

Treasury Releases Proposed Regulations on 15% Corporate Minimum Tax

September 16, 2024

The Treasury Department and the IRS have released long-awaited proposed regulations (the “Proposed Regulations”) on the 15% corporate minimum tax on the book income of certain large corporations (the “CAMT”), more than two years after the CAMT was created as part of the Inflation Reduction Act.¹

The Proposed Regulations demonstrate that the IRS and Treasury favor a complex approach to determining which taxpayers are within scope of the CAMT and in calculating CAMT liability. Under the Proposed Regulations, in addition to tracking CAMT income and losses, shadow CAMT tax basis and earnings will need to be tracked by taxpayers, creating a parallel system of reporting alongside financial and tax accounting. The applicability of these rules is exceedingly broad, as many of the provisions apply by their terms to any so-called “CAMT entity” (any regarded entity, including corporations, partnerships and trusts), even if not a CAMT taxpayer. While the Proposed Regulations are largely consistent with prior CAMT guidance in many respects, they also provide clarifications and significant guidance on items not previously addressed by the IRS, in some cases with notable departures from prior guidance.

Certain sections of the Proposed Regulations apply to tax years ending September 13, 2024, while other sections apply to tax years ending after the date the final regulations are published. A public hearing on the Proposed Regulations is scheduled for January 16, 2025.

The Proposed Regulations are more than 600 pages and took over two years to develop. As such, it will take some time for taxpayers to digest the implications on their businesses fully. This alert is intended to provide a summary and commentary on the salient features of the package. We look forward to discussing them with you.

¹ Treasury also released Notice 2024-66 on the same day, providing additional penalty relief for corporations that fail to pay estimated taxes with respect to CAMT liability for tax years that begin before January 1, 2025.

CAMT Mechanics

Scoping Rules

The CAMT imposes a minimum tax on an “applicable corporation” equal to the excess of (i) 15% of its adjusted financial statement income (“AFSI”) (minus a foreign tax credit) over (ii) its regular corporate tax for the year.

- An applicable corporation is any corporation (other than an S corporation, regulated investment company or real estate investment trust) with average annual AFSI in excess of \$1 billion for any three-year period ending with 2022 or later. The CAMT also applies to a U.S. corporate subsidiary of a foreign-parent group if the group has over \$1 billion, and the U.S. subsidiary at least \$100 million, in average AFSI over a three-year period.
- The rules allow a corporation to use a simplified method to determine whether it is an applicable corporation. Under the simplified method, the thresholds are reduced by half and financial statement income is generally not adjusted.

Comment: Neither the \$1 billion nor the \$100 million threshold is inflation indexed, potentially expanding the scope of applicable corporations over time.

Aggregation of Related Entities

- Aggregation rules apply to determine the \$1 billion and \$100 million thresholds across related entities.

Comment: The proposed regulations leave in place rules for determining when multiple corporate subsidiaries of an investment partnership not engaged in a trade or business are aggregated for CAMT purposes. Language that would have expressly aggregated such subsidiaries was removed from the CAMT shortly prior to passage, suggesting that absent further guidance such subsidiaries should not be aggregated.

- In determining whether a corporation has AFSI in excess of \$1 billion, AFSI of affiliates is included only for the period during which the affiliates were related to the corporation.

Comment: Prior guidance would have required an acquiring corporation to include a target’s three-year history with the acquiror’s to determine whether the acquiror exceeded the \$1 billion threshold. This could have resulted in the acquiror becoming subject to the CAMT after an acquisition despite never generating more than \$1

billion in AFSI. The Proposed Regulations fix that by including the target's AFSI with the acquiror's only on a go-forward basis.

Termination of Applicable Corporation Status

Applicable corporation status generally terminates if an applicable corporation does not exceed the \$1 billion three-year threshold for five consecutive taxable years. In addition, if a corporation experiences a change in ownership and ceases to be related to an applicable corporation, its applicable corporation status terminates if it would not be an applicable corporation on a stand-alone basis and is not being acquired by an applicable corporation.

