Further, if an upper-tier entity is otherwise a member of an FPMG, the upper-tier entity would be deemed to have a controlling interest in any entity that is in the same section 52 group, provided that that the upper-tier entity has a direct or indirect interest in such entity.

## KPMG observation

This proposed rule appears to significantly expand the membership of many FPMGs. For example, assume foreign parent (FP) and a U.S. corporation (US1) are included on the same AFS, and thus give rise to an FPMG. If FP also owns a second U.S. corporation (US2) that is not included on FP's AFS (and is not permitted to be included), but is included in FP's section 52 group, the proposed regulations would treat FP as having a controlling interest in US2 for purposes of satisfying the "included in the AFS" requirement, and thus cause US2 to be a member of the FP-US1 FPMG. In contrast, under Notice 2023-64, while US2's AFSI would be included in determining whether US1 is an applicable corporation, US2 would not be included in the FPMG and thus could only be an applicable corporation by satisfying the general scope test for non-FPMG members.

Finally, if an upper-tier entity has a controlling interest in a lower-tier entity, the proposed regulations would treat the upper-tier entity as having a controlling interest in any entity in which the lower-tier entity has a controlling interest. This rule would apply iteratively, starting at the bottom of the controlling interest chain and ending with the FPMG common parent.

## KPMG observation

As a result of this "bottoms up" approach, an FPMG common parent can be treated as having a "controlling interest" in a lower-tier entity that is not included (or otherwise deemed included) in the FPMG common parent's AFS, as long as the upper-tier entity would be an FPMG member (without regard to the lower-tier entity that is not included in the FPMG common parent's AFS).

## FPMG common parent

The proposed regulations would define certain non-corporate entities as an FPMG common parent. For this purpose, a non-corporate ultimate parent entity is treated as a foreign corporation if the entity directly or indirectly owns (other than through a domestic corporation, excluding a deemed domestic corporation) (1) a foreign trade or business within the meaning of Treas. Reg. § 1.989(a)-1(c); or (2) an equity interest in a foreign corporation if the entity also has a controlling interest in the foreign corporation (including through a domestic corporation).

## KPMG observation

Notably, this rule could cause even a *domestic* non-corporate entity (such as a partnership or trust) to be treated as a foreign corporation. The combination of expanding the definition of FPMG common parent to include non-corporate entities, in conjunction with the broad "included in the same AFS" standard, may expand the scope of the FPMG rules significantly.

## AFSI rules for FPMGs

For purposes of applying the \$1 billion global AFSI test to an FPMG, non-U.S. entities in the section 52 group do not apply any AFSI adjustments that depend on the regular tax treatment of an item (e.g., the depreciation of section 168 property), except as related to an entity's effectively connected income. Further, the proposed regulations would provide that the AFSI of a shareholder of a foreign corporation is determined without regard to any items attributable to the FSI of the foreign subsidiary.

### KPMG observation

These proposed rules are intended to prevent the duplication of global AFSI. The preamble illustrates this effect with an example in which FP, a foreign corporation, owns both FS, a foreign corporation, and DC, a domestic corporation. The preamble concludes that, for purposes of applying the FPMG scoping rules, "the AFSI of FP is determined without regard to the adjustments described in Prop. Treas. Reg. § 1.56A-4 (concerning AFSI adjustments with respect to stock of a foreign corporation)." Thus, it appears that dividends from FS to FP out of FS's global AFSI would not be counted again in the global AFSI of FP by operation of the adjustment required under section 56A(c)(2)(C). On the same facts, the preamble also concludes that FP disregards any items of FSI attributable to its interest in FS, thus preventing double counting by reason of, e.g., equity method of accounting. However, it is not clear whether this would also disregard mark-to-market gain or loss of a shareholder, since such gain or loss might not be considered "attributable" to the FSI of the subsidiary.

## Joining or leaving a test group

The proposed regulations would generally provide that a corporation's AFSI for purposes of the scope determination includes the AFSI of a related entity (e.g., members of a section 52 group or FMPG) only for the period during which the corporation and that entity were related.

### KPMG observation

The preamble explains that the option adopted, as opposed to another option considered, better implements the statute, "as it would decrease the instances in which a person's AFSI is duplicated in more than one corporation's AFSI for the same three-taxable-year testing period." The treatment in the proposed regulations of members joining and leaving section 52 groups resembles the regulatory rules provided for the section 59A base erosion and anti-abuse tax (the "BEAT").

If a corporation experiences a "change in ownership," the proposed regulations generally would provide that the corporation's AFSI following the change in ownership would not include the AFSI of any entity that had been related to the corporation prior to, but is not related after, the change in ownership. In general, a change in ownership would occur (A) if a corporation was not the "parent" of a section 52 group (a "test group parent"), (B) the corporation was treated as related to a test group parent as of the first day of a tax year, and (C) as a result of a transaction (or series of transactions) the corporation and the test group parent are not related as of the last day of the tax year.

### KPMG observation

The proposed regulations do not describe the consequences of certain fact patterns involving tax consolidated groups, including whether a tax consolidated group that is not an applicable corporation takes into account the historical AFSI of a newly acquired member.

## Termination of applicable corporation status

In general, under the statute, once a corporation becomes an applicable corporation in any tax year, it remains an applicable corporation indefinitely. This is often referred to as the “once-an-applicable-corporation, always-an-applicable corporation rule.” However, the statute provides two exceptions to this rule. Specifically, section 59(k)(1)(C) excludes from the definition of an applicable corporation any corporation that either experiences a change of ownership or fails to satisfy the relevant AFSI threshold(s) for a specified number (to be determined by Treasury) of consecutive tax years, *and* where “the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation.”

Consistent with the statute, the proposed regulations would provide two ways for applicable corporation status to terminate. First, if a corporation has a change in ownership (as discussed above), its applicable corporation status terminates as of the first day of the first tax year following the tax year of the change in ownership (however, applicable corporation status may be retained if the corporation joins a tax consolidated group that is an applicable corporation or if the corporation’s AFSI during the testing period exceeds the relevant scope determination threshold). Second, the proposed regulations would include a “termination test,” pursuant to which, if a corporation does not exceed the relevant scope determination threshold for five consecutive tax years, its applicable corporation status would terminate as of the first day of the immediately succeeding tax year.

### KPMG observation

While exceeding the three-year average threshold in one tax year causes a corporation to become an applicable corporation, the termination test would require a corporation to be below the relevant threshold in five consecutive tax years (which generally will require seven consecutive tax years of AFSI calculations since each of the five test years would include a three-year lookback). Absent the termination test, a corporation generally would not need to analyze the scope determination after it becomes an applicable corporation. Taxpayers who are in-scope will need to determine whether to track AFSI for scope determination purposes in hopes of meeting the termination test.

## Safe harbor for scope determination

The notices previously provided taxpayers with a safe harbor method to determine whether they are an applicable corporation (the “simplified method”) for the first tax year beginning after December 31, 2022. Under the simplified method, the general test and, for a member of an FPMG, the global AFSI test are both reduced to \$500 million (computed with limited adjustments to AFSI) and, for a member of an FPMG, the \$100 million U.S. AFSI test is reduced to \$50 million. The proposed regulations would extend the simplified method indefinitely, at these same thresholds “or such other amount specified in IRB guidance the IRS may publish.”

### KPMG observation

Although a permanent safe harbor for determining applicable corporation status is a welcome modification to the CAMT rules, the contours of the simplified method result in significant CAMT work for taxpayers who qualify for this safe harbor. Notably, a taxpayer will still need to determine whether it is a member of an FPMG under the complex proposed rules and will still need to determine the members of its section 52 group. In addition, while the simplified method respects consolidation entries for entities consolidated on the same AFS, the continued requirement to reverse consolidation entries of entities that are not part of the tested corporation’s section 52 group or FPMG requires significant analysis and adds another complication to this “simplified” method.

Moreover, many taxpayers who are not applicable corporations will likely still find themselves unable to avail themselves of this safe harbor, and thus will be subject to CAMT's burdensome computational and reporting requirements. Taxpayers should consider requesting expanded or additional safe harbors for scope determination (e.g., the creation of simplified methods for determining some (or many) of the AFSI adjustments, and/or the ability to use a materiality threshold). For example, taxpayers may wish to request that the rules in Prop. Treas. Reg. § 1.56A-18, Prop. Treas. Reg. § 1.56A-19 and Prop. Treas. Reg. § 1.56A-20 (each of which require the analysis of transactions) do not apply on a mandatory basis for scope determination purposes.

# AFS and FSI issues

## Applicable financial statements

The proposed regulations would generally retain the AFS hierarchy and ordering rules set forth in the notices that require taxpayers to use a consolidated financial statement ("consolidated AFS") in many situations. Of note, a U.S. taxpayer which is a member of an FPMG and is included in consolidated financial statements with the FPMG (i.e., the FPMG consolidated AFS) would use the FPMG consolidated AFS, even if the taxpayer prepares its own separate financial statements under U.S. generally accepted accounting principles (GAAP).

### KPMG observation

This proposed rule may present significant complications from a practical standpoint for a U.S. taxpayer which is a member of an FPMG. In some cases, the U.S. taxpayer may prepare separate financial statements under U.S. GAAP whereas the consolidated financial statements of the FPMG are prepared under International Financial Reporting Standards ("IFRS"). U.S. GAAP and IFRS accounting standards are not fully converged (and are unlikely to be in the near future).<sup>9</sup> The proposed regulations' requirement to use FSI as reported under IFRS in this situation requires pushing adjustments related to U.S. GAAP and IFRS differences down to the U.S. taxpayer to determine the taxpayer's FSI. However, in some cases, these adjustments are prepared topside as part of the consolidation process and the U.S. taxpayer may have no insight into the nature and extent of such adjustments. Taxpayers that are members of an FPMG should consider stressing to Treasury the difficulties, if not impossibilities, in applying such a burdensome rule.

The proposed regulations would expand the list of acceptable financial statements to include certain certified financial statements prepared in accordance with accounting standards other than U.S. GAAP or IFRS but issued by an accounting standards board charged with developing accounting standards for one or more jurisdictions. These financial statements would have a higher priority than "other government and regulatory statements," but a lower priority than U.S. GAAP or IFRS financial statements.

### KPMG observation

The expansion of the categories of financial statements to include this type of financial statement appears to foreclose the possibility that existed under the interim guidance for a U.S. tax filer not to have an AFS in most fact patterns.

<sup>9</sup> See [Handbook: IFRS® compared to US GAAP \(kpmg.com\)](#) for a side-by-side comparison of IFRS and U.S. GAAP standards.

## Computation of FSI and AFSI

In general, the proposed regulations would import a series of rules which complicate the process of identifying and computing FSI from a consolidated AFS. The proposed regulations would include requirements to compute *entity-level* FSI, AFS basis, and balance sheet account amounts for CAMT entities as well as complex rules for adjusting certain FSI amounts in a manner that is not consistent with either financial accounting or regular tax principles.

In determining FSI, the proposed regulations would direct taxpayers that are members of a consolidated AFS to disregard certain elimination entries which eliminate transactions between certain financial statement members and allocate among CAMT entities certain purchase accounting and push down adjustments. Additionally, the proposed regulations would require a CAMT entity that book consolidated in its AFS an investment in a partnership or domestic corporation to report items of income and expense as well as balance sheet accounts as though parent-only financial statements were prepared. The proposed regulations make clear that each taxpayer that is a member of a consolidated AFS would be required to maintain books and records (including trial balances) sufficient to demonstrate how its FSI was determined, including a reconciliation to the consolidated FSI of the financial statement group.

### KPMG observation

The proposed regulations continue to require, and make even more complex, and burdensome, the “cracking” of consolidated financial statements in many situations where a taxpayer is a member of a book consolidated group and the consolidated AFS is the taxpayer’s AFS. The burdensome nature of the requirement to track entity-level FSI, AFS basis, and balance sheet accounts cannot be stated. Essentially, each taxpayer within a book consolidated group will need to prepare separate standalone financial statements to determine its FSI.

The rules around intercompany elimination entries are also noteworthy. The proposed regulations will require companies to effectively restore many elimination entries for purposes of calculating FSI, which may be difficult depending on how and where intercompany elimination entries are recorded in the consolidation process. The result of these changes is the potential introduction of a new set of processes that will likely require a new, separate set of standalone books and records. Current systems may need to be revamped in order to provide for the appropriate reporting and data needs. Taxpayers should consider submitting comments suggesting alternatives that are less burdensome. While the proposed regulations are clear in that entity-level FSI must be derived from the consolidated financial statements of a larger parent entity, it is unclear as to how taxpayers could practically implement this proposed rule. The “Parent-Entity Financial Statement” accounting standards referred in the proposed regulations are seldomly used in practice and there is virtually no authoritative guidance under U.S. GAAP as to how to prepare “parent-entity financial statements.” Therefore, there is likely to be significant complexity and diversity in practice in applying these standards. However, we believe in many cases, the FSI amount determined under the approach described in the proposed regulations may be consistent with the FSI amount that would be determined if carve-out financial statements were prepared, which is a well understood term in the accounting professional and is widely used in practice. Taxpayers should consider stressing to Treasury the difficulties, if not impossibilities, in applying a rule with such limited guidance and may wish to request guidance endorsing the use of carve-out financial statements instead.

# AFSI adjustments

## In general

Treasury generally rejected previous comments asking for the general import of tax realization and recognition principles similar to those under section 451(b).<sup>10</sup> The proposed regulations, consistent with the notices, provide that items of income, expense, gain, or loss would need not be recognized or realized for regular tax purposes to be included in FSI or AFSI. For example, FSI would include gain on a like-kind exchange that would ordinarily qualify for non-recognition treatment under section 1031. And importantly, certain mark-to-market adjustments appear to remain in AFSI in the year they are recognized in the taxpayer's AFS (but exceptions are provided for certain hedging transactions and certain investments in stock, discussed later).

### KPMG observation

Taxpayers should consider submitting additional comments in response to the proposed regulations treating such mark-to-market amounts as includable in AFSI, providing examples as to the industries which will be negatively affected by such inclusion and suggesting specific mechanisms to ensure that such mark-to-market amounts are included at later times.

## Adjustment for taxes

Section 56A(c)(5) requires taxpayers to disregard the effect of federal and foreign income taxes in determining AFSI (the “tax adjustment rule”). The proposed regulations would implement the tax adjustment rule by disregarding any “applicable income taxes” that are taken into account in a CAMT entity’s AFS. For this purpose, applicable income taxes are federal income taxes and foreign income taxes that are taken into account in a CAMT entity’s AFS as current tax expense (or benefit), as deferred tax expense (or benefit), or through increases or decreases to other AFS accounts of the CAMT entity.

### KPMG observation

Consistent with the statute, the proposed regulations would make no adjustment to AFSI for state and local taxes. Therefore, deferred taxes attributable to state and local taxes could result in a timing mismatch between tax income and AFSI, which in turn could result in a CAMT liability.

