



March 27, 2023

The Honorable Lily Batchelder  
Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Mr. William Paul  
Principal Deputy Chief Counsel  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Mr. Brett York  
Deputy Tax Legislative Counsel  
Department of the Treasury  
1500 Pennsylvania Ave, NW  
Washington, DC 20020

**RE: Comments on Notice 2023-7 – Initial Guidance Regarding the Application of the Corporate Alternative Minimum Tax under Sections 55, 56A, and 59 of the Internal Revenue Code**

Dear Ms. Batchelder, Mr. Paul, and Mr. York:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) in providing interim guidance in [Notice 2023-7](#) (“the Notice”) regarding time-sensitive issues intended to be addressed by the forthcoming proposed regulations. The Notice addresses how the Corporate Alternative Minimum Tax (CAMT) applies to corporations, certain partnerships, troubled companies, and affiliated groups of corporations that file consolidated tax returns. The interim rules also address determining CAMT adjustments for depreciation and the treatment of federal income tax credits, as well as providing a safe-harbor method for determining whether a corporation is an applicable corporation subject to CAMT.

The below comments and recommendations identify and provide additional information to Treasury and the IRS regarding CAMT guidance provided in the Notice and for rules not included in the Notice. We offer these CAMT comments in addition to our letters previously submitted to Congress on October 28, 2021<sup>1</sup> and June 21, 2022<sup>2</sup> and our October 14, 2022 comments to Treasury and IRS requesting immediate guidance on the CAMT rules.<sup>3</sup>

---

<sup>1</sup> See AICPA Letter, “[Corporate Profits Minimum Tax in Reconciliation Being Considered](#),” October 28, 2021.

<sup>2</sup> See AICPA Letter, “[AICPA Comments on the Corporate Profits Minimum Tax in Reconciliation Being Considered](#),” June 21, 2022.

<sup>3</sup> The AICPA submitted pre-release comments to IRS and Treasury on CAMT. See: “[AICPA Comments on the Corporate Alternative Minimum Tax Needed Immediate Guidance](#),” October 14, 2022.

## **SPECIFIC COMMENTS**

Our attached comments include the following recommendations:

### **1. Financial Reporting and Accounting for Income Taxes**

- **Clarify that items within Other Comprehensive Income (OCI) and similar unrealized gain/losses are not included in calculating AFSI**
  - Additional guidance should be issued to clarify that items within OCI are not included in AFS net income or loss and thus are not included in calculating AFSI.
  - Similar exceptions should be provided for other unrealized gain/loss unless the unrealized gain/loss relates to property market to market for tax purposes under section 475.
- **Issue guidance providing that items of unrealized gain or loss related to mark to market adjustments are not included in calculating AFSI**
  - Treasury and IRS should provide that AFSI does not include mark to market unrealized gains and losses to the extent such gains and losses do not relate to property that is marked to market for federal income tax purposes.
  - In addition, Treasury and IRS should clarify the application of this rule in the context of investments in corporations that are not included in the consolidated return with the taxpayer and not marked to market for tax purposes. In accordance with section 56A(c)(2)(C), any unrealized gain or loss from marking these investments to market in the AFS should not be included in AFSI. Instead, the taxpayer should only take into account dividends received from such corporation and other amounts includible in gross income or deductible as a loss for federal income tax purposes with respect to such corporation. A similar rule should be provided in the context of investments in partnerships that are marked to market for AFS purposes but not for tax purposes.

### **2. Passthrough Issues**

- **Clarify the scope of the exception in section 59(k)(1)(D) to the Distributive Share Adjustment**
  - We agree with Section 7.02 of the Notice; however, guidance should further provide that when a corporate partner consolidates a partnership for financial accounting purposes but is not related to the partnership under section 52(b), the corporation may still remove financial statement net income or loss attributable to noncontrolling interests (“NCI”) for purposes of the applicable corporation status determination.
  - In addition, guidance should clarify whether a corporate partner that does not consolidate a partnership for financial accounting purposes and is not related to a

partnership under section 52(b) uses its financial statement net income or loss with respect to the partnership for the applicable corporation test (i.e. with no other section 56A adjustments).

- **Provide a flexible approach to the meaning of “Distributive Share” for purposes of section 56A(c)(2)(D)(i)**
  - Similar to our October 14, 2022 prior comment letter,<sup>4</sup> a flexible approach that allows a partnership to determine its partners’ distributive shares of partnership AFSI using any reasonable method should be allowed. Guidance should provide examples of methods that may be considered reasonable and not reasonable.
  - Reasonable methods may include, for example, allocating AFSI in accordance with the percentage share of net section 704(b) income or loss, the percentage share of net taxable income or loss, the percentage share of financial statement income (if applicable), in accordance with the principles of section 704(b) but using financial statement amounts instead of section 704(b) amounts, or an allocation method that accounts for special allocations of specific partnership items under the partnership agreement. The method chosen by the partnership should be applied consistently (unless the Secretary expressly permits or requires a change in methodology) for purposes of both computing the CAMT and determining applicable corporation status.
- **Allow adjustments to AFSI with respect to part recognition partnership transactions**
  - To the extent a subchapter K transaction is a recognition transaction in part (whether under section 707(a)(2)(B) or otherwise), a corresponding portion of the financial statement net income or loss (if any) should be adjusted for purposes of determining AFSI from the transaction and on a prospective basis.
- **Clarify that unrealized gains and losses on partnership interests are excluded from AFSI, and that realized gains and losses on partnership interests are included in AFSI**
  - Clarify that mark to market gains and losses with respect to partnership interests, held directly or indirectly by a corporation through a tiered partnership structure, are not included in a corporation’s AFSI until recognized.
  - Clarify that realized gains and losses with respect to partnership interests, held directly or indirectly by a corporation through a tiered partnership structure, are included in a corporation’s AFSI when recognized for AFSI purposes (i.e., taking into account the principles of other guidance addressing timing of recognition of gain and loss for AFSI purposes, such as Covered Nonrecognition Transaction under Notice 2023-7).

---

<sup>4</sup> See [“AICPA Comments on the Corporate Alternative Minimum Tax Needed Immediate Guidance,”](#) October 14, 2022.

- **Aggregation of S Corporation Financial Statement Income with C Corporation Financial Statement Income**
  - Clarify that under section 59(k)(1)(A) an excluded corporation cannot be part of a single employer group under section 52(a) or section 52(b) for purposes of the CAMT.

### 3. General Concepts and Methods & Periods

- **Define Tax Cost of Goods Sold (COGS) Depreciation as the amount of depreciation allowance with respect to Section 168 Property capitalized to the basis of inventory during the tax year**
  - Under the existing rule, Treasury and IRS should confirm taxpayers are allowed to compute the amount of Tax COGS Depreciation using a method consistent with the taxpayer's section 263A method, including the simplified methods.
  - In addition, we recommend that Treasury and IRS offer an alternative method that defines Tax COGS Depreciation as the amount of the depreciation allowance with respect to Section 168 Property capitalized to inventory in the current tax year rather than the amount recovered through COGS in the current tax year.
- **Provide a safe harbor election for taxpayers to only take into account basis differences of Section 168 Property in the year the property is disposed of when basis differences are immaterial**
  - Taxpayers should be permitted to make a *de minimis* safe harbor election to forgo annually adjusting AFSI for unadjusted basis differences of Section 168 Property when the cumulative difference in basis between book and tax of all Section 168 Property of the same recovery period placed in service during the tax year is 5 percent or less of the taxpayer's AFS basis in the property. The election may be made annually for each separate recovery period and is binding on the taxpayer once made.
- **Allow taxpayers to adjust AFSI for amounts deducted for tax purposes that are included in book depreciation with respect to Section 168 Property for AFS purposes**
  - Taxpayers should be allowed to reduce AFSI for "Covered Tax Expenses," defined as costs deducted for federal income tax purposes that are capitalized into the basis of Section 168 Property for AFS purposes.
  - Taxpayers should be allowed to include the amount of repairs expenditures incurred during the tax year in Tax Depreciation if those costs are capitalized for AFS purposes in order to simplify the computation of a taxpayer's AFSI.

- **Clarify that Section 168 Property includes the full basis of bonus-eligible property**
  - Treasury and IRS should clarify that the Section 168 Property is the entire basis of bonus-eligible property, including the amount of basis not subject to the special allowance for bonus depreciation.
- **Allow basis differences in Section 168 Property due to tax credits to not be treated as Section 168 Property**
  - We recommend that AFSI should not be increased for Book Depreciation claimed on Section 168 Property to the extent a tax credit is claimed with respect to that basis.
- **Clarify the duration (if any) required under section 59(k)(1)(C)(i)(II) before an applicable corporation should be treated as no longer an applicable corporation**
  - Provide a rule whereby a corporation would be excepted from applicable corporation status if it fails an AFSI test for the 3-taxable-year period preceding a relevant tax computation year.
- **Provide a simplified method to determine if a taxpayer is an applicable corporation**
  - Provide a safe-harbor method similar to the Simplified Method and may be applied beyond a corporation's first tax year beginning after December 31, 2022.
  - Provide a new simplified method, or modify the safe harbor, to allow taxpayers to use the full \$1 billion or \$500 million thresholds where appropriate, but without any AFSI adjustments or without any AFSI adjustments that relate to adjusting AFSI net income or loss to reflect certain federal income tax principles (e.g., depreciation, pension).
- **Modify the rules under section 451(b)(5) for purposes of determining the AFSI of a corporation included in an AFS Group**
  - Provide priority rules like those set forth in Treas. Reg. § 1.451-3(a)(5) that identify a taxpayer's relevant AFS, but eliminate the requirement that a taxpayer must use a separate statement if of equal or higher priority to the consolidated statement in favor of using a consistent financial accounting standard for members of a tax consolidated group.
  - Eliminate requirement that separately stated items on a consolidated AFS take priority over the taxpayer's separate source documents used for the consolidated AFS.
  - Consistent with the reference in section 56A(c)(2)(A) to section 451(b)(5), provide a rule similar to Treas. Reg. § 1.451-3(h)(3) that allows taxpayers to compute AFSI from separate source documents that were used to create the consolidated AFS

when the AFS includes entities that are not members of the taxpayer's consolidated group.

- Provide examples of source documents and information that taxpayers could use to determine net income or loss allocable to the taxpayer.
  - Confirm AFSI should include elimination entries in the AFS only to the extent that the entries relate to transactions between and within members of the tax consolidated group.
- **A change in AFSI financial accounting principle not otherwise affecting taxable income should be treated as a change in fact for purposes of the CAMT**
    - Provide guidance stipulating that changes in financial accounting principle for purposes of determining AFS net income or loss are changes in fact and a change in method of accounting under section 446(e) is not necessary.
  - **Tax accounting method changes related to AFSI adjustments (e.g., change in method of accounting for depreciation or pensions) are changes in method of accounting for CAMT purposes**
    - Treat CAMT as a separate but parallel tax system, similar to the treatment of the former alternative minimum tax system.
    - Provide that changes in method of accounting for taxable income purposes for items that are treated as AFSI adjustments (e.g., depreciation, pension) also are treated as changes in method of accounting for CAMT purposes. As such, sections 446 and 481 apply for both regular tax and CAMT purposes.
    - Allow method changes to be made solely for purposes of AFSI when an item is properly treated for regular taxable income purposes but not properly treated for CAMT.

#### 4. Mergers & Acquisitions Issues

- **Modify the definition of Covered Nonrecognition Transaction and the scope of the adjustments**
  - The definition of Covered Nonrecognition Transaction should include these types of transactions with respect to the retained noncontrolling interest of stock to the extent that there is not a realization event for federal income tax purposes.
  - The Nonrecognition Adjustment and the Basis Adjustment should only apply to Covered Nonrecognition Transactions that have both adjustments. The Nonrecognition Adjustment and the Basis Adjustment should apply to any Party of a Covered Nonrecognition Transaction.
  - The definition of Covered Nonrecognition Transaction should exclude transactions that may technically qualify for nonrecognition treatment under the specified Code sections, but at the same time, do not result in the omission or duplication of an

item in AFSI and do not conflict with the principles of part II of subchapter C (sections 331 through 346) and part III of subchapter C (sections 351 through 368).

- The Nonrecognition Adjustment and the Basis Adjustment should not be applied unless they prevent the omission or duplication of any item and are needed to carry out the principles of subchapter C and subchapter K as specified in section 56A(c)(15).
- **Clarify definition of predecessor for section 59(k)(1)(E)**
  - The regulations should clarify whether there is a difference in determining a predecessor if Target is a member of a tax consolidated group. If a member of a tax consolidated group is tested as a single entity, the regulations should clarify other situations that a member of a tax consolidated group is treated as a single entity for CAMT purposes, if any.
  - In addition, that guidance should define whether for these purposes a predecessor is limited to taxpayers that are corporations, or if the term could also include partnerships.
- **Provide allocation of financial statement NOL carryovers to a departing member**
  - Treasury and the IRS should provide guidance to taxpayers detailing how accrued financial statement NOL carryovers should be allocated between a departing member and its AFS Group.
    - We suggest that financial statement NOL carryovers should be allocated between a departing member and its AFS Group in the same manner that consolidated NOLs are allocated between a group of corporations filing a consolidated return (a “consolidated group”) and a departing member under Treas. Reg. §1.1502-21.
- **Provide guidance on acquisition of Section 168 Property in Covered Recognition Transactions and Covered Nonrecognition Transactions**
  - If future guidance does not modify AFSI to mirror the federal income tax treatment of a Covered Recognition Transaction involving a taxable stock acquisition, Treasury and IRS should disregard any increase or decrease in the AFS basis of Section 168 Property that is not taken into account for federal income tax purposes for purposes of determining a corporation’s AFSI.
  - Future guidance should clarify that the basis adjustment rule of section 3.03(2) of the Notice applies to any property that is acquired *directly or indirectly* by the Party as part of a Covered Nonrecognition Transaction.
- **Modify the Notice Cancellation of Indebtedness Income (CODI) approach**
  - Book CODI should be disregarded in computing AFSI, with AFSI instead adjusted to take into account Tax CODI when and to the extent recognized for tax purposes

(“Imported Book CODI”), with a corresponding reduction to CAMT attributes in the amount of the Imported Book CODI that is excluded from income under section 108 (which becomes a black hole to the extent the Imported Book CODI exceeds available CAMT attributes).

- Guidance should clarify that Book CODI (if any) resulting from debt that is purely intercompany between members of a federal income tax consolidated group is disregarded, consistent with the provision in the Notice indicating that a consolidated group should be treated as a single entity for CAMT purposes.
  
- **Adopt the Notice approach for Fresh Start accounting from bankruptcy**
  - The approach taken in the Notice should be adopted (i) for scope purposes; (ii) when a troubled company restructuring does not create a recognition event for tax purposes.
  - When a troubled company restructuring involves a taxable transaction for federal income tax, any asset gain or loss or basis adjustments that result from that taxable transaction under Book should be retained for CAMT purposes.
  
- **Apply principles of federal income tax and section 382 and section 383 and SRLY to limit CAMT attributes for tentative minimum tax**
  - The principles provided in sections 382 and section 383, and SRLY should apply to limit the availability of CAMT attributes for purposes of calculating the tentative minimum tax.
  - When an ownership change occurs for section 382 purposes, and the amount of the limitations, should be based on federal income tax principles.

\* \* \* \* \*

The AICPA is the world’s largest member association representation the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact George Manousos, Chair, AICPA Corporate AMT Task Force at (202) 302-0942 or [george.manousos@pwc.com](mailto:george.manousos@pwc.com); Reema Patel,



The Honorable Lily Batchelder, Mr. William M. Paul, and Mr. Brett York

March 27, 2023

Page 9 of 9

Senior Manager - AICPA Tax Policy & Advocacy, at (202) 434-9217, or [Reema.Patel@aicpa-cima.com](mailto:Reema.Patel@aicpa-cima.com); or me at (601) 326-7119 or [JanLewis@HaddoxReid.com](mailto:JanLewis@HaddoxReid.com).

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Lewis". The signature is fluid and cursive, with the first name "Jan" being more prominent and the last name "Lewis" following in a similar style.