Comment: If an applicable corporation sells a corporate subsidiary, that corporate subsidiary can get a fresh start in determining its applicable corporation status. However, the selling corporation still includes the subsidiary's AFSI for the pre-sale period during which they were related and would have to satisfy the five consecutive taxable year test to terminate its own applicable corporation status.

Identifying the Applicable Financial Statement

- The Applicable Financial Statement ("AFS"), which is the starting point for determining AFSI, is determined based on a descending hierarchy: audited GAAP statements, audited IFRS Statements, audited financial statements under non-GAAP standards, financial statements prepared for government agencies and regulators, and unaudited financial statements.
- Taxpayers generally are required to use the highest available statement within the hierarchy. If a CAMT entity within a financial consolidated group has a stand-alone financial statement that is equal to or higher than the financial statement of the financial consolidated group, the CAMT entity uses the stand-alone financial statement as its AFS.

Comment: The Proposed Regulations provide that financial statements of a higher priority will not be respected for CAMT purposes if they are prepared to improve a taxpayer's CAMT posture. For example, a taxpayer that is part of a consolidated financial statement prepared under IFRS is not permitted to prepare audited US GAAP financial statements for itself solely for the purpose of producing a lower CAMT liability.

Adjustments to AFSI

Adjustments for a Partner's Distributive Share of Partnership AFSI

The CAMT rules provide that the AFSI of a partner in a partnership is adjusted so that it only takes into account the partner's distributive share of the partnership's AFSI.

- In determining how to implement this rule, Treasury considered a “top-down” approach and a “bottom-up” approach for determining the adjustment. The Proposed Regulations take the “bottom-up” approach, which starts with an AFSI determination at the partnership level, because in Treasury's view, it would comport with the structure of the CAMT and allow for a consistent methodology for calculating the adjustments to AFSI.
- Under the “bottom-up” approach, the CAMT entity partner would remove from its AFSI any amount on its AFS attributable to its interest in the partnership and instead include in its AFSI its distributive share of the partnership's modified FSI (generally, the AFSI). A partner's distributive share is determined based on its “distributive share percentage,” which generally is the partner's FSI attributable to the partnership divided by the partnership's total FSI, unless the partner accounts for the partnership interest based on fair market value accounting, in which case the denominator is based on change in the fair market value of the partnership.

Comment: Treasury recognized the proposed sharing percentage method may produce imprecise results under certain circumstances (e.g., resulting in a negative distributive share percentage) and requested comments.

- Gain or loss on the sale or other disposition of a partnership interest reflected on the FSI of a partner is not excluded from the AFSI under the bottom-up approach.
- If a CAMT entity partner owns an interest in an upper-tier partnership that owns one or more lower-tier partnerships, each partnership (starting with the lowest-tier partnership and continuing in order up the chain of ownership) must determine the distributive share of each CAMT entity partner in the tiered-partnership chain.

Comment: While the “bottom-up” approach will necessitate a significant expansion in compliance and reporting obligations, it may be a positive development for certain businesses, including asset managers, which in many cases are required to account of interests in investment partnerships using a fair value method. Under this approach, mark-to-market book gains would be removed from the calculation and replaced with the partner's distributive share percentage of the partnership's AFI, starting with the lowest-tier partnership, which may not be required to utilize

the fair value method. The “bottom-up” method thus may have the effect of significantly limiting the risk that CAMT will apply to unrealized gains to these businesses.

Reporting and Filing Requirements for Partners and Partnerships

- The Proposed Regulations would impose far-reaching reporting and filing requirements on both the CAMT entity partner and the partnership. The proposed reporting and filing requirements would represent a significant expansion to existing annual compliance obligations, and failure to comply would be subject to penalties. Treasury has requested comments on whether exceptions to the reporting requirements should apply for partnerships that meet certain criteria.
- Under these reporting requirements, each CAMT entity partner generally is required to request information from the partnership within 30 days of the end of the year to the extent the CAMT entity partner cannot determine its distributive share of the partnership’s AFSI without receiving such information. The information received (and the request for information) must be maintained by the CAMT entity partner in its books and records.
- A partnership is required to file information requested by a CAMT entity partner with the IRS and to furnish information to the CAMT entity partner in such manner as required by the IRS. A partnership is not required to furnish the information to a CAMT entity partner until it has received a request. However, once a partnership has received a request, it is required to continue to provide the information to the CAMT entity partner for each subsequent taxable year unless notified otherwise by the CAMT entity partner.
- An upper-tier partnership subject to the reporting and filing requirements must request information from a lower-tier partnership, which must file the information with the IRS and provide it to the upper-tier partnership.