## Federal income taxes

The proposed regulations would define “federal income taxes” to include: (i) any taxes imposed by subtitle A of the Code (“subtitle A”),<sup>11</sup> and (ii) amounts allowed as credits against taxes imposed by subtitle A, including credit amounts generated by a partnership and passed through to a partner.<sup>12</sup>

<sup>10</sup> Section 451(b) generally provides that the all events test with respect to an item of gross income is deemed to be satisfied no later than the year in which that amount is taken into account as revenue on the taxpayer's AFS. Footnote 872 of the Conference Report to the Tax Cuts and Jobs Act (“TCJA”), Pub. L. No. 115-97, states that this general rule does not revise the rules associated with when an item is realized for federal income tax purposes and does not require the recognition of income in situations where the federal income tax realization event has not taken place. See H.R. Rep. No. 115-466, at 428 fn. 872 (2017) (Conf. Rep.).

<sup>11</sup> Subtitle A imposes income taxes on individuals, corporations, trusts and estates, and generally includes sections 1 through 1564 of the Code.

<sup>12</sup> See Prop. Treas. Reg. § 1.56A-1(b)(18).

### KPMG observation

Because of the varying treatments of tax credits for financial accounting purposes (depending on whether a credit is refundable, transferable, non-refundable, non-transferable, etc.),<sup>13</sup> the inclusion of tax credits in the proposed definition of federal income taxes for CAMT purposes permits taxpayers to disregard from AFSI tax credits that are not accounted for through the income tax provision for financial accounting purposes (e.g., since some credits may be treated as government grants that are accounted for outside of the income tax provision in an AFS).<sup>14</sup> Similarly, the financial accounting rules provide various methods of accounting for investments in passthrough entities that generate tax credits, depending on the type of credit and how the taxpayer accounts for its investment in the passthrough entity.<sup>15</sup>

## Foreign income taxes

Section 56A(c)(5) provides Treasury authority to not disregard foreign income taxes paid or accrued by a taxpayer that does not choose to credit its FTCs for regular tax purposes. The proposed regulations would exercise this authority by providing that, if an applicable corporation does not choose to claim FTCs for regular tax purposes, solely in determining its CAMT liability, the applicable corporation reduces its AFSI by the amount of the deduction permitted the corporation under section 164 for regular tax purposes. This rule would only apply for direct taxes of an applicable corporation. For foreign taxes paid or accrued by a CFC (i.e., CFC taxes), as discussed above, the proposed regulations would instead reduce the CFC adjustment of a taxpayer that does not choose to credit, rather than provide a deduction to the taxpayer's CFCs.

### KPMG observation

Treasury's exercise of its authority under section 56A(c)(5), while welcome, has some limitations. First, the deduction is only for purposes of the liability determination; it does not apply for purposes of the scope determination. Second, the deduction is only with respect to foreign income taxes paid or accrued for U.S. tax purposes; therefore, it would not provide a deduction for federal, state, or local taxes, or a deferred tax expense related to a foreign income tax.

## When taxes are taken into account in an AFS

The proposed regulations would follow the rule in the notices that a tax is considered to be taken into account on an AFS (including for purposes of the CAMT FTC) if any journal entry has been recorded in the books and records used to determine an amount in the AFS, even if the taxes do not increase or decrease FSI at the time of the journal entry. Further, the proposed regulations provide an example illustrating when a tax that is taken into account on a partnership's AFS is considered to be taken into account on any AFS of its partners.<sup>16</sup>

<sup>13</sup> See, e.g., [Handbook: Tax credits \(kpmg.com\)](https://www.kpmg.com/us/en/services/tax/tax-credits).

<sup>14</sup> Note, however, that if a tax credit reduces the basis of section 168 property for regular tax purposes, such reduction would be taken into account as part of determining CAMT basis upon any disposition of the section 168 property (see discussion below of "AFSI Adjustments for Section 168 Property").

<sup>15</sup> *Id.*

<sup>16</sup> See Prop. Treas. Reg. § 1.56A-8(e), Example 3.

## Adjustment for section 168 property

Despite numerous requests in comment letters submitted prior to the release of the proposed regulations, Treasury declined to offer much in the way of safe harbors or *de minimis* elections to simplify the depreciation adjustment under section 56A(c)(13). The proposed regulations generally mirror the rules provided in the previous notices, for the adjustment for depreciation on section 168 property, which seemingly would place significant administrative burdens on taxpayers where the burdens might outweigh the benefits.<sup>17</sup> Note that, because section 56A(c)(14) generally parallels section 56A(c)(13), the discussion below generally also applies to AFSI adjustments for amortization of qualified wireless spectrum except for certain proposed rules that are not applicable to qualified wireless spectrum (e.g., the definition of section 168 property and rules for tax depreciation capitalized under section 263A to inventory or to the basis of property under section 1221(a)(1) that is not inventory).

### KPMG observation

The proposed regulations would place significant administrative burdens on taxpayers where the burdens might outweigh the intended benefits of section 56A(c)(13).<sup>18</sup> 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. Taxpayers should consider providing additional feedback to Treasury as to the need for simplifying conventions or safe harbors, especially for scope determination purposes and certain industries subject to regulatory guidance that increases the disparities between the book and tax treatment of assets.

Under the proposed regulations, the definition of section 168 property for purposes of the adjustment to AFSI is generally consistent with the notices. In a change from the notices, Treasury did adopt commenters' (including KPMG) requests to treat computer software, qualified film or television productions, and qualified theatrical productions as section 168 property for purposes of the adjustment under section 56A(c)(13) regardless of whether a taxpayer claims or elects to forgo the additional first-year depreciation deduction provided in section 168(k), but only to the extent of the depreciation allowed under section 167.<sup>19</sup> Thus, for example, any portion of the cost of a qualified film production that is expensed under section 181 is not part of the section 56A(c)(13) adjustment to AFSI.

Although comments recommending that deductible tax repairs under section 162 be treated as tax depreciation were rejected,<sup>20</sup> Treasury did expand the scope of the section 56A(c)(13) adjustment to include section 481(a) adjustments for "tax capitalization method changes." Specifically, the proposed regulations would provide that tax capitalization method changes include a change from treating an amount incurred with respect to section 168 property as a deductible repair under section 162 to treating it as a capital expenditure subject to depreciation (or vice versa). The proposed regulations would include special adjustment spread periods to take into account cumulative AFSI adjustments related to tax capitalization

<sup>17</sup> See [KPMG Report: Initial observations on round 1 of CAMT guidance in Notice 2023-7](#) and [KPMG Report: Initial observations on round 4 of CAMT guidance in Notice 2023-64](#).

<sup>18</sup> See [KPMG Report: Initial observations on round 1 of CAMT guidance in Notice 2023-7](#) and [KPMG Report: Initial observations on round 4 of CAMT guidance in Notice 2023-64](#).

<sup>19</sup> Section 168(k) permits an additional first year depreciation deduction ("bonus depreciation") for qualified property. Computer software, qualified films or television productions, and qualified live theatrical productions are only subject to the rules of section 168 when treated as qualified property and bonus depreciation is claimed. Under section 168(k)(7) a taxpayer may elect not to claim bonus depreciation with respect to a class of property for qualified property in such class placed in service during the taxable year. Under the notices, computer software, qualified film or television productions, and qualified live theatrical productions only qualified as section 168 property if bonus depreciation was claimed.

<sup>20</sup> It is noteworthy that Treasury and the IRS indicated in the preamble that they are still considering this issue and requested comments on whether the AFSI adjustment with respect to section 168 property should take into account repairs with respect to the section 168 property that are deducted for regular tax purposes but capitalized and depreciated for AFS purposes.

method changes that generally mirror those provided under section 481(a),<sup>21</sup> but the amount of the tax capitalization method change AFSI adjustment may not equate to the adjustment computed under section 481(a) for regular tax purposes<sup>22</sup> under subtitle A.

Interim guidance provided that depreciation expense capitalized to inventory under section 263A and *recovered as part of cost of goods sold* ("COGS") in computing taxable income for the tax year is included in the section 56A(c)(13) depreciation adjustment. The proposed regulations would provide additional clarification on how taxpayers determine tax COGS depreciation and covered book COGS depreciation (i.e., using the methods of accounting under section 263A and, in the case of inventory property, the method used to identify and value inventories for regular tax purposes). However, simplifying conventions would be provided for both FIFO and LIFO method taxpayers to compute the amount of depreciation in ending inventory and determine tax COGS depreciation and covered book COGS depreciation.

### KPMG observation

The proposed computation of the adjustment included in AFSI for a tax capitalization method change differs from the computation of the adjustment included in AFSI for a tax depreciation method change.<sup>23</sup> This disparate treatment results in additional complexity and potential tracking requirements with regards to the AFSI adjustment for section 168 property, especially when such property is disposed of at a later date. Additionally, the requirement to track the year of recovery for depreciation capitalized to inventory and other assets (e.g., capitalized section 174 expenses) adds yet another step to the sizable list of calculations necessary to properly compute a taxpayer's CAMT liability. Although the offering of a simplifying method somewhat eases the burden of this requirement, taxpayers are still left with yet another tracking exercise in computing both additional section 263A costs and annual AFSI.

Consistent with the notices, which provide that the section 56A(c)(13) depreciation adjustment includes both depreciation allowed as a deduction in computing regular taxable income and the amount recovered through COGS or other provisions of the Code (e.g., depreciation capitalized under section 174 and included in the amortization deduction for the current tax year), the proposed regulations would expand the definition of a "tax depreciation section 481(a) adjustment" to also include an adjustment (or portion thereof) required under section 481(a) for any other change in method of accounting (other than a tax capitalization method change) that impacts the timing of when depreciation with respect to section 168 property is taken into account in computing taxable income. For example, under the proposed regulations, this adjustment to AFSI would include a section 481(a) adjustment (or portion thereof) resulting from a change in a taxpayer's method of capitalizing and amortizing depreciation of section 168 property as part of its section 174 costs.

While the notices include AFS impairment losses and impairment loss reversals with respect to section 168 property as part of the section 56A(c)(13) adjustment, it was unclear what was included within the definition of an "impairment loss." The proposed regulations would favorably define the term "impairment loss" to mean a loss reflected in FSI from the impairment write-down of the AFS basis of an asset (or group of assets) to fair value while the asset (or group of assets) is still held by the taxpayer. An "impairment write-down" occurs if an asset (or group of assets) has an AFS basis that exceeds the fair value basis of the asset (or group of assets). The frequency of testing for impairment is not relevant in determining whether an impairment loss has occurred. The term "impairment loss reversal" is defined to mean the reversal of a prior-year impairment loss that is reflected in current-year FSI.

The proposed regulations provide special rules for section 168 property held by a partnership that require the partnership to disregard amounts from basis adjustments under section 743(b) or Treas. Reg. § 1.1017-

<sup>21</sup> See Prop. Treas. Reg. § 1.56A-15(d)(4).

<sup>22</sup> See Prop. Treas. Reg. § 1.56A-15(b)(11).

<sup>23</sup> Compare Prop. Treas. Reg. § 1.56A-15(b)(9) with Prop. Treas. Reg. § 1.56A-15(b)(11).

1(g)(2) attributable to section 168 property in computing the tax adjustments to AFSI for depreciation to the extent such basis adjustments amounts are treated as increases or decreases to tax depreciation or a tax depreciation section 481(a) adjustment for regular tax purposes. Instead, such amounts are separately stated to the partnership's partners (see discussion above). Amounts which result from basis adjustments under section 734(b) attributable to the section 168 property that are treated as increases or decreases to tax depreciation, or a tax depreciation section 481(a) adjustment are included in the tax adjustments to AFSI for depreciation. Similar rules apply for purposes of computing the adjustment to AFSI for the disposal of section 168 property held by a partnership.

Consistent with the notices, Treasury exercised its authority under section 56A(c)(13) to provide for the adjustment to AFSI upon disposition of section 168 property. Such adjustments are made to AFSI for the tax year in which the disposition occurs for regular tax purposes, and taxpayers are required to adjust AFS basis in the section 168 property to take into account all current and prior year adjustments under section 56A(c)(13) as if the taxpayer had been subject to CAMT in all prior years (including those prior to the effective date of CAMT). However, the proposed regulations would introduce additional steps to adjust such AFS basis of section 168 property, which require an adjustment for any reductions to the CAMT basis of such property under the rules for troubled companies, amounts allowed as a credit against tax imposed by subtitle A with respect to such property (to the extent the amount reduces the basis for regular tax purposes), and for any adjustments to AFS basis that are disregarded for AFSI and CAMT basis purposes under other sections of the proposed regulations.

### KPMG observation

The proposed disposition rules operate to true up basis and timing differences related to section 168 property that may otherwise result in a permanent difference in AFSI. Note that in the event there is a disposition of section 168 property for AFS purposes prior to the disposition event for regular tax purposes, AFSI is adjusted in the AFS disposal year only in the case of a loss or basis recovery in the AFS prior to the tax disposition year (*i.e.*, as part of the covered book amounts). If the property is disposed of at a gain in the AFS disposal year, the gain is recognized in AFSI in that year, subject to a later re-computation of the AFS adjusted basis to equal the CAMT basis in the year of tax disposition.

## AFSI adjustments attributable to certain tax credits

The proposed regulations generally follow the notices and would exclude from AFSI the amounts treated as payments against regular tax pursuant to a direct payment election under section 48D(d) or 6417, as well as amounts received from the transfer of a tax credit under section 6418. In addition, the proposed regulations address the impact on a transferee taxpayer's AFSI as the result of the purchase of an eligible credit. The proposed regulations would generally provide rules similar to those found in the respective Code sections with respect to the credit monetization mechanisms.

- **Elective payment taxpayer:** If a taxpayer elects to receive a direct payment under section 48D(d) or 6417, AFSI would be adjusted to disregard the amount treated as a payment against the tax liability, and any amount received as tax-exempt income (the net elective payment amount).
- **Transferor:** The taxpayer who generates an eligible credit and sells it to an unrelated third party would adjust AFSI to disregard any cash consideration received from the transfer of an eligible credit that is either not includable in gross income or treated as tax-exempt income for regular tax purposes.
- **Transferee taxpayer:** The transferee taxpayer, or the buyer of an eligible credit, would adjust AFSI to disregard two portions of the credit purchase transaction: (1) any amount that is paid by the transferee to the eligible taxpayer as consideration for the transfer of the eligible credit, provided such amount is not otherwise disregarded as part of the AFSI adjustment for certain taxes (discussed above), and (2) any increase in the transferee taxpayer's FSI resulting from the utilization of the purchased eligible

credit, provided such increase is not otherwise disregarded as part of the AFSI adjustment for certain taxes (discussed above).<sup>24</sup>

Additionally, the proposed regulations would provide that any increase in tax expense recognized in FSI as a result of a credit recapture would be disregarded in AFSI.

#### **KPMG observation**

While the notices included guidance on how the transferor should adjust AFSI for amounts received from the transfer of eligible credits, the guidance did not address the transferee's treatment. Thus, the inclusion of proposed rules regarding how a transferee taxpayer should treat the purchase of an eligible credit for AFSI purposes is generally welcome.