Jan Lewis, CPA  
Chair, AICPA Tax Executive Committee

cc: The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service  
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
Mr. Timothy Powell, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury  
Mr. Colin Campbell, Attorney-Advisor, Office of Tax Policy, Department of the Treasury  
Mr. Scott Vance, Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service  
Ms. Julie Hanlon-Bolton, Deputy Associate Chief Counsel, Income Tax & Accounting, Internal Revenue Service  
Mr. Russell Jones, Special Counsel, Corporate, Internal Revenue Service  
Mr. William Burhop, Senior Technician Reviewer, Corporate, Internal Revenue Service

## AMERICAN INSTITUTE OF CPAs

### **Comments on Notice 2023-7 – Initial Guidance Regarding the Application of the Corporate Alternative Minimum Tax (CAMT) under Sections 55, 56A, and 59 of the Internal Revenue Code (IRC)**

**March 27, 2023**

Our comments cover the following issues:

1. Financial Reporting and Accounting for Income Taxes
2. Passthrough Issues
3. General Concepts and Methods & Periods
4. Mergers & Acquisitions Issues

#### **SPECIFIC COMMENTS**

##### **1. Financial Reporting and Accounting for Income Taxes**

- **Clarify that items within Other Comprehensive Income (OCI) and similar unrealized gain/losses are not included in calculating AFSI**

- Overview

- The Notice asks (16) To what extent (if any) should items included in OCI in a taxpayer's AFS be included in AFSI?
- [FASB Master Glossary](#) defines Other Comprehensive Income as revenues, expenses, gains, and losses that under generally accepted accounting principles (GAAP) are included in comprehensive income but excluded from net income.
- OCI reflects revenues, expenses, gains, and losses that have yet to be realized. ASC 220-10-45-10A notes items of other comprehensive income include the following:
  - Foreign currency translation adjustments (see paragraph 830-30-45-12).
  - Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date (see paragraph 830-20-35-3(a)).
  - Gains and losses on intra-entity foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting entity's financial statements (see paragraph 830-20-35-3(b)).
  - Gains and losses on derivative instruments that are designated as, and qualify as, cash flow hedges (see paragraph 815-20-35-1(c)).

- For derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognized in earnings under a systematic and rational method in accordance with paragraphs 815-20-25-83A and 815-35-35-5A.
  - Unrealized holding gains and losses on available-for-sale debt securities (see paragraph 320-10-45-1).
  - Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category (see paragraph 320-10-35-10(c)).
  - Amounts recognized in other comprehensive income for debt securities classified as available-for-sale and held-to-maturity related to an other-than-temporary impairment recognized in accordance with Section 320-10-35 if a portion of the impairment was not recognized in earnings.
  - Subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of available-for-sale debt securities previously written down as impaired (see paragraph 320-10-35-18).
  - Gains or losses associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j)).
  - Prior service costs or credits associated with pension or other postretirement benefits (see paragraph 715-20-50-1(j)).
  - Transition assets or obligations associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j)).
  - Changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected (see paragraph 825-10-45-5).
- Section<sup>1</sup> 56A(a) states that AFSI means the net income or loss of the taxpayer set forth on the taxpayer's AFS with adjustments

○ Recommendations

- Additional guidance should be issued to clarify that items within OCI are not included in AFS net income or loss and thus are not included in calculating AFSI.
- Similar exceptions should be provided for other unrealized gain/loss unless the unrealized gain/loss relates to property market to market for tax purposes under section 475.

---

<sup>1</sup> Unless otherwise indicated, all references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (IRC or the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

- Analysis
  - A fundamental premise of general tax accounting principles is to tax gains that are clearly realized. See, e.g., *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955) and *United States v. Gotcher*, 401 F.2d 118 (5<sup>th</sup> Cir. 1968). Requiring taxpayers to include unrealized gains and losses in AFSI and potentially pay CAMT on those gains is inconsistent with this fundamental premise.
  - The financial accounting gain or loss in OCI resulting from the application of the accounting standards used to prepare the AFS of the AFS Group should not be taken into account for purposes of calculating AFSI to the extent it is excluded for federal income tax purposes. Items included in OCI generally represent unrealized revenue, unrealized expenses, unrealized gains and unrealized losses. These items generally reside in OCI, not in net income or loss, and get realized in the income statement when recognition is triggered under the applicable accounting standard. Including these unrealized financial accounting gains or losses in OCI in the calculation of AFSI when unrealized, and then again in the AFS income or loss when realized, could result in duplication.
  - Treasury and IRS also should consider providing similar rules for other unrealized gains or losses that are recognized in AFS net income or loss, but do not relate to property that is marked to market for tax purposes.
  - We note that [Notice 2023-20](#) addressed certain matters within the insurance industry and includes an example to disregard unrealized gain or loss for purposes of determining AFSI, and suggest the policy of not taxing unrealized gains inherent in that Notice be expanded to other appropriate areas.
- **Issue guidance providing that items of unrealized gain or loss related to mark to market adjustments are not included in calculating AFSI**
  - Overview
    - The Notice asks (18) “To what extent should guidance provide adjustments to AFSI to *disregard* mark to market unrealized gains and losses that are otherwise included in AFSI? Should this depend on the extent to which the taxpayer marks to market the item for regular tax purposes?” Similarly, question (19) asks “To what extent should guidance provide adjustments to *include* in AFSI mark to market unrealized gains and losses that are not otherwise included in AFSI? Should this depend on the extent to which the taxpayer marks to market the item for regular tax purposes?”
    - AFS net income or loss often includes unrealized gains or losses related to mark to market adjustments. For example, financial accounting requires unrealized gains and losses arising from changes in market prices of investments in equity securities to be included in net income or loss.
    - Section 56A(c)(2)(C) provides that “In the case of any corporation which is not included on a consolidated return with the taxpayer, adjusted financial statement income of the taxpayer with respect to such other corporation shall be determined by only taking into account the dividends received from such other corporation (reduced to the extent provided by the Secretary in regulations or other guidance)

and other amounts which are includible in gross income or deductible as a loss under this chapter (other than amounts required to be included under section 951 and section 951A or such other amounts as provided by the Secretary) with respect to such other corporation.”

○ Recommendations

- Treasury and IRS should provide that AFSI does not include mark to market unrealized gains and losses to the extent such gains and losses do not relate to property that is marked to market for federal income tax purposes.
- In addition, Treasury and IRS should clarify the application of this rule in the context of investments in corporations that are not included in the consolidated return with the taxpayer and not marked to market for tax purposes. In accordance with section 56A(c)(2)(C), any unrealized gain or loss from marking these investments to market in the AFS should not be included in AFSI. Instead, the taxpayer should only take into account dividends received from such corporation and other amounts includible in gross income or deductible as a loss for federal income tax purposes with respect to such corporation. A similar rule should be provided in the context of investments in partnerships that are marked to market for AFS purposes but not for tax purposes.

○ Analysis

- As noted above, a fundamental premise of general tax accounting principles is to tax gains that are clearly realized. See, e.g., *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955) and *United States v. Gotcher*, 401 F.2d 118 (5<sup>th</sup> Cir. 1968). Requiring taxpayers to include unrealized gains and losses in AFSI and potentially pay CAMT on those gains is inconsistent with this fundamental premise and could cause a significant hardship where taxpayers do not have the cash needed to pay tax that may be due on unrealized gains.
- Additional guidance should be issued to clarify that items of unrealized gain or loss related to mark to market adjustments included in AFS net income or loss should not be included in calculating AFSI to the extent such property is not marked to market for tax purposes. Instead, AFSI should include only mark to market gains or losses in the AFS that also are reflected in the entity’s taxable income. In this instance, the guidance also could provide for appropriate AFS basis adjustments to reverse out the impact that mark to market unrealized gains or losses have on AFS basis.
  - For example, consider the following facts (no depreciation is calculated for simplicity). Taxpayer acquires a real estate asset for \$100 in 2023. In the taxpayer’s AFS, the asset is marked to market and unrealized gains are recorded for \$10 in 2024 and \$50 in 2025. For federal income tax purposes, unrealized gains are not taken into account in 2024 and 2025. The asset is sold for \$140 in 2026.
    - If unrealized gains are included in the computation of AFSI, then AFSI will reflect a loss upon disposition in 2026 of \$20 (\$140 sales

price – (\$100 acquisition cost + \$10 2024 unrealized gain + \$50 2025 unrealized gain)).

- We recommend that guidance be provided to adjust AFS basis to not reflect unrealized gains and losses that are not taken into account for federal income tax purposes. As such, in this example, AFS basis should be adjusted to remove unrealized gains and losses such that AFSI will reflect a realized gain upon disposition in 2026 of \$40 (\$140 sales price - \$100 acquisition cost).
- Our recommendations more clearly reflect the fundamental premise of general tax accounting principles – to tax gains that are clearly realized instead of unrealized gains.
- We believe that the financial accounting mark to market gain or loss, whether in OCI or net income, resulting from the application of the accounting standards used to prepare the AFS of the AFS Group should not be taken into account for purposes of calculating AFSI to the extent it is excluded for federal income tax purposes. These items represent unrealized gains and unrealized losses and should not be included in AFSI until realized. However, if the entity is including the mark to market gains or losses in taxable income under section 475 or a similar guidance, the unrealized gain or loss should be includable in AFSI in the period in which it is included in the entity's taxable income in order to minimize complexity and create a correlation between the financial accounting and federal income tax timing of recognition.
- Similarly, Treasury and IRS should provide regulations that require the inclusion of mark to market unrealized gains and losses in AFSI in circumstances where the item may be reflected in taxable income prior to recognition in the AFS. To the extent that these items are includable in a taxable income prior to being included in the entity's AFS net income or loss, they should be included in AFSI when included in regular taxable income in order to minimize complexity and create a correlation between the financial accounting and income tax timing of recognition of unrealized gains.
- Alternatively, guidance could be issued to provide that items of unrealized gain or loss related to mark to market adjustments are included in calculating AFSI in the same period in which they are included in the entity's taxable income.
- We note that Notice 2023-20 addressed certain matters within the insurance industry and includes an example to disregard unrealized gain or loss for purposes of determining AFSI, and we suggest the policy of not taxing unrealized gains inherent in that Notice be expanded to other appropriate areas.

## 2. Passthrough Issues

### • Clarify the scope of the exception in section 59(k)(1)(D) to the Distributive Share Adjustment

#### ○ Overview

- Section 56A(c)(2)(D)(i) provides that except as provided by the Secretary, if the taxpayer is a partner in a partnership, AFSI of the taxpayer with respect to such partnership shall be adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership (the "Distributive Share Adjustment"). Section 59(k)(1)(D) provides that solely for purposes of determining whether a corporation is an applicable corporation, all AFSI of persons treated as a single employer with such corporation under section 52(a) or section 52(b) shall be treated as AFSI of such corporation, and AFSI of such corporation shall be determined without regard to the Distributive Share Adjustment and section 56A(c)(11).
- Section 7.02 of the Notice accordingly provides that the Distributive Share Adjustment does not apply in all circumstances in determining the applicable corporation status. Section 9.02(1) requests what, if any, additional guidance is needed regarding the scope of the exception in section 59(k)(1)(D) to the Distributive Share Adjustment in section 56A(c)(2)(D)(i) for purposes of determining applicable corporation status.

#### ○ Recommendations

- We agree with Section 7.02 of the Notice; however, guidance should further provide that when a corporate partner consolidates a partnership for financial accounting purposes but is not related to the partnership under section 52(b), the corporation may still remove financial statement net income or loss attributable to noncontrolling interests ("NCI") for purposes of the applicable corporation status determination.
- In addition, guidance should clarify whether a corporate partner that does not consolidate a partnership for financial accounting purposes and is not related to a partnership under section 52(b) uses its financial statement net income or loss with respect to the partnership for the applicable corporation test (i.e. with no other section 56A adjustments).

#### ○ Analysis

- With respect to the NCI issue, it is common in umbrella partnership-corporation ("UP-C") structures for a publicly traded corporation to own less than 50 percent of the capital and profits of an operating partnership, but the publicly traded corporation still consolidates the partnership for financial statement purposes. It is possible that full consolidated net income is above \$1 billion, but that net income after backing out noncontrolling interests (i.e., the other partners of the operating partnership) is less than \$1 billion.

- Similar to our comments in our October 14, 2022 prior letter,<sup>2</sup> we believe that one reasonable mechanism to exclude NCI in this fact pattern could be an adjustment under section 56A(c)(2)(A) and its reference to using rules similar to section 451(b)(5) when multiple entities are included on the same financial statement. Section 451(b)(5) and Treas. Reg. § 1.451-3(h) include rules for apportioning revenue between entities included on the same consolidated financial statement. Applying these principles to apportion AFSI in this fact pattern seems reasonable. Another approach to reducing consolidated net income for net income attributable to noncontrolling interests could be based on the section 56A(a) AFSI definition and its reference to net income or loss “of the taxpayer.” However, if section 56A(a) is read in this manner, it is unclear what the purpose of section 56A(c)(2)(A) is.
- With respect to corporations that own interests in partnerships more generally (i.e., no financial statement consolidation and no section 52(b) aggregation), it would be helpful for guidance to provide examples on how the applicable corporation determination should be made. For example, assume a calendar year corporation owns a 10% interest in a partnership and reflects \$100 of financial statement net income with respect to the partnership in each year from 2020-2022. It may be most administrable for the corporation to use the \$100 in the applicable corporation determination because this is a historic number that does not require additional information from the partnership for the three prior years 2020-2022. However, this type of approach may not be the most accurate as other section 56A adjustments may be missed (e.g., what if the corporation is using mark-to market financial accounting and reflecting \$100 of mark to market income with respect to a “dry” partnership that just owns corporate stock and has \$0 AFSI from 2020-2022).
- **Provide a flexible approach to the meaning of “Distributive Share” for purposes of section 56A(c)(2)(D)(i)**
  - Overview
    - Section 56A(c)(2)(D)(i) provides that a partner’s AFSI with respect to its partnership interest shall be adjusted to only take into account the partner’s “distributive share” of the partnership’s AFSI. Congress did not, however, provide any insight into the intended meaning of the phrase “distributive share” as it related to the CAMT.
    - Section 9.02(1) of the Notice requests comments on how the term “distributive share” of a partnership’s AFSI in section 56A(c)(2)(D)(i) should be interpreted.
  - Recommendations
    - Similar to our October 14, 2022 prior comment letter,<sup>3</sup> a flexible approach that allows a partnership to determine its partners’ distributive shares of partnership

---

<sup>2</sup> See [“AICPA Comments on the Corporate Alternative Minimum Tax Needed Immediate Guidance,”](#) October 14, 2022.

<sup>3</sup> See [“AICPA Comments on the Corporate Alternative Minimum Tax Needed Immediate Guidance,”](#) October 14, 2022.



AFSI using any reasonable method should be allowed. Guidance should provide examples of methods that may be considered reasonable and not reasonable.

- Reasonable methods may include, for example, allocating AFSI in accordance with the percentage share of net section 704(b) income or loss, the percentage share of net taxable income or loss, the percentage share of financial statement income (if applicable), in accordance with the principles of section 704(b) but using financial statement amounts instead of section 704(b) amounts, or an allocation method that accounts for special allocations of specific partnership items under the partnership agreement. The method chosen by the partnership should be applied consistently (unless the Secretary expressly permits or requires a change in methodology) for purposes of both computing the CAMT and determining applicable corporation status.
- Analysis
  - We acknowledge that in certain circumstances, a method that may be considered reasonable for one tax year may result in unexpected allocations of AFSI in another tax year. For example, when allocations are based on percentage share of net section 704(b) income or loss for a partnership that allocates section 704(b) income or loss based on liquidation rights (i.e., a “distribution waterfall”), section 704(b) depreciation and amortization may influence allocations in situations where no such amortization or depreciation exists for financial accounting purposes. We maintain our recommendation to provide a flexible approach notwithstanding the existence of circumstances, such as the preceding example and instead address seemingly enigmatic results through the mechanics of rules related to realized gains and losses on sale, exchange, or disposal of partnership interests in a manner similar to the mechanics described for Covered Nonrecognition Transactions under the Notice (i.e., ensuring that the proper amount of cumulative financial accounting gain or loss is ultimately recognized for AFSI purposes).
- **Allow adjustments to AFSI with respect to part recognition partnership transactions**
  - Overview
    - In Section 3.03(e) Example 5 of the Notice, a partner transfers property to a partnership and receives cash from the partnership in a transaction that is treated in part a nonrecognition transaction under section 721 and in part a disguised sale of property by the partner to the partnership under section 707(a)(2)(B) and Treas. Reg. § 1.707-3.
    - Even though the transaction in the example is only treated as a disguised sale of property in part, the example treats the entire transaction as a Covered Recognition Transaction, and accordingly no adjustments to AFSI are made (even with respect to the section 721 portion of the transaction).
    - Section 9.01(1)(b) of the Notice requests comments on Covered Transactions in which, for federal income tax purposes, gain or loss is recognized in part.

