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In this report, the final installment of a two-part series, the authors continue their examination of the new corporate alternative minimum tax, noting issues that can be resolved through guidance, at least in part, and those for which the only remedy is repeal of the new tax.

All views expressed in this report are solely those of the authors, not of their firms, and any errors likewise are exclusively the authors'.

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In part 1 of this report,[1] we began our examination of key provisions of the new corporate alternative minimum tax enacted by the Inflation Reduction Act of 2022 (IRA, P.L. 117-169).[2] This corporate AMT is based on book income and thus known as the book minimum tax (BMT). Part 1 selectively explored the 1986 predecessor to the IRA BMT — the book income adjustment — including a few of the problems that may have prompted Congress to terminate it in 1989. In this part 2, we continue our look at key provisions of the IRA BMT, and we cautiously wade into the issues that, based on our initial reading of the statute, will pose challenges for the IRS in providing guidance to administer this new regime.

[1] Jerred G. Blanchard Jr. et al., "The Corporate AMT: Are the Issues Insurmountable?" *Tax Notes Federal*, Jan. 16, 2023, p. 343.

[2] IRA section 10101.

III. The 2002 Rebirth of the BMT

B. Summary of IRA BMT Provisions

2. Determining the amount of BMT owed by an applicable corporation.

a. Calculation of AFSI.

xii. AFS NOL carryforward for post-2019 net book losses.

Section 56A(d)(1) provides that adjusted financial statement income (AFSI) for a tax year is reduced by the lesser of (1) the total amount of financial statement net operating loss carryovers (AFS NOL carryforwards) to the tax year, and (2) 80 percent of the AFSI for the tax year, determined without regard to the AFS NOL carryforward.[3] The term "financial statement net operating loss" (AFS NOL) is defined as the amount of any net loss set forth on the corporation's applicable financial statement (AFS) (determined after the application of section 56A(c) and without regard to section 56A(d)) for tax years ending after December 31, 2019.[4] Thus, if the computation of AFSI for a tax year ending after 2019 results in a net book loss after applying the section 56A(c) adjustments but without taking into account any reduction under section 56A(d) for prior AFS NOL carryforwards, the net book loss becomes an AFS NOL carryforward to each subsequent tax year indefinitely.[5]

Because an AFS NOL carryforward can arise in a tax year before the first tax year a corporation becomes subject to the IRA BMT, potential applicable corporations should review their AFSs for all tax years ending after December 31, 2019, to determine whether any AFS NOLs were incurred and remain unabsorbed.

Example 1: *AFS NOL carryforward from a pre-2023 tax year.* P is a large, publicly traded domestic corporation with a tax year ending January 31 of each calendar year. For its tax year ending January 31, 2020, P incurs an AFS NOL carryforward of $4.6 billion. For its tax year ending January 31, 2021, P earns AFSI of $1.9 billion. For its tax year ending January 31, 2022, P earns AFSI of $900 million. Finally, for its tax year ending January 31, 2023, P earns AFSI of $800 million. P is an applicable corporation for its tax year ending January 31, 2024, because its average annual AFSI for the three preceding tax years, determined without regard to section 56A(d), exceeds $1 billion ([$1.9 billion for the year ended January 31, 2021 + $900 million for the year ended January 31, 2022 + $800 million for the year ended January 31, 2023] / 3 = $1.2 billion). Further, P has an AFS NOL carryforward available for its tax year ending January 31, 2024, of $1 billion (the $4.6 billion AFS NOL for the year ended January 31, 2020 - the $3.6 billion of AFSI earned in the years ended January 31, 2021, January 31, 2022, and January 31, 2023).

Note that even though P is not subject to the IRA BMT for the tax years ended January 31, 2021, through January 31, 2023, the AFSI earned by P in those tax years reduces the AFS NOL carryforward from the year ended January 31, 2020. Thus, in addition to P's being required to determine its AFSI for its first tax year for which P is subject to the IRA BMT (the year ended January 31, 2024) and for each of the preceding three tax years (the years ending January 31, 2021; January 31, 2022; and January 31, 2023), without taking into account any AFS NOL carryforwards under section 59(k) in ascertaining its applicable corporation status for the year ended January 31, 2024, P is well advised to determine its AFSI or AFS NOL for the tax year ended January 31, 2020, and the extent to which any AFS NOL carryover originated in that tax year is available to reduce AFSI for the tax year ended January 31, 2024, under section 56A(d).

Section 53(e) is the AMT-reducing counterpart to the regular tax-reducing AMT credit allowed under section 53(b) (discussed in Section III.B.3, *infra*). The AMT credit against regular tax — equal to the amount by which tentative minimum tax (TMT) (the excess of 15 percent of the taxpayer's AFSI over its corporate AMT foreign tax credit)

[3] Section 56A(d)(1)(B) conforms the use of an AFS NOL carryforward to the 80 percent limitation on the use of post-2017 regular tax NOL carryforwards in section 172(a)(2)(B).