## **Partnership issues**

### **Overview of partnership rules**

The CAMT proposed regulations address a number of partnership issues, including a tested corporation's partnership income inclusion (for scope purposes), the distributive share of partnership AFSI (for liability purposes), the importation of certain subchapter K principles for determining AFSI for liability purposes (which generally allow for the "spreading" of AFSI that results from certain contributions to, and distribution from, partnerships), and partnership information sharing and reporting.

### **Partnership inclusion for scope determination**

The proposed regulations under section 59(k) would provide certain rules with respect to a tested corporation's inclusion of partnership income for scope determination purposes. These proposed rules are generally consistent with the notices, which provide that the distributive share of partnership AFSI rule is inapplicable for scope determination purposes and instruct a tested corporation to look to its FSI inclusion with respect to its partnership investment (unless the partnership is a member of the tested corporation's section 52 group or FPMG). Additionally, the proposed regulations would provide that certain partner-level FSI items with respect to a partnership interest, including FSI from the sale or exchange of a partnership interest, deconsolidation FSI, and dilution FSI, may be included in AFSI for scope purposes.

#### **KPMG observation**

It is important to note that the portion of the proposed regulations addressing a tested corporation's inclusion of partnership income for scope determination purposes would apply for tax years of the tested corporation ending after September 13, 2024, if the proposed rule is finalized in final regulations. Corporate partners that are including a distributive share of partnership AFSI for scope purposes (based on a statutory reading and Bluebook statement) or are excluding deconsolidation and dilution gain for the 2023 tax year should revisit their scope computations for the 2024 tax year.

<sup>24</sup> For a discussion of the U.S. GAAP treatment of the purchase of a credit, see [Handbook: Tax credits \(kpmg.com\)](https://www.kpmg.com/us/en/services/tax/tax-credits).

## Distributive share of partnership AFSI

### Background

Under section 56A(c)(2)(D)(i), if a taxpayer is a partner in a partnership, the AFSI of the taxpayer with respect to such partnership is adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership. Prior to the release of the proposed regulations, no guidance had been provided on the distributive share of partnership AFSI rule (other than prior notices stating it was inapplicable for scope determination purposes).

### Overview

Prop. Treas. Reg. § 1.56A-5 sets forth the "applicable method," described in the preamble as a "bottom-up" approach, for determining a CAMT entity's (e.g., an applicable corporation or a upper-tier partnership's) distributive share of partnership AFSI. The rules would provide for the determination of a CAMT entity's "distributive share percentage" and a partnership's "modified FSI." The proposed regulations also enumerate certain items as "separately stated AFSI items" and otherwise would require the inclusion of certain partner-level FSI items. Additionally, the proposed regulations would set forth an exception to the use of the applicable method, add a loss limitation rule, provide rules for when tax and book years differ, and require the determination and tracking of the CAMT entity's "CAMT basis" in its partnership investment. Furthermore, the proposed regulations contain numerous reporting rules.

#### KPMG observation

The applicable method is not a pure bottom-up approach and would require partners, including middle-tier partnerships and upper-tier partnerships, to perform various aspects of the computation, notably the determination of the correct distributive share percentage. Middle-tier partnerships will face an exceptionally heavy administrative burden, and all partnerships should consider submitting comments on the sizeable administrative burdens the CAMT regime imposes. Partnerships and partners should consider requesting *de minimis* and other exceptions to the applicable method (and attendant burdensome reporting requirements). For example, partners and partnerships may wish to ask for the exception to the applicable method be allowed in a greater number of situations (or on an elective basis).

### Applicable method—multi-part determination

The applicable method is presented as a multi-part determination. First, a CAMT entity's AFSI with respect to its partnership investment would be adjusted to disregard certain amounts the CAMT entity reflects in its FSI with respect to its partnership investment for the tax year (e.g., the CAMT entity's share of the partnership's earnings that are reflected in the CAMT entity's FSI under the equity method or changes in the fair value of the partnership investment that are reflected in the CAMT entity's FSI under the fair value method). Next, the CAMT entity would then adjust its AFSI to include its "distributive share amount." Finally, in certain situations, the CAMT entity would adjust its FSI to exclude certain equity method amortization adjustments (i.e., increase AFSI by the amount of those equity method amortization adjustments).

#### Applicable method—Part 1

With respect to the first determination, it is important to note that not all amounts a CAMT entity reflects in its FSI with respect to its partnership investment would be subject to removal. The CAMT entity's AFSI with respect to its partnership investment would not be adjusted to disregard any FSI amounts attributable to a transfer, sale or exchange, contribution, distribution, dilution, deconsolidation, change in ownership, any other transaction between a partner and the partnership or between partners of the partnership. However, such FSI may be subject to the "spreading" rules in Prop. Treas. Reg. § 1.56A-20 (discussed further below).

## Applicable method—Part 2

The second prong of the applicable method, determining the CAMT entity's distributive share amount, would be computed under the following four steps:

- **Step 1:** The CAMT entity determines its distributive share percentage (see chart below).
- **Step 2:** The partnership determines its modified FSI (modified FSI is similar to but not identical to AFSI as certain adjustments to FSI, namely those involving "separately stated AFSI items," do not apply).
- **Step 3:** The CAMT entity multiplies its distributive share percentage by the partnership's modified FSI.
- **Step 4:** The CAMT entity adjusts the amount determined in Step 3, including for certain "separately stated AFSI items" (e.g., basis adjustments under section 743(b) and Treas. Reg. § 1.1017-1(g)(2) attributable to section 168 property or qualified wireless spectrum). Certain other separately stated AFSI items (e.g., certain AFSI items with respect to stock of foreign corporations owned by the partnership) would be taken into account as adjustments to a CAMT entity partner's AFSI.

The proposed regulations specifically address how the distributive share amount computation works in the tiered partnership context. The proposed regulations would generally require the application of the applicable method at every level, starting with the lowest-tier partnership. Therefore, each partnership in a tiered structure would calculate and provide 100% of its modified FSI to the CAMT entity partner (e.g., a middle-tier or upper-tier partnership), and the partner would then multiply the modified FSI amount provided by the partnership by the distributive share percentage it computed itself.

More details and observations regarding Step 1 (distributive share percentage) and Step 2 (partnership's modified FSI) of the applicable method are discussed immediately below.

### Distributive share amount—Step 1: Distributive share percentage

Under Step 1, a partner (not the partnership) would determine its distributive share percentage. Determination of the distributive share percentage would be based on the amount of FSI a CAMT entity reports on its AFS with respect to its partnership investment. The percentage uses as the numerator the amount of FSI that the CAMT entity "reverses" as described above, and the denominator is determined based on a computation, which generally appears intended to approximate 100% of partnership economics as measured under the financial accounting rules.

The following table is a high-level summary of the distributive share percentage determination under the proposed regulations based upon the method of accounting used by the partner to report the investment in the partnership:

Method of accounting	Numerator amount	Denominator amount
Book consolidation	FSI amount determined as though the CAMT entity partner created a "Parent-Entity Financial Statement"	100% of partnership FSI
Equity method	Partner's share of partnership's earnings reflected in the partner's FSI under the equity method	100% of partnership FSI
Fair value method	Change in the fair value of the partnership investment	Total change in fair value of the partnership (as determined by partner)

	reflected in the partner's FSI	for inclusion of its share of total change in its AFS)
Any other method of accounting (presumably including the measurement alternative)	FSI amount disregarded under the applicable method (presumably, zero if the measurement alternative is used and there is no identifiable event)	"An amount determined under the principles of Prop. Reg. § 1.56A-5(e)(2)(i) and (ii) [regarding partnership investment accounted for under equity method or book consolidation, or fair value method] that is reasonable under the facts and circumstances and reflective of the proportionate amount of the partnership's FSI the CAMT entity is reporting for AFS purposes"

The preamble to the proposed regulations contemplates the possibility of a distributive share percentage being a negative number, which, per the preamble, may produce "imprecise results."

### KPMG observation

The distributive share percentage calculation raises a number of questions (whether or not the percentage is a negative number). It is noteworthy that, under the proposed rules, it appears that the total distributive share percentage of all partners in a partnership may be less than or more than 100%, and it seems such a result will often be the case.

The formula for calculating the distributive share percentage in situations where the partner uses the fair value method to account for its partnership investment raises questions when such partner does not value the *total* fair value of the partnership when figuring its financial statement inclusion, which we understand to occur not infrequently. Furthermore, the fair value of a partner's interest often reflects minority discounts and illiquidity discounts.

The proposed regulations would provide special rules if any partner treats its partnership investment as something other than equity for financial accounting purposes. Specifically, in the case of a partner which treats its partnership investment as something other than equity for financial accounting purposes (e.g., debt), the FSI amount disregarded under the applicable method (e.g., the interest) would be the numerator and 100% of partnership FSI plus the FSI amount included in the numerator (e.g., the interest) would be the denominator. In the case of a partner who treats itself as the 100% equity owner of a tax partnership for financial accounting purposes, the numerator would be the FSI amount disregarded under the applicable method (see chart above) and the denominator would be 100% of partnership FSI plus the sum of any amounts reflected in partnership FSI that are treated as paid or accrued to the other partners.

### KPMG observation

These formulas raise numerous questions. Consider a tax equity partnership with a single sponsor and one or more investors. The sponsor is treated as owning equity interests for tax and financial accounting purposes. Assume each investor's interest is treated as equity for tax purposes and debt for financial accounting purposes and each investor is allocated a \$10 tax credit. Whether there is only a single investor or a hundred investors, each investor's distributive share percentage is the same under the formula regardless of the fact that the economics are different. However, the sponsor's distributive share percentage decreases as the investors' aggregate economic entitlements increase. One can query whether this formula reflects a singular or plural drafting issue or was purposeful. The preamble specifically raises the issue of imprecise results under this situation, suggesting the drafting could reflect a purposeful choice to, for example, address

information asymmetries. Impacted taxpayers should respond to the specific requests for comments on this issue.

### **Distributive share amount—Step 2: Partnership's modified FSI**

In computing a partnership's modified FSI, the partnership would start with its FSI and make any AFSI adjustments under the proposed regulations that are applicable to partnerships, except for certain "separately stated AFSI items." Such items would instead be taken into account at the partner level as Step 4 of the calculation.

#### **KPMG observation**

As noted above, the proposed rules for determining a partner's distributive share of partnership AFSI would generally require both partners and partnerships to perform different steps of the process. Under the proposed regulations, it appears partnerships would be required to report their total modified FSI (rather than the partner's percentage of the partnership's FSI) to their partners. The total FSI of a partnership is often commercially sensitive information, raising certain non-tax concerns.

There is little guidance regarding how section 56A adjustments apply in the partnership context. Note that comment letters were submitted, raising issues associated with a bottom-up approach and application of the AFSI adjustments under section 56A that do not appear to be addressed in the proposed regulations. For example, it remains unclear how exactly to apply the adjustment for tax-exempt entities and the adjustment for ECI. Taxpayers should consider submitting additional comments, including comments suggesting instances in which items currently not enumerated as separately stated AFSI items should be enumerated as such.

### **Loss limitation provision**

The proposed regulations would also impose a loss limitation if a CAMT entity's distributive share amount is negative. This limitation would require computation of the CAMT entity's CAMT basis in its partnership investment and would apply to the negative distributive share amount in excess of such basis. A CAMT entity's basis in its partnership investment would start with the CAMT entity's AFS basis in the partnership investment as of the first day of the partnership's first tax year ending after December 31, 2019, with enumerated adjustments. Determination of which items of loss, deduction, and presumably credit, are to be determined using rules similar to those in Treas. Reg. § 1.704-1(d)(2). However, there are significant divergences in the computation of a CAMT entity's CAMT basis in its partnership investment under the CAMT regime and in the computation of a partner's outside basis in the partnership interest under the regular tax rules.

#### **KPMG observation**

It is unclear whether the proposed regulations would often include liabilities in a CAMT entity's basis in its partnership investment for purposes of the loss limitation provision. Prop. Treas. Reg. § 1.56A-20(e) provides that the treatment of partnership liabilities for purposes of determining a CAMT entity partner's AFSI is based on the applicable liability treatment for AFS purposes and not under section 752. If liabilities are not included in the book carrying amount of a partnership investment, a situation we understand to occur frequently, it appears that a negative distributive share amount could accordingly be limited in a way a partner's distributive share of a partnership loss would not be limited under regular tax rules.

### **Applicable method—Part 3**

The final step of the applicable method may not be relevant to all CAMT entities. The proposed regulations provide a special rule in the case of a partner that uses the equity method with respect to its partnership investment and is amortizing an equity method basis adjustment in its FSI attributable to section 168 or qualified wireless spectrum property. In this case, if the partner also has a section 743(b) adjustment with respect to the same property that is included in its distributive share amount, then the CAMT entity partner would adjust its AFSI to disregard the equity method amortization included in FSI.

## Partner FSI rule where the partnership has no AFS other than a tax return

A special rule for computing a partner's distributive share amount would apply if the partnership has no AFS other than a federal tax return. In such cases, the applicable method would not apply and instead a partner (a middle-tier partnership, an upper-tier partnership, or applicable corporation) would start with the FSI amount it reports on its tax return and make very limited adjustments. The limited adjustments under this "partner FSI" rule would include amounts related to the direct ownership of stock of a foreign corporation, federal and foreign income taxes, and certain separately stated AFSI items.

### KPMG observation

Under the partner FSI rule, a partner's distributive share of AFSI could include mark-to-market amounts.

The partner FSI rule, however, greatly simplifies partnership CAMT reporting as there are only very limited items to report to a CAMT entity partner since the partner would look to its own AFS to determine its distributive share amount. For example, if an applicable corporation invests in a fund by directly holding an interest through a partnership that does not have an AFS other than its tax return, and no other applicable corporation owns (directly or indirectly) an interest in that partnership, no modified FSI reporting would appear to be required. The partner FSI rule may also apply to any middle-tier or upper-tier partnership in a tiered structure. For example, consider an investment fund that invests in portfolio companies through a holding partnership with no AFS other than its tax return. In such fact patterns, no modified FSI information is seemingly necessary from the portfolio companies treated as partnerships for federal income tax purposes. When evaluating the potential application of the partner FSI rule, one should note that a partnership's AFS may be the consolidated AFS of a direct or indirect partner.

Furthermore, taxpayers concerned with the proposed CAMT partnership reporting requirements should consider submitting comments requesting the elective expansion of the partner FSI rule to other fact patterns.

## Subchapter K principles: Nonrecognition transfers and liabilities

Prop. Treas. Reg. § 1.56A-20, most importantly, would modify a CAMT entity's determination of its distributive share of AFSI from a partnership investment under the applicable method. More globally, Prop. Treas. Reg. § 1.56A-20 generally would require inclusion of FSI from partner-partnership transactions, except, in the case of full and partial nonrecognition transactions under sections 721 and 731 (*i.e.*, certain contributions and distributions). These special rules regarding such contributions and distributions are based on section 56A(c)(15)(B) and 56A(e)'s delegations to the Secretary, including the delegation to take into account certain principles under Part II of subchapter K. In such instances, the proposed regulations would generally adopt a deferred or installment sale approach to FSI resulting from the contribution or distribution.