- Recommendation
  - To the extent a subchapter K transaction is a recognition transaction in part (whether under section 707(a)(2)(B) or otherwise), a corresponding portion of the financial statement net income or loss (if any) should be adjusted for purposes of determining AFSI from the transaction and on a prospective basis.
- Analysis
  - The implication of Section 3.03(e) Example 5 of the Notice is that even a very small or immaterial portion of a partnership contribution or distribution being treated as a disguised sale under section 707(a)(2)(B) could result in no adjustments to AFSI being made to the extent the transaction also results in financial statement income or loss. In this situation, we believe that it is more consistent with the principles of subchapter K to instead provide those adjustments to AFSI are still made corresponding to the nonrecognition portion of the transaction
- **Clarify that unrealized gains and losses on partnership interests are excluded from AFSI, and that realized gains and losses on partnership interests are included in AFSI**
- Overview
  - As discussed above, under certain financial statement methods of accounting, income presented on an AFS may include mark to market gains and losses, which generally represent unrealized gains and losses on investment assets. Congress provided a rule that reverses out mark to market gains and losses attributable to a corporate subsidiary that is not consolidated on the corporation's tax return (i.e., section 56A(c)(2)(C)). Congress also provided a rule that states AFSI of a partner with respect to its partnership interest is adjusted to *only* take into account the partner's *distributive share* of the partnership's AFSI (i.e., section 56A(c)(2)(D)(i)), which has been similarly interpreted to exclude mark to market unrealized gains and losses on partnership interests, but with less certainty.
  - By extension, however, this reading may also be interpreted as excluding realized gains and losses on partnership interests.
- Recommendation
  - Clarify that mark to market gains and losses with respect to partnership interests, held directly or indirectly by a corporation through a tiered partnership structure, are not included in a corporation's AFSI until recognized.
  - Clarify that realized gains and losses with respect to partnership interests, held directly or indirectly by a corporation through a tiered partnership structure, are included in a corporation's AFSI when recognized for AFSI purposes (i.e., taking into account the principles of other guidance addressing timing of recognition of gain and loss for AFSI purposes, such as Covered Nonrecognition Transaction under Notice 2023-7).

- Analysis
  - Section 56A(c)(2)(C) provides an adjustment to a corporation’s AFSI that effectively backs out mark to market gains and losses of an unconsolidated corporate subsidiary and instead includes only dividend income upon distributions and gain or loss recognition on disposal of the stock of the corporate subsidiary.
  - Section 56A(c)(2)(D)(i) provides a partner’s AFSI “with respect to” the partnership shall be adjusted to only take into account the partner’s distributive share of the partnership’s AFSI. Furthermore, section 56A(c)(2)(D)(ii) provides that the AFSI of a partnership shall be adjusted under rules similar to the rules adjusting a corporation’s AFSI under section 56A (i.e., adjustments under section 56A(c)).
  - There does not appear to be any policy reason for subjecting mark to market gains and losses attributable to partnership interests and unconsolidated corporate subsidiaries any more or less favorable than the other. Moreover, we believe section 56A(c)(2)(D)(i), which limits the corporation’s AFSI with respect to a partnership interest to only the corporation’s distributive share of the partnership’s AFSI, reflects an intention to treat mark to market gains and losses on partnership interests the same as for unconsolidated corporations. The statutory language of section 56A(c)(2)(D)(i) can be interpreted as excluding mark to market gains and losses when a corporation marks up (or down) its investment in a partnership, as such gain or loss is not part of the corporation’s distributive share of the partnership’s AFSI, but rather the corporation’s ‘outside’ gain or loss on the partnership interest. Furthermore, we believe section 56A(c)(2)(D)(ii) can be interpreted to exclude mark to market gains and losses on indirectly held tiered partnership interests, as the AFSI of any tiered partnership interest is determined under rules similar to the adjustment rules under section 56A, such that section 56A(c)(2)(D)(i) would continue to apply at each level.
  - We note also that section 3.02 of the recently released Notice 2023-20 strongly suggests an interpretation of section 56A(c)(2)(D)(i) that excludes unrealized gains and losses on partnership interests from AFSI.
  - We acknowledge an argument can be made that the statute excludes realized gains and losses on partnership interests for the same reason it excludes mark to market unrealized gains and losses. However, we do not believe it was the intent of Congress to go as far as to exclude realized gains and losses on partnership interests. We believe clarification of this point in connection with the above recommendation is appropriate.
- **Aggregation of S Corporation Financial Statement Income with C Corporation Financial Statement Income**
  - Overview
    - Section 59(k)(1)(A) explicitly excludes S corporations, RICs and REITs (collectively, “excluded corporations”) from the definition of an “applicable corporation” subject to the CAMT.

- Section 59(k)(1)(D) provides that, in determining whether a C corporation is subject to the CAMT, “all adjusted financial statement income of persons treated as a single employer with such corporation under subsection (a) or (b) of section 52 shall be treated as adjusted financial statement income of such corporation....”
  - Despite being excluded from the CAMT under section 59(k)(1)(A), the AFSI of excluded corporations may need to be aggregated with the AFSI of C Corporations for purposes of the applicable corporation test.
- Recommendation
    - Clarify that under section 59(k)(1)(A) an excluded corporation cannot be part of a single employer group under section 52(a) or section 52(b) for purposes of the CAMT.
  - Analysis
    - Based on current guidance, there is concern that the AFSI of an excluded corporation and the AFSI of a C corporation may be aggregated under section 52(a) or section 52(b). If this is the case, an excluded corporation could cause a C corporation otherwise below the relevant AFSI threshold to be subject to the CAMT.
    - However, under section 59(k)(1)(A) excluded corporations are specifically exempt from the definition of applicable corporations subject to the CAMT. As excluded corporations were not intended to be subject to the CAMT, guidance is necessary to resolve the unintended consequence of needing to aggregate the AFSI of excluded corporations with the AFSI of C corporations.

### 3. General Concepts and Methods & Periods

- **Define Tax Cost of Goods Sold (COGS) Depreciation as the amount of depreciation allowance with respect to Section 168 Property capitalized to the basis of inventory during the tax year**
  - Overview
    - Section 4.02(7) of the Notice defines Tax Depreciation as depreciation deductions allowed under section 167 with respect to Section 168 Property, a term defined in Section 4.04 of the Notice. Section 4.02(6) of the Notice further defines Tax COGS Depreciation as Tax Depreciation capitalized to the basis of inventory and recovered through cost of goods sold as a reduction to gross income under section 61. Section 4.03(1) of the Notice provides that adjusted financial statement income (AFSI) is reduced by Tax COGS Depreciation, but only to the extent recovered through cost of goods sold in the current tax year.

○ Recommendations

- Under the existing rule, Treasury and IRS should confirm taxpayers are allowed to compute the amount of Tax COGS Depreciation using a method consistent with the taxpayer's section 263A method, including the simplified methods.
- In addition, we recommend that Treasury and IRS offer an alternative method that defines Tax COGS Depreciation as the amount of the depreciation allowance with respect to Section 168 Property capitalized to inventory in the current tax year rather than the amount recovered through COGS in the current tax year.

○ Analysis

- We recommend Treasury and IRS confirm taxpayers may use their simplified method under section 263A to determine the amount of depreciation remaining in ending inventory. This approach could be achieved by allowing taxpayers to use the principles of section 263A, particularly the simplified methods for producers and resellers.
- Under the simplified methods provided by section 263A, the amount of additional section 263A costs capitalized to ending inventory effectively is determined by multiplying additional section 263A costs incurred in the tax year by the inventory turnover ratio for that year. The inventory turnover ratio effectively is computed as section 471 costs (generally book inventoriable costs adjusted for certain direct costs and variances) in ending inventory over total section 471 costs incurred in the tax year. To determine the amount of tax depreciation remaining in ending inventory, an equivalent calculation to that made for capitalizing additional section 263A costs should be reasonable. Therefore, tax depreciation remaining in ending inventory could be determined by the following formula:

*Section 471 costs in ending inventory / section 471 costs incurred in the tax year  
\* tax depreciation included in inventoriable costs in the tax year = tax  
depreciation remaining in ending inventory*

- Tax COGS Depreciation could then be computed by the following formula:

*Tax depreciation remaining in beginning inventory + tax depreciation included in  
inventoriable costs in the tax year – tax depreciation remaining in ending inventory.*

- The AICPA welcomes the decision by Treasury to clarify that depreciation capitalized to inventory is included in the adjustment described in section 56A(c)(13)(A) whereby AFSI is reduced by depreciation deductions allowed under section 167 with respect to property to which section 168 applies. However, the definition of Tax COGS Depreciation may impose an additional burden on taxpayers that would have to determine the amount of its ending tax basis of inventory that is attributable to depreciation.
- In addition to reducing the burden on taxpayers, adopting the proposed definition of Tax COGS Depreciation would make the treatment of depreciation capitalized

to COGS for purposes of the CAMT consistent with that of section 163(j). Similar to section 56A(c)(13)(A), section 163(j)(8)(A)(v) provides that for tax years beginning before January 1, 2022, taxable income is adjusted by adding back allowable depreciation deductions when determining adjusted taxable income (“ATI”) for computing the limitation on business interest deductions. The Treasury regulations under section 163(j) clarify that the full depreciation allowance capitalized to the basis of inventory in a given tax year, including any amount still in ending inventory, is added back to taxable income to reach ATI. This approach to depreciation capitalized to inventory is easy for taxpayers to comply with, and presumably, did not lead to a material distortion of income.

- **Provide a safe harbor election for taxpayers to only take into account basis differences of Section 168 Property in the year the property is disposed of when basis differences are immaterial**

- Overview

- The Notice defines Covered Book COGS Depreciation, Covered Book Depreciation Expense, Covered Book Expense, and Deductible Tax Depreciation in sections 4.02(1) – (4) of the Notice, respectively. In particular, Covered Book Expense are amounts capitalized to the basis of Section 168 Property for federal income tax purposes, but not for AFS purposes. AFSI in a tax year is increased by adding back Covered Book COGS Depreciation, Covered Book Depreciation Expense, and Covered Book Expense (collectively, “Book Depreciation Adjustments”) and reduced by subtracting Tax COGS Depreciation and Deductible Tax Depreciation (collectively, “Tax Depreciation Adjustments”).
- Section 4.07 of the Notice provides the rules for making AFSI adjustments when Section 168 Property is disposed of. These adjustments require taxpayers to adjust the gain or loss recognized in its AFS by making Book Depreciation Adjustments and Tax Depreciation Adjustments to the AFS basis of its property as if the taxpayer had always been under CAMT.

- Recommendation

- Taxpayers should be permitted to make a *de minimis* safe harbor election to forgo annually adjusting AFSI for unadjusted basis differences of Section 168 Property when the cumulative difference in basis between book and tax of all Section 168 Property of the same recovery period placed in service during the tax year is 5 percent or less of the taxpayer’s AFS basis in the property. The election may be made annually for each separate recovery period and is binding on the taxpayer once made.

- Analysis

- The approach in the Notice for applying section 56A(c)(13)(A) is administratively burdensome for taxpayers. Each year, the taxpayer is required to track unadjusted

basis differences of individual assets of Section 168 Property to adjust AFSI by the Book Depreciation Adjustments and Tax Depreciation Adjustments for each asset. Even if a taxpayer is not subject to CAMT for a given year, taxpayers must still track these differences to compute the amount of gain recognized in AFSI if they dispose of Section 168 Property during a year when they are subject to CAMT.

- In lieu of these annual adjustments, taxpayers should be permitted to make a *de minimis* safe harbor election as an administrative convenience when the cumulative difference between the tax basis and the book basis of all Section 168 Property of the same recovery period placed in service during the tax year is 5 percent or less of the taxpayer’s AFS basis in such property. The safe harbor would eliminate the need of taxpayers to annually compute Covered Book Expense for such property as Tax Depreciation Adjustments and Book Depreciation Adjustments will be based only on the basis in Section 168 Property under either set of accounting rules. Upon disposal of the property, the computation of the AFSI gain or loss would include a one-time adjustment for cumulative basis differences that adds back the cumulative book depreciation to the AFS basis of the section 168 Property and reduces AFS basis by cumulative tax depreciation. If a taxpayer makes this *de minimis* election, then they must also treat repairs expenses that have been capitalized for book purposes, but not for tax purposes, as Section 168 Property.

Example:

Taxpayer places into service on January 1, 2023 Section 168 Property with a recovery period of 5 years, a tax basis of \$52,500, and book basis of \$50,000. For both book and tax, the property is depreciated using the straight-line method and there is no salvage value. Taxpayer has no other 5-year property and does not make an election out of bonus. Taxpayer makes the *de minimis* election because the difference between book basis and tax basis is 5 percent  $[(52,500 - 50,000)/50,000 = 5\%]$ . Taxpayer computes its depreciation adjustment for AFSI as:

Year	Tax Depreciation per Form 1120	Book Depreciation per AFS	Adjustment to AFSI
2023	\$44,100	\$10,000	(\$34,100)
2024	\$2,100	\$10,000	\$7,900
2025	\$2,100	\$10,000	\$7,900
Total	\$48,300	\$30,000	(\$18,300)

Taxpayer sells the property on January 1, 2026, for \$30,000 and makes the following adjustment on disposal:

AFSI Gain = Proceeds – (AFS Basis – Cumulative Tax Depreciation per Form 1120 + Cumulative Book Depreciation per AFS)

AFSI Gain = \$30,000 – (\$30,000 - \$48,300 + 30,000) = \$30,000 – (\$30,000 - \$18,300) = \$30,000 – \$11,700 = \$18,300

- Application of the safe harbor would alleviate much of the cost to taxpayers of complying with the depreciation adjustment procedures in the Notice without

materially distorting AFSI in any particular tax year. This is because, for most property, differences between tax and book basis are generally small. Treasury and IRS have provided equivalent *de minimis* safe harbors as an administrative convenience in other Code sections. For example, for purposes of applying the rules of section 263A, if 5 percent or less of the costs of a service department are allocable to inventory, a taxpayer is permitted to treat all costs of that department as deductible service costs. Similar to the election to opt out of bonus depreciation provided by section 168(k), this election will be made annually for each recovery period and will be irrevocable for property placed in service during the tax year once made.

- **Allow taxpayers to adjust AFSI for amounts deducted for tax purposes that are included in book depreciation with respect to Section 168 Property for AFS purposes**

- Overview

- Under the Notice, AFSI in a tax year is increased by adding back Covered Book COGS Depreciation, Covered Book Depreciation Expense, and Covered Book Expense (collectively, “Book Depreciation Adjustments”) and reduced by subtracting Tax COGS Depreciation and Deductible Tax Depreciation (collectively, “Tax Depreciation Adjustments”).
- The Notice defines Covered Book COGS Depreciation, Covered Book Depreciation Expense, Covered Book Expense, and Deductible Tax Depreciation in sections 4.02(1) – (4) of the Notice, respectively. In particular, Covered Book Expense are amounts capitalized to the basis of Section 168 Property for Federal income tax purposes, but not for AFS purposes. A similar rule is not provided for so-called “Covered Tax Expenses,” where amounts are deducted for federal income tax purposes but included in the basis of Section 168 property for AFS purposes, which could arise if book capitalizes more indirect costs than tax or if tax deducts repairs that are capitalized for book purposes.
- With respect to additional indirect costs capitalized to Section 168 Property for AFS purposes only, under the Notice, AFSI is increased to remove the book depreciation on that additional basis but is not reduced for indirect costs not capitalized into the basis of the Section 168 property for tax purposes. In these instances, there will be a net increase in AFSI relative to regular taxable income.
- With respect to repairs, Section 4.05 of the Notice provides that if a taxpayer deducts an expenditure for a repair for Federal income tax purposes, that expense does not give rise to Section 168 Property and thus section 56A(c)(13)(A) (the adjustment for depreciation) does not apply. As such, there will be a net increase in AFSI relative to regular taxable income to the extent these tax deductible repairs relate to improvements that are capitalized for book purposes and give rise to Covered Book Depreciation.