[4] Section 56A(d)(3) ("the term 'financial statement net operating loss' means the amount of the net loss (if any) set forth on the corporation's applicable financial statement (determined after application of subsection (c) and without regard to this subsection) for taxable years ending after December 31, 2019").

[5] Section 56A(d)(2). While not specified in the statute, presumably AFS NOL carryforwards generally will be absorbed on a first-in, first-out basis (from oldest to newest). *Cf.* section 172(b)(2)(A) (in determining whether an NOL carryover from a loss year is absorbed in a later tax year, taxable income is determined without regard to the NOL carryover from the loss year or any subsequent tax year).

for a tax year exceeds the sum of the amount of regular tax plus any base erosion and antiabuse tax imposed under section 59A for that tax year — can arise even if AFSI and regular taxable income are positive amounts for the tax year in which the credit arises. The AFS NOL carryforward, on the other hand, requires the AFSI computation for a tax year, without regard to the adjustment required by section 56A(d)(1) for any AFS NOL carryforward from a prior tax year, to result in a net book loss.

Nonetheless, in applying the limitation in section 53(c) on the AMT credit for a tax year (that limitation being the excess regular tax (plus BEAT incurred under section 59A) over TMT for the year), any AFS NOL carryforward to that tax year under section 56A(d) must first be applied so that the taxpayer's TMT can be determined. Thus, it is possible that a taxpayer will use both the AFS NOL carryforward and AMT credit in the same tax year, as illustrated by Example 4 in Section III.B.3.a, *infra.*

Suppose T has an AFS NOL carryforward and merges into P in a reorganization described in section 368(a)(1)(A). Because the reorganization is described in section 381(a), P succeeds to the T tax attributes described in section 381(c). While a regular tax NOL carryforward is described in section 381(c)(1), there is no reference to AFS NOL carryforwards in section 381(c). But the lack of an express reference in section 381(c) to a particular tax attribute does not necessarily preclude the acquiring corporation from succeeding to that tax attribute. The Senate committee report accompanying section 381 states explicitly that section 381 "is not intended to affect the carryover treatment of an item or tax attribute not specified in the section or the carryover treatment of items or tax attributes in corporate transactions not described in section 381(a)," and that "no inference is to be drawn from the enactment of this section whether any item or tax attribute may be utilized by a successor or a predecessor corporation under existing law."[6] Further, reg. section 1.381(a)-1(b)(3) provides:

> Section 381 does not apply to the carryover of an item or tax attribute not specified in subsection (c) thereof. In a case where section 381 does not apply to a transaction, item, or tax attribute by reason of either of the preceding sentences, no inference is to be drawn from the provisions of section 381 as to whether any item or tax attribute shall be taken into account by the successor corporation.

Thus, although section 381(c) does not expressly refer to AFS NOL carryforwards, that item or attribute should still carry over to the successor corporation, P, based on the principles in pre-1954 case law and subject to limitations similar to the limitations in section 381(c)(1) applicable to regular tax NOL carryovers.[7]

Section 56A(a) states: "For purposes of this part, the term 'adjusted financial statement income' means, with respect to *any corporation* for any taxable year, the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement for such taxable year, adjusted as provided in this section." (Emphasis added.) The only limitation on this general rule found in section 56A(d) is that an AFS NOL carryforward cannot arise in a tax year ending on or before December 31, 2019. Thus, even if T is a relatively small corporation that has not satisfied, and likely will never satisfy, the average annual AFSI requirements of section 59(k), T may nonetheless have incurred an AFS NOL carryforward in a tax year ending after December 31, 2019, to which P succeeds when T merges into P in a section 368(a)(1) reorganization or completely liquidates into P under section 332.[8]

Suppose P is the common parent of a consolidated group, T is an includable

[6] S. Rep. No. 83-1622, at 277 (1954).

[7] *See, e.g.*, *Libson Shops Inc. v. Koehler*, 353 U.S. 382 (1957); and *Koppers Co. v. United States*, 134 F. Supp. 290 (Ct. Cl. 1955) (acquiring corporation in a statutory merger, completed before enactment of section 381, succeeds to acquired corporation's unused excess profits credit). In light of the legislative history, the IRS has issued several rulings, private letter rulings, and general counsel memoranda that provide for the carryover of tax attributes not listed in section 381(c). *See* Rev. Rul. 72-453, 1972-2 C.B. 439 (and the accompanying GCM 34539 (June 30, 1971)); Rev. Rul. 72-452, 1972-2 C.B. 438; Rev. Rul. 68-350, 1968-2 C.B. 159; Rev. Rul. 75-205, 1975-1 C.B. 347; Rev. Rul. 66-125, 1966-1 C.B. 342; and Rev. Rul. 72-356, 1972-2 C.B. 452.