## KPMG observation

The approach for contributions appears to be largely adopted from a recommendation in a New York State Bar Association (“NYSBA”) report to adopt, for CAMT purposes, the deferred sale method that was set forth in the section 704(c) proposed regulations and replaced by the remedial method when the section 704(c) regulations were finalized. It is noteworthy that the CAMT proposed regulations adopt an approach that was rejected in final regulations for regular tax purposes. It is equally interesting that the CAMT proposed regulations adopt as a key principle a provision that is in Part I, rather than Part II, of subchapter K. Taxpayers who believe that these rules will place impossible administrative burdens on them may wish to highlight these issues in comment letters to Treasury.

Prop. Treas. Reg. § 1.56A-20 would modify and add complexity to this installment sale approach (which the proposed regulations refer to as the “deferred sale approach”) that attaches to contributions. The rules would use a mix of book and tax concepts to determine whether there is “deferred sale property.” For example, the proposed regulations would incorporate modified disguised sale rules. The proposed regulations are specific that the liability rules of section 752 are inapplicable in determining whether section 721(a) or section 731(b) applies to a transaction. This is illustrated in Example 6 in Prop. Treas. Reg. § 1.56A-20, where property transferred to the partnership encumbered by debt is treated as transferred in a disguised sale for CAMT purposes even though such property is not treated as transferred in a disguised sale for regular tax purposes. As another example, the requirement to determine the applicable recovery period for deferred sale property transferred to the partnership generally depends on whether such property is section 168 property or qualified wireless spectrum and when that property is placed in service. The rules would use a tax recovery period for section 168 or qualified wireless spectrum property but would generally use a book recovery period for other depreciable/amortizable property. Furthermore, the recovery period could depend on whether the partner or partnership placed the property in service and on the property’s placed in-service date. In addition, the deferred sale rules would be based on CAMT basis (rather than AFS carrying values), which would require additional tracking. Furthermore, the rules would create a number of acceleration events, including acceleration of a deferred sale gain if the contributor’s distributive share percentage decreases by more than one third, acceleration of deferred sale gain (but not loss) in certain situations, acceleration of deferred sale gain and loss if the contributor disposes of its entire partnership interest or the partnership disposed the deferred sale property (including in a nonrecognition transaction).

The approach for partial recognition transactions is equally complex and the approach for distributions is even more complicated. To effectuate these rules, involved rules for basis tracking are proposed, including determining and tracking CAMT basis in the partnership and CAMT basis in properties distributed from a partnership.

## KPMG observation

These rules in Prop. Treas. Reg. § 1.56A-20 appear designed to be helpful. However, there are a medley of ways they would be taxpayer adverse. For example, AFSI deferred as a result of these rules could be moved from a pre-in-scope year to post-in-scope year. As another example, deferred AFSI could move from an earlier year with no CAMT liability to a later year with a CAMT liability resulting (and no CAMT credit). Applicable corporations concerned with this result may want to submit comments to Treasury.

The deferred sale rules also would apply to contributions of property by an upper-tier partnership to a lower-tier partnership, and in that instance the ratable inclusion of the deferred sale gain could be allocated to partners who were not partners of the upper-tier on the date of the deferred sale transaction. For a CAMT-sensitive investor buying into the partnership this provision would present a due-diligence item.

## Other partnership issues

Numerous other parts of the proposed regulations address certain partnership aspects of the CAMT regime. For example, the rules in Prop. Treas. Reg. § 1.56A-4 generally would adopt a KPMG recommendation to determine a partner's share of a partnership's foreign taxes by reference to the regular tax creditable foreign tax expenditure rules.

### KPMG observation

Many of the partnership rules that appear throughout the regulations package are necessary to understand the regime as applied to partners and to understand the compliance burdens on partnerships.

## Partnership reporting rules

The proposed regulations contain numerous reporting requirements for partners and partnerships, many of which are contained within Prop. Treas. Reg. § 1.56A-5 and Prop. Treas. Reg. § 1.56A-20.

### 2023 considerations

The IRS previously released post-release changes to update the 2023 Partner's Instructions to Schedule K-1, as well as the 2023 Partnership's Instructions to Schedule K-1 which left taxpayers with many unanswered questions. For example, the previous guidance strongly implies that if the requested CAMT information is not furnished by the due date for the partnership return, a partnership should file either a Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)* or an amended return<sup>25</sup> to report such requested information. For the 2023 tax year, the preamble to the proposed regulations provides limited relief by allowing a partnership that receives a request for information after the preparation of its Schedules K and K-1 to provide the information to the partner on a separate statement, presumably in lieu of the AAR or amended return process.

### Reporting and filing requirements for partners and partnerships under the proposed regulations

The proposed regulations would require that a CAMT entity partner must request certain CAMT information from the partnership if the CAMT entity cannot determine its distributive share of the partnership's AFSI without such information from the partnership. Generally, the CAMT entity would be required to request the information by the 30<sup>th</sup> day after the close of the partnership's tax year (e.g., January 30<sup>th</sup> for a calendar year partnership). Similarly, to meet an upper-tier partnership's reporting and filing requirements with respect to its investment in a lower-tier partnership, the upper-tier partnership would be required to request any necessary CAMT information from a lower-tier partnership by the later of the 30<sup>th</sup> day after the close of the lower-tier's tax year, or 14 days after the date the upper-tier partnership receives a request for information from another partnership-partner.

A partnership would not be required to furnish information to a CAMT entity partner unless the partnership received such a request, but then would be required to continue to provide the information for each

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<sup>25</sup> Depending on whether the partnership is subject to the Centralized Partnership Audit regime (the Bipartisan Budget Act of 2015 (Pub. L. No. 114-74) repealed the TEFRA partnership procedures and replaced them with a centralized partnership audit regime (see sections 6221 through 6235 of the Code)). Partnerships subject to this regime are often referred to as "BBA partnerships."

subsequent year, unless the CAMT entity partner provides written notification that the information is no longer required.

### **KPMG observation**

The requirement to request CAMT distributive share information presumably only attaches to applicable corporations and upper-tier partnerships with one or more direct or indirect partners who are applicable corporations.

Any applicable corporation who is a partner in a partnership would be required to request information from the partnership unless the applicable corporation knew the partnership did not have an AFS other than a tax return (a determination most partners will be unable to make).

Many upper-tier partnerships would likely want to request information in order to have necessary information on hand if and when they received a request from a CAMT entity partner unless the upper-tier partnership knew (i) no direct or indirect partner of the upper-tier partnership was an applicable corporation, or (ii) knew the lower-tier partnership did not have an AFS other than a tax return in order to have necessary information on hand if and when they received the request discussed in the next paragraph. Using this proactive approach would allow an upper-tier partnership to mitigate the compression issues inherent in the proposed rules.

The proposed regulations would provide that the partnership must file with the IRS and furnish the information requested by a partner in accordance with IRS forms, instructions, or other guidance. The partnership generally would be required to furnish the requested information by the due date of the partnership return (including extensions). A failure to furnish information as required by the proposed regulations would be subject to penalty under section 6722. The proposed regulations include enumerated lists of the types of information a partnership may be required to furnish to a partner upon request from that partner.

If a partnership fails to provide the requested CAMT information requested by a CAMT entity, the CAMT entity would be required to determine its distributive share amount with respect to the partnership by making a good faith estimate. The proposed regulations state that the entity must “continue to use its best efforts to obtain the requested information from the partnership.”

Specific rules would apply to BBA partnerships and CAMT entities that are partners in BBA partnerships. For example, the proposed regulations would also require a BBA partnership that has a CAMT entity as a partner to file an AAR “to adjust any partnership-related items, including as part of furnishing information to a CAMT entity that is a partner in the partnership.” If a BBA partnership that is a CAMT entity is filing an AAR to adjust taxable income as a result of a prior year AFS restatement, the CAMT entity would be required to use the restated AFS for purposes of determining AFSI on the AAR, in lieu of adjusting its AFSI for the tax year in which the restated AFS is issued.

### **KPMG observation**

A partnership generally does not have a statutory duty to amend its return. However, these proposed regulations, if finalized, would be one of the rare exceptions in which a partnership would be required to correct its return.

The preamble to the proposed regulations would contain a number of requests for comments on partnership reporting requirements, including whether exceptions should apply and, if exemptions are provided, how a partner’s distributive share of partnership AFSI should be computed.

### KPMG observation

Partnerships concerned with the extensive, or perhaps impossible, CAMT compliance and reporting burdens set forth in the proposed regulations should strongly consider explaining the practical issues they face and suggesting concrete alternatives in comment letters. For example, partnerships may want to suggest that the rules in Prop. Treas. Reg. § 1.56A-20 are impracticable from a compliance perspective and note some of the technical issues identified above.

## International issues

### Ownership and transfers of foreign corporation stock or assets

In applying the adjustment in section 56A(c)(2)(C) to ownership in foreign corporations (including controlled foreign corporations ("CFCs")), the proposed regulations would determine the AFSI of a taxpayer by substituting any FSI items resulting from ownership of foreign stock with items of income, deduction, gain or loss included for regular tax purposes resulting from the ownership of stock, other than items resulting from the application of section 78, 250, 951, or 951A. For example, a taxpayer that is permitted a dividends received deduction under section 245A (a "section 245A DRD") for regular tax purposes by reason of a dividend from a foreign corporation would include the dividend in its AFSI and then reduce AFSI by the amount of the section 245A DRD.

### KPMG observation

This broad regular tax replacement rule for income and deductions relating to stock in a foreign corporation presents a welcome simplification and significant expansion of the relief afforded by Notice 2024-10, which permitted a section 245A DRD only for section 316 dividends resulting from actual distributions from CFCs. In contrast, the proposed rule would allow a section 245A DRD in computing AFSI for all dividends under the Code, including deemed dividends under sections 304, 367(b), and 1248 and dividends from non-CFC specified foreign corporations (i.e., "10/50 companies"), to the extent a section 245A DRD is permitted for regular tax purposes.

While generally taxpayer favorable, there remain limited circumstances in which CAMT double taxation can arise from a foreign stock investment. For instance, assume a U.S. shareholder includes a CFC's adjusted net income ("ANI," defined below) in its AFSI as a CFC adjustment (also defined below), but because of a book-tax difference the CFC has no taxable income for regular tax purposes and thus no possibility of a corresponding basis increase under the section 961 at the U.S. shareholder level or regular tax E&P to generate a section 245A-eligible dividend under section 1248(j) or section 964(e)(4). Upon the taxable disposition of the CFC stock in a later year, the U.S. shareholder could recognize gain for regular tax and therefore CAMT purposes, notwithstanding that the gain is attributable to the same item(s) of income taken into account by the U.S. shareholder in computing its earlier CFC adjustment.

An exception to the proposed regular tax replacement approach to section 56A(c)(2)(C) is the exclusion of the section 78 gross-up, which is included in gross income for regular tax purposes and not afforded a section 245A DRD. This exclusion is necessary to prevent double counting, because the proposed rules, consistent with section 56A(c)(5), would already add back these foreign taxes in

computing the CFC adjustment of a U.S. shareholder that chooses to credit its foreign taxes for regular tax purposes.

The proposed regulations would generally disregard the impacts of purchase accounting resulting from the purchase of stock of a foreign corporation. If, however, a section 338(g) election is made for regular tax purposes upon the acquisition, the proposed regulations would give effect to section 338(g) elections for purposes of computing AFSI and CAMT basis and thereby mirror the impact of purchase accounting. Specifically, the proposed regulations would provide that, if the stock of a foreign corporation is acquired in a transaction for which a section 338(g) election is made, the ANI of the foreign corporation would then be adjusted to include any resulting regular tax gain or loss, except determined by reference to the foreign corporation's CAMT basis. The foreign corporation's CAMT basis in its assets immediately after the transaction would be its regular tax basis.

### KPMG observation

For a taxpayer that is limited in crediting CFC taxes by reason of the CFC tax limitation (see discussion below), a section 338(g) election could convert AFSI from the sale of the CFC's stock into ANI on the deemed sale of the CFC's assets, thereby increasing the CFC tax limitation and allowing the taxpayer to credit more CFC taxes. However, because the gain on the stock would be determined by reference to regular tax basis, whereas the gain on the assets would be determined by reference to CAMT basis, taxpayers would have to model out whether, and to what extent, a section 338(g) election provides a benefit.

Similarly, with respect to transfers of a foreign corporation's assets, the proposed regulations would adjust a taxpayer's AFSI to only reflect regular tax items resulting from a "covered asset transaction." In general, covered asset transactions encompass tax-free (and partially tax-free) transfers and taxable distributions of (i) assets, stock, or securities to or by a foreign corporation and (ii) assets by or to a domestic corporation if at least one of the assets is stock of a foreign corporation. Where applicable, a transferor's AFSI would generally reflect only regular tax items of income, gain, deduction, or loss, except that any gain or loss would be determined by reference to the transferor's CAMT basis rather than its regular tax basis.

In addition to a general anti-abuse rule (discussed below), the proposed regulations would adopt a targeted anti-abuse rule in Treas. Reg. § 1.56A-4 to prevent the perceived avoidance of CAMT through the conversion of assets with a CAMT basis that is book basis into foreign stock with a CAMT basis equal to the regular tax basis. The proposed anti-abuse rule would apply if the regular tax basis<sup>26</sup> of foreign corporation stock received in a covered asset transaction, determined under section 358 by reference to the regular tax basis of the assets transferred in the transaction, is greater than the hypothetical CAMT basis of the foreign corporation stock, determined under section 358 by reference to the CAMT basis of the exchanged assets, and *either* of two conditions is satisfied. First, a principal purpose of the covered asset transaction is to avoid treatment of a CAMT entity as an applicable corporation or otherwise reduce or avoid a CAMT liability. Second, the regular tax basis in the foreign corporation stock received in the covered asset transaction is taken into account, in whole or in part, in the AFSI of the recipient CAMT entity or another CAMT entity within two years of the receipt of the foreign corporation stock. If this proposed anti-abuse rule applies, the transferor CAMT entity would be required to increase its AFSI for the tax year in which such stock is received by the amount that the regular tax basis of the foreign stock is greater than the hypothetical CAMT basis in such stock.

<sup>26</sup> The proposed regulations would provide that a CAMT entity's regular tax basis in the stock of a foreign corporation *is* its CAMT basis. See Prop. Treas. Reg. § 1.56A-4(d)(5). However, to avoid confusion, this report still refers to such basis as "regular tax basis."