Comment: The significant reporting obligations introduced by the Proposed Regulations could impact the willingness of certain partnerships (or fund sponsors) to accept partners that may potentially be subject to CAMT and therefore request such information, and the party responsible for bearing the incremental compliance expenses would likely become a point of negotiation.

Partnership Contributions and Distributions

The Proposed Regulations would create a new “deferred sale” regime that applies with respect to contributions to and distributions from partnerships.

- These rules apply when a CAMT entity contributes property with a built-in gain (or loss) to a partnership, for purposes of determining AFSI, the CAMT entity takes into account any financial statement gain (or loss) from the contribution (which must be redetermined using the property's CAMT basis). This gain or loss is taken into account ratably over the applicable recovery period for the contributed property. The recovery period generally matches the tax depreciation schedule, and there are corresponding CAMT basis adjustments to the CAMT entity's partnership interest.
- If the partnership sells the contributed property, the CAMT entity partner's remaining deferred financial gain (or loss) accelerates. The Proposed Regulations also contain deferred sale rules with respect to distributions of property that would qualify for nonrecognition transaction under normal tax principles, yet trigger gain and a basis step-up for financial statement purposes.

Comment: For financial statement purposes, a contribution of assets to a partnership generally triggers gain, and a corresponding financial statement basis step-up. In contrast, the regular income tax rules provide for tax-free treatment with respect to a contribution to a partnership, and corrective tax allocations over the recovery period for the contributed property, which seek to equalize partnership book and tax capital account balances. The deferred sale rules are intended to align the CAMT consequences of the contribution with the income tax rules, by recognizing financial statement income over the applicable recovery period.

Comment: The Proposed Regulations provide a backstop 15-year recovery period for these deferred sale rules where the partnership is not otherwise depreciating the property for AFS purposes.

Income from Foreign Corporations

- The Proposed Regulations provide that a CAMT entity that is a shareholder of a foreign corporation determines its AFSI with respect to its shares of foreign corporation stock by disregarding all financial statement income with respect to the stock, and taking into account only dividends and other items of income, deduction, gain and loss, as determined under the regular income tax rules (other than deemed inclusions of subpart F income and GILTI).
- A CAMT entity that is a 10% US shareholder of a controlled foreign corporation (or "CFC") also takes into account in its AFSI its pro rata share of the CFC's own AFSI, which is determined with special CFC adjustments. Positive and negative AFSI from multiple CFCs is netted but not below zero. If the resulting AFSI adjustment would be negative, then no adjustment is made and the negative amount is carried forward to the next taxable year.

Comment: The Treasury Department and IRS recognized the income duplication issues implicated by ownership of foreign corporations and CFCs. Rather than create a complex and burdensome parallel regime for CAMT to more precisely avoid duplication issues, the Proposed Regulations generally rely on regular tax rules with respect to foreign corporations and CFCs to mitigate the duplication.

For example, the Proposed Regulations provide that, if a CFC distributes earnings and profits that have not been previously taxed as subpart F income or GILTI to a 10% US shareholder, the shareholder's AFSI takes into account the dividend recognized for regular income tax purposes, which may be reduced by the 100% dividends received deduction under Section 245A for qualifying dividends from foreign corporations.

Similarly, if a 10% US shareholder sells stock in a CFC, gain that would be treated as a dividend under Section 1248 of the Code may benefit from the 100% dividends received deduction. In this situation, for purposes of determining AFSI, the selling shareholder disregards any financial statement gain from the sale and takes into account the amount recognized for regular tax purposes, which includes the benefit of the dividends received deduction.