[8] The definition of AFS NOL carryforward in section 56A(d)(3) is not limited to domestic corporations and hence includes AFS net book losses of foreign corporations, determined after making all adjustments required by section 56A(c), including the elimination of items of income or deduction that are not effectively connected with the conduct of a U.S. trade or business required by section 56A(c)(4).

corporation within the meaning of section 1504(b), and P acquires all the stock of T when T has an AFS NOL carryforward. If the AFSI of a consolidated group is determined on a consolidated basis by aggregating the net book income or loss and section 56A adjustments of the group's members, should a separate return limitation year (SRLY) restriction similar to reg. section 1.1502-21(c) apply to the AFS NOL carryforward?[9] The policy underlying the SRLY rules is tax neutrality — if T cannot absorb a favorable T tax attribute after joining the P consolidated group faster than T could absorb the attribute before joining the group, federal income tax consequences will not influence a decision to acquire T. This broad neutrality policy likely will result in an SRLY limitation on AFS NOL carryforwards.

Suppose T is a member of the P consolidated group and originates a large AFS NOL carryforward that is not fully absorbed by the P group before the close of a consolidated return year in which a nonmember buys all the stock of T. Should T leave the P consolidated group with a portion of the consolidated AFS NOL carryforward (for example, under the principles of reg. section 1.1502-21(b)(2), which generally apportions an unused, regular tax consolidated NOL carryover among the members responsible for the consolidated NOL carryover in the same proportion as the ratio that each of those members' separate NOL for the year the consolidated NOL carryover was originated bears to the aggregate of all those separate NOLs). Again, the answer should be yes if the group's AFSI and AFS NOL are determined on a consolidated basis.

If a corporation (whether or not an applicable corporation) with one or more AFS NOL carryforwards from prior tax years undergoes an ownership change within the meaning of section 382(g), it is unclear whether its AFS NOL carryforwards attributable to pre-change periods will be limited under section 382(a). Section 382(a), by its terms, applies only to pre-change losses, defined in section 382(d)(1) as NOL carryforwards to the tax year of the ownership change and any NOL for the tax year of the ownership change that is allocated to the pre-change period. Section 383, by its terms, applies only to unused general business credits under section 39 (section 383(a)(1) and (a)(2)(A)), unused minimum tax credits under section 53 (section 383(a)(1) and (a)(2)(B)), excess FTCs under section 904(c) (section 383(c)), and net capital losses under section 1212 (section 383(b)). Moreover, there is no IRA BMT provision subjecting AFS NOL carryforwards to the limitation under either section 382 or section 383. Thus, if a corporation's AFS NOL carryforwards to a tax year ending after the date the corporation undergoes an ownership change are to be subject to limitation under section 382, it appears the IRS would have to do so by adopting a regulation to that effect.[10]

How such a limitation would be crafted is anyone's guess. But it seems likely that the limitation, at a bare minimum, would have to consider (1) the impact on the new loss corporation's regular tax liability for a post-change year of any pre-change NOLs subject to a regular tax section 382 limitation and any pre-change net capital losses subject to a regular tax section 383 limitation; (2) the impact on the new loss corporation's regular tax liability for a post-change year of any pre-change tax credits (including the AMT credit allowed under section 53) subject to a regular tax section 383 limitation;[11] and (3) whether a separate BMT limitation, initially equal in amount to the regular tax section

[9]Under reg. section 1.1502-21(c)(1), the P consolidated group's ability to use an NOL carryover of T that originated in a tax year ending on or before the date T joins the P consolidated group generally is limited for each tax year to T's cumulative, net positive contribution to the group's consolidated taxable income for each consolidated return year during which T is a member, up to and including the year in which the NOL is to be used.

[10]Arguably, the IRS has the authority to issue such a regulation under section 56A(e) (authority to issue guidance carrying out the "purposes of" section 56A) or its general authority under section 7805. Note that the authority to provide adjustments to items of AFSI in section 56A(c)(15)(B) applies "to carry out the principles of part II of subchapter C of this chapter (relating to corporate liquidations), part III of subchapter C of this chapter (relating to corporate organizations and reorganizations), and part II of subchapter K of this chapter (relating to partnership contributions and distributions)." Sections 382 and 383, which reside in Part V, are not referenced.

[11]Reg. section 1.383-1(b) coordinates losses subject to a section 382 limitation with credits subject to a section 383 limitation by first applying the section 382 limitation to the losses and, if any section 382 limitation remains, determining the section 383 limitation to be "the tax liability of the new loss corporation for the post-change year which is attributable to so much of the corporation's taxable income that would be reduced by allowing as a deduction its section 382 limitation remaining after accounting for the use of pre-change losses."

382 limitation and adjusted based solely on the loss corporation's IRA BMT experience (the "separate and asynchronous"[12] approach),[13] should be applied to the pre-change AFS NOL carryforwards versus a single coordinated section 382 limitation (for example, a BMT limitation equal to whatever remains of the regular tax limitations under sections 382 and 383 after applying them to the regular tax losses and credits).