## KPMG observation

The proposed anti-abuse rule in Treas. Reg. § 1.56A-4 can be a trap for the unwary. Specifically, if assets with a regular tax / CAMT basis disparity are transferred to a foreign corporation in an exchange described in section 351, the proposed anti-abuse rule could be triggered if the regular tax basis in the transferee foreign corporation stock received in the covered asset transaction is “taken into account” within two years of the transaction, regardless of the purpose of the initial transfer. The scope of “taken into account” for this purpose is not clear; while it certainly would encompass the use of the basis to reduce gain (or increase loss) upon a taxable disposition of the stock, it could also potentially include a return of basis under section 301(c)(2). The proposed anti-abuse rule would rarely apply in the context of an outbound transfer, because an outbound transfer of tangible assets would result in gain recognition under section 367(a) and an outbound transfer of intangible property described in section 367(d) would likely not involve property with regular tax basis in excess of CAMT basis. However, the proposed anti-abuse rule could often be implicated in CFC-to-CFC contributions described in section 351(a).

## Pro rata share CFC adjustment

In accordance with section 56A(c)(3), the proposed regulations would require a U.S. shareholder to increase its AFSI by its aggregate pro rata share of adjusted net income or loss (“ANI”) of all of its CFCs (such adjustment, the “CFC adjustment”). A CFC’s ANI is not AFSI (see below for a discussion of the exclusion of ECI from ANI) and is relevant solely for purposes of determining the amount of the CFC adjustment for a US shareholder of the CFC. Nevertheless, subject to some important exceptions and modifications (discussed below), the proposed regulations would apply the same proposed section 56A regulations used for computing AFSI to determine CFC ANI.

A CFC adjustment for a tax year can only be positive (*i.e.*, increase a U.S. shareholder’s AFSI). If a U.S. shareholder’s CFC adjustment would be negative, there is no adjustment for that year but rather such negative adjustment is carried forward to offset the U.S. shareholder’s positive CFC adjustment in subsequent years (a “CFC adjustment carryover”). The proposed regulations would clarify that any CFC adjustment carryover applies in the order of the tax years in which the negative adjustment arose (*i.e.*, on a first in, first out basis) beginning with losses that arose in tax years ending after December 31, 2019, and absorbed in each succeeding tax year in which there would be a positive CFC adjustment (without regard to the CFC adjustment carryover), whether or not the U.S. shareholder is an applicable corporation in such year. Further, the proposed regulations clarify that the AFSI adjustment for financial statement net operating loss (“FSNOL”) carryovers in section 56A(d) does not apply in computing ANI of a CFC.

## KPMG observation

There is uncertainty under the statute as to the relevant period for determining CFC adjustment carryovers, and whether they can be generated and absorbed for liability determination purposes even while the U.S. shareholder is not an applicable corporation. The proposed regulations would conform the rules for CFC adjustment carryovers to the rules for FSNOLs, which by statute only arise in tax years ending after December 31, 2019, and, under the proposed regulations, would be absorbed in each succeeding year regardless of whether the corporation is an applicable corporation. Conforming these loss carryover provisions makes sense since they complement each other—CFC adjustment carryovers represent aggregate losses of a corporation generated through its CFCs and FSNOLs represent aggregate losses that a taxpayer generated directly. However, important differences remain between CFC adjustment carryovers and FSNOLs. For example, FSNOLs are only permitted to offset 80% of AFSI, whereas CFC adjustment carryovers may offset 100% of a U.S. shareholder’s CFC adjustment in a year. Also, CFC adjustment carryovers are taken into account for both CAMT liability and scoping purposes, whereas FSNOLs only apply for liability determinations.

The proposed regulations would, pursuant to section 56A(c)(5), adjust ANI to disregard federal and foreign income taxes paid or accrued by a CFC, similar to the adjustment required for AFSI. As discussed below, pursuant to the authority provided in section 56A(c)(5), the proposed regulations would allow an applicable corporation that chooses not to credit foreign taxes for regular tax purposes to deduct such taxes in computing CAMT liability to the extent a deduction is allowed under section 164 for regular tax purposes. However, the proposed regulations would not permit this deduction to a CFC in computing its ANI, but rather would require an AFSI reduction for non-credited CFC foreign taxes at the U.S. shareholder level. Specifically, if a U.S. shareholder chooses not to credit foreign taxes for regular tax purposes, the proposed regulations would reduce the U.S. shareholder's CFC adjustment for liability determination purposes by the amount of the CAMT foreign tax credits ("FTCs") the U.S. shareholder would have been entitled to had it chosen to credit the foreign taxes paid or accrued by its CFCs.

### KPMG observation

Taxpayers will be pleased to be able to reduce the CFC adjustment by foreign income taxes if the taxpayer deducts (and does not credit) foreign taxes for regular tax purposes. However, there are some important limitations to this rule that could reduce its benefit. First, it appears that the tax reduction rule cannot apply for purposes of the scope determination because the deduction is only available to an applicable corporation. Further, because the tax reduction rule is predicated on the amount of CAMT FTCs an applicable corporation could have claimed had it chosen to credit, and, as discussed below, CAMT FTCs are subject to certain regular tax disallowances and limitations, the tax reduction to the CFC adjustment might be less than the section 164 deduction permitted to a CFC in computing the U.S. shareholder's GILTI and subpart F income. Thus, taxpayers should carefully consider any foreign tax credit disallowances or suspensions that could limit the amount of eligible CAMT FTCs in determining the actual benefit of the tax reduction.

The proposed regulations would provide that any item included in ANI that is not expressed in U.S. dollars must be translated to U.S. dollars using the relevant weighted average exchange rate for the CFC's tax year.

In determining potential adjustments to CFC ANI by reason of ownership in a lower-tier foreign corporation (including a CFC), the proposed regulations would provide special rules similar to the AFSI adjustments described above relating to foreign stock ownership. Thus, in general, the proposed regulations would determine the ANI of a CFC by substituting any FSI items resulting from ownership of foreign stock with regular tax items of income, deduction, gain or loss resulting from the stock ownership, for this purpose taking into account section 961(c). The proposed regulations would also exclude in computing a CFC's ANI any "CAMT excluded dividend"—defined to include a dividend that would be excluded from either (1) the CFC's gross income under section 959(b), or (2) both the recipient's foreign personal holding company income under section 954(c)(3) or (c)(6) and the recipient's gross tested income under Treas. Reg. § 1.951A-2(c)(1)(iv) (relating to dividends received from related persons).

## CAMT FTC

For the purposes of determining an applicable corporation's CAMT liability, section 59(l) provides a CAMT FTC for any tax year in which the applicable corporation elects to claim an FTC for regular tax purposes.

Notably, the proposed regulations would largely adopt regular tax rules to determine the timing and amount of CAMT FTCs. For example, consistent with Notice 2023-64, a foreign income tax would be creditable under the proposed regulations when paid or accrued for regular tax purposes, thus generally importing the timing rules under section 905, including the relation back doctrine applicable to foreign tax redeterminations.

The proposed regulations would additionally import certain limitations on the creditability of FTCs from the regular tax rules. An "eligible tax" for CAMT FTC purposes, under the proposed regulations, is defined as

a foreign income tax “other than a foreign income tax for which a credit is disallowed or suspended for regular tax purposes under section 245A(d), 245A(e)(3), 901(e), 901(f), 901(i), 901(j), 901(k), 901(l), 901(m), 907, 908, 909, 965(g), 999, or 6038(c) of the Code.” This limitation applies to both direct foreign income taxes and CFC taxes.

### KPMG observation

Although leveraging the regular tax rules will generally make computing the CAMT FTC a simpler exercise for taxpayers, applying some of these regular tax limitations to the CAMT FTC may inappropriately increase a taxpayer’s CAMT liability. For example, section 907 generally limits regular tax FTCs relating to oil and gas income to 21% of the oil and gas income for the year. Applying this limitation to CAMT FTCs (without modification) seems to produce an arbitrary additional limit given that the CAMT rate is 15% and the CAMT base is AFSI rather than taxable income. Notably, however, the proposed regulations would not import the section 904 limitations that apply to the regular tax FTC.

With respect to foreign taxes paid or accrued by a partnership, following Notice 2023-64, the proposed regulations would provide that an applicable corporation that is a partner in a partnership may credit its share of the partnership’s eligible taxes. Under the proposed regulations, an applicable corporation’s share of partnership taxes for purposes of the CAMT FTC would be equal to the “creditable foreign tax expenditures” that are allocated to the partner for regular tax purposes under section 704(b) regulations and are eligible taxes for purposes of the CAMT FTC.

### KPMG observation

This is another situation in which the amount allowed as a CAMT FTC may not match the inclusion of a partnership, because the proposed regulations adopt an approach that follows regular tax rather than the methodology for determining the partner’s “distributive share” of partnership AFSI. Nonetheless, given the complexity involved in determining an applicable corporation’s distributive share of a partnership’s AFSI (discussed herein), taxpayers may welcome the simple approach adopted by Treasury.

Under section 59(l)(1), an applicable corporation’s CAMT FTC is equal to the sum of two amounts. Under section 59(l)(1)(B), a domestic applicable corporation may credit the eligible foreign income taxes paid or accrued by it directly, including taxes paid by any foreign disregarded entity, to the extent the taxes have been taken into account on the applicable corporation’s AFS. Additionally, an applicable corporation that is a U.S. shareholder with respect to one or more CFCs may credit its pro rata share of the foreign taxes of its CFCs in the aggregate (“CFC taxes”), limited to 15% of the CFC adjustment in section 56A(c)(3) (the “CFC tax limitation”).

Under the proposed regulations, CFC taxes would generally include foreign income taxes deemed paid by an applicable corporation attributable to previously taxed E&P; eligible current year taxes (as defined in Treas. Reg. § 1.960-1(b)(5)) deemed paid by the corporation attributable to subpart F; the corporation’s proportionate share of the eligible current year taxes attributable to tested income; and the corporation’s pro rata portion of the eligible current year taxes attributable to CFC residual income. Special rules allow a CAMT FTC for eligible current year taxes attributable to net losses in subpart F and tested income.

Under section 59(l)(2), excess CFC taxes that cannot be credited in a tax year because of the CFC FTC limitation would be carried forward to be used “in any of the first 5 succeeding tax years to the extent not taken into account in a prior taxable year.” The proposed regulations provide that such “unused CFC taxes” would be carried into the five succeeding years in chronological order and absorbed (on a first in, first out basis) irrespective of whether the taxpayer claims an FTC for regular tax purposes in such years.

## KPMG observation

The requirement that unused CFC taxes be absorbed in years the taxpayer does not elect to credit foreign taxes is a narrow reading of the statute, which, in contrast to the rules in section 904(c), could be reasonably read to provide that the unused CFC taxes carry to any of the first five years in which the taxpayer is claiming a credit for regular tax purposes. Potentially impacted taxpayers may wish to make comments noting that the five-year limitation on the carryover of unused CFC taxes already significantly impedes a taxpayer's ability to use such taxes in future years and that this additional limitation should be removed in final regulations.

The proposed regulations, unlike the regular tax rules, do not provide a mechanism to prevent CFC taxes from being lost due to an overall domestic AFSI loss ("ODAL"). An ODAL could offset AFSI attributable to a CFC adjustment and render useless any CAMT FTCs associated with the CFC adjustment. Such CAMT FTCs are not treated as unused CFC taxes and therefore do not carry forward. As is, the CAMT FTC rules' lack of parity with the regular tax overall domestic loss ("ODL") rules could create or increase a CAMT liability, since an ODL would provide section 904 foreign tax credit limitation allowing a taxpayer to reduce regular tax liability through greater regular FTC utilization, whereas the proposed regulations would provide the taxpayer no greater ability to credit CAMT FTCs in computing its tentative minimum tax.

## ECI

Section 56A(c)(4) provides that a foreign corporation's AFSI is determined in accordance with section 882 (i.e., ECI) principles (the "ECI rule"). The proposed regulations generally restate the statutory ECI rule, except that the proposed regulation would clarify that a foreign corporation's ECI for this purpose is determined by taking into account only income that would be included in ECI and expenses that would be allowable as a deduction under section 882(c).

## KPMG observation

In failing to provide a method for determining a foreign corporation's adjustment to AFSI in accordance with the principles of section 882, the proposed regulations would leave taxpayers with some flexibility in how they determine what portion of their FSI is attributable to ECI and included in AFSI. However, there are certain issues where taxpayers may want clarity, including, for example, how this adjustment works when a foreign corporation holds an interest in a partnership.

Further, the proposed regulations would not incorporate Notice 2023-64's clarification that treaty-exempt ECI is excluded from a foreign corporation's AFSI under the ECI rule, noting in the preamble that section 894(a) already provides guidance that the Code is applied "with due regard to" treaty obligations of taxpayers.

## KPMG observation

The preamble suggests that AFSI would not include treaty-exempt ECI by operation of other provisions in law. Accordingly, the proposed regulations would not include a specific adjustment in determining AFSI for treaty-exempt ECI. However, the provisions of existing income tax treaties do not address the implications of a foreign corporation earning ECI beyond the imposition of a tax liability. Section 894(a) does not clearly address how treaty benefits would affect the scope determination for CAMT, including how to compute AFSI for such purposes and whether a foreign corporation with a U.S. trade or business but no permanent establishment can nonetheless be a deemed domestic corporation for purposes of the FPMG rule. By contrast, Notice 2023-64 explicitly excluded treaty-exempt ECI from AFSI for all purposes. The preamble does not indicate that

Treasury intended to narrow the notice's exclusion from AFSI for treaty-exempt ECI, but it is not clear under the proposed regulations that treaty-exempt ECI would be excluded from AFSI for scope determination purposes.

As discussed above, ECI of a CFC that is an applicable corporation is AFSI for that CFC but, under this proposed rule, would not also be ANI. As a result, such ECI could not also increase the AFSI of the CFC's U.S. shareholder through the CFC adjustment, thus avoiding potential CAMT double taxation.

# Corporate and M&A issues

## General (non-tax consolidated) corporate rules

Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 would provide general rules for many transactions between a domestic corporation and another CAMT entity or an individual. In general, these proposed regulations address the scope and application of section 56A(c)(2)(C) and (c)(15)(B). Separate rules would generally apply to many transactions (1) involving stock of a foreign corporation (see Prop. Treas. Reg. § 1.56A-4), or (2) between members of a tax-consolidated group (see Prop. Treas. Reg. § 1.1502-56A), and therefore, unless otherwise specified, the discussion below refers to transactions between domestic corporations that are not part of the same tax-consolidated group.

Section 56A(c)(2)(C) generally provides that, if a corporate taxpayer holds an interest in another corporation not included in the taxpayer's tax-consolidated return, the taxpayer's AFSI with respect to that other corporation includes only dividends and certain other amounts includible in gross income (but excluding subpart F and GILTI inclusions) or deductible as a loss for regular tax purposes by the taxpayer. The preamble states that Treasury believes section 56A(c)(2)(C) only applies if a CAMT entity's role in a transaction is purely as a shareholder of a domestic corporation (and not as a party to the transaction). Consistent with section 56A(c)(2)(C), for purposes of determining a taxpayer's AFSI, the proposed regulations generally would disregard a taxpayer's financial statement consolidation with a subsidiary, as well as fair value and equity method adjustments made for financial statement purposes with respect to a taxpayer's stock investments. However, Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 generally would not interpret section 56A(c)(2)(C) as providing for the use of regular tax amounts (e.g., the amount of regular tax dividend income, or regular tax gain or loss on a stock sale) in calculating AFSI. Rather, in many cases the proposed regulations would require "redetermining" the amount of FSI gain or loss by reference to separately calculated CAMT stock basis and "CAMT earnings" in order to determine the AFSI inclusion from stock sales, distributions, and other stock transactions. The term "CAMT earnings" would refer to an amount similar to regular tax earnings and profits (E&P) but calculated by reference to AFSI. The determination of whether a distribution constitutes a dividend for CAMT purposes generally would be made by reference to CAMT earnings (and not regular tax E&P).