- Recommendations
  - Taxpayers should be allowed to reduce AFSI for “Covered Tax Expenses,” defined as costs deducted for federal income tax purposes that are capitalized into the basis of Section 168 Property for AFS purposes.
  - Taxpayers should be allowed to include the amount of repairs expenditures incurred during the tax year in Tax Depreciation if those costs are capitalized for AFS purposes in order to simplify the computation of a taxpayer’s AFSI.
  
- Analysis
  - Taxpayers should be allowed to reduce AFSI for “Covered Tax Expense” to ensure parity between book and tax because adjustments are required to be made only for Covered Book Expense at this time. For example, it’s not uncommon that taxpayers need to capitalize costs into the basis of Section 168 Property for AFS purposes in excess of what is required for federal income tax purposes. Requiring these taxpayers to only add back Covered Book Expense results in a net unfavorable result for AFSI as opposed to a neutral result if “Covered Tax Expense” is included.
  - Under the rules for applying section 56A(c)(13)(A) provided in the Notice, Book Depreciation Adjustments do not include book depreciation on the basis of property that is treated as a deductible repair expenditures for Federal income tax purposes. Taxpayers also do not include the amount deducted for Federal income tax purposes in Tax Depreciation Adjustments. The effect of this rule is that taxpayers must determine the amount of depreciation expense in its AFS attributable to such repairs expenditures and make an adjustment to remove that amount from AFS depreciation to arrive at Book Depreciation Adjustments.
  - Instead, taxpayers should be allowed to treat repairs expenditures as Deductible Tax Depreciation and include related AFS depreciation in Book Depreciation Adjustments in the tax year those costs are incurred if the repair is for property that otherwise would meet the definition of Section 168 Property. In this instance, there would be no omission of basis recovery because AFSI would be reduced by the amount of repairs expenditures deducted in the tax year and increased as depreciation allowance on the property is recognized for AFS purposes.
  - The proposed approach for indirect costs capitalized for AFS and repairs deducted for tax also mirrors how the Notice treats costs that are capitalized for Federal income tax purposes but expensed for AFS purposes through the category of costs defined as Covered Book Expenses. Covered Book Expenses are added back to AFSI, but no such category was defined for the opposite case. Adopting this recommendation will reduce the compliance burden on taxpayers because they will no longer be required to separately track and adjust AFS depreciation on property treated as a repair expenditure for Federal income tax purposes.
  - Note a taxpayer that avails itself of the proposed 5 percent *de minimis* election (discussed above) will not be able to treat repairs costs as Tax Depreciation. This restriction will prevent a whipsaw to the Government as otherwise most differences between book basis and tax basis of tangible property are generally favorable to

taxpayers due to the application of section 263A increasing the tax basis of tangible property.

- **Clarify that Section 168 Property includes the full basis of bonus-eligible property**

- Overview

- Section 4.04(1)(b) and section 4.04(1)(c) of the Notice provides that Section 168 Property includes bonus-eligible property defined in section 168(k).
- Section 4.04(2) further provides that section 56A(c)(13)(A) (the adjustment to AFSI for depreciation) only applies to the portion of depreciation deducted under section 167 and section 168, and if a portion is deducted under another section of the Code, that amount is not included in Tax Depreciation Adjustments.
- For example, if a portion of the cost of a property described in section 4.04(1)(c) of the Notice is deducted under section 181, and the remainder of the cost of the property is depreciated under section 167 and section 168, only the portion of the cost of property depreciated under section 167 and section 168 is considered property to which section 168 applies for purposes of section 56A(c)(13).

- Recommendation

- Treasury and IRS should clarify that the Section 168 Property is the entire basis of bonus-eligible property, including the amount of basis not subject to the special allowance for bonus depreciation.

- Analysis

- The language in section 4.04(2) of the Notice is a source of confusion for taxpayers and practitioners. Some have interpreted the example for amounts deductible under section 181 to mean that for property described in section 168(k)(2)(A)(IV)-(V), only the portion of the basis subject to bonus depreciation is Section 168 Property. Others have considered that the entire basis of such property is Section 168 Property.
- Section 56A(c)(13)(A) states that an adjustment is made to reduce AFSI by the amount of depreciation allowed under section 167 for property to which section 168 applies. It is clear that section 168 applies to all types of property described in section 168(k). Section 168(a) states that the depreciation deduction determined under section 168 is provided by section 167. Section 168(k)(1)(A) further states that the special allowance provided by section 168(k) is an amount included in the depreciation deduction provided by section 167(a). In other words, the depreciation deductions provided by section 167 for bonus-eligible property are more than simply the amounts deducted as bonus depreciation. It follows that even in a year where the special allowance for bonus depreciation is less than 100%, the full basis of any property described in section 168(k) is Section 168 Property.
- We note that representatives of Treasury and IRS have been quoted in the tax press that this interpretation is the intended reading of the rule in the Notice.

- **Allow basis differences in Section 168 Property due to tax credits to not be treated as Section 168 Property**

- Overview

- Section 56A(c)(13)(A) states that an adjustment is made to reduce AFSI by the amount of depreciation allowed under section 167 for property to which section 168 applies.
- Under the Notice, AFSI in a tax year is increased by adding back Covered Book COGS Depreciation, Covered Book Depreciation Expense, and Covered Book Expense (collectively, “Book Depreciation Adjustments”) and reduced by subtracting Tax COGS Depreciation and Deductible Tax Depreciation (collectively, “Tax Depreciation Adjustments”).
- Section 4.04(2) of the Notice provides that section 56A(c)(13)(A) (the adjustment to AFSI for depreciation) only applies to the portion of depreciation deducted under section 167 and section 168, and if a portion is deducted under another section of the Code, that amount is not included in Tax Depreciation Adjustments. For example, if a portion of the cost of a property described in section 4.04(1)(c) of the Notice is deducted under section 181<sup>4</sup>, and the remainder of the cost of the property is depreciated under section 167 and section 168, only the portion of the cost of property depreciated under section 167 and section 168 is considered property to which section 168 applies for purposes of section 56A(c)(13).
- There are many examples of book to tax basis differences in Section 168 Property because of basis reductions from tax credits. For example:
  - Section 40C provides a credit for the cost any qualified alternative fuel vehicle refueling property placed in service during the tax year. Section 40C(e)(1) requires basis of depreciable property to be reduced to extent a tax credit is claimed with respect to such property.
  - Section 30B provides credits for various qualified alternative energy motor vehicles. Section 30B(h)(4) requires basis of depreciable property to be reduced to extent a tax credit is claimed with respect to such property.
  - Section 48 provides a credit for the “energy percentage” of the basis of qualified energy property placed in service during the tax year. The credit is subject to the section 50 basis reduction rules whereas the basis in eligible property is reduced by the amount of the credit.

- Recommendation

- We recommend that AFSI should not be increased for Book Depreciation claimed on Section 168 Property to the extent a tax credit is claimed with respect to that basis.

---

<sup>4</sup> Section 181 provides, at the election of the taxpayer, an immediate deduction for the cost of any qualified film, television or live theatrical production. The portion of the production otherwise eligible for section 181 but for section 181(a)(2) and section 181 (g) are eligible for the special depreciation allowance under section 168(k)(2)(A)(i)(IV) and (V).

- Analysis
  - It is unclear how the rule in section 56A(c)(13)(A) applies in the context of Section 168 Property that is eligible for a tax credit (e.g. investment tax credit or production tax credit). In this instance, the basis of the Section 168 Property must be reduced for some or all of the tax credit claimed. See, e.g., section 40C, section 30B and section 48. As such, the Notice could be interpreted to not treat this portion of the tax basis as property depreciated under section 168 similar to the rule for property depreciated in part under section 181. Alternatively, the Notice could be interpreted to treat the property as entirely depreciated under section 168 because the entire tax basis of the property is depreciated under section 168.
  - Due to this uncertainty, we recommend that Treasury and IRS clarify that AFSI is not increased for Book Depreciation claimed on Section 168 property to the extent a tax credit is claimed with respect to that basis. The inclusion of basis reductions for tax purposes with no corresponding adjustment for AFSI basis would harm taxpayers by increasing AFSI for additional book depreciation taken on that basis. The Tax Depreciation component of the section 56A(c)(13) AFSI adjustment will always be less than Book Depreciation for property for which a tax credit is taken where a corresponding basis reduction is required. Equalizing book and tax basis for AFSI adjustment purposes when tax basis is required to be reduced by a credit furthers the tax policy objective of allowing these credits and not penalizing taxpayers for claiming such credits.
- **Clarify the duration (if any) required under section 59(k)(1)(C)(i)(II) before an applicable corporation should be treated as no longer an applicable corporation**
- Overview
  - Section 59(k)(1)(A) defines an applicable corporation as meaning, with respect to any tax year, a corporation (other than an S corporation, regulated investment company (RIC), or real estate investment trust (REIT) that meets the average annual AFSI test for one or more tax years prior to the tax year and ending after December 31, 2021.
  - Section 59(k)(1)(B) states that a corporation meets the average annual AFSI test if the average annual AFSI of the corporation (determined without regard to financial statement net operating loss (NOL) carryovers) for the 3-taxable-year-period ending with the tax year exceeds \$1 billion. Additional rules exist for foreign-parented multinational groups, whereas the corporation meets the average AFSI test for a tax year if (1) the corporation meets the \$1 billion test (determined after application of section 59(k)(2)), and (2) the average AFSI (determined without regard to section 59(k)(2) and financial statement NOL carryovers) for the 3-taxable-year-period ending with the tax year is \$100 million or more for the U.S. corporation

- Presently, section 59(k)(1)(C)(i)(II) delegates authority to the Secretary to designate the required time period that a corporation does not meet the AFSI test in section 59(k)(1)(B) to be excepted from applicable corporation status.
  - Comments were requested related to this matter in section 9.02(6) of Notice 2023-7.
- Recommendation
    - Provide a rule whereby a corporation would be excepted from applicable corporation status if it fails an AFSI test for the 3-taxable-year period preceding a relevant tax computation year.
- Analysis
    - The underlying AFSI test described in section 59(k)(1)(B) utilizes a 3-taxable-year test. In addition to the general AFSI test, other tax concepts rely on this duration. For example, section 448 (gross receipts test for purposes of utilizing the cash basis of accounting) and section 59A (gross receipts test for the base erosion and anti-abuse tax) utilize a 3-taxable-year test to evaluate whether a taxpayer is subject to the respective rules.
    - The concept of relying on a 3-year period is also relevant from a financial reporting perspective (and required for large Securities and Exchange Commission (SEC) registrants). For example, [Topic 1110.1 – General Requirements for a Domestic Registrant of the Securities Exchange Commission Financial Reporting Manual](#) stipulates that 3 years of comparable information is required for the statement of comprehensive income. The requirement acknowledges that a 3-year period is valuable to external users in developing an understanding of earnings or expectations of future earnings.
    - A 3-taxable-year period of failing to meet the AFSI test in section 59(k)(1)(B) would align with other 3-taxable-year tests used in the IRC and financial reporting guidance.
- **Provide a simplified method to determine if a taxpayer is an applicable corporation**
    - Overview
      - Section 5 of Notice 2023-7 provides a safe harbor method for determining applicable corporation status by substituting \$500 million for \$1 billion and \$50 million for \$100 million as the AFSI thresholds for the applicable corporation tests. For purposes of the safe harbor, AFSI is determined without regard to the adjustments in section 56A(c) and section 56A(d) except for section 56A(c)(2)(A) (i.e., rules similar to section 451(b)(5) apply if financial results of a taxpayer are reported on the AFS for a group of entities), section 56A(c)(2)(B) (i.e., AFSI for a consolidated federal return group shall take into account items on the group’s AFS that are properly allocable to the members of such group), and section 56A(c)(5) (i.e., AFSI shall be adjusted to disregard federal income taxes, etc.). However, in

applying the \$100 million test of section 59(k)(1)(B)(ii)(II) to a U.S. corporation that is a member of a foreign-parented multinational group, the adjustment in section 56A(c)(4) also applies (i.e., the corporation must continue to apply the principles of section 882 in determining the amount of effectively connected income included in its AFSI). This safe harbor is applicable for the first tax year beginning after December 31, 2022.

- Lastly, adjustments to eliminate transactions between related persons not treated as a single employer under section 52 are taken into account.
  
- Recommendations
  - Provide a safe-harbor method similar to the Simplified Method that may be applied beyond a corporation's first tax year beginning after December 31, 2022.
  - Provide a new simplified method, or modify the safe harbor, to allow taxpayers to use the full \$1 billion or \$500 million thresholds where appropriate, but without any AFSI adjustments or without any AFSI adjustments that relate to adjusting AFS net income or loss to reflect certain federal income tax principles (e.g., depreciation, pension).
  
- Analysis
  - We commend the Treasury and the IRS for providing a safe-harbor method in the Notice that can be used by taxpayers for the first tax year beginning after December 31, 2022. We still advocate for one or more permanent safe-harbor methods to determine applicable corporation status in an abbreviated manner in order to alleviate the burdens on taxpayers for AFSI computations and aggregations while still providing them comfort that they are in compliance.
  - It is expected that the net income or loss reported on an AFS for a group that includes non-controlling interest consolidations is likely to far exceed AFSI for the group, especially due to the fact that AFS income or loss will include income of corporations and partnerships not consolidated for tax purposes as opposed to the income or distributive share that would be included in AFSI if relevant adjustments are made to determine AFSI. As such, a simplified method that retains the same thresholds but allows a taxpayer to ignore all AFSI adjustments that almost always would have the effect of increasing AFS net income or loss will be a much more effective way for a taxpayer to determine whether they are an applicable taxpayer.
  - Alternatively, a simplified method that uses the same thresholds but allows a taxpayer to ignore all tax adjustments that are almost certain to have a bias of increasing AFSI also would be an easier way for a taxpayer to determine if they are an applicable taxpayer without the need to consider complicated and potentially unknown book-tax differences.

- **Modify the rules under section 451(b)(5) for purposes of determining the AFSI of a corporation included in an AFS Group**

- Overview

- Section 56A(c)(2) provides special rules for determining AFSI. Section 56A(c)(2)(A) states that rules similar to those in section 451(b)(5) shall apply if the financial results of a taxpayer are reported on the AFS for a group of entities.
- Section 451(b)(1), which provides rules on the timing of recognition of income for certain taxpayers, states that the “all events test” for any item of gross income shall not be treated as met any later than when that item is taken into account as revenue in an AFS. Under section 451(b)(3), a taxpayer’s AFS includes financial statements prepared in accordance with generally accepted accounting principles (GAAP), financial statements prepared in accordance with international financial reporting standards, and other statements filed with specific authorities. Section 451(b)(5) provides, for purposes of paragraph (1), if the financial results of a taxpayer are reported on the AFS (as defined in paragraph (3)) for a group of entities, such statement shall be treated as the AFS of the taxpayer.
- Treas. Reg. § 1.451-3(a)(5) provides priority rules that identify the AFS of the taxpayer. Under these rules, taxpayers first must use audited statements prepared under GAAP. If GAAP statements are not available, then the AFS are those that were prepared using audited international financial reporting standards (IFRS) statements; if IFRS statements are not available, then an AFS includes certain other statements filed with specific authorities.
- Treas. Reg. § 1.451-3(h) provides clarity around additional AFS issues.
  - Treas. Reg. § 1.451-3(h)(1)(i) provides when the financial results of a taxpayer are reported on the AFS for a group of entities (consolidated AFS), the taxpayer’s AFS is the consolidated AFS. However, if the taxpayer’s financial results are also reported on a separate AFS that is of equal or higher priority to the consolidated AFS, then the taxpayer’s AFS is the separate AFS.
  - Under Treas. Reg. § 1.451-3(h)(2), to determine the amount of AFS revenue allocated to the taxpayer in a consolidated AFS, the taxpayer must include the amount of any items listed separately in the consolidated AFS, including any notes or other supplementary data that is considered part of the consolidated AFS.
  - Under Treas. Reg. § 1.451-3(h)(3), if the consolidated AFS does not separately list items for the taxpayer, then the portion of the AFS revenue allocable to the taxpayer is determined by relying on the taxpayer’s separate source documents that were used to create the consolidated AFS and includes amounts subsequently eliminated in the consolidated AFS. Whether a taxpayer that changes the source documents it uses for this purpose from one tax year to another tax year has changed its method of accounting is determined under the rules of section 446.
  - It is unclear how the priority rules for determining the applicable AFS and for separately listed items apply in the context of computing AFSI. In

addition, it is unclear how to determine the net income or loss on the AFS when the group of entities included in the consolidated AFS, and related eliminations, are different than the group of entities included in the consolidated tax return.