US Trade or Business Income of Foreign Corporations

The CAMT rules apply to income of in scope foreign corporations that is effectively connected with a U.S. trade or business. Foreign corporations that benefit from the protection of a U.S. income tax treaty generally are not subject to tax on their U.S. trade or business income unless it is attributable to a permanent establishment.

- The Proposed Regulations do not include a clarification that if a foreign corporation is entitled to the benefits of an applicable income tax treaty, treaty protection should also apply in determining the foreign corporation's AFSI.

Comment: This clarification was included in prior guidance. Treasury acknowledged the absence of this statement in the preamble to the Proposed Regulations, noting their view that the clarification was unnecessary, as Section 894(a) of the Code already provides that the Code (including the CAMT rules) is applied with due regard to any income tax treaty obligation of the United States. Foreign corporations relying on treaty benefits should take comfort from this commentary.

Other Adjustments to AFSI

The Proposed Regulations provide guidance on computing other adjustments to AFSI which are largely consistent with prior guidance, including the treatment of certain

energy tax credits, covered benefit plans, tax-exempt entities and depreciation of certain tangible depreciable property and qualified wireless spectrum property.

- The Proposed Regulations generally retain the approach in prior guidance and make adjustments so that AFSI takes into account tax (rather than book) depreciation for tangible assets (as well as certain computer software and film, television and theatrical productions) and qualified wireless spectrum property, with corresponding adjustments upon dispositions of such property. The Proposed Regulations include new and expanded definitions to simplify certain methods for determining depreciation of inventory and to prevent depreciation from being duplicated or omitted from AFSI.

Comment: As with prior guidance, these adjustments preserve tax preferences for certain types of investments (such as tangible property or software). There is no CAMT amortization for goodwill, except as specifically provided in the statute in relation to qualified wireless spectrum.

CAMT Net Operating Loss Carryovers

Since there is no financial accounting concept of net operating loss carryforwards, the CAMT rules create a shadow carryforward system for financial statement net operating losses (“FSNOLs”). Like the income tax rules, a CAMT taxpayer can carry forward FSNOLs to reduce up to 80% of AFSI in the carryforward year. A taxpayer can carry forward unused FSNOLs indefinitely.

- In a favorable development, the Proposed Regulations allow out of scope loss corporations that become CAMT taxpayers to take into account pre-CAMT year FSNOLs.

Comment: The pre-CAMT FSNOL carryover applies only to FSNOLs arising in taxable years ending after December 31, 2019. As required by the underlying statute, losses arising before then are not available for CAMT purposes.

- The Proposed Regulations would create additional complexity by subjecting FSNOL carryovers to a separate return limitation year (SRLY) limitation. The CAMT SRLY rules would apply if there is an ownership change that causes the CAMT taxpayer to cease to be a related party with another person under the CAMT rules, the taxpayer joins a new consolidated group or its assets are acquired by another corporation in a non-recognition transaction described in Section 381. If the CAMT SRLY rules apply, FSNOL carryforwards can only be set off against AFSI of the acquired business, which taxpayers are required to track on a separate basis.

- The Proposed Regulations would also adopt a parallel recognized built-in loss (“RBIL”) system, where built-in losses of a CAMT taxpayer (determined using CAMT tax basis) also are subject to the CAMT SRLY limitation if the taxpayer recognizes the built-in losses during the 5-year period following the ownership change.

Comment: Treasury’s fear of loss trafficking in relation to CAMT taxpayers seems unfortunate, given the additional complexity of tracking and applying the SRLY and RBIL limitations.