In general, CAMT stock basis and CAMT earnings would be determined based on regular tax stock basis and regular tax E&P as of the beginning of the first tax year beginning after December 31, 2019, with these amounts then subsequently adjusted in subsequent years as provided in Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19.

### KPMG observation

The approach in Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 would likely create significant administrative and technical complexity. In particular, the calculation of CAMT stock basis and CAMT earnings apparently would have to be done not just on a go-forward basis from the date of final regulations but often retroactively beginning in 2020. Further, it appears that corporations not currently subject to CAMT, but that later become subject to CAMT as a result of an acquisition or otherwise, generally would be required to calculate CAMT stock basis and CAMT earnings beginning

in 2020. From a technical perspective, it is not entirely clear how FSI gain or loss is “redetermined” using CAMT basis where the treatment of the transaction for FSI purposes differs from the regular tax treatment. In particular, there may be instances in which no income or loss is reflected in FSI from a transaction that is taxable for regular tax purposes, regardless of the relevant asset’s AFS basis.

This hybrid book-tax approach in Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 differs from the regular tax replacement approach with respect to foreign corporate stock adopted by Treasury in Prop. Treas. Reg. § 1.56A-4 (discussed above), which wholly replaces items of income, expense, gain, or loss reflected in FSI (if any) attributable to such stock with income, deduction, gain, or loss for regular tax purposes. Treasury’s decision to adopt different approaches to account for items of income attributable to domestic stock as opposed to foreign stock is surprising given that the same statutory provision (section 56A(c)(2)(C)) applies to both foreign and domestic corporations.

Section 56A(c)(15) provides that Treasury “shall” issue regulations containing various adjustments, including adjustments under section 56A(c)(15)(B) “to carry out the principles” of parts II and III of subchapter C (relating to corporate liquidations, organizations and reorganizations). The proposed regulations would implement section 56A(c)(15)(B) by requiring several adjustments to FSI. For instance, the proposed regulations would, at least in certain circumstances (see below), disallow “purchase accounting” or “push-down accounting” adjustments (referred collectively hereinafter as “purchase accounting”) in transactions treated as stock acquisitions for regular tax purposes. However, if a transaction is treated as a taxable asset acquisition for regular tax purposes other than by reason of an election under section 336(e), section 338(g), or section 338(h)(10) (e.g., a purchase of an interest in a disregarded entity), the proposed regulations would require the acquired assets’ CAMT basis to be determined by reference to the acquirer’s AFS basis (*i.e.*, taking into account purchase accounting). In contrast, for a stock acquisition subject to an election under section 336(e), section 338(g), or section 338(h)(10), the proposed regulations would provide that the CAMT basis in the assets deemed to be acquired by “new target” are equal to the regular tax basis resulting from such an election. Thus, these elections would provide results similar to those provided by purchase accounting, but with CAMT basis determined based on regular tax amounts rather than purchase accounting.

Technically, disallowance of purchase accounting appears to apply only to acquisitions by an “acquirer corporation,” which would seemingly mean that purchase accounting still would apply to stock acquisitions by non-corporate entities. Similarly, the proposed rules for determining a seller’s consequences on a transfer of stock appear to be limited to transfers to an “acquirer corporation.” The preamble to the proposed regulations does not indicate an intent to limit these provisions to corporate (as opposed to non-corporate) entities, leaving it unclear whether this limit was intentional. Disregarding purchase accounting would in many cases effectively require the creation of a separate set of “CAMT books” from those prepared for financial statement purposes. Based on the general rule in the proposed regulations for the determination of CAMT basis in assets, it appears that this adjustment would be required to be made for transactions occurring in any tax year ending after 2019.

The proposed regulations would also, consistent with the notices, depart from financial statement treatment for “covered nonrecognition transactions.” Very generally, a covered nonrecognition transaction would be treated similarly to a regular tax nonrecognition transaction, in that income, gain, or loss would not be recognized on the transaction, but property received in the transaction would have a “substituted,” rather than fair market value, CAMT basis. As a result, purchase accounting generally would be disregarded for an acquirer in a covered nonrecognition transaction. In addition, consistent with the notices, the preamble describes the proposed regulations as adopting a “cliff effect,” pursuant to which the recognition of **any** gain or loss by a party to the transaction prevents the transaction from qualifying as a covered nonrecognition transaction to that party. The proposed regulations would, similar to the notices, provide for the separate assessment of covered nonrecognition transaction status of each “component transaction” that constitutes a part of a larger transaction. Under this framework, a single transaction may be a covered nonrecognition

transaction for one party but not its counterparty, and a single party may engage in more than one component transaction (each of which is separately assessed for covered nonrecognition transaction status) as part of a larger reorganization.

### KPMG observation

The application of a “cliff effect” for covered nonrecognition treatment could lead to attempts to avoid covered nonrecognition treatment through the provision of a minimal amount of “boot” that gives rise to a minimal amount of regular tax gain. There are certain rules within Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19, as well as a general anti-abuse rule in Prop. Treas. Reg. § 1.56A-26(c), that may limit the ability to effectively “elect out” of covered nonrecognition transaction treatment. On the other hand, given that the proposed regulations specifically intend to treat any gain or loss as resulting in recognition transaction treatment, arguably planning into the cliff effect is not counter to the purposes of the rules. It is also noteworthy that the “cliff effect” appears in the corporate rules in Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 but partial nonrecognition transactions are afforded special treatment in the Prop. Treas. Reg. § 1.56A-20’s partnership rules.

The covered nonrecognition transaction rules would involve a complex framework. For any transaction involving regular tax non-recognition, an evaluation of each “component transaction” generally would be required, and this evaluation would often involve assessing the interplay of regular tax treatment, financial statement treatment, CAMT-specific basis and earnings, and the specific rules under Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 that would provide for various transaction categories. In addition, similar to other aspects of the proposed regulations, this would often require a parallel set of “CAMT books” (e.g., for an acquirer in a covered nonrecognition transactions because purchase accounting is disregarded).

Prop Treas. Reg. §§ 1.56A-18 and 1.56A-19 would force taxpayers to evaluate the CAMT impact of any restructurings and M&A activity, a significant endeavor. Furthermore, diligence with respect to CAMT-specific basis and earnings will take significant time and resources, especially as the CAMT regime ages (because certain calculations start with 2020 numbers).

Taxpayers that believe that the rules in Prop Treas. Reg. §§ 1.56A-18 and 1.56A-19 would place a near impossible compliance burden on the computation of AFSI should consider submitting comments requesting safe harbors, *de minimis* rules and/or the ability not to apply certain provisions for purposes of the scope determination.

## Financial statement net operating losses (FSNOLs)

The statute provides for the creation and absorption of FSNOLs (i.e., AFSI net losses) in tax years ending after December 31, 2019. By statute, FSNOLs are carried forward indefinitely and utilized to offset up to 80% of a taxpayer’s AFSI (similar to the rules for most regular tax NOLs), but solely for purposes of the liability determination. The proposed regulations would confirm that FSNOLs can be created, and absorbed, in tax years in which a corporation is not an applicable corporation.

The proposed regulations do not adopt rules similar to section 382 for FSNOLs. However, the proposed regulations would introduce a separate limitation (the “CAMT SRLY limitation”) on the utilization of FSNOLs (and certain built-in losses) that resembles the “separate return limitation year” or “SRLY” limitations that can apply in a tax consolidated group for regular tax purposes. The CAMT SRLY limitation would apply to a “successor transaction,” generally defined as (i) a transaction described under section 381(a), or (ii) an acquisition of stock (a) that constitutes a “change in ownership” within the meaning of Prop. Treas. Reg. § 1.59-2(f) or (b) in which the target joins a tax consolidated group. The CAMT SRLY limitation would appear to limit the amount of “acquired” FSNOLs that could be utilized following the successor transaction to the aggregate AFSI generated by each “separately tracked business” of the entity acquired in the successor transaction. Similar to the SRLY limitations applicable to tax consolidated groups for regular tax purposes,

the CAMT SRLY limitation would be based on a cumulative register of positive or negative AFSI, which would be reduced to the extent positive AFSI allowed for the utilization of FSNOLs.

The CAMT SRLY limitation would also apply to a corporation that had a “CAMT net unrealized built-in loss” (CAMT NUBIL) immediately before a successor transaction. In general, the proposed regulations would limit the use of recognized built-in losses following the successor transaction in a manner similar to the limitation on pre-successor transaction FSNOLs. The amount of recognized built-in loss subject to limitation would not be capped at the amount of the CAMT NUBIL.

### KPMG observation

The CAMT SRLY limitation would raise significant compliance and technical issues for M&A transactions. Tracking separate business lines may require the preparation of pro forma or otherwise separate financials solely for purposes of the CAMT SRLY limitation. Further, this approach appears likely to generate recurring questions as to what is the relevant “business,” which assets and activities belong to which business, and what transactions constitute an expansion of an existing business. In the common situation in which the goal of the acquisition transaction is to combine and integrate the activities of the target and acquiring entities, it appears very challenging to maintain a distinction between the target’s business and the acquirer’s business post-acquisition, particularly where the assets and/or employees of the businesses are integrated post-acquisition. Taxpayers may want to comment on these significant compliance and technical issues.

The application of the section 382 limitation to regular tax NOLs and the CAMT SRLY limitation to FSNOLs appears likely to lead to unfavorable results for many taxpayers. Very generally, CAMT liability tends to be minimized to the extent AFSI and regular tax income for a tax year more closely match, as the effective regular tax rate generally exceeds the 15% “rate” applied to AFSI. However, even if a taxpayer has the same amount of regular tax NOLs and FSNOLs, different amounts of regular tax NOLs and FSNOLs often would be used in each tax year based on the different applicable limitations. Thus, CAMT liability could result from the different absorption rules for regular tax NOLs and FSNOLs.

For purposes of determining the amount of a CAMT NUBIL, the rule in Prop. Treas. Reg. § 1.56A-23(f)(4) specifies that “no consideration or deemed consideration in excess of fair market value is taken into account.” This would appear to mean that, for an insolvent taxpayer, so-called “built-in” cancellation of indebtedness income would not be part of the determination of the CAMT NUBIL. In contrast, many practitioners believe that such built-in cancellation of indebtedness income is part of the calculation of a net unrealized built-in loss for regular tax purposes under current guidance applicable to section 382. Notably, new guidance under section 382 addressing this concept and related issues is in progress. The inclusion of this provision in the proposed regulations may signal the approach that section 382 guidance is likely to take.

## Troubled companies

### Cancellation of debt income

For regular tax purposes, gross income generally includes income from the cancellation or discharge of debt (“tax CODI”). Tax CODI generally is realized when a debt is satisfied or repurchased for less than its adjusted issue price. The regular tax rules prescribe the amount of consideration treated as received by the creditor in discharge of the debt in different fact patterns. There are also certain events that create deemed exchanges that can result in tax CODI. Generally, tax CODI gives rise to taxable income for regular tax purposes. However, exceptions from this general rule are set forth in section 108(a), including when the discharge occurs in a title 11 (bankruptcy) case or when the taxpayer is insolvent (to the extent of the insolvency). For regular tax purposes, if a section 108(a) exception applies, the tax CODI is excluded from taxable income, but tax attributes must be reduced under section 108(b).

In general, financial accounting standards can also treat cancellations of debt as giving rise to financial statement income (AFS CODI). However, because the financial accounting rules differ from the regular tax rules, the timing and amount of AFS CODI may differ from that of tax CODI. Furthermore, under the financial accounting rules, there is no analogue to section 108(a) whereby AFS CODI is excluded from FSI. Therefore, absent guidance indicating otherwise, a taxpayer could generate a CAMT liability due to, for example, a debt discharge triggering AFS CODI that is included in FSI along with tax CODI that is excluded from taxable income.

The proposed regulations would adopt a CAMT parallel to section 108(a), in which AFS CODI is excluded from AFSI, and CAMT attributes would be reduced based on the principles under section 108(b), but without regard to any corresponding tax CODI amount and tax attribute reduction. However, the proposed regulations would prioritize reductions to the CAMT basis of “covered property” (*i.e.*, section 168 property, qualified wireless spectrum, and depreciable or depletable assets of an Alaska Native Corporation) to be reduced first to the extent the basis of such property is reduced for regular tax purposes, and for which regular tax depreciation amounts are superimposed for CAMT purposes.

### KPMG observation

The approach under the proposed regulations appears to avoid many of the issues that would arise under the framework set forth in the notices, which adopted a concept similar to section 108 (exclusion of AFS CODI from FSI and corresponding reduction in attributes) for CAMT purposes but tied amounts of exclusion and attribute reduction to corresponding tax CODI.

Notwithstanding, AFS CODI and tax CODI still may not align in timing and amount. Thus, there is still a possibility that a taxpayer could have CAMT liability arising out of AFS CODI in certain cases. For example, if a taxpayer is insolvent or in bankruptcy at a time when tax CODI is triggered, but AFS CODI on the same instrument is triggered in an earlier or later year when the corporation is not insolvent or in bankruptcy. Furthermore, the proposed regulations do not appear to incorporate any parallel to certain rules that can cause tax CODI not to be realized for regular tax purposes (*e.g.*, section 108(e)(2) or section 108(e)(6)).

The proposed regulations would exclude from the definition of a “discharge of indebtedness” (and thus the exclusion from AFSI) indebtedness of a CAMT entity to the extent incurring such indebtedness previously resulted in a reduction in the FSI of the CAMT entity.

### KPMG observation

It is unclear what is intended by this proposed rule as the incurrence of debt, within the meaning of financial accounting rules, generally does not reduce FSI. Furthermore, for regular tax purposes, the cancellation of indebtedness that had previously reduced taxable income (*i.e.*, given rise to a deduction) can still give rise to tax CODI that can be excluded under section 108(a) and reduce attributes under section 108(b). It is unclear why a different rule for AFS CODI would be necessary or appropriate, unless Treasury was concerned that financial accounting rules could change.

## Bankruptcy emergence

In general, “fresh start” accounting applies on a company’s emergence from bankruptcy, pursuant to which the company recognizes financial statement gain (or loss) based on the difference between the historical carrying value of the company’s assets and their current fair market value as of the emergence. Treasury and the Service recognized that the AFS of a company emerging from bankruptcy could include significant FSI from fresh start accounting.

