December 14, 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 2023-64 – Additional Interim 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 additional interim guidance in Notice 2023-64 ("the Notice") regarding time-sensitive issues intended to be addressed by the forthcoming proposed regulations. The Notice provides further clarification to the application of the new corporate alternative minimum tax (CAMT).

The below comments and recommendations identify and provide additional information to Treasury and 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[1] and June 21, 2022,[2] and our letters previously submitted to Treasury and IRS on October 14, 2022 requesting immediate guidance on CAMT rules,[3] and March 27, 2023[4] on Notice 2023-7.

Our attached comments include the following issues and recommendations:

1. Financial Reporting and Accounting for Income Taxes

[1] See AICPA Letter, "Corporate Profits Minimum Tax in Reconciliation Being Considered," October 28, 2021.
[2] See AICPA Letter, "AICPA Comments on the Corporate Profits Minimum Tax in Reconciliation Being Considered," June 21,2022.
[3] The AICPA submitted pre-release comments to Treasury and IRS on CAMT. See: "AICPA Comments on the Corporate Alternative Minimum Tax Needed Immediate Guidance," October 14, 2022.
[4] See AICPA Letter, " 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," March 27, 2023.

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Section 5.02(2) states adjusted financial statement income (AFSI) includes discontinued operations and nonrecurring items, but not other comprehensive income (OCI) and equity accounts.

- Additional guidance should be issued to clarify that all items of income, expense, gain, and loss reflected outside the net income or loss in the income statement is excluded from financial statement income (FSI). For example, it should be clarified whether noncontrolling interest is excluded.
- Additional guidance should be issued to clarify whether tax mark to market elections impact AFSI, as there may be components that are included within OCI, and components included within the income statement.
- 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.

Sec 11.02(2)(b)(i) – Adjustment Spread Period Rule - If there is an Accounting Principle Change Adjustment, such adjustment is taken into account ratably over 4 years, beginning with the year first implemented. However, if the taxpayer can demonstrate that duplication is reasonably anticipated to occur over a different period, then the adjustment can be made ratably over that period (not to exceed 15 years).

- Additional guidance should be issued to provide examples of accounting principle changes for which a period of time other than four taxable years is appropriate.
- The guidance should consider examples that include accounting principle changes for both retrospective adoption and those that are prospectively adopted.
- Treasury and IRS should consider allowing consistent spread periods for omissions and duplications.

Sec. 11.02(4) – Adjustments for amounts disclosed in an auditor's opinion. Is this the current year adjustment only or cumulative effect?

- Additional guidance should be issued to address how to apply the adjustment to AFSI, and the application of the adjustment if it covers multiple periods.

Request for Comments – AFSI Adjustments to Prevent Duplications and Omissions

a) **Can Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments be traced to a separate trade or business (within the meaning of Treas. Reg. § 1.446-1(d))?**
b) **What events should be considered a cessation of a trade or business for purposes of accelerating inclusion of an Adjustment? Should rules similar to those in section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419 apply?**

- Additional guidance should be issued to provide examples of when Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments can be traced to a

separate trade or business within the meaning of Treas. Reg. § 1.446-1(d). Examples should include scenarios where (1) the trades or businesses are truly separate and distinct, with separate recordkeeping for financial accounting purposes; (2) the trades or businesses are included in a single set of underlying accounting records, such as those maintained for a single entity that operates two distinct trades or businesses; and (3) the accounting records for trades or businesses are separately maintained but include intercompany or other transactions that create or shift profits or losses between the trades or businesses of the taxpayer.
- Additional guidance should be issued to clarify that rules similar to those in section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419 should apply to take into account the remaining balance of any unrecognized effects of an Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment in taxable income in the taxable year of the cessation when the taxpayer ceases to engage in a trade or business.

Request for Comments - Whether there are circumstances in which adjustments to AFSI are required to clearly reflect income (related party example).

- Additional guidance should be issued to address intra-entity transfers and intercompany transactions within a taxpayer's adjusted financial statements (AFS).
- The guidance should consider the consolidated financial accounting rules and tax laws related to consolidated returns.
- Treasury and IRS should provide that AFSI does not include intra-entity transfers to the extent the amounts are not recognized in the taxpayer's AFS.

2. General Concepts and Methods & Periods

Provide a depreciation adjustment safe harbor in the year allowable, instead of allowed. Alternatively, provide taxpayers with the ability to elect out (year by year) of identifying the depreciation component of other assets for administrative ease.

- Treasury and IRS should provide an election whereby taxpayers may elect to not reduce AFSI by Deductible Tax Depreciation that resulted from Tax Depreciation being capitalized into other assets. As a result of this election, at the time of disposition, the taxpayer would only reduce the AFS basis by the tax depreciation that reduced AFSI in prior years.
- Treasury and IRS should also consider allowing taxpayers that make this election to take the remaining future Deductible Tax Depreciation that was subject to the election into account as an increase in AFS basis in the year of disposition.
- Lastly, Treasury and IRS should consider providing a safe harbor to take Tax Depreciation that is capitalized into account when allowable instead of when deductible under other provisions.
- The election should be available in the year the depreciable asset was placed in service.

If a taxpayer changes its method of accounting for Regular Tax purposes from deducting amounts paid or incurred to capitalizing and depreciating such amounts under sections 167 or 168, or vice versa, how should such change be taken into account for AFSI purposes? For example, what if a taxpayer deducted an amount paid or incurred as a repair under its present method of accounting but later changed its accounting method to capitalize the

amount paid or incurred as an improvement that is Section 168 Property? How, if at all, should the taxpayer account for the adjustments that would have been made under section 56A(c)(13) in prior years had the proposed method been used instead? Or what if a taxpayer capitalized an amount paid or incurred as an improvement that is Section 168 Property under its present method of accounting but later changed its method to deduct the amount paid or incurred as a repair? How should the taxpayer take into account the adjustments that were made under section 56A(c)(13) in prior years, but that would not have been made had the proposed method been used instead?