If Treasury does limit AFS NOLs under section 382, then, unquestionably, the better approach to use is the separate and asynchronous approach. The regular income tax and IRA BMT systems are on parallel tracks that never cross until they reach the final stop at section 55(a). At that final stop, any regular tax remaining after taking into account the section 382/383-limited regular tax attributes, including any regular tax FTC, is subtracted from TMT. TMT also has been reduced, taking into account any section 382-limited AFS NOL carryforward and any AMT FTC, in determining the amount of net AMT owed by the loss corporation. If the section 382/383-limited regular tax attributes' use of the section 382 limitation reduces the amount of section 382 limitation available for the AFS NOL carryforward, it is highly likely that the sum of the regular tax and net AMT incurred by the loss corporation will, for one or more profitable tax years, meaningfully exceed the tax Congress, in enacting sections 382 and 383, intended the loss corporation to incur after taking into account the limited tax attributes.[14]

Example 2: *Application of section 382 to both an NOL carryover for regular tax purposes and an AFS NOL.* For a tax year for which L is subject to the IRA BMT, L has (1) $1,000 of regular taxable income before deducting a $900 section 382-limited NOL carryover, (2) $1,300 of AFSI before deducting a $700 section 382-limited AFS NOL carryforward, and (3) a section 382 limitation of $500, applicable to both the NOL carryover and the AFS NOL carryforward.

Coordinated approach. If the section 382 limitations are coordinated by reducing the IRA BMT limitation by the amount of limitation used for regular tax purposes, (1) L's regular tax is $105 (21 percent * [$1,000 - the $500 NOL carryover allowed under section 382] = $105); (2) because the entire section 382 limitation is used in determining L's regular tax, L's TMT is $195 (15 percent * $1,300 = $195); (3) L's net AMT is $90 ($195 - $105 = $90); and (4) L's total federal tax liability is $195 ($105 regular tax + $90 net AMT).

Separate and asynchronous approach. If the separate and asynchronous approach is used, the use of the $500 section 382 limitation for IRA BMT purposes is not affected by the use of the limitation for regular tax purposes, and vice versa. Thus, (1) L's regular tax remains $105 (21 percent of $500 of regular taxable income); (2) the entire $500 section 382 limitation is available for absorption of the $700 AFS NOL carryforward, thus reducing TMT to $120 (15 percent * [$1,300 - $500 (the AFS NOL carryforward allowed under section 382(b))] = 15 percent * $800 = $120); (3) L's net AMT is $15 ($120 TMT - $105 regular tax); and (4) L's total federal tax liability is $120.

The $195 of total tax using a coordinated approach to the application of section 382 (39 percent of L's $500 of regular taxable income) is far greater than the tax Congress, in enacting section 382 in 1986, must have believed is an appropriate tariff in connection with an ownership change, especially after the 2017 repeal of the 1986 corporate AMT and lowering of the regular corporate tax rate to 21 percent. On the other hand, the $120 of total tax using a separate and asynchronous approach (24 percent of L's $500 of regular taxable income) seems well within the ballpark of the effective tax rates (ETRs) Congress must have believed are appropriate after an ownership change.

A second issue that must be addressed if section 382 is applied to AFS NOL carryforwards

[12] We use the term "asynchronous" merely to denote that a reduction in a section 382 limitation applicable to a regular tax NOL carryover attributable to the use of the limitation does not simultaneously reduce the section 382 limitation applicable to an AFS NOL carryforward, or vice versa.

[13] Like the regular tax limitation, under section 382(b)(1), the initial annual limitation on AFS NOL carryforwards under the separate and asynchronous approach generally would equal the fair market value of the new loss corporation's stock on the change date (subject to potential adjustments) multiplied by the long-term tax-exempt rate in effect on the change date. For subsequent tax years, the initial annual BMT limitation would be increased under section 382(b)(2) by any unused limitation in prior post-change tax years.

[14] Also, the separate and asynchronous approach better matches the timing of the use of the pre-change regular tax attributes with the timing of the use of the pre-change AFS NOL carryforwards, thus mitigating a timing difference problem similar to that litigated in *CSX*, discussed in Section II.B of part 1 of the report.

involves the application of section 382(h) (the built-in gain or loss provisions). For example, in determining an applicable corporation's net unrealized built-in gain or loss under section 382(h)(3)(A) for IRA BMT purposes, presumably the book value of the corporation's assets, subject to adjustments required by section 56A(c)(13) for depreciable assets and by section 56A(c)(14) for qualified wireless spectrum, is subtracted from the fair market value of the assets at the change date. If the book value of the assets, determined based on the applicable corporation's AFS for the tax year of the ownership change, includes an increase for a deferred tax asset (DTA) or decrease for a deferred tax liability (DTL), to what extent should the DTA or DTL be disregarded under section 56A(c)(5) in determining the corporation's net unrealized built-in gain or net unrealized built-in loss? The same question applies to determinations of recognized built-in gain or loss under section 382(h)(2).

Finally, if section 382 applies to an AFS NOL carryforward, presumably section 384 also applies. For example, suppose P, the common parent of a consolidated group, has an AFS NOL carryforward, and T has a large net unrealized book gain in its assets, determined under the principles of section 382(h)(3) and applying the adjustments to book basis required under section 56A(c). P's acquisition of all the T stock, or of all the T assets in a reorganization described in section 381(a), likely should not enable P to use its AFS NOL carryforward against recognized built-in book gains, determined under the principles of section 382(h)(2), for a period of five consecutive years beginning the day after the date of P's acquisition of all the stock or assets of T. The same would be true if T acquired P.

xiii. Adjustments when no regular tax benefit is derived from different treatment of items.