○ Recommendations

- Provide priority rules like those set forth in Treas. Reg. § 1.451-3(a)(5) that identify a taxpayer's relevant AFS, but eliminate the requirement that a taxpayer must use a separate statement if of equal or higher priority to the consolidated statement in favor of using a consistent financial accounting standard for members of a tax consolidated group.
- Eliminate requirement that separately stated items on a consolidated AFS take priority over the taxpayer's separate source documents used for the consolidated AFS.
- Consistent with the reference in section 56A(c)(2)(A) to section 451(b)(5), provide a rule similar to Treas. Reg. § 1.451-3(h)(3) that allows taxpayers to compute AFSI from separate source documents that were used to create the consolidated AFS when the AFS includes entities that are not members of the taxpayer's consolidated group.
- Provide examples of source documents and information that taxpayers could use to determine net income or loss allocable to the taxpayer.
- Confirm AFSI should include elimination entries in the AFS only to the extent that the entries relate to transactions between and within members of the tax consolidated group.

○ Analysis

- The financial statements identified in section 451(b) control when income must be recognized for tax purposes. Under these rules, the consolidated AFS may include entities that are not part of the taxpayer's consolidated group. Any mismatch between the entities included in the consolidated AFS and those included in the taxpayer's consolidated group typically has little impact on the timing of income recognition, while a mismatch of financial accounting standards could significantly affect the taxpayer's AFSI computation.
- As such, Treasury should not require taxpayers to use separate statements to compute AFSI if the statements are of equal or higher priority to the consolidated statements. Under this approach, a taxpayer could determine AFSI using either consolidated AFS, adjusted to reflect members of the taxpayer's tax consolidated group, or separate statements combined to include members of the taxpayer's tax consolidated group, as long as the statements used consistent financial accounting standards and included appropriate eliminations.
- The requirement that separately stated items take priority over non-separately stated items is confusing in the context of determining net income or loss in the applicable AFS and could imply that equity income of partnerships or controlled corporations that is separately stated in the AFS must be included despite the rule for non-



separately stated items that allows a taxpayer to use source documents to determine the income allocable to a member of the group. As such, it is recommended that Treasury make clear that the separately stated rule does not apply in the context of determining AFS net income or loss.

- To carry out the purpose of section 56A, rules similar to Treas. Reg. § 1.451-3(h)(3) should be provided to create parity between AFSI and taxable income by ensuring that the same entities are included in the taxpayer's computations of both AFSI and taxable income. These revised rules should permit taxpayers to make adjustments to AFSI necessary to exclude the financial information of entities that are not part of the taxpayer's consolidated group, and to adjust elimination entries to eliminate transactions between and within entities that are members of the tax consolidated group.
- **A change in AFSI financial accounting principle not otherwise affecting taxable income should be treated as a change in fact for purposes of the CAMT**
  - Overview
    - Methods of accounting, in general - section 446(e) provides the general rules for methods of accounting and states that except as otherwise expressly provided in Chapter 1 of the IRC, a taxpayer who changes the method of accounting on the basis of which the taxpayer regularly computes the taxpayer's income in keeping the taxpayer's books shall, before computing the taxpayer's taxable income under the new method, secure the consent of the Secretary. The regulations further provide that a change in method of accounting does not include a change in treatment resulting from a change in underlying facts.
    - Rules for changes in method of accounting under section 451 - Under Treas. Reg. § 1.451-3(h)(3), the rules of section 446 are used to determine whether the taxpayer has changed its method of accounting when the taxpayer changes the source documents it uses for this purpose from one tax year to another tax year. Treas. Reg. § 1.451-3(l)(1) provides that, in part, a change in the manner of recognizing revenue in an AFS that changes or could change the timing of the inclusion of income for federal income tax purposes is generally a change in method of accounting under section 446 and the regulations under section 446 of the Code. However, a change resulting from the restatement of AFS revenue may not always constitute a change in method of accounting under section 446 and the regulations. For example, a restatement of AFS revenue to correct an error described in Treas. Reg. § 1.446-1(e)(2)(ii)(b) does not constitute a change in method of accounting under section 446.
  - Recommendation
    - Provide guidance stipulating that changes in financial accounting principle for purposes of determining AFS net income or loss are changes in fact and a change in method of accounting under section 446(e) is not necessary.

- Analysis
  - There is no guidance addressing how a change in financial accounting principle should be treated for purposes of the CAMT. Therefore, it's unclear whether certain items arising from changes in financial accounting principle that do not otherwise affect taxable income in turn affect AFS net income or loss (e.g., items arising out of the change in leasing standard ASC 842, etc.).
  - AFS net income or loss fundamentally relies on the earnings computed under the applicable financial reporting standard and not entirely on federal income taxation principles. Requiring consent of the Secretary for changes in financial reporting standard would impose an unnecessary burden on both taxpayers (for something that they cannot control such as in the case of accounting standard changes) and the government. In addition, it would not be appropriate for the Secretary to deny a change in AFSI that otherwise is required for financial accounting. As such, guidance should make clear that a change in determining AFS net income or loss is not a change in method of accounting.
- **Tax accounting method changes related to AFSI adjustments (e.g., change in method of accounting for depreciation or pensions) are changes in method of accounting for CAMT purposes**
  - Overview
    - Certain methods of accounting used for federal income tax purposes will also be used for purposes of computing AFSI adjustments under section 56A.
    - When a taxpayer changes its method of accounting, a section 481(a) adjustment is generally required. A section 481(a) adjustment is necessary to prevent amounts from being duplicated or omitted when a taxpayer changes from one method of accounting to another. It is made to effectively restate income as if the taxpayer has always been using the proposed method and is computed as of the beginning of the year of change.
    - The inclusion of section 481(a) adjustments in separate tax provisions is considered in the context of section 163(j). Section 163(j) generally limits the amount of business interest expense that can be deducted in the current tax year for tax years beginning after December 31, 2017. Under section 163(j)(8), adjusted taxable income (ATI) is the taxable income of the taxpayer computed without regard to certain items, including any deduction allowable for depreciation, amortization, or depletion for tax years beginning before January 1, 2022. Under Treas. Reg. § 1.163(j)-1(b)(1)(iii) amounts of depreciation, amortization, or depletion that are capitalized under section 263A during the tax year are deemed to be included in the computation of the taxpayer's tentative taxable income for such tax year, regardless of the period in which the capitalized amount is recovered. Similarly, but not precedential, [CCA 202123007](#) concluded that in regard to the inclusion of section

481(a) adjustments in the determination of ATI, the addition to ATI for depreciation includes section 481(a) adjustments representing additional depreciation.

○ Recommendations

- Treat CAMT as a separate but parallel tax system, similar to the treatment of the former alternative minimum tax system.
- Provide that changes in method of accounting for taxable income purposes for items that are treated as AFSI adjustments (e.g., depreciation, pension) also are treated as changes in method of accounting for CAMT purposes. As such, sections 446 and 481 apply for both regular tax and CAMT purposes.
- Allow method changes to be made solely for purposes of AFSI when an item is properly treated for regular taxable income purposes but not properly treated for CAMT.

○ Analysis

- Tax methods of accounting for depreciation and pension are commonly changed by taxpayers and it is currently unclear how these changes affect the CAMT.
- Providing guidance that section 446 and section 481 apply when changing AFSI methods for purposes of the CAMT will help to clarify this uncertainty. For example, taxable income will include the impact of a depreciation section 481(a) adjustment in the year of change (or ratably over a longer period if the adjustment is an addition to taxable income) and therefore AFSI should also include the effect of this adjustment in the corresponding period so that there is parity between taxable income and AFSI. This approach will treat a section 481(a) adjustment similarly to how it is treated for purposes of section 163(j). Furthermore, this approach will ensure that the method used for AFSI purposes will correspond to the method used for taxable income purposes.
- Guidance also should be provided that makes clear that a change in method for AFSI purposes only also is a change in method of accounting to which section 446 and section 481 apply. Applying method of accounting principles will encourage voluntary compliance when a taxpayer is inadvertently using an impermissible method for AFSI purposes.

#### **4. Mergers & Acquisitions Issues**

- **Modify the definition of Covered Nonrecognition Transaction and the scope of the adjustments**

○ Overview

- Section 56A(c)(15) provides the Secretary shall issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes of this section, including adjustments:

- To prevent the omission or duplication of any item, and
  - To carry out the principles of part II of subchapter C of this chapter [section 331 through section 346] (relating to corporate liquidations), part III of subchapter C of this chapter [section 351 through section 368] (relating to corporate organizations and reorganizations), and part II of subchapter K of this chapter (relating to partnership contributions and distributions).
- Section 3.02(5) of the Notice defines Covered Nonrecognition Transaction as a transaction that, solely with regard to a corporation or a partnership (as appropriate), qualifies for nonrecognition treatment for federal income tax purposes, respectively, under section 332, section 337, section 351, section 354, section 355, section 357, section 361, section 368, section 721, section 731, or section 1032, or a combination thereof, and is not treated as resulting in any amount of gain or loss for federal income tax purposes (that is, solely with regard to the corporation or partnership, as appropriate).
  - Each component transaction of a larger transaction is examined separately for qualification as a Covered Nonrecognition Transaction. Because Covered Nonrecognition Transaction status requires nonrecognition treatment for federal income tax purposes, the treatment of a component transaction as a Covered Nonrecognition Transaction may be affected by the federal income tax consequences of any other component transaction of the larger transaction as well as all other component transactions of the larger transaction.<sup>5</sup>
  - Any financial accounting gain or loss resulting from the application of the accounting standards used to prepare the AFS of a Party to the Covered Nonrecognition Transaction is not taken into account solely for purposes of calculating the AFSI of the Party for the one or more tax years in which the AFS of the Party takes into account the Covered Nonrecognition Transaction (the “Nonrecognition Adjustment”).<sup>6</sup>
  - With regard to any property transferred to a Party as part of a Covered Nonrecognition Transaction, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that Covered Nonrecognition Transaction is not taken into account solely for purposes of computing the AFSI of the Party receiving the transferred property with regard to any tax year of that Party (the “Basis Adjustment”).<sup>7</sup>
  - Section 3.02(9) of the Notice defines the term Party to mean, with regard to a Covered Transaction: (i) a Controlled; (ii) a Distributing AFS Group; (iii) a partnership; (iv) a corporate partner transferring to, or receiving property from, a partnership in a Covered Transaction; (v) a Target; (vi) a Target AFS Group; or (vii) an Acquirer AFS Group.

---

<sup>5</sup> Notice 2023-7, section 3.02(5)(b).

<sup>6</sup> Notice 2023-7, section 3.03(1).

<sup>7</sup> Notice 2023-7, section 3.03(2).

○ Recommendation

- Modify the definition of Covered Nonrecognition Transaction and the scope of the Nonrecognition Adjustment and the Basis Adjustment.
  - The definition of Covered Nonrecognition Transaction should include these types of transactions with respect to the retained noncontrolling interest of stock to the extent that there is not a realization event for federal income tax purposes.
  - The Nonrecognition Adjustment and the Basis Adjustment should only apply to Covered Nonrecognition Transactions that have both adjustments. The Nonrecognition Adjustment and the Basis Adjustment should apply to any Party of a Covered Nonrecognition Transaction.
  - The definition of Covered Nonrecognition Transaction should exclude transactions that may technically qualify for nonrecognition treatment under the specified Code sections, but at the same time, do not result in the omission or duplication of an item in AFSI and do not conflict with the principles of part II of subchapter C (sections 331 through 346) and part III of subchapter C (sections 351 through 368).
  - The Nonrecognition Adjustment and the Basis Adjustment should not be applied unless they prevent the omission or duplication of any item and are needed to carry out the principles of subchapter C and subchapter K as specified in section 56A(c)(15).

○ Analysis

- The Notice defines a Covered Nonrecognition Transaction as a transaction that, solely with regard to a corporation or a partnership (as appropriate), meets two requirements: (i) the transaction qualifies for nonrecognition treatment for federal income tax purposes under certain specified sections of the Code, or a combination thereof; and (ii) the transaction is not treated as resulting in any amount of gain or loss for federal income tax purposes, solely with regard to such corporation or partnership, as appropriate. If a transaction qualifies as a Covered Nonrecognition Transaction, a Party to the transaction is subject to the Nonrecognition Adjustment and/or the Basis Adjustment.
- The definition of a Covered Nonrecognition Transaction in the Notice does not include transactions that may result in gain or loss for financial statement purposes without a corresponding realization event for federal income tax purposes. In our October 14, 2022 prior comment letter, we mentioned examples of transactions that can result in gain or loss for financial statement purposes that would be included in AFSI even though no gain or loss is recognized for federal income tax purposes (*e.g.*, multi-stage acquisitions under ASC 805-10-25-10 and deconsolidations under ASC 810-10-40-5).
- Specifically, a deconsolidation may result when a subsidiary corporation issues new shares to dilute and reduce an AFS Group's existing ownership interest so that the AFS Group no longer has a controlling financial interest, but the AFS Group retains a non-controlling interest in the stock of the subsidiary. When the AFS Group loses control, ASC 810-10-40-5 requires the AFS Group to recognize a gain

- or loss in net income, which may include gain or loss related to the stock of the subsidiary retained by the AFS Group.
- If the purpose of the rules for Covered Nonrecognition Transactions was to provide parity between AFSI and regular taxable income, we do not think it is appropriate that AFSI includes gain or loss with respect to the retained noncontrolling interest of stock until there is a tax realization event (*e.g.*, a sale or disposition by the AFS Group of the remaining noncontrolling interest). In our example, if the gain or loss related to the retained interest was not included in AFSI, there would not be an omission of such item because gain or loss would be recognized upon a tax realization event. The definition of Party in the Notice is limited to include a corporation only if it is included in an AFS Group (either as an Acquirer AFS Group, Target AFS Group, or Distributing AFS Group) or if it is a corporate partner transferring to, or receiving property from, a partnership in a Covered Transaction. Notably, the Notice applies the Nonrecognition Adjustment and the Basis Adjustment unilaterally and there is no requirement that they both apply, in order for either to apply, in the Notice. For example, the Basis Adjustment could apply to a Party of a Covered Nonrecognition Transaction if there is no Nonrecognition Adjustment to the Party, or another Party.
    - Example 1-: A corporation in an Acquirer AFS Group obtains control of another corporation, T, by way of the acquisition of T stock, which qualifies as a Covered Nonrecognition Transaction. The former shareholders of T were not a Party as defined in the Notice and no AFS Group recognized gain or loss on AFS related to the deconsolidation of T.
    - In this example, the Acquirer AFS Group is a Party to a Covered Nonrecognition Transaction and the Acquirer AFS Group would be subject to the Basis Adjustment under the Notice. However, there may be no corresponding gain or loss in the CAMT system because there was no Party that recognized gain or loss related to T on AFS (*i.e.*, neither the former shareholders of T nor T were a Party to the Covered Nonrecognition Transaction). If the intended purpose of the Basis Adjustment was to prevent the duplication related to a Covered Nonrecognition Transaction subject to the Nonrecognition Adjustment, it seems that the Basis Adjustment would not be necessary for a transaction in which there was no symmetry in the CAMT system.
  - Regarding our recommendation that the definition of Covered Nonrecognition Transaction excludes transactions that may technically qualify for nonrecognition treatment under the specified Code sections, but at the same time, do not result in the omission or duplication of an item in AFSI and do not conflict with the principles of part II of subchapter C (sections 331 through 346) and part III of subchapter C (sections 351 through 368), we provide the below example.
  - An example is a transaction that qualifies for nonrecognition under section 1032 that is taxable to the transferor. The definition of Covered Nonrecognition Transaction in the Notice includes the receipt of property by a corporation in exchange for its own stock because such corporation generally has no gain or loss under section 1032. However, this definition includes a “taxable 1032 Transaction” in which the transferee corporation has no gain or loss, but the transferor has a

taxable exchange under section 1001 because a nonrecognition provision (*e.g.*, section 351) does not apply to the transferor. In such a transaction, the transferee corporation's basis of the acquired property is the cost, which is fair market value of the stock issued as confirmed in a ruling by the IRS.<sup>8</sup>

- If a taxable 1032 Transaction is a Covered Nonrecognition Transaction, and the transferee corporation was a Party to such taxable 1032 Transaction, the Basis Adjustment would apply to provide that any increase or decrease in the financial accounting basis of the transferred property from the taxable 1032 Transaction is not taken into account for purposes of computing the AFSI of the transferee corporation. This result seems to be inappropriate because the transferee corporation would be entitled to cost basis for tax purposes under section 1012 in subchapter O. The transferee's basis was not determined as an ancillary result of section 1032 or another nonrecognition provision in the definition. In this situation, the Basis Adjustment does not prevent the omission or duplication of an item, nor does it carry out the principles in subchapter C that are referenced in section 56A(c)(15).
  