- Treasury and IRS should limit the requirement for the section 481(a) adjustment, as defined in section 4.03 of Notice 2023-7 and modified by Notice 2023-64, to only apply with respect to changes involving (to, from or within) section 168.
- Treasury and IRS should include additional adjustments under section 56A(c)(13) (considered in the year of change) that would ensure that any cumulative AFSI adjustments already made or that are going to be made with respect to characterization change property (e.g., from repair to capital or vice versa) reverse over time and that they are otherwise applied prospectively starting in the year of change.
- Alternatively, Treasury and IRS should consider allowing taxpayers to account for such change (i.e., deducting amounts paid or incurred to capitalizing and depreciating such amounts under section 167 or section 168, or vice versa) upon disposition of the relevant property.

Treasury and IRS should provide guidance clarifying how taxpayers using General Asset Accounts (GAAs) should apply the rules in section 4 of Notice 2023-7 as amended by Notice 2023-64.

- Treasury and IRS should provide guidance clarifying how taxpayers using GAAs should apply the rules in section 4 of Notice 2023-7, as amended by Notice 2023-64, for adjusting the AFS gain or loss on a disposition of Section 168 Property. For assets in a GAA, unless the taxpayer elects to recognize gain or loss upon the disposition of the last asset in the GAA or a qualifying disposition of a specific asset in the GAA, there is no disposition event for tax purposes. The AICPA recommends Treasury and IRS include language in the proposed regulations that makes clear disposition adjustments only occur when a GAA is terminated and a taxpayer recognizes a gain or loss for Regular Tax.

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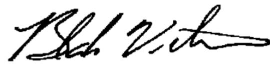
We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact George Manousos, Chair, AICPA Corporate AMT Task Force at (202) 302-0942 or george.manousos@pwc.com; Reema Patel, Senior Manager - AICPA Tax Policy & Advocacy, at (202) 434-9217, or Reema.Patel@aicpa-cima.com; or or me at (830) 372-9692 or bvickers@alamo-group.com.

Sincerely,



Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: The Honorable Daniel I. Werfel, Commissioner, Internal Revenue Service
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 2023-64 – Additional Interim Guidance Regarding the Application of the Corporate Alternative Minimum Tax (CAMT) under Sections 55, 56A, and 59 of the Internal Revenue Code (IRC)

December 14, 2023

Our comments cover the following issues:

1. Financial Reporting and Accounting for Income Taxes

2. General Concepts and Methods & Periods

SPECIFIC COMMENTS

1. Financial Reporting and Accounting for Income Taxes

- **Section 5.02(2) states adjusted financial statement income (AFSI) includes discontinued operations and nonrecurring items, but not other comprehensive income (OCI) and equity accounts**
  a. **Consider including/confirming all non-continuing operations items in guidance.**
  b. **Consider whether tax mark to market (MTM) elections impact AFSI.**
  c. **Consider addressing unrealized MTM in financial statement income (FSI) (not OCI) – mentioned in Sec. 16 as forthcoming.**

<u>Overview</u>

- The Notice, when defining FSI, states that FSI includes all of the taxpayer's items of income, expense, gain, and loss reflected in the net income or loss set forth on such income statement for the taxable year, including nonrecurring items and net income or loss from discontinued operations.
- The Notice states that FSI does not include amounts reflected elsewhere in the taxpayer's adjusted financial statement (AFS), including in equity accounts such as retained earnings and OCI.
- The Notice states that the Department of the Treasury ("Treasury") and Internal Revenue Service (IRS) intend to address the extent to which any unrealized mark to market gains and losses in the taxpayer's FSI should be adjusted in determining the taxpayer's AFSI.
- 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.

Recommendations

- Additional guidance should be issued to clarify that all items of income, expense, gain, and loss reflected outside the net income or loss in the income statement is excluded from FSI. For example, it should be clarified whether noncontrolling interest is excluded.
- Additional guidance should be issued to clarify whether tax mark to market elections impact AFSI, as there may be components that are included within OCI, and components included within the income statement.
- 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.

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 (5th 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[1] 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 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.

- **Sec 11.02(2)(b)(i) – Adjustment Spread Period Rule - If there is an Accounting Principle Change Adjustment, such adjustment is taken into account ratably over 4 years, beginning with the year first implemented. However, if the taxpayer can demonstrate that duplication is reasonably anticipated to occur over a different period, then the adjustment can be made ratably over that period (not to exceed 15 years).**

Overview

- The Notice states that AFSI must be adjusted to take into account any cumulative adjustment to the retained earnings of the taxpayer on its AFS if such adjustment results from a change in financial accounting principle. The adjustment is taken into account ratably over the four-taxable-year period beginning with the taxable year for which the change in financial accounting principle is implemented in the Taxpayer's AFS. The Notice further states that, if the taxpayer is able to demonstrate that the duplication is reasonably anticipated to occur over a different period, then the adjustment may be taken into account in AFSI ratably over such period, not to exceed fifteen years.

Recommendations

- Additional guidance should be issued to provide examples of accounting principle changes for which a period of time other than four taxable years is appropriate.

[1] 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.

- The guidance should consider examples that include accounting principle changes for both retrospective adoption and those that are prospectively adopted.
- Treasury and IRS should consider allowing consistent spread periods for omissions and duplications.