Consistent with the notices, the proposed regulations generally would exclude from FSI gain or loss resulting from a CAMT entity's emergence from bankruptcy (*i.e.*, from fresh start accounting) and require corresponding adjustments to CAMT basis. However, unlike the notices which did not appear to distinguish AFS gain or loss arising from a bankruptcy emergence undertaken in a tax-free or a taxable transaction, the proposed regulations generally cross reference the provisions of Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 to prescribe the CAMT consequences of covered transactions undertaken in connection with the CAMT entity's emergence from bankruptcy.

## Tax consolidated group issues

### In general

The proposed regulations would provide a series of rules to address the application of CAMT to tax consolidated groups. Consistent with the notices, members of a tax consolidated group generally are treated as a single CAMT entity for purposes of determining (1) the AFSI of the tax consolidated group, (2) the tentative minimum tax under section 55(b)(2)(A), and (3) status as an applicable corporation. However, notwithstanding this single-entity framework, the proposed regulations would also call for CAMT calculations on a separate-entity basis. For example, the proposed regulations would require that the CAMT liability of a tax consolidated group be allocated among the members of the tax consolidated group using a formula based on each member's separate positive AFSI. The proposed regulations also would require that, when a member leaves a tax consolidated group, the departing member is allocated an amount of AFSI based on the AFSI it would have generated had it been a separate CAMT entity instead of a member of the tax consolidated group.

#### KPMG observation

The proposed regulations add additional detail to the framework initially previewed in Notice 2023-7, which provided that tax consolidated groups would be treated as a single entity for purposes of calculating AFSI for both scope and liability purposes. Soon after publication of Notice 2023-7, government officials in public forums emphasized that the notice did not call for single-entity treatment for all purposes of CAMT. In that regard, the proposed regulations would require tax consolidated groups to perform calculations on a single-entity basis for certain purposes and make calculations on a separate-entity basis. This will significantly increase CAMT's administrative and compliance burden on tax consolidated groups. Tax consolidated groups should consider the systems and processes they likely will need to put in place to meet these needs.

### Calculating the FSI of a tax consolidated group

The proposed regulations generally follow the rules previewed in the notices for calculating the FSI of a tax consolidated group, while clarifying some uncertainty regarding the location of FSI in the group. If the AFS that includes the tax consolidated group (referred to as the "tax consolidated group AFS") does not include any other CAMT entities (*i.e.*, the tax consolidated group AFS *only* includes the members of the tax consolidated group), then the tax consolidated group's FSI would equal the consolidated FSI reflected on the tax consolidated group AFS. But if the tax consolidated group's AFS also includes the results of other entities, then the FSI of the tax consolidated group would be determined under the rules of Prop. Treas. Reg. § 1.56A-1(c)(3) by treating the tax consolidated group as a single CAMT entity. Thus, AFS consolidation entries between members of the tax consolidated group would generally be regarded, while AFS consolidation entries between members and non-members would be disregarded.

However, upon the occurrence of certain events, AFS consolidation entries that were previously regarded may become disregarded. In general, so long as the transacting members remain members of the tax consolidated group, and so long as the property that was the subject of the transaction remains in the tax consolidated group, the AFS consolidation entries remain regarded. If either of the aforementioned conditions ceases to be satisfied, however, the previously regarded AFS consolidation entries would be

disregarded—that is, the effects of the transaction are taken into account in the tax consolidated group's FSI. In contrast to the notices, examples in the proposed regulations illustrate that, when a previously regarded AFS consolidation entry becomes disregarded, the consequences would be accounted for on a separate-entity basis.

### KPMG observation

Consider property that is sold by S to B, both members of a tax consolidated group, at a \$2x gain, and then by B to Z, a non-member whose financial results are included in the tax consolidated group's AFS, at a \$3x gain. Under the notices, the tax consolidated group had \$5x of FSI without any apparent allocation between the members; under the proposed regulations, S would have \$2x of FSI and B would have \$3x of FSI. Thus, tax consolidated groups would need to diligently maintain records of the financial accounting treatment of intercompany transactions in the event that previously regarded AFS consolidation entries become disregarded in the future. Once again, this has the potential to significantly increase CAMT's administrative and compliance burden on tax consolidated groups.

## Other tax consolidated group rules

The proposed regulations would add several other rules applicable to tax consolidated groups that would both provide clarity and raise additional questions. The proposed regulations would introduce a system of adjustments to CAMT basis to prevent the same economic income or loss from being duplicated upon the disposition of stock in a subsidiary member. The preamble explains that this system, which is intended to mirror the investment adjustment system of Treas. Reg. § 1.1502-32, calls for AFSI calculations to be made on a separate-entity basis. However, the operative rules provide little detail on how exactly these CAMT basis adjustments are determined, and the proposed regulations do not include any examples.

The proposed regulations also provide a series of rules that would ensure that intercompany transactions do not distort the so-called "tax-for-book" adjustments in calculating AFSI, such as those described in section 56A(c)(13) and 56A(c)(14) (regarding the AFSI adjustments for depreciation of section 168 property and amortization of qualified wireless spectrum, respectively).

# Other issues

## Hedging transactions

For financial statement purposes, a CAMT entity may be required to carry certain derivative contracts at fair value with the periodic mark-to-market adjustment reflected in FSI. Comment letters raised concerns about situations in which a derivative contract is used to hedge risk of a related item, and the related item is not carried at fair value. Under these scenarios, there is a timing mismatch in the CAMT entity's FSI even though the derivative contract and related item economically offset one another.

Commenters also requested that guidance address hedging transactions used to manage foreign currency exposure of a net investment in foreign operations. For financial statement purposes, the derivative's mark-to-market adjustment may be included in an equity account (e.g., other comprehensive income ("OCI")) and not impact FSI. However, the derivative contract may be marked-to-market in regular taxable income. As a result, differences can arise between FSI and regular taxable income based solely on the location of the mark-to-market adjustment reported in the AFS.

## Fair value measurement adjustment rule

In order to address these concerns, Treasury provided two rules in Prop. Treas. Reg. § 1.56A-24. The first rule (the “fair value measurement adjustment rule”) would apply if the following two requirements are satisfied: (1) either the “AFSI hedge” or hedged item is marked-to-market in FSI but the corresponding item (*i.e.*, the hedged item or AFSI hedge, respectively) is not marked-to-market in FSI, and (2) neither the AFSI hedge nor the hedged item is marked-to-market in regular taxable income. An AFSI hedge is an asset or liability of a CAMT entity that satisfies certain tax-based hedging definitions or financial statement-based hedging definitions.<sup>27</sup>

If a CAMT entity qualifies to apply the fair value measurement adjustment rule, the mark-to-market adjustment reflected in FSI would be excluded from AFSI. For example, the proposed regulations contain an example where a CAMT entity enters into a commodity forward contract to manage price risk with respect to an asset and such contract meets the definition of an AFSI hedge. In Year 1, the AFSI Hedge is marked-to-market in FSI, but the corresponding hedged item is not, and neither the AFSI Hedge nor the hedged item is marked-to-market in regular taxable income. Under the fair value measurement adjustment rule, the CAMT entity’s AFSI does not include the AFSI hedge’s mark-to-market adjustment in Year 1. Further, as illustrated in another example, in the year that the CAMT entity disposes of the AFSI Hedge or hedged item, or the AFSI hedge no longer qualifies as a hedging transaction for tax or financial accounting purposes, the CAMT entity’s AFSI for the year would include any prior year FSI mark-to-market adjustments. Further, if the CAMT entity continues to retain the AFSI hedge or hedged item that was subject to the fair value measurement adjustment rule, the CAMT entity uses the AFS basis of the AFSI Hedge or hedged item for purposes of computing future AFSI gain or loss.

### KPMG observation

The fair value measurement adjustment rule would only mitigate mismatches to the extent that either the hedging transaction or the hedged item (but not both) is marked-to-market in FSI, and neither are marked-to-market for regular tax purposes. However, distortions can still arise between regular taxable income and AFSI. For example, a hedging transaction can be marked-to-market in regular taxable income without the corresponding hedged item being marked-to-market. If both the hedging transaction and hedged item are marked-to-market in AFSI (or neither is marked-to-market in AFSI), a difference arises from the mark-to-market adjustment recognized in regular taxable income.

For regular tax purposes, the hedge timing rules in Treas. Reg. § 1.446-4 can defer gain or loss from a terminated hedging transaction to the extent the CAMT entity continues to retain the hedged item. However, for AFSI purposes, the fair value measurement adjustment rule would require the CAMT entity to recognize prior year FSI mark-to-market gain or loss in the year the hedging transaction is terminated (regardless of whether the CAMT entity continues to retain the hedged item). In these situations, gain or loss from the hedging transaction may be recognized in AFSI earlier than when it is recognized in regular taxable income.

## Net investment hedge rule

Under the second rule (“the NIH rule”), to the extent a CAMT entity marks-to-market a net investment hedge for regular tax purposes (*e.g.*, under section 1256), gain or loss from such mark-to-market adjustment would

<sup>27</sup> The tax-based hedging definitions include the following: (i) a Treas. Reg. § 1.1221-2(b) hedge (whether or not the character of the gain or loss from the transaction is determined under Treas. Reg. Treas. Reg. § 1.1221-2); (ii) a Treas. Reg. § 1.1275-6 hedge that is part of an integrated transaction subject to § 1.1275-6; (iii) a section 1256(e) hedging transaction; (iv) a section 988(d) hedging transaction that is part of a transaction that is integrated under Treas. Reg. § 1.988-5 or other regulations issued under section 988(d) that govern the character or timing of gain or loss from the transaction; or, (v) a position that is a hedge under section 475(c)(2)(F). The financial statement-based hedging definition is defined as a transaction that qualifies for and is properly treated by the CAMT entity as subject to, hedge accounting and reported on a CAMT entity’s AFS.

be included in AFSI. A “net investment hedge” is an asset or a liability that satisfies the following two requirements: (1) it is entered into by a CAMT entity to manage the foreign currency exposure of a net investment in a foreign operation, and (2) mark-to-market adjustments associated with the asset or liability are included in the CAMT entity’s equity accounts for AFS purposes (e.g., retained earnings or OCI).

In the year in which a net investment hedge subject to the NIH rule matures or is sold, disposed of, or otherwise terminated, or in which the asset or liability that was a net investment hedge ceases to constitute a net investment hedge, the CAMT entity would adjust the amount included in AFSI by the cumulative mark-to-market gain or loss for regular tax purposes that was previously included in AFSI under the NIH rule.<sup>28</sup>

### KPMG observation

It is not clear how the NIH rule would operate if a portion of the net investment hedge is ineffective for financial accounting purposes. While the effective portion of the hedge would generally be marked-to-market in OCI, the ineffective portion of a net investment hedge would be marked-to-market in FSI. It appears that mark-to-market adjustments associated with the ineffective portion should be removed from FSI before taking into account the regular tax mark-to-market adjustment to prevent double counting. However, the proposed regulations do not specifically address this fact pattern.

If the cumulative gain or loss is recognized in FSI in the year the net investment hedge is sold, disposed of, or otherwise terminated, the NIH rule would seem to work as intended (i.e., the operative rule has the effect of not requiring AFSI to recognize additional gain or loss in the year of disposition since those amounts have already been taken into account in prior years). However, if any gain or loss continues to be reflected in the CAMT entity’s equity accounts, the operative rule would seem to result in a distortion of AFSI by such amount.

Impacted taxpayers should consider submitting comments on these issues, along with associated administrative burdens.

## Rules applicable to related party and anti-avoidance transactions

The proposed regulations would provide rules for adjusting AFSI to account for certain related party transactions and CAMT avoidance transactions. Specifically, Prop. Treas. Reg. § 1.56A-26 includes the following three rules:

- **Loss deferral rule:** If two or more related CAMT entities enter into a transaction with respect to property that results in a loss reflected in AFSI of one of the CAMT entities, the loss deferral rule would defer that loss until the property is no longer held by a related party of the CAMT entity. For this purpose, CAMT entities are related if they are included in the same section 52 group.
- **General anti-abuse rule:** The general anti-abuse rule would allow the IRS to recharacterize or disregard arrangements entered into with a principal purpose of avoiding the application of CAMT, including avoiding treatment as an applicable corporation or reducing or otherwise avoiding a CAMT liability.

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<sup>28</sup>If the asset or liability that was a net investment hedge and was subject to the NIH Rule ceases to constitute a net investment hedge but does not mature or is not sold, disposed, or otherwise terminated, the CAMT entity redetermines the CAMT basis of the net investment hedge.

### KPMG observation

The general anti-abuse rule could be viewed as importing the various anti-abuse rules present in the Code and Regulations for regular tax purposes to the CAMT regime. However, the reach of this rule may extend beyond tax into accounting choices more broadly. The proposed regulations do not themselves contain any examples illustrating the operation of the general anti-abuse rule. The preamble, however, suggests that an improper “arrangement” for purposes of this rule would include, for example, the filing of a financial statement with the SEC (or foreign agency equivalent) if such filing is not required, but is made for the purpose of affecting the applicable financial accounting standard under the proposed FPMG rules.

- **Clear reflection of income rule:** The proposed regulations would provide that, with respect to a controlled transaction or controlled transfer between two or more CAMT entities, if any item of income, expense, gain, or loss reflected in the FSI of a CAMT entity does not reflect the principles of section 482 and the regulations thereunder (regardless of whether section 482 is otherwise considered to apply), the CAMT entity must make appropriate adjustments to its AFSI and CAMT basis.

### KPMG observation

While the text in Prop. Treas. Reg. § 1.56A-26(d)(1) states that adjustments should be made to the CAMT basis of the CAMT entity, this appears to be a mistake. The example in Prop. Treas. Reg. § 1.56A-26(d)(3), which involves the sale of a self-created intangible by a CFC to its U.S. parent, makes clear that the appropriate adjustment would be made to the AFSI of the *selling* CAMT entity.

The clear reflection of income rule is similar to Article 3.2.3 of the GloBE Model Rules, which requires that transactions between constituent entities of the same multinational enterprise group that are located in different jurisdictions reflect arm's length principles. While the need to apply arm's length principles is not as obvious in CAMT as it is for GloBE—CAMT is generally a worldwide regime whereas GloBE is country-by-country—Treasury could be concerned with taxpayers converting AFSI into ANI, which could allow an applicable corporation to credit more CFC taxes (or use more of a CFC adjustment carryover), or accelerating taxable income while deferring AFSI. In any case, the clear reflection of income rule would more closely align the CAMT consequences of a related party transaction with the regular tax consequences of the transaction.

## Comments adopted, comments requested, and comment period

The preamble to the proposed regulations includes at least 40 requests for comments, and any comments must be submitted within 90 days after the date of publication in the Federal Register (*i.e.*, by December 12, 2024). See the Appendix for a list of comments requested. Additionally, Treasury announced that a public hearing on the proposed regulations is tentatively scheduled to be held on January 16, 2025, at 10 a.m. Eastern Time (ET). Requests to speak and outlines of topics to be discussed at the hearing must also be received by December 12, 2024. Requests to attend the public hearing must be received by 5 p.m. ET on January 14, 2025.