- **Clarify definition of predecessor for section 59(k)(1)(E)**
  - Overview
    - Section 59(k)(1) provides the definition of Applicable Corporation. Section 59(k)(1)(E) provides other special rules for purposes of the definition of Applicable Corporation. Specifically, section 59(k)(1)(E) provided:
      - If the corporation was in existence for less than 3 years, the average annual AFSI test under section 59(k)(1)(B) is applied on the basis of the period during which such corporation was in existence (the Testing Period Rule);
      - AFSI for any tax year of less than 12 months shall be annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months in the short period (the Annualization Rule); and
      - Any reference in section 59(k)(1)(E) to a corporation includes a reference to any predecessor of such corporation.
  - Recommendations
    - The regulations should clarify whether there is a difference in determining a predecessor if Target is a member of a tax consolidated group. If a member of a tax consolidated group is tested as a single entity, the regulations should clarify other situations that a member of a tax consolidated group is treated as a single entity for CAMT purposes, if any.
    - In addition, that guidance should define whether for these purposes a predecessor is limited to taxpayers that are corporations, or if the term could also include partnerships.

---

<sup>8</sup> Rev. Rul. 56-100 *modifying* Rev. Rul. 54-96 1954-1 C.B. 111 (ruling that the basis of assets acquired by a corporation in a taxable exchange for its stock was the fair market value of the stock used to purchase the assets).

○ Analysis

- The term predecessor for purposes of section 59(k)(1)(E) is not defined in the Code nor in the Notice. The term is used in several places in the Code and the regulations thereunder with different meanings intended for different purposes. Several definitions of the term reference section 381.<sup>9</sup> For example, Treas. Reg. § 1.59A-2 provides a predecessor is the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation.
- The purpose of section 59(k)(1)(E) seems to be to remove distortions in the average annual AFSI test from a corporation that was in existence for less than 3 years and/or a tax year of less than 12 months. Therefore, similar to the use of the term in section 59A, we expect that a predecessor for purposes of section 59(k)(1)(E) include the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation. However, further considerations may be necessary in determining whether there is a predecessor for purposes of section 59(k)(1)(E) in relation to other rules set forth in Notice 2023-7.
- Status as an applicable corporation is generally permanent, and due to general challenges for taxpayers and the government in applying the applicable corporation determination, we generally believe that a narrower definition of predecessor (i.e., one that is limited to corporations and does not include partnerships, consistent with the section 59A regulations) may be most appropriate for these purposes.
- Because a tax consolidated group is treated as a single entity for purposes of calculating AFSI for determining applicable corporation status, the regulations should clarify whether a member of a tax consolidated group is tested to be a predecessor, or whether the tax consolidated group is tested to be a predecessor as a single entity.
- In Example 6 of the Notice, Acquirer AFS Group acquires Target solely in exchange for stock through a merger of Target into a member of Acquirer AFS Group that qualifies as a reorganization described in section 368(a)(1)(A). For purposes of applying the average annual AFSI test to the Acquirer AFS Group, Target's allocated AFSI is combined with Acquirer AFS Group's AFSI under Section 3.04(2)(b) of the Notice. However, the example does not provide that Target is a member of a tax consolidated group.

---

<sup>9</sup> Some examples of different definitions include: (i) for purposes of section 59A, a predecessor is the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation, Treas. Reg. § 1.59A-2(d)(6); (ii) for purposes of section 168(k), predecessor includes: (a) a transferor of an asset to a transferee in a transaction to which section 381(a) applies; (b) a transferor of the asset to a transferee in a transaction in which the transferee's basis in the asset is determined, in whole or in part, by reference to the basis of the asset in the hands of the transferor; (c) a partnership that is considered as continuing under section 708(b)(2) and Treas. Reg. § 1.708-1; or (d) the decedent in the case of an asset acquired by the estate, Treas. Reg. § 1.168(k)-2; (iii) for purposes of Treas. Reg. § 1.385-3 and Treas. Reg. § 1.385-4, the term predecessor means, with respect to a corporation: (a) the distributor or transferor corporation in a transaction described in section 381(a) in which the corporation is the acquiring corporation; or (b) the distributing corporation in a distribution or exchange to which section 355 (or so much of section 356 that relates to section 355) applies in which the corporation is a controlled corporation, Treas. Reg. § 1.385-3(g)(20).



- Under a variation of the facts in Example 6 (*e.g.*, Target was in existence for less than 3 years or Target had a tax year of less than 12 months), the amount of Target’s allocated AFSI taken into account by the Acquirer AFS Group for purposes of the average annual AFSI test could be subject to the Testing Period Rule and the Annualization Rule if Target was a predecessor for purpose of section 59(k)(1)(E). It may also be the case that Target, if respected as a separate entity, is a member of a tax consolidated group.
- **Provide allocation of financial statement NOL carryovers to a departing member**
  - Overview
    - Generally, a financial statement net operating loss (NOL) can be carried forward to subsequent tax years pursuant to section 56A(d).<sup>10</sup> Thus, financial statement NOLs become an attribute of the AFS Group.
  - Recommendation
    - Treasury and the IRS should provide guidance to taxpayers detailing how accrued financial statement NOL carryovers should be allocated between a departing member and its AFS Group.
      - We suggest that financial statement NOL carryovers should be allocated between a departing member and its AFS Group in the same manner that consolidated NOLs are allocated between a group of corporations filing a consolidated return (a “consolidated group”) and a departing member under Treas. Reg. § 1.1502-21.
  - Analysis
    - Under section 56A(d)(2), any financial statement NOLs not absorbed in a tax year become financial statement NOL carryovers in subsequent tax years. For purposes of calculating an applicable corporation’s CAMT liability, section 56A(d)(1) allows a deduction against AFSI equal to the lesser of: (i) an AFS Group’s aggregate financial statement NOL carryovers; or (ii) 80 percent of AFSI (as calculated without regard to the deduction for financial statement NOL carryovers).<sup>11</sup> Because these accrued financial statement NOL carryovers can be used to offset a portion of future AFSI, they become an attribute of the AFS Group for purposes of determining the group’s CAMT liability. Upon a member’s departure, the AFS Group must determine what amount, if any, of that group’s financial statement NOL carryovers should be allocated to the departing member to offset AFSI in subsequent years when it either is not a member of an AFS Group

---

<sup>10</sup> A financial statement NOL means “the amount of the net loss (if any) set forth on the corporation’s AFS (determined after application of section 56A(c) and without regard to section 56A(d)) for tax years ending after December 31, 2019.” *See* section 56A(d)(3).

<sup>11</sup> For purposes of determining whether a taxpayer is an applicable corporation, however, financial statement NOL carryovers are not permitted as a deduction against AFSI. *See* section 59(k)(1)(B).

or is a member of a different AFS Group. Treas. Reg. § 1.1502-21, relating to the NOLs of a consolidated group (“CNOLs”) provides an appropriate framework for making this determination.

- Similar to financial statement NOL carryovers, the ability to use CNOLs to offset the income of a consolidated group, coupled with the ability to carry those CNOLs to prior and/or subsequent tax years,<sup>12</sup> creates an attribute within the consolidated group. When a member departs a consolidated group, the portion of these CNOLs “attributable to” the departing member may generally be carried to a separate return year of the member pursuant to Treas. Reg. § 1.1502-21(b)(2)(i). The amount of unabsorbed CNOLs “attributable to” a member in any consolidated return year is determined based on the *percentage* of CNOL attributable to that member.<sup>13</sup> For these purposes, the percentage of CNOL attributable to a member is the quotient of: (i) the loss computed with respect to only that member’s items of income, gain, deduction, and loss (the “separate NOL”); divided by (ii) the aggregate loss of all consolidated group members that have a separate NOL for the year.<sup>14</sup> However, where a member’s separate NOL for a tax year is absorbed disproportionately compared to the separate NOLs of other members, or where a member leaves a consolidated group, that member’s percentage of attributable CNOL is recomputed based on the remaining CNOLs at the time of the recomputation.<sup>15</sup>
- Applying this framework to the financial statement NOL carryovers of an AFS Group, the allocation to a departing member can be illustrated as follows:
  - Example 2: P is an applicable corporation; S and T are members of P’s AFS Group (the “P Group”). In Year 1, the P Group sustained a financial statement NOL of \$1,100, which was comprised of separate NOLs of P, S, and T in the amounts, respectively, of \$200, \$300, and \$600. In Year 2, the P Group had AFSI, computed without regard to the deduction for financial statement NOL carryovers, of \$500. Pursuant to section 56A(d)(1), the P Group was allowed a deduction for financial statement NOL carryovers in the amount of \$400 in calculating its AFSI.
  - On December 31 of Year 2, P sold all of the stock of T to an unrelated corporation, A. As a result, T became a member of A’s AFS Group (the “A Group”). Under the Notice, T’s status as an applicable corporation terminated, and T’s allocable portion of the P Group’s AFSI for the 3-taxable-year period preceding the relevant tax computation year will be included with that of the A Group for purposes of determining applicable corporation status. Of the P Group’s \$700 financial statement NOL carryovers remaining after the application of section 56A(d), \$382<sup>16</sup> were allocated to T. The P Group as \$318 of financial statement NOL carryovers remaining.

---

<sup>12</sup> See Treas. Reg. § 1.1502-21(a).

<sup>13</sup> See Treas. Reg. §1.1502-21(b)(2)(iv)(A).

<sup>14</sup> See Treas. Reg. §1.1502-21(b)(2)(iv)(B)(1).

<sup>15</sup> See Treas. Reg. §1.1502-21(b)(2)(iv)(B)(2).

<sup>16</sup> Equal to: (i) T’s separate NOLs of \$600 in Year 1; divided by (ii) the aggregate separate NOLs of \$1,100 attributable to P, S, and T; and then multiplied by (iii) the P Group’s remaining \$700 of financial statement NOL carryovers.

- Finally, limitations similar to those found in section 382 or in Treas. Reg. § 1.1502-21(c) can be implemented to prevent AFS Groups from trafficking in financial statement NOL carryovers. Thus, in the prior example, the A Group’s ability to use the financial statement NOL carryovers allocated to T may be generally limited to the separate AFSI of T, computed without regard to the deduction for financial statement NOL carryovers in section 56A(d).
- **Acquisition of Section 168 Property in Covered Recognition Transactions and Covered Nonrecognition Transactions**
  - Overview
    - Section 56A(c)(13)(A) requires AFSI to be reduced by depreciation deductions allowed under section 167 with respect to property to which section 168 applies (“Section 168 Property”), to the extent of the amount allowed as deductions in computing taxable income for the tax year (“Deductible Tax Depreciation”). In addition, section 56A(c)(13)(B)(i) requires appropriate adjustments to AFSI to disregard any amount of depreciation expense that is taken into account on the taxpayer’s AFS with respect to Section 168 Property. The Notice provides that section 56A(c)(13) applies to Section 168 Property placed in service in any tax year, including tax years beginning before January 1, 2023. An example to the Notice clarifies that adjustments to AFSI basis in Section 168 Property for years prior to January 1, 2023, must be taken into account.
    - The Notice further provides that, with regard to any property transferred to a Party as part of a Covered Nonrecognition Transaction, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that Covered Nonrecognition Transaction is not taken into account solely for purposes of computing the AFSI of the Party receiving the transferred property with regard to any tax year of that Party. In the context of a Covered Recognition Transaction, the Notice does not provide for an adjustment to any increase or decrease in the AFS basis of property for purposes of determining the Party’s AFSI.
    - If depreciable property is acquired in a nonrecognition transaction described in section 168(i)(7)(B) (*i.e.*, transactions described in section 332, section 351, section 361, section 721, and section 731), the transferee will be treated as the transferor for purposes of computing depreciation deductions determined under section 168 with respect to the basis of the property in the hands of the transferee that does not exceed the adjusted basis in the hands of the transferor.<sup>17</sup> In other words, the transferee will generally step into the shoes of the transferor with respect to the transferor’s period and method of depreciation under section 168.<sup>18</sup> If the transferee’s basis in the property acquired in the transaction exceeds the transferor’s

---

<sup>17</sup> Section 168(i)(7)(A).

<sup>18</sup> Special rules apply to nonrecognition transactions for ACRS but not MACRS purposes, which have the effect of lengthening the period over which the transferee can recover a portion of the transferor’s adjusted basis.

adjusted basis, the excess is treated as property that may be separately depreciated.<sup>19</sup>

○ Recommendations

- If future guidance does not modify AFSI to mirror the federal income tax treatment of a Covered Recognition Transaction involving a taxable stock acquisition, Treasury and IRS should disregard any increase or decrease in the AFS basis of Section 168 Property that is not taken into account for federal income tax purposes for purposes of determining a corporation's AFSI.
- Future guidance should clarify that the basis adjustment rule of section 3.03(2) of the Notice applies to any property that is acquired *directly or indirectly* by the Party as part of a Covered Nonrecognition Transaction.

○ Analysis

- Regarding the first recommendation, if a corporation directly acquires Section 168 Property in a Covered Nonrecognition Transaction or a Covered Recognition Transaction that is fully taxable for federal income tax purposes, Section 4.06 of the Notice, which requires that taxpayers apply section 56A(c)(13) based on when the Section 168 Property was placed in service, provides sufficient guidance for determining Deductible Tax Depreciation. That is, AFSI and the federal income tax treatment of the Section 168 Property should generally align in these cases. For example, if the corporation acquired Section 168 Property solely in exchange for shares of its stock in a Covered Nonrecognition Transaction (*i.e.*, under section 1032), it would take a carryover basis in the Section 168 Property under the basis adjustment rule of Section 3.03(2) of the Notice and look to when the property was placed in service, consistent with section 168(i)(7)(A), to determine Deductible Tax Depreciation.<sup>7</sup> If the corporation directly acquires Section 168 Property in a Covered Recognition Transaction that is fully taxable for federal income tax purposes, the Section 168 Property would be treated as having been placed in service on the date of the Covered Recognition Transaction for purposes of applying section 56A(c)(13).
- However, under the current formulation of the rules, if a corporation acquires stock of a corporation in a Covered Recognition Transaction, any increase or decrease in the AFS basis in the assets of the target corporation, including subsidiaries of the target corporation, would be taken into account for AFSI purposes. For federal income tax purposes, absent a section 338 election,<sup>20</sup> the target corporation (and its subsidiaries) would keep its existing basis and continue to depreciate its assets over their remaining useful lives. The Notice requests comments on the treatment of Covered Recognition Transactions and whether AFSI adjustments should also be taken into account to better align AFSI with federal income tax principles. If future

---

<sup>19</sup> Prop. Reg. §1.168-5(b)(7).