Analysis

- Accounting Standards Codification (ASC) 250-10-20 defines a change in accounting principle as "a change from one generally accepted accounting principle to another generally accepted accounting principle when there are two or more generally accepted accounting principles that apply or when the accounting principle formerly used is no longer generally accepted. A change in the method of applying an accounting principle is also considered a change in accounting principle." New accounting guidance generally provides specific transition requirements, such as prospective application, full retrospective application, modified retrospective application, etc. If transition requirements are not provided by the new accounting guidance, or if the change is from one generally accepted accounting principle to another generally accepted accounting principle, ASC 250 applies.
- Depending on the nature of the change in accounting principle and the underlying financial statement line item to which it relates, four years may not be an appropriate period of time. Examples of changes should include accounting principle changes associated with the treatment of items of income or loss, shorter lived assets and liabilities such as inventory, and longer lived assets and liabilities such as fixed assets in order to provide clarity on when a term longer than four years is appropriate.
- Changes in financial statement accounting principle may be presented on a prospective basis in certain circumstances (based on the transition rules when there is new accounting guidance). In a prospective basis, there is generally a cumulative retained earnings adjustment, net of tax, in the year of adoption and the new accounting principle is applied going forward. In that case, the basic examples are sufficient to illustrate how the adjustment should be ratably included in AFSI. However, other changes are implemented on a full or modified retrospective basis, with the cumulative adjustment recorded in the earliest period presented in the financial statements and subsequent periods are presented using the new financial accounting principle. Examples should be provided to illustrate how the adjustment is included in income when the adjustment is applied retrospectively. For example, if the AFS present the current year and prior two years (e.g., 20X3, 20X2 and 20X1), under the retrospective application, 20X1 would reflect a cumulative adjustment to beginning retained earnings. The full year 20X1 and 20X2 would be revised to reflect the new financial accounting principle, and 20X3 would be prepared using the new financial accounting principle. In that instance, clarification is needed to demonstrate that the 20X1 opening balance retained earnings adjustment would be included in AFSI over the appropriate period beginning in 20X3 when the change in accounting principle was made, along with any adjustments to the related financial statement items that were recognized in the recast 20X2 and the current 20X3 amounts due to the accounting principle change.
- An example of an omission may be when the current GAAP method is to recognize advance payments into revenue ratably over three years, but there is a GAAP accounting change to begin recognizing revenue upon receipt. Assume that there was $100 of unrecognized revenue at the beginning of the year of the GAAP change. Therefore, GAAP would record a retained earnings adjustment to increase retained earnings by $100. If no retained earnings adjustment

were recorded, then this would be a circumstance where the $100 is never recognized into income for GAAP purposes (i.e., an omission). As such, the $100 retained earnings adjustment is necessary to prevent an omission of revenue.

- An example of a duplication may be when the current GAAP method is to recognize revenue upon receipt, but there is a GAAP accounting change to begin recognizing revenue ratably over three years. Further assume that $100 of revenue was recognized under the present method that now needs to be deferred under the new method. Therefore, GAAP would record a retained earnings adjustment to reduce retained earnings by $100. If no retained earnings adjustment were recorded, then this would be a circumstance where the $100 may be recognized into income for GAAP twice (i.e., a duplication). As such, the $100 retained earnings adjustment is necessary to prevent the duplication of revenue.
- The guidance should clarify how the quantification of a retrospective change should impact AFSI given that the change impacts multiple periods.
- The existence of different spread periods for omissions and duplications introduces complexity into the CAMT analysis. To alleviate complexity, Treasury should consider making the spread period for omissions and duplications consistent.

- **Sec. 11.02(4) – Adjustments for amounts disclosed in an auditor's opinion. Is this the current year adjustment only or cumulative effect?**

<u>Overview</u>

- The Notice states that AFSI must be adjusted to take into account amounts disclosed in an auditor's opinion described in section 4.02(2)(b) or (c), to the extent such amounts would have increased FSI had they been reported in the taxpayer's AFS. Section 4.02(2)(b) and (c) considers a taxpayer's AFS as a certified financial statement if the auditor's opinion is qualified, modified, or adverse, but only if the financial statement presents fairly the financial position and results of operations in conformity with the relevant accounting standards, except for the matter to which the qualified or modified opinion relates to. In the case of an adverse opinion, the taxpayer's AFS will be considered a certified financial statement only if the auditor discloses the amount of the disagreement with the statement.

<u>Recommendation</u>

- Additional guidance should be issued to address how to apply the adjustment to AFSI and the application of the adjustment if it covers multiple periods.

<u>Analysis</u>

- The AICPA Auditing Standard (specifically AU-C Section 705.22), states that if there is a material misstatement of the financial statements that relates to specific amounts in the financial statements, the auditor should include in the "Basis for Opinion" section a description and quantification of the financial effects of the misstatement, unless impracticable.
- As illustrated in "Illustration 1" of AU-C 705.A38 a balance sheet related item, such as inventory stated at cost (instead of the lower of cost and net realizable value in accordance with Accounting Standards Codification Topic 330, Inventory), could have an impact on

multiple years if a write-down is required because of the departure from Generally Accepted Accounting Principles (GAAP). Therefore, this illustrates that the quantification of the financial effects could cover multiple periods.

- Treasury and IRS should clarify how the quantification of the material misstatement should impact AFSI, especially if related to a balance sheet item where the quantification relates to multiple years.

- **Request for Comments – AFSI Adjustments to Prevent Duplications and Omissions**

  a) **Can Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments be traced to a separate trade or business (within the meaning of Treas. Reg. § 1.446-1(d))?**
  b) **What events should be considered a cessation of a trade or business for purposes of accelerating inclusion of an Adjustment? Should rules similar to those in section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419 apply?**

Overview

- The Notice states that Treasury and IRS request comments on whether Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments can be traced to a separate trade or business within the meaning of Treas. Reg. § 1.446-1(d). Additionally, comments are requested regarding what events should be considered a cessation of a trade or business for purposes of accelerating inclusion of an Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment.

Recommendations

- Additional guidance should be issued to provide examples of when Accounting Principle Change Adjustments or Net Accounting Principle Change Adjustments can be traced to a separate trade or business within the meaning of Treas. Reg. § 1.446-1(d). Examples should include scenarios where (1) the trades or businesses are truly separate and distinct, with separate recordkeeping for financial accounting purposes; (2) the trades or businesses are included in a single set of underlying accounting records, such as those maintained for a single entity that operates two distinct trades or businesses; and (3) the accounting records for trades or businesses are separately maintained but include intercompany or other transactions that create or shift profits or losses between the trades or businesses of the taxpayer.
- Additional guidance should be issued to clarify that rules similar to those in section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419 should apply to take into account the remaining balance of any unrecognized effects of an Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment in taxable income in the taxable year of the cessation when the taxpayer ceases to engage in a trade or business.