Ownership of Stock and Corporate Transactions

Basic Principles

- The Proposed Regulations generally provide that a CAMT entity that holds stock in a corporation that is not part of the CAMT entity’s tax consolidated group excludes from AFSI the FSI impacts of merely holding the stock (e.g., mark to market adjustments or income inclusions attributable to the application of the equity method with respect to the investment in the subsidiary). However, the shareholder takes into account distributions from the subsidiary as well as gain (or loss) from the sale or dispositions of the stock.
- The Proposed Regulations create “shadow” concepts of CAMT inputs (including CAMT basis and retained earnings) which draw from US tax principles but use values derived from FSI, and must be separately tracked to determine the CAMT consequences of a corporate transaction. For example, the recipient of a property distribution must use CAMT retained earnings to determine whether the distribution is treated as a taxable dividend for AFSI purposes, and the distributing corporation must use CAMT basis to determine whether the disposition of property will trigger gain for AFSI purposes.

Comment: While in many cases using CAMT basis and CAMT retained earnings (in lieu of financial accounting inputs) will minimize book-to-tax distortions, the burden on taxpayers for keeping an entirely new set of CAMT books will be considerable.

Comment: The Proposed Regulations provide targeted relief from the requirement to use CAMT retained earnings for determining the taxability of distributions. This relief applies if the CAMT entity owns less than 25% of the distributing corporation (or target corporation), or the distributing corporation (or target corporation) is small enough to qualify for simplified scoping rule calculations, in which case

regular tax earnings and profits are used. This relief applies even to distributions that are part of larger corporate transactions.

- The Proposed Regulations maintain the concepts of “Covered Recognition Transaction” and “Covered Nonrecognition Transaction,” consistent with prior guidance. In general, Covered Nonrecognition Transactions are fully tax-free and do not result in AFSI, whereas Covered Recognition Transactions are recognition transactions that trigger AFSI calculated using CAMT inputs.

Taxable Stock and Asset Sales

In general, the consequences of Covered Recognition Transactions are determined using financial accounting principles, but use CAMT inputs in lieu of financial accounting inputs.

- *Stock sale:* The Proposed Regulations provide that a seller will have AFSI gain (or loss) determined using CAMT basis and an acquiror will take CAMT basis in the acquired stock equal to AFS basis (i.e., fair value). Any purchase accounting or push down adjustments, where the assets of a target and its subsidiaries would be marked to fair value for FSI purposes, will be disregarded for CAMT purposes.

Comment: By backing out purchase accounting and push down adjustments, a stock acquiror will preserve any built-in gain in target assets, resulting in increased AFSI in a subsequent asset sale to match taxable income.

- *Asset sale:* A seller will have asset gain (or loss) determined using CAMT basis and an acquiror will take CAMT basis in the assets equal to AFS basis (i.e., fair value).
- *Section 338(h)(10) election:* A stock sale with a Section 338(h)(10) election is treated as a deemed asset sale for CAMT purposes, as is the case under regular tax rules. The target corporation determines AFSI using regular tax principles but with CAMT inputs.

Tax-Free Reorganizations and Spin-Offs

In general, the consequences of Covered Nonrecognition Transactions are determined using regular tax principles, but use CAMT inputs in lieu of regular tax inputs.

- Consistent with prior guidance, the Proposed Regulations preserve the nontaxability of Covered Nonrecognition Transactions: reorganizations, spin-offs, split-offs, formations and liquidations that qualify in whole for nonrecognition treatment for regular tax purposes and that do not result in the recognition of any gain (or loss) for CAMT purposes. In general, each component of a transaction is examined separately

to determine whether it is a Covered Recognition Transaction or Covered Nonrecognition Transaction.

- The Proposed Regulations provide that a distributing corporation that receives “boot” (property or other money) in a spin-off or split-off from the spun-off corporation can preserve nonrecognition treatment for CAMT purposes by distributing all of the boot to its shareholders and securityholders in a tax-free “boot purge.”
- The impact of taxable gain (or loss) in a transaction component that would otherwise be a Covered Nonrecognition Transaction can have variable impacts. With respect to shareholders in a reorganization (such as a “Type A Merger”), AFSI will be recognized based on general tax principles, such that the receipt of \$10 of boot generates \$10 of AFSI. However, in other cases, such as a spinoff where boot is not purged completely in a tax-free manner, AFSI will be computed on financial accounting principles, which can result in outsized gain in comparison to what would have typically occurred under regular tax principles.