Section 59(g), enacted in 1986 as part of the 1986 AMT,[15] contains the following enigmatic language: "Tax Benefit Rule. The Secretary *may* prescribe regulations under which differently treated items shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's regular tax for the taxable year for which the item is taken into account or for any other taxable year." Section 59(g)'s predecessor is former section 58(h) (1976), which provided: "The Secretary *shall* prescribe regulations under which items of tax preference shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's tax under this subtitle for any taxable years." No regulations were ever issued under former section 58(h), and, notwithstanding its presence in the code for some 36 years, no regulations have yet been issued under section 59(g).

The principal differences between the two "tax benefit" provisions are (1) former section 58(h) has been held to be self-executing,[16] whereas section 59(g) has been held not to be;[17] and (2) former section 58(h) addressed tax preference items that should not be included in minimum taxable income because the preferences resulted in no reduction in the taxpayer's federal income tax burden,[18] whereas, in the context of the application of section 59(g) to the BMT, the minimum tax base does not begin with taxable income to which preference items are added. Indeed, the unique feature of the IRA BMT is that there are no tax preferences to be added to taxable income under the IRA BMT because, unlike prior minimum taxes (such as the 1986 AMT) that were aimed at taxpayers' "overuse" of tax preference items like accelerated depreciation, the new BMT is purely a revenue raiser, the starting point for which is net book income or loss as determined

[15] Tax Reform Act of 1986, section 701(a) (repealing section 58(h) and replacing it with section 59(g)).

[16] See, *e.g.*, *Occidental Petroleum Corp. v. Commissioner*, 82 T.C. 819 (1984), in which the Tax Court applied former section 58(h) to relieve Occidental Petroleum of liability for payment of add-on minimum tax in 1977 despite the absence of regulations. *See also First Chicago Corp. v. Commissioner*, 842 F.2d 180, at 182-183 (7th Cir. 1988) (applying the tax benefit rule of former section 58(h) to prevent add-on minimum tax liability despite the failure to promulgate regulations); and Rev. Rul. 80-226, 1980-2 C.B. 26 (same).

[17] *See, e.g.*, *Day v. Commissioner*, 108 T.C. 11 (1997); and *Wai v. Commissioner*, T.C. Memo. 2006-179. *Cf. Breakell v. Commissioner*, 97 T.C. 282 (1991) (applying section 58(h) to adjust an individual taxpayer's alternative minimum taxable income), *aff'd in part and rev'd in part*, 996 F.2d 1231 (11th Cir. 1993).

[18] Congress's intent in enacting former section 58(h) was that tax preference items that are of no tax benefit to a taxpayer should not be included in the computation of the minimum tax on tax preferences. *See* S. Rep. No. 94-938, at 113 (1976).

for financial reporting purposes, not taxable income as determined for regular tax purposes.

Nonetheless, disregarding any difference in regular tax and BMT rates, a difference between the financial reporting treatment of an item and the regular tax treatment of the same item may have the same impact as an increase in taxable income, as determined for regular tax purposes. Thus, if the with-without analysis[19] applied by the authorities under former section 58(h) demonstrates that the regular tax treatment of the item to some extent results in no regular tax reduction, but the financial reporting treatment does increase AFSI, an adjustment should be allowed under section 59(g). This fact is illustrated by the following example.

Example 3: *Section 59(g) adjustment for tax-exempt interest income*. For its first tax year (calendar 2023) beginning after December 31, 2022, X, a domestic calendar-year corporation in the business of manufacturing semiconductors exclusively in the United States, is an applicable corporation incurring no BEAT under section 59A and having the following items: (1) $500 million of interest income on municipal bonds that is exempt from regular tax under section 103; (2) no net operating income or loss for 2023 from the conduct of X's semiconductor manufacturing business; (3) an NOL carryover from 2003 in the remaining amount of $300 million, all of which expires at the end of 2023 to the extent not used in 2023; and (4) AFSI of $510 million, consisting of $500 million of municipal bond interest income plus $10 million of operating income attributable to the manufacturing business. X's regular tax rate is 21 percent under section 11.

Regular tax amount for 2023. For 2023 X incurs $0 regular tax because its taxable income is $0. Also, because the $300 million NOL carryover expires on the last day of 2023, X has no NOL carryovers to 2024.

[19] Rev. Rul. 80-226 phrases the with-without analysis as follows:
In determining the extent to which a taxpayer's tax preference items of deduction reduce the taxpayer's gross income and thereby provide a tax benefit, a taxpayer will be treated as using all non-preference deductions first. . ., followed by preference items of deduction to the extent necessary to reduce taxable income to zero. This approach will limit a taxpayer's items of tax preference to *the excess of (1) taxable income computed* without *regard to preference items, over (2) taxable income computed* with *regard to preference items*. This excess represents the actual tax benefit received by a taxpayer from preference items. [Emphasis added.]