Analysis

- Treas. Reg. § 1.446-1(d) provides guidance with respect to methods of accounting when a taxpayer is engaged in more than one separate and distinct trade or business and provides that

different methods of accounting may be used for separate and distinct trades or businesses. Additional guidance should clarify that, to the extent a change in accounting principle can be traced to a separate and distinct trade or business and the taxpayer ceases operating that trade or business, any remaining unrecognized effects of an Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment should be recognized in taxable income in the taxable year of the cessation.

- Treas. Reg. § 1.446-1(d)(2) clarifies that a trade or business will not be considered separate and distinct unless a complete and separate set of books and records is kept for that trade or business. Additional guidance should clarify that when separate books and records are not kept, the Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment continues to be taken into taxable income over the remaining applicable period, even if the taxpayer ceases to operate a portion or segment of its business.
- Treas. Reg. § 1.446-1(d)(3) provides that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer will not be considered to be separate and distinct. Additional examples should be provided to demonstrate that when the shifting of profits or losses occur between trades or businesses of the taxpayer, the trades or businesses are not considered separate and distinct. In that case, the remaining Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment continues to be taken into taxable income over the remaining applicable period, even if the taxpayer ceases to operate a portion or segment of its business.
- Section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419 provides that a taxpayer that ceases to engage in a trade or business must take any remaining balance of any section 481(a) adjustment related to that trade or business into account in computing taxable income in the taxable year of the cessation. Guidance should clarify that, consistent with the recognition of a remaining section 481(a) adjustment for a tax method of accounting, the taxpayer should recognize any remaining Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment in that taxable year. Further, guidance should clarify that if the taxpayer operates two or more distinct trades or businesses as defined in Treas. Reg. § 1.446-1(d) and ceases operating a distinct trade or business, any remaining Accounting Principle Change Adjustment or Net Accounting Principle Change Adjustment with respect to that separate trade or business should be recognized consistent with the section 481(a) guidance in section 7.03(4) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419.

- **Request for Comments - Whether there are circumstances in which adjustments to AFSI are required to clearly reflect income (related party example).**

Overview

- The Notice states that the Treasury and IRS request comments on whether there are circumstances in which adjustments to AFSI are required to clearly reflect income.
- For example, in a situation in which under the relevant accounting standard, a transaction between related entities is accounted for at the selling entity's cost instead of at an arm's-length value, such that no income, gain, loss, or deduction is recognized in the financial accounts of

the seller, and the buying entity records the transaction in its financial accounts at the seller's cost.

Recommendations

- Additional guidance should be issued to address intra-entity transfers and intercompany transactions within a taxpayer's AFS.
- The guidance should consider the consolidated financial accounting rules and tax laws related to consolidated returns.
- Treasury and IRS should provide that AFSI does not include intra-entity transfers to the extent the amounts are not recognized in the taxpayer's AFS.

Analysis

- For US GAAP purposes, the basic consolidation rules under ASC 810 generally eliminate items of income, gain, loss, or deduction from intercompany transactions in the consolidated financial statements. In some cases, the tax accounting aspects are recognized if the transaction occurs across taxing jurisdictions.
- For US tax purposes, the consolidated return regulations eliminate certain intercompany transactions.
- Section 482 provides the authority for the IRS to make allocations between controlled parties to clearly reflect the income of each of the parties.
- The arm's length standard is the standard that the IRS has adopted for implementing the clear reflection of income principle for controlled transactions under section 482.
- Certain industries are required to apply ASC 980 for their accounting and reporting requirements. ASC 980 outlines the criteria for recognizing revenues, expenses, assets, and liabilities specific to regulated operations.
- Our recommendation to provide that AFSI does not include intra-entity transfers to the extent the amounts are not recognized in the taxpayer's AFS will minimize complexity and create a direct link between the recognition timing for both financial accounting and CAMT.

2. General Concepts and Methods & Periods

- **Provide a depreciation adjustment safe harbor in the year allowable, instead of allowed. Alternatively, provide taxpayers with the ability to elect out (year by year) of identifying the depreciation component of other assets for administrative ease.**

Overview

- Notice 2023-7 Depreciation
    - Section 4.02(7) of Notice 2023-7 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 2023-7.
    - Section 4.02(4) of Notice 2023-7 defines Deductible Tax Depreciation as Tax Depreciation that is allowed as a deduction in computing taxable income.

    - Section 4.02(6) of Notice 2023-7 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 Notice 2023-7 provides that adjusted financial statement income (AFSI) is reduced by Tax Cost of Goods Sold (COGS) Depreciation, but only to the extent recovered through cost of goods sold in the current tax year.
    - Section 4.07 of Notice 2023-7 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 subject to CAMT.

- Notice 2023-64 Depreciation Clarifications

    - Like the Tax COGS Depreciation rule in the preceding notice, section 9.02(2) of Notice 2023-64 provides that if a taxpayer capitalizes Tax Depreciation as defined in section 4.02(7) of Notice 2023-7 and recovers the amount capitalized through one or more deductions allowed in computing taxable income, AFSI is reduced by such deductions, even if such deductions are allowed under a provision of the code other than section 167. Notice 2023-64 provides depreciation capitalized under section 174 and recovered through amortization allowed as an example.
        - Accordingly, section 9.02(5) of Notice 2023-64 modifies the definition of Deductible Tax Depreciation to include Tax Depreciation that is capitalized and subsequently allowed as a deduction in computing taxable income.
        - Section 9.02(7) modified section 4.07 of Notice 2023-7 to account for the addition of Tax Depreciation that is capitalized and recovered through one or more other deductions allowed. Specifically, section 9.03(7) provides that the remaining AFS basis of property is decreased by the full amount of Tax Depreciation with respect to such property (regardless of whether any amount of such Tax Depreciation was capitalized and not yet considered as a reduction AFSI).