Due to the large number of issues left unaddressed by the proposed regulations (as well as new issues created), taxpayers should consider submitting additional requests to Treasury during the proposed regulations comment period requesting relief for some of the more burdensome aspects of CAMT computations and CAMT processes, as well as clarity on issues which still remain uncertain after the

issuance of the proposed regulations. The discussion above notes some of the areas we believe taxpayers should strongly consider offering comments.

# Conclusion

As noted above, the proposed regulations do little to alleviate taxpayer concerns about the complexity of the CAMT regime, and continue to present vast administrative and compliance burdens, lend themselves to varied interpretations, and leave many issues unclear. Furthermore, a number of the rules in the proposed regulations could increase the number of applicable corporations or otherwise increase, perhaps materially, an applicable corporation's CAMT liability. Taxpayers—whether or not they expect to be applicable corporations—should carefully study the proposed regulation package, determine if they want to submit comment letters (due December 12, 2024), and plan for the additional resources their tax (and non-tax) departments will need to comply with the CAMT regime on a go-forward basis. Tax departments should keep their C-suites apprised as to the potential costs—both from an administrative and potential liability standpoint—of the CAMT regime. Such costs of this massively complex and parallel regime have the potential to be significant.

# Appendix

## Comments requested in proposed regulations

### General

1. The Treasury Department and IRS request comments on all aspects of the proposed regulations.

### Prop. Treas. Reg. § 1.56A-2: Applicable financial statement (AFS)

2. Comments are requested on whether additional examples are necessary to illustrate other cases in which a financial statement is used for a substantial non-tax purpose.

### Prop. Treas. Reg. § 1.56A-4: AFSI adjustments and basis determinations with respect to foreign corporations

3. The Treasury Department and the IRS are considering whether rules specific to passive foreign investment companies would be appropriate in Prop. Treas. Reg. § 1.59-4 (CAMT foreign tax credit), including rules similar to the rules in section 1291(g)(1)(C)(ii) in respect of foreign taxes paid by section 1291 funds and rules similar to the rules in section 1293(f) in respect of foreign taxes paid by qualifying electing funds. Comments are requested.
4. Comments requested on the proposed rule for AFSI adjustments in certain cases in which basis in foreign stock is determined under section 358 whether alternatives should be further considered.
5. Comments requested on Prop. Treas. Reg. § 1.56A-4(g), including whether it is appropriate to limit the rule to related party partnerships and whether rules are needed to prevent duplications to AFSI for distributions of foreign stock by a partnership where the distributee partner decreases the basis for regular tax purposes of the distributed foreign stock pursuant to section 732(a)(2) or (b).

### Prop. Treas. Reg. § 1.56A-5: AFSI adjustments for partner's distributive share of partnership AFSI

6. Comments requested on more precise methods that could be used to calculate a CAMT entity's distributive share percentage, including in the circumstances where a CAMT entity that uses the hypothetical liquidation at book value method under the equity method to account for its partnership investment for AFS purposes, treats itself as a non-AFS partner, or treats itself as owning 100% of the equity in the partnership because the CAMT entity treats all other partners in the partnership as non-AFS partners.
7. Comments requested on whether AFSI with respect to a non-AFS partner's partnership investment should be determined other than by use of a distributive share percentage and the applicable method, including in situations where more than one CAMT entity is a non-AFS partner in the partnership.
8. Comments requested on whether exceptions to the reporting requirements should apply for partnerships that meet certain criteria.
9. If a partnership is exempt from some or all of the reporting requirements outlined in Prop. Treas. Reg. § 1.56A-5(i), comments requested on how a partner in the partnership would determine its distributive share of AFSI with respect to its partnership investment.
10. Comments requested regarding the application of the requirement in Prop. Treas. Reg. § 1.56A-5(i)(3) that a partnership provide information requested by a partner by the date prescribed under section 6031(b) of the Code for filing its partnership return when the partnership to which the request is made is a UTP or LTP in a tiered partnership structure.

11. Comments requested regarding the application of the ordering rule in Treas. Reg. § 1.704-1(d)(2) and whether more specific ordering rules are needed for purposes of applying the loss limitation rule for negative distributive share amounts.

### Prop. Treas. Reg. § 1.56A-15: AFSI adjustments for section 168 property

12. Comments requested on whether the AFSI adjustments with respect to section 168 property should take into account or otherwise reflect the repair expenditures with respect to section 168 property that are deducted for regular tax purposes but capitalized and depreciated for AFS purposes.

### Prop. Treas. Reg. § 1.56A-17: AFSI adjustments to prevent certain duplications and omissions

13. Comments requested on whether additional adjustments are necessary to prevent duplications or omissions of items under section 56A.
14. Comments requested about whether a spread period greater than 15 years is necessary for an accounting principle change amount that prevents duplication.
15. Comments requested on Prop. Treas. Reg. § 1.56A-17(c)(4) and whether and to what extent the rules and concepts provided in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, that accelerate the recognition of a section 481(a) adjustment in certain circumstances should apply to accelerate the recognition of an accounting principle change amount (without suggesting that an accounting principle change is inherently also a tax accounting method change).

### Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19: AFSI, CAMT basis, and CAMT retained earnings resulting from certain corporate transactions involving domestic corporations

16. Comments requested on whether additional guidance is needed under Prop. Treas. Reg. §§ 1.56A-18 and 1.56A-19 for shareholders in corporations that appear on the same consolidated AFS as the shareholder but that do not file a consolidated federal income tax return with the shareholder.

### Prop. Treas. Reg. § 1.56A-20: AFSI adjustments to apply certain subchapter K principles

17. Comments requested on the events in the proposed regulations that require an acceleration of a partner's remaining deferred distribution gain or loss and whether additional rules are needed to determine whether a partnership has sold or exchanged substantially all of its assets.

### Prop. Treas. Reg. § 1.56A-22: AFSI adjustments for certain insurance companies and other specified industries

18. Comments requested on whether the rule in Prop. Treas. Reg. § 1.56A-22(d)(3) appropriately describes the circumstances (under GAAP, IFRS, and other generally accepted accounting standards) in which the general rule in Prop. Treas. Reg. § 1.56A-22(d)(1) should not apply.

### Prop. Treas. Reg. § 1.56A-23: AFSI adjustments for financial statement net operating losses and other attributes

19. Stakeholders have observed that this disparity could create a substantial mismatch between AFSI and regular taxable income for nonlife insurance companies that does not exist for other corporations. Comments requested on how substantial this mismatch may be and the severity of the economic effects of such mismatch, whether rules should be provided to address this potential mismatch, and how the rules might operate.

### Prop. Treas. Reg. § 1.56A-24: AFSI adjustments for hedging transactions and hedged items

20. The proposed rules address the situations described by stakeholders in which one component of a transaction is periodically measured at fair value and reflected in FSI in a CAMT entity's AFS, but a related asset or liability is not, without a corresponding mismatch in treatment for regular tax purposes. Comments requested on whether there are other similar situations potentially giving rise to a substantial mismatch for which a similar adjustment to AFSI may be appropriate.

### Prop. Treas. Reg. § 1.56A-25: AFSI adjustments for mortgage servicing income

21. While this NPRM does not include proposed regulations under section 56A(c)(10)(B), the Treasury Department and the IRS continue to study the issue and invite comments concerning whether regulations should be issued pursuant to this specific grant of regulatory authority.

### Prop. Treas. Reg. § 1.59-2: General rules for determining applicable corporation status

22. For purposes of applying the \$1,000,000,000 average AFSI threshold test in Prop. Treas. Reg. § 1.59-2(c)(2)(i)(A), an FPMG corporation that is a foreign corporation and any relevant aggregation entity that is not a United States person (as defined in section 7701(a)(30)) would not make any AFSI adjustment described in the section 56A regulations that is dependent on the treatment of an item for regular tax purposes, such as for depreciation (see section 56A(c)(13) and Prop. Treas. Reg. § 1.56A-15), if the FPMG corporation or relevant aggregation entity, as applicable, does not take such item into account for regular tax purposes. This rule is intended to lessen the burden of determining AFSI when there is no regular tax treatment of an item while ensuring that the item is taken into account. The Treasury Department and the IRS invite comments on the rule.
23. The Treasury Department and the IRS are studying whether additional guidance is needed to carry out the purposes of Prop. Treas. Reg. § 1.59-2(c)(2)(ii)(F), including guidance on determining when an item is attributable to FSI. The Treasury Department and the IRS welcome comments on this matter.

### Prop. Treas. Reg. § 1.59-4: Rules for determining the CAMT FTC

24. Comments requested on additional rules that may be appropriate in determining an applicable corporation's pro rata share of eligible current year taxes where the applicable corporation takes into account a qualified deficit of a CFC under section 951(c)(1)(B) impacting the determination of eligible current year taxes that are deemed paid by the applicable corporation under Treas. Reg. § 1.960-2(b) for regular tax purposes.

## Prop. Treas. Reg. § 1.1502-56A: Application of CAMT to consolidated groups

25. The Treasury Department and the IRS are considering whether CFC adjustment carryovers generated in a separate return year should be subject to more expansive limitations similar to the limitations in Prop. Treas. Reg. § 1.56A-23(e), which currently are proposed to apply to FSNOLs and certain built-in items. Comments requested.

## CAMT entities subject to tonnage tax

26. Comments requested on whether to provide rules addressing the interaction of the CAMT and the tonnage tax, including comments on how best to provide AFSI adjustments to meet the United States national security policy goals of the tonnage tax regime and the MSP while appropriately imposing the CAMT with respect to other AFSI of such entities.

## Transition rules and AFSI-only change procedures

27. Comments requested as to whether the transition year rules should address which AFSI adjustments represent an AFSI timing difference and how such determination should be made.

28. Comments requested as to whether there are circumstances where a transition year adjustment should be entirely taken into account, with no spread period, in the transition year.

29. Comments requested on the scope of AFSI adjustments, and related CAMT attributes, that should be subject to the transition year adjustment to prevent the duplication or omission of the CAMT entity's AFSI.

30. To the extent transition rules are provided allowing transition year adjustments to be spread, the Treasury Department and IRS request comments as to whether the applicable spread period should be determined separately for each AFSI adjustment or if certain AFSI adjustments (for example, all adjustments to AFSI for section 168 property under Prop. Treas. Reg. § 1.56A-15) should be combined into a net transition year adjustment for purposes of determining the applicable spread period.

31. Comments requested on the application of the transition year adjustment approach to a CAMT entity that is a partner in a partnership to which this approach would apply.

32. Comments requested as to whether special rules are needed for the transferor or transferee in certain transactions subject to Prop. Treas. Reg. § 1.56A-18, 1.56A-19, or 1.56A-20 where the CAMT entity no longer holds the property and accounted for its disposition in a tax year not subject to the final regulations to prevent the duplication or omission of the transferor's or transferee's AFSI related to the transaction.

33. Comments requested on the scope of AFSI adjustments and CAMT attributes that should be subject to a cut-off basis transition approach and the application of such transition approach to a CAMT entity that is a partner in a partnership to which this transition approach would apply.

34. For instances where the CAMT basis of an asset may be subject to a "fresh start" transition approach, the Treasury Department and the IRS request comments as to whether the CAMT basis should be based on amounts other than the amounts that should have been reflected in AFSI in prior years under the final rules, such as the actual amounts reflected in AFSI in prior years.

35. If AFSI in prior years reflected excess amortization because the CAMT basis of an amortizable asset exceeded what the CAMT basis would have been had the final regulations applied, comments requested as to whether the redetermined CAMT basis should reflect a reduction for the actual amortization reflected in AFSI in prior years or if the redetermined CAMT basis should instead reflect a reduction for the amortization that would have been reflected in AFSI under the final rules.
36. Comments requested on the scope of CAMT attributes that should be subject to a “fresh start” transition approach as well as the application of such an approach to a CAMT entity that is a partner in a partnership to which this transition approach would apply.
37. Comments requested on the three transition approaches, as well as other approaches for handling changes in the treatment of an item to comply with the final regulations.
38. The Treasury Department and the IRS are evaluating whether consent procedures similar to those required for changes in method of accounting under section 446(e) and Rev. Proc. 2015-13 should apply to an AFSI-only change and request comments on this issue, as well as other approaches for implementing AFSI-only changes.
39. Comments requested on the scope of AFSI-only items that should be subject to the consent procedures (if implemented).
40. Comments requested on the criteria to be applied by a CAMT entity to determine whether it has established a consistent treatment for an AFSI-only item and, thus, is eligible for an AFSI-only change (for example, whether a CAMT entity needs to treat an AFSI-only item in an impermissible manner for a single tax year, or multiple tax years, before it may apply the procedures for making an AFSI-only change).
41. Comments requested on the consent procedure terms and conditions that should apply for making an AFSI-only change, including audit protection and the spread period of the corresponding adjustments to AFSI to implement the AFSI-only change.

## Proposed applicability dates and reliance on the proposed regulations

42. Comments requested regarding whether a different applicability date should apply for purposes of applying any specific provision of the proposed regulations.

## CAMT resources

KPMG has published various reports and articles on such guidance to date:

- [CAMTyland Adventures, Part I: How to Play the Game — Corporate Alternative Minimum Tax Basics | Tax Notes;](#)
- [CAMTyland Adventures, Part II: 'Right-Sizing' in the Licorice Lagoon | Tax Notes;](#)
- [CAMTyland Adventures, Part III: 2023 Scope Bubble Corporations — Lost in Lollipop Woods | Tax Notes;](#)
- [CAMTyland Adventures, Part IV: Retroactive Tax Extenders — Planning for a Move-Backward Card | Tax Notes;](#)
- [CAMTyland Adventures, Part V: Coping with CAMTyland Grief | Tax Notes;](#)
- [KPMG report: Initial observations of Notice 2023-7;](#)
- [KPMG report: Observations from Notice 2023-20;](#)
- [KPMG report: Initial observations on round 4 of CAMT guidance in Notice 2023-64;](#)
- [KPMG report: Key takeaways from recent CAMT releases - KPMG United States;](#)
- [KPMG report: Changes to instructions for Schedule K-1 - KPMG United States;](#) and

- [KPMG's Form 4626 TaxNewsFlash.](#)

Further background information on CAMT is available on a dedicated [KPMG website.](#)<sup>29</sup>

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<sup>29</sup> See, e.g., [KPMG Estimated Payment Comment Letter](#); [KPMG Foreign Tax Credits Comment Letter](#); [KPMG Treatment of M&A Transactions Comment Letter](#); [KPMG Depreciation Comment Letter](#); [KPMG Comment Letter Relating to the Distributive Share of Partnership Adjusted Financial Statement Income](#); [KPMG Comment Letter Relating to Application of CAMT Adjustments under Notice 2023-7 to the Distributive Share of Partnership Adjusted Financial Statement Income](#); [KPMG Comments on the Treatment of CFC Dividends and Partnership Taxes](#) for KPMG-authored comment letters.

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