Comment: This differentiation can result in a “cliff effect” for certain nonrecognition transactions (in particular D-Reorganizations and Section 351 transactions), thereby substantially raising the stakes of the application of the technical reorganization rules.

Tax Consolidated Groups and Insurance Companies

Single Entity Approach with Deferred Intercompany Transactions

The Proposed Regulations provide that a tax consolidated group is treated as a single entity for purposes of determining AFSI and the minimum tax. This single-entity approach also applies to the CAMT scoping rules.

- Under the single-entity approach, financial statement entries that eliminate transactions and investments between members of a tax consolidated group (“AFS consolidation entries”) are taken into account, so that inter-company transactions and investments are not reflected in the tax consolidated group’s AFSI. In contrast, if an AFS includes both members of a tax consolidated group and non-members, AFS consolidation entries between member and non-member companies are disregarded, and transactions and investments between such companies are taken into account in determining the tax consolidated group’s AFSI.

Comment: This single entity approach is consistent with prior guidance, which clarified that single entity treatment was appropriate for CAMT purposes.

- The Proposed Regulations would introduce CAMT deferred transaction rules that apply if one of the parties to an inter-company transaction or the relevant asset leaves the consolidated group. Under these rules, transactions that have been previously eliminated for financial statement purposes spring into effect and are taken into account in AFSI under rules similar to the matching rules that apply for regular tax purposes. For example, deferred gain on a sale of asset between two tax consolidated group members will be taken into account in the group's AFSI if the asset or either of the selling or buying member leaves the group.

Comment: While the introduction of CAMT deferred transaction rules is consistent with the burdensome, parallel CAMT system approach of the Proposed Regulations, Treasury has shown some restraint in forgoing for CAMT purposes intercompany adjustments in respect of depreciation attributable to intercompany asset sales.

- Notwithstanding the Proposed Regulations' adoption of the single-entity approach for tax consolidated groups, the Proposed Regulations require the AFSI of a tax consolidated group to include gain or loss (determined using CAMT tax basis) attributable to one member's sale or exchange of the stock of another member. The rules appear to provide that tax consolidated group takes this gain into account when the subsidiary leaves the group.

Insurance Companies

The proposed regulations generally follow Treasury's prior guidance, which provided important relief from potentially large mismatches in AFSI and taxable income, caused by investment mark-to-market in variable insurance contracts and "funds withheld" and "modified coinsurance" reinsurance transactions. In such cases, investment income and related payment obligations which generally offset for regular tax purposes may not properly offset for AFSI purposes.

- For variable contracts, both FSI and taxable income generally offset investment income and gains against the obligation to pay the investment performance out to policyholders, however the special AFSI adjustments for investments in corporations and partnerships threatened to upset this balance. The Proposed Regulations take a different approach from prior guidance to remove the mismatch—by leaving both the asset and liability changes in AFSI and turning off the AFSI corporation and partnership adjustments.

Comment: The revised approach appears simpler to administer as it preserves the FSI treatment and merely turns off AFSI adjustments that would otherwise need to be made.

- The Proposed Regulations also address some concerns raised by the insurance industry that are relevant for corporate taxpayers more broadly. For example, the AFSI inclusions for dividends from corporations that are not members of the recipient's tax consolidated group are reduced by any associated dividends received deduction. This should address concerns that dividends from life insurance companies that are not currently eligible to consolidate with nonlife insurance holding companies could create full AFSI inclusions despite a 100% dividends received deduction.
- Treasury requested comments on mismatches between the FSNOL rules, which follow the regular net operating loss rules, and nonlife insurance companies that still carry net operating losses back and forward under pre-TCJA rules.

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Please do not hesitate to contact us with any questions.



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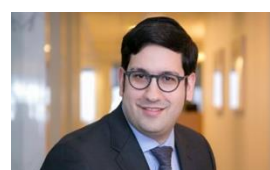
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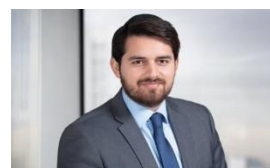
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