Recommendations

- Treasury and IRS should provide an election whereby taxpayers may elect to not reduce AFSI by Deductible Tax Depreciation that resulted from Tax Depreciation being capitalized into other assets. As a result of this election, at the time of disposition, the taxpayer would only reduce the AFS basis by the tax depreciation that reduced AFSI in prior years.
- Treasury and IRS should also consider allowing taxpayers that make this election to take the remaining future Deductible Tax Depreciation that was subject to the election into account as an increase in AFS basis in the year of disposition.
- Lastly, Treasury and IRS should consider providing a safe harbor to take Tax Depreciation that is capitalized into account when allowable instead of when deductible under other provisions.
- The election should be available in the year the depreciable asset was placed in service.

Analysis

- The approach in the Notice for applying section 56A(c)(13)(A) in the case of Deductible Tax Depreciation resulting from Tax Depreciation that is capitalized is administratively burdensome for taxpayers. Each year, taxpayers are required to track the capitalized Tax Depreciation vintage recovery by year for purposes of calculating Deductible Tax Depreciation. Taxpayers would also be required to track the Tax Depreciation allowable (regardless of subsequent capitalization) for purposes of the disposition rule.
- In lieu of these annual adjustments, taxpayers should be permitted to elect out of reducing AFSI for Deductible Tax Depreciation that resulted from Tax Depreciation that is capitalized into other assets. As a result, the Tax Depreciation adjustment for purposes of the disposition rule would be modified to decrease AFS basis by the amount of Deductible Tax Depreciation that the taxpayer has elected take into account as an AFSI reduction, as opposed to decreasing AFS basis by the full amount of Tax Depreciation with respect to such property (regardless of whether any amount of such Tax Depreciation was capitalized and not yet taken into account as a reduction to AFSI). This modification would ensure that the total gain/loss disposition adjustment equals the total net amount of AFSI increases and decreases because of Tax Depreciation capitalization. The following example illustrates this concept.

Example:

Facts: Taxpayer acquires and places into service an asset for $50,000 that is used exclusively in research in 2023. The depreciation on such asset is a specified research and experimentation expenditure under section 174. The asset has a 5-year life for both book and federal income tax purposes. The taxpayer does not elect out of bonus depreciation (80% for 2023). Book depreciates the asset on a straight-line basis and tax depreciates the remaining basis using MACRS rates (20% in 2023, 32% in 2024). The asset is sold on January 1, 2025, for $40,000.

Part (1) Before section 174 capitalization, depreciation for book and tax is computed as follows:

Year	Tax Depreciation Allowable	AFS Depreciation
2023 Bonus	$40,000	
2023	$2,000	$10,000
2024	$3,200	$10,000
Total	**$45,200**	**$20,000**

Part (2) Section 174 capitalization and recovery for each year is then computed as follows:

	Depreciation Capitalized	2023	2024	2025	2026	2027	2028	2029	**Total**
2023	$42,000	$4,200	$8,400	$8,400	$8,400	$8,400	$4,200		**$42,000**
2024	$3,200		$320	$640	$640	$640	$640	$320	**$3,200**
Total	**$45,200**	**$4,200**	**$8,720**	**$9,040**	**$9,040**	**$9,040**	**$4,840**	**$320**	**$45,200**

Part (3) As a result, the AFSI adjustments for this asset are computed as follow:

Year	Section 174 Amortization of Tax Depreciation	AFS Depreciation	AFSI Adjustment (Decrease)/ Increase
2023	$4,200	$10,000	$5,800
2024	$8,720	$10,000	$1,280
2025	$9,040	-	($9,040)
2026	$9,040	-	($9,040)
2027	$9,040	-	($9,040)
2028	$4,840	-	($4,840)
2029	$320	-	($320)
Total Depreciation	**$45,200**	**$20,000**	**($25,200)**

Part (4) Under the existing disposition rule of the Notice, the AFSI gain/loss redetermination and accompanying AFSI disposition adjustment for 2025 would be computed as:

> Redetermined AFSI Gain/Loss = Proceeds – (AFS Basis – Cumulative Tax Depreciation [regardless of subsequent capitalization] + Cumulative Book Depreciation per AFS)
> Redetermined AFSI Gain/Loss = $40,000 – ($30,000 – $45,200 + $20,000) = $40,000 – $4,800 = $35,200 Redetermined AFSI Gain
> As the AFS Gain/Loss is $10,000 ($40,000 proceeds – $30,000 remaining basis), the AFSI disposition adjustment is a positive $25,200.

Part (5) The proposed election out would allow the taxpayer to forgo making the section 174 amortization of Tax Depreciation adjustments totaling $45,200 in years 2023 through 2029 from Part (3). Assume that the taxpayer elected out of computing Deductible Tax Depreciation for this Tax Depreciation that was capitalized in both 2023 and 2024. In this case, and pursuant to the proposed modification to the calculation of the Redetermined AFSI Gain/Loss, the modified AFSI gain/loss redetermination and accompanying AFSI disposition adjustment for 2025 would be computed as:

> Modified Redetermined AFSI Gain/Loss = Proceeds – (AFS Basis – Deductible Tax Depreciation claimed and to be claimed as reduction to AFSI for such asset + Cumulative Book Depreciation per AFS)
> Modified Redetermined AFSI Gain/Loss = $40,000 – ($30,000 – $0 + $20,000) = $40,000 – $50,000 = ($10,000) Modified Redetermined AFSI Loss
> As the AFS Gain/Loss is $10,000 ($40,000 proceeds – $30,000 remaining basis), the AFSI disposition adjustment is a negative $20,000.