<sup>20</sup> See section 338(g) and section 338(h)(10); see also section 336(e).

guidance does not modify AFSI to mirror federal income tax treatment in the case of a Covered Recognition Transaction involving a taxable stock acquisition, the disconnect between the AFSI and federal income tax treatment in this case raises a question of how section 56A(c)(13) should be applied. Section 56A(c)(13) appears to deny Deductible Tax Depreciation on any AFS increase in the basis of Section 168 Property, while allowing for an adjustment to any Deductible Tax Depreciation on any AFS decrease in AFSI basis of Section 168 Property. This result would be improper if Treasury decides not to align AFSI with federal income tax treatment in this scenario.

- Regarding the second recommendation above, if a corporation acquires stock of another corporation in a Covered Nonrecognition Transaction, the current language of Section 3.03(2) of the Notice raises the question of what property is subject to a basis adjustment. Specifically, section 3.03(2) of the Notice states that “with regard to any property *transferred to* a Party as part of a Covered Nonrecognition Transaction, any increase or decrease in the financial accounting basis of *that property*” is not taken into account. Because Section 3.03(1) of the Notice is drafted from a federal income tax perspective (*i.e.*, referring to transfers governed by section 351, section 354, section 355, etc.), the literal language of Section 3.03(2) of the Notice could support an argument that only the assets directly acquired in the Covered Nonrecognition Transaction are adjusted. For book accounting purposes, the corporation is treated as having acquired all of the assets held directly and indirectly by the target corporation. The examples in the Notice do not directly address this issue, as one could assume that example 1 and example 2 of the Notice do not involve a direct acquisition of assets through a subsidiary of the target corporation in a section 368(a)(1)(A) reorganization.
  - Presumably Treasury and IRS intended for Section 3.03(2) of the Notice to apply to property acquired *directly or indirectly*, which would mean, consistent with book treatment, all of target’s assets, regardless of the form of the transaction and regardless of whether target holds assets directly or is a holding company.
- **Modify the Notice Cancellation of Indebtedness Income (CODI) approach**

- Overview

*Regarding CODI*

- For federal income tax purposes, gross income generally includes income from the cancellation or discharge of debt (“Tax CODI”).<sup>21</sup> Under the federal income tax rules, Tax CODI generally is realized when a debt is satisfied or repurchased<sup>22</sup> for less than its adjusted issue price.<sup>23</sup>

---

<sup>21</sup> Section 61(a)(11). Treas. Reg. § 1.61-12(a).

<sup>22</sup> The term “repurchase” includes a retirement of a debt instrument, the conversion of a debt instrument into stock of the issuer, and the exchange (including an actual or deemed exchange under section 1001) of a newly issued debt instrument for an existing debt instrument. *See* Treas. Reg. § 1.61-12(c)(2)(i).

<sup>23</sup> Treas. Reg. § 1.61-12(c); *see also* Treas. Reg. § 1.1275-1(b)(1) (defining adjusted issue price as the issue price, increased by the amount of OID previously includible in the gross income of any holder, and decreased by the amount of any payment previously made on the debt instrument other than a payment of qualified stated interest).

- In general, the amount of Tax CODI is the excess of the adjusted issue price of a discharged debt over the amount of consideration received by the creditor in discharge of the debt.<sup>24</sup> If a debtor issues a new debt instrument in satisfaction of existing debt, the debtor is treated as having satisfied the existing debt with an amount of money equal to the issue price of such new debt instrument.<sup>25</sup> As a result, the debtor generally realizes Tax CODI to the extent the adjusted issue price of the existing debt instrument exceeds the issued price of the newly issued debt instrument (as determined under section 1273 and section 1274). If a debtor corporation issues its stock in satisfaction of existing debt, such corporation is treated as having satisfied the debt with an amount of money equal to the fair market value of the stock.<sup>26</sup> As a result, the debtor generally realizes Tax CODI to the extent the adjusted issue price of the existing debt instrument exceeds the fair market value of the stock. If a debtor corporation acquires its debt from a shareholder as a contribution to capital, the debtor is treated as having satisfied the debt with an amount of money equal to the shareholder's adjusted basis in the debt.<sup>27</sup> As a result, the debtor generally realizes Tax CODI to the extent the adjusted issue price of the existing debt instrument exceeds the holder's basis in the debt instrument.
- There are certain events that create deemed exchanges that can accelerate Tax CODI. Under section 108(e)(4), the acquisition of an outstanding debt by a party related to the debtor from an unrelated party is treated as an acquisition of the debt by the debtor.<sup>28</sup> The debt is then treated as new debt with an issue price of either the holder's adjusted basis or the fair market value of the indebtedness, issued by the debtor to the related holder on the acquisition date.<sup>29</sup> Treas. Reg. § 1.1001-3 generally provides that a significant modification of a debt instrument, as defined therein, creates a deemed exchange of the "old" debt instrument for a "new" modified instrument, which can give rise to Tax CODI.<sup>30</sup> Under Treas. Reg. § 1.1502-13(g), intercompany debt or debt that becomes intercompany likewise can be deemed satisfied and reissued (DSR) when certain triggering transactions occur.<sup>31</sup>
- Generally, for federal income tax purposes, Tax CODI gives rise to taxable income.<sup>32</sup> However, there are exceptions from this general rule, set forth in section 108(a) (the "Section 108(a) Exclusions"). The Section 108(a) Exclusions include (1) when the discharge occurs in a title 11 (bankruptcy) case; (2) when the discharge occurs when the taxpayer is insolvent (to the extent of the insolvency); (3) when the debt is qualified farm indebtedness; (4) in the case of a C corporation, when the debt is qualified real property business debt; (5) in certain cases, when the debt is

---

<sup>24</sup> Treas. Reg. § 1.61-12(c)(2)(ii).

<sup>25</sup> Section 108(e)(10).

<sup>26</sup> Section 108(e)(8).

<sup>27</sup> Section 108(e)(6).

<sup>28</sup> Section 108(e)(4).

<sup>29</sup> Treas. Reg. § 1.108-2(g)(1).

<sup>30</sup> Treas. Reg. § 1.1001-3.

<sup>31</sup> Treas. Reg. § 1.1502-13(g)(3).

<sup>32</sup> Section 61.

qualified principal residence debt.<sup>33</sup> If one of the Section 108(a) Exclusions applies, the Tax CODI is excluded from income, but federal income tax attributes have to be reduced under section 108(b).<sup>34</sup> This regime was enacted by Congress “to accommodate bankruptcy policy and tax policy... so that a debtor coming out of bankruptcy (or an insolvent debtor outside bankruptcy) is not burdened with an immediate tax liability.”<sup>35</sup> Another exception to Tax CODI is for liabilities the payment of which would give rise to a deduction.<sup>36</sup> From a policy perspective, section 108(e)(2) excludes from Tax CODI expenses from which no tax benefit has been derived, and puts cash method taxpayers on the same footing as accrual method taxpayers.<sup>37</sup>

- For federal income tax purposes, generally debt is considered discharged at “the moment it becomes clear that a debt will never have to be paid.”<sup>38</sup> The moment of discharge should be fixed by an “identifiable event,” but the “identifiable event” need not be an overt act.<sup>39</sup> The determination should be based on a practical assessment of the facts and circumstances relating to the likelihood of payment.<sup>40</sup>

#### *Regarding Book CODI*

- In general, financial accounting standards (“Book”) can also treat cancellations of indebtedness as giving rise to gain (“Book CODI”); however, differing accounting standards (e.g., U.S. GAAP or IFRS) may result in the application of different Book rules.
- For example, the Financial Accounting Standards Board (FASB) ASC, prescribes rules relevant to “troubled debt restructurings” (TDR). A TDR generally is defined to include a situation where a creditor for economic or legal reasons related to the debtor’s financial difficulties grants a concession to the debtor that it would not otherwise consider.<sup>41</sup> ASC includes separate subtopics applicable to the Book treatment of a TDR by the creditor and the debtor, and the rules do not necessarily require symmetry between the two.<sup>42</sup> From the debtor’s perspective, when debt is modified, but not extinguished, Book CODI generally arises to the extent the total future cash payments specified by the new terms of the debt are less than the existing carrying amount of the debt.<sup>43</sup> In such a case, the carrying amount is reduced to an amount equal to the total future cash payments specified by the new

---

<sup>33</sup>Section 108(a).

<sup>34</sup> Section 108; *See also* Treas. Reg. § 1.1502-28.

<sup>35</sup> S. REP. 96-1035, 9-10, 1980 U.S.C.C.A.N. 7017, 7024-25.

<sup>36</sup> Section 108(e)(2).

<sup>37</sup> Cash-method taxpayers would be disadvantaged if the cash-method of accounting has delayed their ability to deduct liabilities that have not been paid (*i.e.*, “lost deductions”), but they nevertheless are required to include the cancellation of such debt in income. *See* H.R. Rep. No. 833, 96th Cong., 2d Sess. 7, 16 (1980); S. Rep. No. 1035, 96th Cong., 2d Sess. 8, 20 (1980). *See also* P.L. 96-589, Bankruptcy Tax Act of 1980, H.R. 5043, 96th Cong. (enacted Dec. 24, 1980).

<sup>38</sup> *See, e.g.*, *Cozzi v. Comm’r*, 88 T.C. 435 (1987); *Friedman v. Comm’r*, 216 F.3d 537 (6th Cir. 2000).

<sup>39</sup> *See, e.g.*, *Cozzi v. Comm’r*, 88 T.C. 435 (1987); *Friedman v. Comm’r*, 216 F.3d 537 (6th Cir. 2000).

<sup>40</sup> *Cozzi v. Comm’r*, 88 T.C. 435 (1987).

<sup>41</sup> ASC 470-60-15-5.

<sup>42</sup> ASC 470-60-15-3.

<sup>43</sup> ASC 470-60-35-6.

terms, and Book CODI is recognized in the amount of the reduction.<sup>44</sup> If, in a TDR, a debtor transfers assets in satisfaction of existing debt, the debtor generally realizes Book CODI to the extent the carrying amount of the debt exceeds the fair value of the assets transferred to the creditor.<sup>45</sup> If a debtor corporation transfers its stock in satisfaction of existing debt, such corporation generally realizes Book CODI to the extent the carrying amount of the debt exceeds the fair value of the equity transferred to the creditor.<sup>46</sup> TDRs are treated as occurring at the date of consummation, *i.e.*, at the time of the transfer of assets or equity interest, the effective date of new terms, or the occurrence of another event that constitutes consummation of the restructuring.<sup>47</sup>

- Outside of the TDR context, ASC indicates that when a debt is deemed extinguished for Book purposes, Book CODI is recognized in the period of extinguishment in an amount equal to the difference between the reacquisition price of the debt<sup>48</sup> and the net carrying amount<sup>49</sup> of the extinguished debt.<sup>50</sup> An exchange of debt instruments with substantially different terms is treated as a debt extinguishment and must be accounted for similar to an extinguishment.<sup>51</sup> Generally, an exchange of debt instruments or a modification of a debt instrument by a debtor and a creditor in a nontroubled debt situation is deemed to have been accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument.<sup>52</sup>
- We know of no concepts analogous to section 108(a), section 108(e)(2), section 108(e)(4), section 108(e)(6), or the DSR rules that apply under the Book regime.

#### *Regarding CAMT Policy*

- There is minimal formal legislative history related to CAMT. However, one can surmise Congressional intention from various statements relating to the CAMT or predecessors thereof. A CAMT proposal was introduced by Senators Elizabeth Warren, Angus King, and Ron Wyden. A statement published to announce the proposal explained: “Currently, the U.S. tax code allows large corporations to pay little or no tax because they are able to exploit a host of loopholes, deductions, and exemptions to drive down their tax liability. While these companies report billions

---

<sup>44</sup> ASC 470-60-35-6.

<sup>45</sup> ASC 470-60-35-2.

<sup>46</sup> ASC 470-60-35-4.

<sup>47</sup> ASC 470-60-20.

<sup>48</sup> For ASC purposes, reacquisition price of the debt is defined as the amount paid on extinguishment, including a call premium and miscellaneous costs of reacquisition. If extinguishment is achieved by a direct exchange of new securities, the reacquisition price is the total present value of the new securities. ASC Master Glossary.

<sup>49</sup> For Book purposes, net carrying amount of debt is the amount due at maturity, adjusted for unamortized premium, discount, and cost of issuance.

<sup>50</sup> ASC 470-50-40-2.

<sup>51</sup> ASC 470-50-40-6.

<sup>52</sup> ASC 470-50-40-10.



in profits, they often pay no income tax to the IRS.”<sup>53</sup> It further notes that, “Between 2008 and 2015, 40% of our biggest companies paid zero or less in federal taxes in at least one year, even while they were telling their shareholders they were wildly profitable.”<sup>54</sup> In Congressional debates, other members of Congress similarly indicated an intention to address a perception that, “some of the most profitable companies in our entire country... don’t pay a single cent in tax.”<sup>55</sup> “This ends the shameful practice of large, profitable businesses paying zero in income taxes.”<sup>56</sup> A statement by the White House in connection with the enactment of the Inflation Reduction Act likewise referenced “billion-dollar companies paying zero in taxes.”<sup>57</sup>

- Corporations that recognize Tax CODI are troubled nearly as a rule.<sup>58</sup> Discharge of debt requires agreement by the creditor, and creditors generally are not inclined to gratuitously forgive debt of profitable debtors. As courts have noted, “[t]he underlying rationale for the inclusion of canceled debt as income is that the release from a debt obligation the taxpayer would otherwise have to pay frees up assets previously offset by the obligation and acts as an accession to wealth--i.e., income.”<sup>59</sup> However, Tax CODI does not appear to be in the nature of the sort of “wild[] profit[s]” Congress was targeting when it enacted the CAMT.
- Furthermore, for the most part, differences between Tax CODI and Book CODI do not result from federal income tax “loopholes, deductions, and exemptions.” Many of the differences between Tax CODI and Book CODI result simply from differences in the manner in which the two regimes developed -- e.g., differences in how issue price and adjusted issue price are defined for federal income tax purposes versus carrying value for Book purposes; differences in the significant modification regimes that exists for federal income tax versus Book purposes (which may result in CODI under one regime but not the other or may result in CODI at different times); differences that result from deemed exchanges that occur under the federal income tax regime, but do not occur for Book purposes; differences in the timing rules relevant to each regime -- in which the federal

---

<sup>53</sup><https://www.warren.senate.gov/imo/media/doc/Warren-King-Wyden%20Corporate%20Profits%20Minimum%20Tax%20-%20One%20Pager.pdf>

<sup>54</sup><https://www.warren.senate.gov/imo/media/doc/Warren-King-Wyden%20Corporate%20Profits%20Minimum%20Tax%20-%20One%20Pager.pdf>

<sup>55</sup> The full statement was as follows: “Mr. President, we have just heard a discussion of the issue of tax reform, and my colleague across the aisle has said there should be no corporate minimum tax on corporations, and yet Americans know that billionaire companies one after the other--some of the most profitable companies in our entire country, companies like Amazon--don’t pay a single cent in tax. They use our legal system. They use our road system. They use our education system. They use it all in vast quantities and don’t contribute a single dime. One single ordinary worker does more to pay for all of the infrastructure these massive companies utilize than the company does. It is about time corporations that make massive profits pay something, and 15 percent isn’t even their fair share. And it is part of a global agreement to hold corporations accountable, so they don’t skip from one country to another, to another, to another, evading everyone everywhere.” 168 Cong. Rec. S4165-03, S4169

<sup>56</sup>, 167 Cong. Rec. H6659-06, H6661

<sup>57</sup> <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/09/13/remarks-by-president-biden-on-the-passage-of-h-r-5376-the-inflation-reduction-act-of-2022/>

<sup>58</sup> There are some exceptions to this principle. For example, if interest rates go up, the value of a debt may decrease; thus, a corporation may generate a small amount of CODI if it repurchases for a market rate at a discount from face. However, it is generally troubled company restructurings that give rise to large amounts of CODI.