Amount of net AMT for 2023. X's TMT for 2023 is $76.5 million ([15 percent * $510 million of AFSI] - $0 corporate AMT FTC = $76.5 million). Thus, without a section 59(g) adjustment, X's net AMT for 2023 is $76.5 million ($76.5 million TMT - $0 regular tax).

Clearly, setting aside the difference in BMT and regular tax rates, the BMT/financial reporting treatment of the $500 million of municipal bond interest as an item included in X's AFSI is identical in tax effect to increasing taxable income by a $500 million preference in the form of an elimination of the exemption of the interest income under section 103. Consequently, it is appropriate under section 59(g) to determine the regular tax effects *with* the section 103 exemption, compare those effects to the regular tax effects *without* the section 103 exemption, then see if the difference justifies an adjustment treating all or part of the $500 million of interest income as excluded from X's AFSI.

"With" analysis. With the $500 million exemption of its municipal bond income under section 103, X's 2023 regular tax liability is $0. While the $300 million NOL carryover from 2003 remains unused in 2023, that produces no regular tax benefit because it expires on the last day of 2023.

"Without" analysis. Without the $500 million exemption under section 103, X's 2023 regular tax liability is $42 million ($500 million of taxable interest income - the $300 million expiring NOL carryover from 2003 = $200 million of taxable income; 21 percent * $200 million = $42 million).

The with-without analysis establishes that, thanks to the $300 million expiring NOL carryover from 2003 that disappears at the end of 2023 unless used in X's 2023 return, X is indifferent about whether $300 million of the municipal bond interest income is exempt from tax. In other words, if $300 million of the income had been taxable interest and $200 million tax-exempt interest, X's regular tax consequences would have been unchanged ($0 regular tax [$300 million of interest income - $300 million of remaining NOL carryover from 2003 = $0] and no NOL carryovers to 2024).

Of the $105 million of potential regular tax benefit attributable to the exemption (21 percent * $500 million = $105 million), $42 million is critical and $63 million is not because the $300 million NOL carryover from 2003 would have generated that amount of tax benefit (21 percent * $300 million = $63 million). This suggests that an adjustment under section 59(g) that reduces AFSI by $300 million (that is, treats $300 million of the $500 million of municipal bond interest income ($500 million * $63 million/$105 million) as excluded from net book income) is appropriate because $300 million of the tax exemption produces no regular tax benefit. In that regard, preserving the $300 million of NOL carryforward from 2003 results in no regular tax benefit because the carryforward expires on the last day of 2023.

Net AMT with section 59(g) adjustment. If X's $510 million of AFSI is reduced by $300 million under section 59(g), X's TMT for 2023 is $31.5 million (15 percent * $210 million of AFSI). Thus, with an appropriate section 59(g) adjustment, X's net AMT for 2023 is reduced by $45 million, from $76.5 million to $31.5 million ($31.5 million of TMT - $0 regular tax).

If the current trend under section 59(g) continues and guidance is not issued under section 59(g) for purposes of the BMT, it will be interesting to see whether the courts continue to hold that the statute is not self-executing, especially in cases clearly meriting an adjustment, like Example 3.

xiv. Authority to issue guidance.

There is ample authority in sections 56A and 59 for the secretary to issue regulations or other guidance regarding adjustments to net book income, including (1) section 56A(c)(15) (guidance preventing duplications and omissions and guidance regarding adjustments needed to carry out the policies of particular nonrecognition provisions); (2) section 56A(e) (guidance to carry out the purposes of section 56A, "including regulations and other guidance relating to the effect of the rules of this section on partnerships with income taken into account by an applicable corporation"); and (3) section 59(g) (authority to issue guidance appropriately adjusting AFSI or TMT when the financial reporting treatment of an item differs from the regular tax treatment of the item, and the regular tax treatment of the item does not reduce regular tax liability).

b. Computation of net AMT liability.

i. Determination of TMT.

Under section 55(b)(2)(A), an applicable corporation's TMT for a tax year is any excess of:

1. 15 percent of the corporation's AFSI for the tax year, taking into account all applicable adjustments required by section 56A (including any AFS NOL carryforward, subject to the 80 percent of current AFSI limitation, and any adjustment under section 59(g) described in Section III.B.2.a.xiii of the report), over
2. the corporate AMT FTC for the tax year.

If an applicable corporation elects to credit rather than deduct creditable foreign taxes incurred by the corporation for a tax year, its corporate AMT FTC will equal the sum of (1) for an applicable corporation that is a domestic corporation, the amount of creditable foreign taxes imposed by any foreign country or possession of the United States to the extent those taxes are taken into account on the applicable corporation's AFS for the year and are paid or accrued (as determined for regular tax purposes) by the applicable corporation during the year;[20] plus (2) the lesser of (A) its pro rata share of creditable foreign taxes taken into account on the AFS of each controlled foreign corporation, for which the applicable corporation is a U.S. shareholder, to the extent those taxes are paid or accrued for regular tax purposes for that tax year, or (B) the product of the rate set forth in section 55(b)(2)(A)(i) (that is, 15 percent) times the amount of the adjustment under section 56A(c)(3) (the CFC's net book income shown on its AFS for the tax year, subject to adjustments similar to those described in section 56A(c)).[21] Section 59(l)(3) authorizes regulations to carry out the purposes of these provisions.