- In addition to providing an election to forgo making Deductible Tax Depreciation adjustments for Tax Depreciation otherwise capitalized, Treasury and IRS should consider providing taxpayers with the ability to accelerate the future AFSI reductions for Deductible Tax

Depreciation post disposition to ease the burden of continuing to identify Tax Depreciation capitalized in such asset. To accommodate this rule, the Tax Depreciation adjustment for purposes of the disposition rule could also modified (similar to the above example) to add future section 174 Deductible Tax Depreciation in the computation of Redetermined AFSI Gain/Loss. If the proposed adjustment is made, then the taxpayer must not make future AFSI reductions for the accelerated Deductible Tax Depreciation. Consider the following example that uses the same facts as the previous example, but includes the proposed modification to allow the future Deductible Tax Depreciation to be considered as a reduction in AFSI in the year of disposition:

Example:

Assume the same facts as the previous example and that the taxpayer computed section 174 Deductible Tax Depreciation in a manner that is consistent with Part (3) above. The remaining Deductible Tax Depreciation post January 1, 2025, disposition is $32,280 (sum of years 2025 through 2029). In this case, and pursuant to the proposed modification to the calculation of the Redetermined AFSI Gain/Loss, the modified AFSI gain/loss redetermination and accompanying AFSI disposition adjustment for 2025 would be computed as:

Modified Redetermined AFSI Gain/Loss = Proceeds – (AFS Basis – Cumulative Tax Depreciation [regardless of subsequent capitalization] + remaining Deductible Tax Depreciation post disposition + Cumulative Book Depreciation per AFS)
Modified Redetermined AFSI Gain/Loss = $40,000 – ($30,000 – $45,200 + $32,280 + $20,000) = $40,000 – $37,080 = $2,920 Modified Redetermined AFSI Gain
As the AFS Gain/Loss is $10,000 ($40,000 proceeds – $30,000 remaining basis), the AFSI disposition adjustment is a negative $7,080.

The table in the example Part (3) above would be modified as follows:

Year	Sec. 174 Amortization of Tax Depreciation	AFS Depreciation	AFSI Adjustment (Decrease)/ Increase
2023	$4,200	$10,000	$5,800
2024	$8,720	$10,000	$1,280
2025 - 2029	-	-	-
Total Depreciation	**$12,920**	**$20,000**	**$7,080**

- **How should a change in the treatment of an item that involves the proper time for taking such item into account for AFSI purposes be treated for AFSI purposes when such change is not otherwise treated as a change in method of accounting for Regular Tax purposes because it does not affect taxable income (AFSI only change)? For example, what if a taxpayer consistently does not make a required AFSI adjustment under section 56A(c)(13) or makes a change in financial accounting principle? Should rules similar to those in sections 446 and 481, and the method change procedures in Rev. Proc. 2015-13,**

2015-5 I.R.B. 419, apply? Should the result depend on whether the AFSI only change was discretionary or mandated by financial accounting standards? Should taxpayers be required to file a Form 3115, Application for Change in Accounting Method, to obtain consent for AFSI only changes?

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.
- There is uncertainty regarding how taxpayers may correct AFSI adjustments improperly made when the same item is properly treated for regular income tax purposes.

Recommendations

- 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 related to an adjustment that would otherwise be treated as a method for regular tax purposes.
- Do not allow method changes for items that would not otherwise be treated as a method for regular tax purposes.

Analysis

- Guidance should be provided that makes clear that a change in method for AFSI purposes only is also 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.
- The current method change guidance considers section 481(a) differences for purposes of other tax regimes (e.g., regular tax, alternative minimum tax, and adjusted current earnings) in section 6 of Rev. Proc 2023-24. Although this does not specifically address changes solely for such other tax regimes, it is reasonable to apply the same rules and procedures to prevent duplication or omission of amounts exclusive to one provision and not the other (i.e., an amount was properly accounted for as an item in taxable income, but an improper AFSI adjustment of a timing nature was not made).
- Method changes are generally only allowed if the issue is related to a timing item. For example, tax depreciation life and convention differences are matters of timing (i.e., the same amount of basis is recovered, just over a different period). However, not deducting depreciation expense in a particular year is not a timing item, as the lifetime deductions for claiming depreciation versus not claiming depreciation are not equal.

- **If a taxpayer changes its method of accounting for Regular Tax purposes from deducting amounts paid or incurred to capitalizing and depreciating such amounts under sections**

167 or 168, or vice versa, how should such change be taken into account for AFSI purposes? For example, what if a taxpayer deducted an amount paid or incurred as a repair under its present method of accounting but later changed its accounting method to capitalize the amount paid or incurred as an improvement that is Section 168 Property? How, if at all, should the taxpayer account for the adjustments that would have been made under section 56A(c)(13) in prior years had the proposed method been used instead? Or what if a taxpayer capitalized an amount paid or incurred as an improvement that is Section 168 Property under its present method of accounting but later changed its method to deduct the amount paid or incurred as a repair? How should the taxpayer take into account the adjustments that were made under section 56A(c)(13) in prior years, but that would not have been made had the proposed method been used instead?

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.
- Section 9.02(1) of the Notice provides that if a taxpayer changes its method of accounting for depreciation for any item of Section 168 Property for Regular Tax purposes, the taxpayer must adjust AFSI to reflect the adjustment required under section 481(a) for such change to prevent depreciation from being duplicated or omitted under section 56A(c)(13). Section 9.02(5) and (6) and the Notice modifies and clarifies sections 4.02 and 4.03 of Notice 2023-7 to take into account this section 481(a) adjustment. Section 9.02(8) of the Notice modifies and clarifies section 4.08 of Notice 2023-7 to provide an example of this rule.