<sup>59</sup> *Bui v. Comm’r*, T.C. Memo. 2019-54 citing *United States v. Kirby Lumber Co.*, 284 U.S. 1, 2 (1931).

income tax regime is conceptually neither preferential nor detrimental as compared with Book treatment; the outcome will vary based on the precise facts at issue. The rules applicable to Tax CODI, as compared to Book CODI, may be preferential to taxpayers in some cases (e.g., where section 108(e)(6) or section 108(e)(2) apply), but also may be detrimental to taxpayers in other cases (e.g., where Tax CODI is accelerated under section 108(e)(4) or a result of a DSR). The Section 108(a) Exclusions are in the nature of an exemption; however, Treasury and IRS have already indicated a willingness to import this concept, recognizing that failure to do so could significantly burden troubled companies, contrary to both bankruptcy and tax policies.

### *Regarding the Notice*

- Absent guidance, the AFSI of a company restructuring its debt could include significant Book CODI, while Tax CODI is either excluded or not realized, which could (i) cause the corporation, which might otherwise have average AFSI well below \$1 billion dollars, to become an applicable corporation; (ii) cause the corporation to have a significant CAMT liability, contrary to the bankruptcy and tax policy. The Notice attempts to address this issue. It provides “to the extent that a discharge of indebtedness results in excluded COD income to an AFS Group for federal income tax purposes, but results in gain to the AFS Group on the AFS of the AFS Group:
    - Adjustment of financial accounting gain. The financial accounting gain resulting from application of the accounting standards used to prepare the AFS of the AFS Group to the discharge of indebtedness that is equal to the amount of excluded COD income (for federal income tax purposes) of the AFS Group is not taken into account for purposes of calculating the AFSI of that AFS Group for the tax year in which the discharge of indebtedness occurs.
    - Corresponding adjustments to CAMT attributes of AFS Group. If financial accounting gain resulting from a discharge of indebtedness is not taken into account under Section 3.06(1) of the Notice for purposes of calculating the AFSI of an AFS Group, the AFS Group’s CAMT attributes must be reduced to the extent of the section 108(b) Reduction Amount under the principles of, including taking account the ordering provided by, section 108(b) and section 1017.”
  - We appreciate that Treasury and the IRS have recognized the issue with Book CODI, and set forth a framework in how to address these issues (the “Notice CODI Approach”). However, we recommend an approach that diverges from the Notice CODI Approach.
- Recommendations
- Book CODI should be disregarded in computing AFSI, with AFSI instead adjusted to take into account Tax CODI when and to the extent recognized for tax purposes

(“Imported Book CODI”), with a corresponding reduction to CAMT attributes in the amount of the Imported Book CODI that is excluded from income under section 108 (which becomes a black hole to the extent the Imported Book CODI exceeds available CAMT attributes).

- Guidance should clarify that Book CODI (if any) resulting from debt that is purely intercompany between members of a federal income tax consolidated group is disregarded, consistent with the provision in the Notice indicating that a consolidated group should be treated as a single entity for CAMT purposes.
- Analysis
- The Notice CODI Approach ties the AFSI exclusion and amount of CAMT attributes that are reduced (the “CAMT Reduction”) to the amount of Tax CODI and the amount of attributes that are reduced for federal income tax purposes (the “Tax Reduction”). This tying of concepts can create issues when the timing and amount Tax CODI and Book CODI, or federal income tax attributes and CAMT attributes, do not match, as will often be the case since, as explained above, the regimes apply different rules. If Tax CODI exceeds Book CODI, then under the Notice CODI Approach, the CAMT Reduction seems to be an amount equal to the Tax Reduction, even though such an amount was not excluded from AFSI. This result does not strike us as appropriate. If Book CODI exceeds Tax CODI, the excess appears not to be excludible from AFSI, even if the corporation is in bankruptcy or insolvent by an amount in excess of the Book CODI. To the extent the excess of Book CODI over Tax CODI results from an exclusion or exception under the federal income tax rules (e.g., section 108(a), section 108(e)(6) or section 108(e)(2)), one could argue this result is consistent with the CAMT regime, which the available history indicates seeks to prevent taxpayers from taking excessive advantage of tax preferences granted by the IRC. However, as noted above, in many cases, the difference between Book CODI and Tax CODI will result not from a tax preference, but rather from a simple difference in the regimes that is conceptually neither beneficial nor detrimental. Furthermore, the policy behind CAMT seems generally not to be aimed at troubled corporations, which are not “telling their shareholders they were wildly profitable” in the colloquial sense. Therefore, we find this result to be inconsistent with the CAMT policy as well.
  - We considered recommending an approach wherein the principles of section 108 are applied to Book CODI, without requiring any matching of Book CODI to Tax CODI. This approach generally seems to avoid the issues mentioned in the prior paragraph. Therefore, we find it preferable to the Notice CODI Approach. However, we believe such an approach still would be unnecessarily complex and administratively burdensome,<sup>60</sup> given that the CAMT policy does not seem to be intended to capture the CODI regime.

---

<sup>60</sup> For example, a determination would need to be made as to how and when insolvency should be measured for Book CODI purposes. There already is uncertainty in how to calculate the extent of insolvency for tax purposes. See, ABA Comments on Workout-Related Relief in Response to COVID-19, available at <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2020/081720comments.pdf>. Requiring

- To minimize complexity and administrative burden, we recommend that Treasury and the IRS adopt a rule that would disregard Book CODI entirely, and instead adjust AFSI to take into account Tax CODI when and to the extent recognized for tax purposes, with a corresponding CAMT Reduction in the amount of the Imported Book CODI (which becomes a black hole to the extent the Imported Book CODI exceeds available CAMT attributes). Such a rule is not a “giveaway” to taxpayers because whether or not the federal income tax results are preferred over the Book results depends on the facts at issue. However, such an approach would be significantly more administrable because there would be no separate analysis required with respect to Book CODI.
  - With respect to the CAMT Reduction, we note that there could be a potential double detriment to the extent tax basis in depreciable property is reduced for tax purposes, but other attributes are reduced for CAMT purposes, because CAMT generally looks to tax basis, not carrying value, in depreciation deductions. Thus, the Tax Reduction of basis already impacts CAMT, and then CAMT attributes are reduced again. The AICPA recommends that this double detriment be addressed.
- **Modify the Notice approach for Fresh Start accounting from bankruptcy**
    - Overview
      - 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 FMV as of the emergence.
      - Absent guidance, the AFSI of a company emerging from bankruptcy or otherwise restructuring its debt could include significant gain from fresh start accounting. The Notice addresses this issue, providing as follows:
        - Adjustment of financial accounting gain or loss. The financial accounting gain or loss resulting from application of the accounting standards used to prepare the AFS of the AFS Group to the emergence from bankruptcy by the AFS Group is not taken into account for purposes of calculating the AFSI of that AFS Group for the tax year in which the emergence from bankruptcy occurs [(the “Fresh Start Gain Loss Exclusion”)].
        - Corresponding adjustments to basis of transferred property on an AFS. With regard to any property of a Party emerging from bankruptcy in a transaction described in Section 3.07(1) of the Notice, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that emergence from bankruptcy (other than as a result of the excluded COD income reduction under the principles of, including taking into account the ordering provided by, section 108(b) and section 1017) is not

---

an insolvency measurement in a different context, perhaps using different principles, could exacerbate this area of uncertainty. There are also questions as to how to treat mismatches between Book CODI and Tax CODI. What if a taxpayer is insolvent or in Bankruptcy at a time when Tax CODI is triggered, but Book CODI on the same instrument is triggered in an earlier or later year, when the corporation is not insolvent. Should the Book CODI be excluded? What if an instrument is treated as debt for USFIT purposes but equity for Book purposes or vice versa?

taken into account for purposes of computing AFSI with regard to any tax year of that Party (that is, to determine the AFSI of an AFS Group described in Section 3.07(2), financial accounting basis of a Party (that is a member of that AFS Group) emerging from a bankruptcy equals the financial accounting basis of those assets of the Party immediately prior to the Party's emergence from bankruptcy, as adjusted under Section 3.06(2) of the Notice) [(the "Fresh Start Basis Adjustment")].

○ Recommendations

- Fresh Start Gain Loss Exclusion in the Notice should be adopted (i) for scope purposes; (ii) when a troubled company restructuring does not involve a taxable asset transfer.
- When a troubled company restructuring involves a taxable transaction for federal income tax purposes, any asset gain or loss and basis adjustments that result from that taxable transaction under Book should be retained for CAMT purposes.

○ Analysis

- For scope purposes, it seems appropriate to disregard Book gain or loss that results from a troubled company restructuring because a troubled company restructuring is an extraordinary event in the life of a corporation, which does not seem the sort of event that should put a corporation in scope if it is not otherwise.
- Likewise, to the extent a troubled company restructuring does not result in tax gain or loss, it seems appropriate to adopt the Fresh Start Gain Loss Exclusion, otherwise a troubled company could have significant CAMT liability as a result of its restructuring, contrary to bankruptcy policy.
- In such instances, the AICPA believes it would be supportable to retain only the Fresh Start Gain Loss Exclusion, but not the corresponding Fresh Start Basis Adjustment, because this would be consistent with the "fresh start" concept embodied in bankruptcy policy. This approach would also have the advantage of being more administrable because there would be one less instance that requires maintenance of separate CAMT books.
- To the extent the Fresh Start Basis Adjustment is retained, the AICPA recommends some limitations on the Fresh Start Basis Adjustment to reduce the administrative burden associated with entities that are not applicable corporations having to track separate CAMT books or recreate such books when they come into the CAMT net in the future (e.g., upon acquisition by an applicable corporation).<sup>61</sup>
- When a troubled company restructuring involves a taxable asset transfer for federal income tax purposes, we believe it is appropriate to recognize corresponding asset gain or loss and basis adjustments that result from the transaction under Book for CAMT liability purposes.

---

<sup>61</sup> We further note that the Notice language appears to need a technical correction. As drafted, the basis rule appears literally not to capture any entities that would receive a basis step up because (i) in a standalone restructuring, there is no "Target"; (ii) in an acquisitive restructuring, the acquiring entity is not the entity that is "emerging from bankruptcy."

- **Apply principles of federal income tax and section 382 and section 383 and SRLY to limit CAMT attributes for tentative minimum tax**

- Overview

*Regarding section 382 and Separate Return Limitation years (SRLYs)*

- Corporate taxpayers have long been allowed to carry forward net operating losses (“Tax NOLs”) for deduction in future tax years. The rationale is that a taxpayer should be able to average income and losses over a period of years, to reduce the disparity between the taxation of businesses that have stable income and businesses that experience fluctuations in income.<sup>62</sup> However, Congress has also enacted various provisions “intended to limit tax-motivated acquisitions of loss corporations,” and “to restrict the function of carryforwards to that of an averaging device.”<sup>63</sup>
- One such provision, section 382, generally provides that, after an ownership change, the amount of a loss corporation’s taxable income for any post-change year that may be offset by pre-change losses and certain “recognized built-in losses” shall not exceed the section 382 limitation for that year.<sup>64</sup> In general, a section 382 limitation is equal to the net equity value of the loss corporation immediately before the ownership change, multiplied by the long-term tax-exempt rate in effect on the change date.<sup>65</sup> Section 382(h) provides rules for the treatment of built-in gain or loss recognized during the 5-year period beginning on the change date (the recognition period) with respect to assets owned by the loss corporation at the time of an ownership change.<sup>66</sup> Generally, if a loss corporation has net unrealized built-in gain (NUBIG) immediately before the ownership change, the section 382 limitation for any recognition period tax year is increased by the recognized built-in gain (i.e., RBIG) for such tax year to the extent of the NUBIG.<sup>67</sup> If, on the other hand, a loss corporation has net unrealized built-in loss (NUBIL) immediately before the ownership change, the recognized built-in loss (RBIL) for any recognition period tax year is treated as a pre-change loss for purposes of the section 382 limitation, to the extent of the NUBIL.<sup>68</sup>
- Another such limitation provision relevant to consolidated groups is the “separate return limitation year” (SRLY) regime. Under these rules, a tax year of a member of a consolidated group (or of a predecessor of a member) for which it filed a separate return or for which it joined in the filing of a consolidated return by another group is a SRLY.<sup>69</sup> Attributes that arise in a SRLY generally are subject a limitation under the consolidated return regulations.<sup>70</sup> Generally, if a company with SRLY

---

<sup>62</sup> S. REP. 99-313, 1986-3 (PART 3) C.B. 1.

<sup>63</sup> S. REP. 99-313, 1986-3 (PART 3) C.B. 1.

<sup>64</sup> Section 382(a), (h).

<sup>65</sup> Section 382(b)(1).

<sup>66</sup> Section 382(h).

<sup>67</sup> Section 382(h)(1)(A).

<sup>68</sup> Section 382(h)(1)(B).

<sup>69</sup> Treas. Reg. § 1.1502-1(e) and (f).

<sup>70</sup> Treas. Reg. § 1.1502-21(c).

attributes joins a consolidated group within six months of an ownership change under section 382, the SRLY rules do not apply to those SRLY attributes.<sup>71</sup>

### *Regarding CAMT*

- For purposes of measuring CAMT liability, section 56(d) applies a reduction to AFSI for “financial statement net operating loss carryovers” (“FSNOLs”).<sup>72</sup> Specifically, AFSI is reduced by the lesser of (a) the aggregate amount of the corporation’s FSNOL carryovers to the tax year, and (b) 80 percent of the AFSI computed without regard to FSNOL carryovers.<sup>73</sup> FSNOLs are comprised of AFSI net losses for tax years ending after December 31, 2019.<sup>74</sup> FSNOLs can be carried over indefinitely.<sup>75</sup>
- Recommendations
  - The principles provided in sections 382 and section 383, and SRLY should apply to limit the availability of CAMT attributes for purposes of calculating the tentative minimum tax.
  - When an ownership change occurs for section 382 purposes, and the amount of the limitations, should be based on federal income tax principles.
- Analysis
  - Applying the principles provided in section 382, section 383 and SRLY to limit the availability of CAMT attributes for purposes of calculating the tentative minimum tax appears appropriate because the same concerns with trafficking attributes apply under the CAMT regime as exist for federal income tax purposes. Furthermore, failure to apply such limitations for CAMT purposes could lead to distortions from CAMT attributes being absorbed at a faster pace than limited federal income tax attributes. For example, assume a corporation generates \$1000 of AFSI and \$1000 of regular taxable income each year, before being offset by NOLs and FSNOLs, respectively. Assume the corporation has \$1000 of NOLs, subject to a \$500 382 limitation, and \$1000 of FSNOLs, not subject to any limitation. (For the purposes of this simplified example, we are disregarding the 80 percent limitation on NOL / FSNOL absorption.) In Year 1, the corporation offsets \$500 of its \$1000 regular taxable income, resulting in taxable income of \$500. It offsets \$1000 of its AFSI, resulting in zero AFSI. In Year 2, the corporation offsets another \$500 of its \$1000 income for regular tax purposes; however, it no longer has any FSNOLs. Therefore, the corporation recognizes \$45 of CAMT liability because its tentative minimum tax ( $\$1000 \times 15\% = \$150$ ) exceeds its regular tax ( $\$500 \times 21\% = \$105$ ), solely as a

---

<sup>71</sup> Treas. Reg. § 1.1502-21(g)

<sup>72</sup> Section 56(d)(1).

<sup>73</sup> Section 56(d)(1).

<sup>74</sup> Section 56(d)(3).

<sup>75</sup> Section 56(d)(3).

result of disconformity in NOL absorption, which appears to be what Congress intended to avoid when it adopted the FSNOL concept.

- While policy appropriate, section 382 and SRLY are extremely administratively complex. To make this concept administrable in the CAMT context,<sup>76</sup> we recommend that an “ownership change” for CAMT purposes occurs when an “ownership change” occurs for federal income tax purposes. Similarly, we recommend that the section 382 limitation (including any RBIG uplift) and SRLY limitation that is calculated for federal income tax purposes is likewise applied to limit CAMT attributes, rather than requiring the computation of any separate “CAMT limitation.”

---

<sup>76</sup>In addition to the general complexity involved, it is not immediately clear to us how NUBIG / NUBIL and RBIG / RBIL should be computed under Book principles.