[20] Section 59(l)(1)(B).

[21] Section 59(l)(1)(A). The 15 percent limit on deemed-paid foreign income taxes attributable to a U.S. shareholder's pro rata share of the CFC's section 56A(c)(3)-adjusted net book income prevents the U.S. shareholder from using its deemed-paid corporate AMT FTCs to reduce AMT imposed on non-CFC income. Under section 59(l)(2), if the applicable corporation's share of CFC creditable foreign taxes for a tax year exceeds that limitation, the excess may be carried forward for five years and treated as increasing the applicable corporation's pro rata share of CFC creditable foreign tax expense in future tax years.

Finally, if single-entity principles are applied in determining the AFSI of a consolidated group, as suggested in Section III.B.2.a.ii of part 1 of this report, single-entity principles should also apply in determining the group's TMT. For further discussion, see Section III.C.10, *infra*.

ii. Determination of net AMT liability.

An applicable corporation's net AMT liability for a tax year (that is, the AMT liability required to be paid for the tax year) is the excess, if any, of (1) the corporation's TMT for the tax year over (2) the sum of its regular tax for the tax year plus any BEAT imposed under section 59A for the tax year.[22] For this purpose, regular tax means "the regular tax liability for the taxable year (as defined in section 26(b)[23]) reduced by the foreign tax credit allowable under section 27(a)," but excluding any increase in tax attributable to tax credit recapture under section 45(e)(11)(C) (recapture of renewable electricity production credit of a cooperative organization), section 49(b) (recapture of general business credit when there is a net increase to the taxpayer in the amount of nonqualified nonrecourse financing), section 50(a) (recapture of general business credit on early disposition of investment tax credit property), section 42(j) (recapture of low-income housing credit because of a reduction in the basis of qualifying property), or section 42(k) (recapture of low-income housing credit because of a reduction in the taxpayer's at-risk amount).[24]

Section 26(b) defines regular tax for the purpose of limiting the aggregate amount of tax credits allowed under sections 21 through 25D (the so-called nonrefundable personal credits) and, hence, is not reduced by credits. Thus, an applicable corporation's regular tax is the amount of regular tax imposed under section 11 without reduction for allowed tax credits, such as the general business credit of section 38,[25] without increase for various tax credit recapture, but after its reduction by any allowable FTC.[26]

Finally, if single-entity principles are applied in determining the AFSI and TMT of a consolidated group, as suggested in Section III.B.2.a.ii of part 1 of this report and III.B.2.b.i, *supra*, then single-entity principles should also apply in determining the group's net AMT. For further discussion, see Section III.C.10, *infra*.

3. Determining the allowable minimum tax credit against regular tax and the BEAT.

a. General.

If an applicable corporation incurs net AMT for a tax year (that is, its TMT exceeds the sum of its regular tax for the year plus any BEAT incurred for the tax year), the net AMT becomes a minimum tax credit allowed under section 53(a) as a credit in later tax years, including later tax years for which the corporation is not an applicable corporation under the exception in section 59(k)(1)(C), discussed in Section III.B.1 of part 1 of the report. The maximum potential minimum tax credit allowable for any given tax year is the sum of the total amount of net AMT incurred in prior tax years reduced by any amount of that net AMT allowed as a credit for one or more prior tax years.[27] The amount of minimum tax credit allowed as a credit for a tax

[22] Section 55(a).

[23] While section 26(b)(1) broadly defines regular tax liability as "the tax imposed by this chapter for the taxable year," section 26(b)(2) excludes from this broad definition a laundry list of 25 taxing provisions, including sections 55 and 59A. Thus, X's regular tax does not include any BEAT or net AMT incurred for the relevant tax year.

[24] Section 55(c)(1).

[25] This comparatively favorable treatment of general business credits for IRA BMT purposes, relative to deductions and other tax attributes, may well change the behavior of applicable corporations. For example, taxpayers claiming research credits under section 41 generally are required under section 280C to add back certain amounts claimed as qualified research expenses or basic research expenses in computing the credit to prevent taxpayers from obtaining a double benefit — credits and deductions — for the same economic outlay. In lieu of this section 280C adjustment, section 280C(c)(2) allows taxpayers to elect to reduce their research credits by the corporate tax rate (21 percent). Beginning in 2023, applicable corporations will factor in the IRA BMT's more favorable treatment of credits over deductions when evaluating whether to make an election under section 280C(c)(2).

[26] Section 55(c)(1) might be described as credit-friendly because the only credit that reduces regular tax (which in turn reduces TMT in determining net AMT) is the FTC. An interesting contrast to section 55(c)(1) is the credit-hostile section 59A(b)(1)(B), which, in determining the BEAT reduction for regular tax, also defines regular tax by reference to section 26(b) but then modifies that definition by reducing section 26(b)'s untainted regular tax by any excess of "(i) the credits allowed under this chapter against such regular tax liability, over (ii) the sum of (I) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus (II) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this subclause)."