Recommendations

- Treasury and IRS should limit the requirement for the section 481(a) adjustment, as defined in section 4.03 of Notice 2023-7 and modified by Notice 2023-64, to only apply with respect to changes involving (to, from or within) section 168.
- Treasury and IRS should include additional adjustments under section 56A(c)(13) (considered in the year of change) that would ensure that any cumulative AFSI adjustments already made or that are going to be made with respect to characterization change property (e.g., from repair to capital or vice versa) reverse over time and that they are otherwise applied prospectively starting in the year of change. For example:

    - In the case of changing the character of an asset from non-Section 168 Property to Section 168 Property, AFSI increases in the tax year of change by the cumulative Covered Book Depreciation Expense and decreases by the cumulative Deductible Tax Depreciation that would have been used in the computation of AFSI if the property had always been treated as property subject to section 168.

    - In the case of changing the character of an asset from Section 168 Property to non-Section 168 Property, AFSI increases in the tax year of change by the Deductible Tax Depreciation already incorporated to date and decreases by the Covered Book Depreciation Expense already incorporated to date.
    - With respect to the previous examples, the adjustments should be spread over the section 481(a) spread period determined for such characterization change property under the applicable revenue procedure (i.e., Rev. Proc. 2015-13 and Rev. Proc. 2023-24 or more recent equivalents).

- Alternatively, Treasury and IRS should consider allowing taxpayers to account for such change (i.e., deducting amounts paid or incurred to capitalizing and depreciating such amounts under section 167 or section 168, or vice versa) upon disposition of the relevant property.

Analysis

- The application of the rule with respect to section 481(a) adjustments for recharacterization (e.g., presently deducting repairs under section 162 versus capitalizing under section 263(a) and recovering via depreciation under section 167) is administratively burdensome, and any simplifying mechanisms should be considered.
- The net book and tax adjustments made under section 56A(c)(13) should reverse over time. Changes made to the character of an asset from non-Section 168 Property to Section 168 Property (or vice versa) could result in missed AFSI adjustments or improperly taken AFSI adjustments. If AFSI adjustments were missed (or improperly taken), then future (or cumulative) AFSI adjustments will not reverse, outside of disposition adjustments (see example below), without an additional preventative adjustment.
- The adjustments proposed in the recommendation would ensure the reversal of improper cumulative or future AFSI adjustments. Future adjustments under section 56A(c)(13) would then be applied prospectively after making the proposed adjustment.

For example, consider the following:

Taxpayer purchases an asset with a 5-year life for $5,000 on January 1, 2023. The asset is depreciated on a straight-line basis for AFS purposes. Scenario A assumes that for tax purposes the asset is presently improperly treated as a repair but a method change will be filed to properly capitalize and depreciate the asset over 5 years using MACRS with no bonus. Scenario B assumes that for tax purposes the asset is presently improperly treated as a capital expenditure and has been depreciated over 5 years using MACRS with no bonus but a method change will be filed to properly expense the costs as a repair. The tax accounting method change is assumed to be made in 2027 in both scenarios.

Scenario A

Taxpayer takes into account an adjustment to AFSI in 2027 that increases AFSI by the cumulative missed Covered Book Depreciation Expense (2023 through 2026 of $4,000) and decreases AFSI by the cumulative missed Deductible Tax Depreciation (2023 through 2026 of $4,136: $5,000 * 20% + $5,000 * 32% + $5,000 * 19.2% + $5,000 * 11.52% = $1,000 + $1,600 + $960 + $576)

that should have been used in the computation of AFSI had the property properly been treated as subject to section 168.

Proposed Method AFSI Adjs.			
	Tax Expense	Book Expense	AFSI Adj. (Decrease) / Increase
Present Method:			
2023	$-	$-	$-
2024	$-	$-	$-
2025	$-	$-	$-
2026	$-	$-	$-
Total	**$-**	**$-**	**$-**
Proposed Method:			
2027 Scenario A Adj.	**($4,136)**	**$4,000**	**($136)**
2028	($576)	$1,000	$424
2029	($288)	$-	($288)
Total	**($5,000)**	**$5,000**	**$0**

Alternatively, consider that instead of the Scenario A Adjustment above, the adjustments are caught up upon disposition of the related property. Assume that the related asset is disposed of on January 1, 2028, and the asset was acquired on January 1, 2023. Upon disposition, the AFSI gain/loss adjustment would be computed as follows:

Redetermined AFSI Gain/Loss = Proceeds – (AFS Basis – Cumulative Tax Depreciation + Cumulative Book Depreciation per AFS + Tax Depreciation 481(a) Adjustment for such Property)

Redetermined AFSI Loss = $0 – ($0 – $576 [2027 Tax Depreciation] + $1,000 [2027 AFS Book Depreciation] + $864) = $0 – $1,288 = $1,288 Redetermined AFSI Loss

The AFS gain in this situation would be $0 (i.e., proceeds of $0 less $0 remaining basis). The Redetermined AFSI Loss of $1,288 would give rise to an AFSI decrease adjustment of $1,288, or the remaining adjustment to be taken into account that would ensure book and tax AFSI increases or decreases are equal. See table below:

	AFS Expense	Regular Tax Expense	CAMT Tax Adjustment	CAMT AFS Adjustment	AFSI Adj. (Decrease) / Increase
Present Method:					
2023	($1,000)	($5,000)	$-	$-	$-
2024	($1,000)	$-	$-	$-	$-
2025	($1,000)	$-	$-	$-	$-

2026	($1,000)	$-	$-	$-	$-
Total	**($4,000)**	**($5,000)**	**$-**	**$-**	**$-**
Proposed Method:					
2027	($1,000)	($576)	($576)	$1,000	$424
2027 Sec. 481(a)	$-	$216	$216	$-	$216
2028 Disposition Adjustment	$-	($288)	($288)	($1,000)	($1,288)
2028 Sec. 481(a)	$-	$216	$216	$-	$216
2029 Sec. 481(a)	$-	$216	$216	$-	$216
2030 Sec. 481(a)	$-	$216	$216	$-	$216
Total	**($5,000)**	**($5,000)**	**$-**	**$-**	**$-**

Scenario B

Taxpayer takes into account an adjustment to AFSI in 2027 that increases AFSI by the Deductible Tax Depreciation incorporated to date (2023 through 2026 of $4,136: $5,000 * 20% + $5,000 * 32% + $5,000 * 19.2% + $5,000 * 11.52% = $1,000 + $1,600 + $960 + $576) and decreases AFSI by the Covered Book Depreciation Expense ($4,000) incorporated to date.

Scenario B AFSI Adjustment Table			
	Tax Expense	Book Expense	AFSI Adj. (Decrease) / Increase
Present Method:			
2023	($1,000)	$1,000	$-
2024	($1,600)	$1,000	($600)
2025	($960)	$1,000	$40
2026	($576)	$1,000	$424
Subtotal	($4,136)	$4,000	($136)
Proposed Method:			
2027 Scenario B Adj.	$4,136	($4,000)	$136
2027	$-	$-	$-
2028	$-	$-	$-
Subtotal	$4,136	($4,000)	$136
Grand Total	**$-**	**$-**	**$-**

- **Treasury and IRS should provide guidance clarifying how taxpayers using General Asset Accounts (GAAs) should apply the rules in section 4 of Notice 2023-7 as amended by Notice 2023-64.**

Overview

- Section 4 of Notice 2023-7 provides detailed rules for how a taxpayer must adjust its AFSI when there is a disposition of Section 168 Property. Notice 2023-64 modifies and clarifies these rules. Specifically, Notice 2023-64 clarified that a taxpayer must wait until the taxable year in which the disposition event occurs for Regular Tax to take the disposition into account for AFSI purposes. If a disposition is taken into account in a taxpayer's AFS in a year prior to the disposition event for Regular Tax, any resulting AFS loss is removed from the taxpayer's AFS. When a disposition event occurs for Regular Tax, the taxpayer must adjust AFSI for the taxable year to redetermine any gain or loss taken into account in the taxpayer's AFS.
- Section 168(i)(4) and Treas. Reg. § 1.168(i)-1 allow taxpayers an irrevocable election to include assets in a GAA instead of treating them as single asset accounts. The benefit of GAAs for many taxpayers is a simplification of the regular tax accounting for property. Assets placed in service in the same year with the same depreciation method, recovery period, and depreciation convention may be grouped together in a GAA that is then generally treated as a single asset for depreciation purposes.
- An asset in a GAA is disposed of when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income and includes events such as the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition of a portion of an asset is not a disposition except in limited circumstances. Unless the GAA is terminated, a disposition of an asset in a GAA does not give rise to a disposition gain or loss. The disposed asset is given an adjusted basis of zero immediately before the disposition, so no loss is recognized, and any proceeds from the disposition are recognized as ordinary income. Instead, the taxpayer continues to depreciate the unadjusted basis of the GAA as if no disposition had taken place.
- A taxpayer may elect to terminate a GAA when all of the assets, the last asset, or the remaining portion of the last asset in a GAA are disposed of. If the taxpayer makes this election, gain or loss is recognized based on the proceeds and the adjusted basis of the entire GAA. A taxpayer may also elect to terminate GAA treatment for a specific asset upon a qualifying disposition of the asset even when there are other assets or a portion of other assets remaining in the GAA. In the case of a qualifying disposition, the GAA treatment for the asset is terminated as of the first day of the taxable year when the disposition occurs, and the amount of gain or loss is taken into account based on the asset's adjusted depreciable basis at the time of the qualified disposition.

Recommendations

- Treasury and IRS should provide guidance clarifying how taxpayers using GAAs should apply the rules in section 4 of Notice 2023-7, as amended by Notice 2023-64, for adjusting the AFS gain or loss on a disposition of Section 168 Property. For assets in a GAA, unless the taxpayer elects to recognize gain or loss upon the disposition of the last asset in the GAA or a qualifying disposition of a specific asset in the GAA, there is no disposition event for tax purposes. The

AICPA recommends Treasury and IRS include language in the proposed regulations that makes clear disposition adjustments only occur when a GAA is terminated and a taxpayer recognizes a gain or loss for Regular Tax.

Analysis

- The purpose of the GAA election is to avoid the need for taxpayers to compute gain or loss on assets in the GAA. It would be counter to the intent of Congress in enacting section 168(i)(4) as a simplifying provision to require disposition adjustments similar to the ones under Notice 2023-7 because taxpayers using GAAs would need to maintain a separate set of books and records to separately track the adjusted bases of those assets. It also would appear counter to the intent of section 56A(c)(13), which preserves the benefits of a taxpayer's method of depreciation for Regular Tax when computing AFSI. It would therefore be appropriate for taxpayers who have made an irrevocable GAA election for Regular Tax be allowed to preserve the benefit of greater simplicity that was intended when the GAA election was originally made.

- We therefore recommend Treasury and IRS provide a clarification to the rules for dispositions in Notice 2023-7, as amended and clarified by Notice 2023-64. This clarification should provide that disposition adjustments do not apply for assets in a GAA unless a GAA is terminated and a gain or loss would be recognized for Regular Tax. If a GAA is not terminated, then taxpayers would simply adjust AFSI to disregard the disposition gain or loss taken into account in the taxpayer's AFS, recognize any proceeds received in AFSI for the year of the tax disposal event, and continue to reduce AFSI by the amount of depreciation deductions allowed for the GAA under section 168 until the GAA is fully depreciated. Because this treatment is consistent with the treatment of dispositions of assets in a GAA for Regular Tax, this will prevent the duplication or omission of any item consistent with the statute of section 56A(c)(15)(A). In fact, not following GAA treatment for the purposes of the CAMT could lead to situations where recovery of basis is duplicated. For example, assume a taxpayer disposes of property in a GAA in Year 1 when the taxpayer is subject to the CAMT and recognizes a disposition loss in AFSI of $10,000 based on the adjusted basis of the asset at the time of disposition. Now assume in Year 2, the taxpayer is no longer subject to the CAMT. In that year, the taxpayer will claim a depreciation deduction for the GAA computed using the unadjusted basis of the entire GAA, which still includes the unadjusted basis of the disposed asset.