[27] Section 53(b).

Table 1. Basic Facts of Example 4

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
Tax Year	AFSI (Loss) (Without AFS NOL Carryforward)	TMT (15% of AFSI Without AFS NOL Carryforward)	Pre-AMT Credit Regular Tax	BEAT	Net AMT
1	$1,000	$150	$40	$0	$110
2	($500)	$0	$50	$0	$0
3	$800	$120	$120	$0	$0

Table 2. Use of AMT Credit and AFS NOL Carryforward Under Example 4

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Tax Year	Net AFSI (AFSI - AFS NOL Carryforward) or (AFS Loss)	TMT (15% of Positive Net AFSI)	Pre-AMT Credit Regular Tax	AMT Credit Allowed	Net AMT	Total Tax Due (Column 4 - Column 5 + Column 6)
1	$1,000	$150	$40	$0	$110	$150
2	($500)	$0	$50	($50)	$0	$0
3	$800 - ($500) = $300	$45	$120	($60)	$0	$60
Totals	$1,300	$195	$210	($110)	$110	$210

year, however, is limited to the excess of (1) the sum of the regular tax incurred for that tax year, reduced by any allowed credits described in sections 27 through 52 (other than sections 31 through 37), plus any BEAT incurred for that tax year, over (2) any TMT determined for that tax year.[28] If the corporation is not an applicable corporation for the tax year for which a minimum tax credit under section 53 is sought, the amount of its TMT is deemed to be zero.[29] Thus, the potential minimum tax credit available for a tax year (the current year) is measured by the excess net AMT incurred by the applicable corporation for prior tax years over the amount of minimum tax credit used in prior tax years under section 53. But the amount that can be used in the current year is limited to the excess regular tax and BEAT incurred for the current year over the corporation's TMT for the current year (which is zero if the corporation is not an applicable corporation for the current year).

As mentioned in Section III.B.2.a.xii, *supra*, the AFS NOL carryforward allowed by section 56A(d) and the minimum tax credit allowed by section 53 may both apply to a tax year to eliminate or reduce regular tax. Consider Example 4.

Example 4: *Use of AMT credit and AFS NOL carryforward in the same tax year*. X, an applicable corporation subject to the IRA BMT for tax years 1, 2, and 3, and, with the exception of AMT credit, generating no tax credits during this three-year period, takes into account the following amounts

[28] Section 53(c) ("The credit allowable under subsection (a) shall not exceed the excess (if any) of (1) the regular tax liability of the taxpayer for such taxable year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part, over (2) the tentative minimum tax for the taxable year.") and (e)(2) ("the amount determined under subsection (c)(1) shall be increased by the amount of tax imposed under section 59A for the taxable year"). Thus, for an applicable corporation, the minimum tax credit allowed for a tax year is limited to the excess of (1) the sum of (A) the corporation's regular tax liability for the year, reduced by any allowed credits other than refundable credits described in sections 31-37 (*e.g.*, the credit for overpayment of tax due for a prior tax year), plus (B) any BEAT incurred for the year, over (2) the corporation's TMT for the year.

[29] Section 55(b)(2)(B) ("In the case of any corporation which is not an applicable corporation, the tentative minimum tax for the taxable year shall be zero.").

(expressed in millions of U.S. dollars) for each tax year shown in Table 1.

Table 2 demonstrates that thanks to the combined use of the AFS NOL carryforward of section 56A(d) and the AMT credit of section 53, X's total net AMT and regular tax for years 1-3 of $210 (column 7 of Table 2) equals the $210 of regular tax X would have incurred had the IRA BMT not been enacted (shown in column 4 of Table 2). This indicates that the AFSI of X for the three tax years may have been attributable primarily to timing differences. The analysis is as follows.

Year 1. For year 1, X generates a $110 AMT credit by incurring a $110 net AMT liability (column 6 of Table 1, which is the excess of its $150 TMT over the sum of its $40 regular tax and $0 BEAT).

Year 2. For year 2, $50 of the $110 AMT credit from year 1 is used to eliminate the $50 of regular tax for year 2. Thus, X pays no tax for year 2 and has a remaining $60 AMT credit carryforward from year 1 to year 3.

Year 3. Also, for year 2, X has a $500 AFS NOL under section 56A(d) that carries forward to year 3 and reduces the $800 AFSI for year 3 by the lesser of negative $500 (the amount of the carryforward) and $640 (80 percent of the $800 pre-carryforward AFSI), from $800 to $300. Consequently, the year 3 TMT is reduced from $120 (15 percent * $800) to $45 (15 percent * $300), and the pre-AMT credit regular tax of $120 for year 3 therefore now exceeds the $45 reduced TMT for year 3 by $75. This enables X to satisfy the section 53(c) limitation for the entire $60 of remaining AMT credit carryforward from year 1. Thus, after taking into account the AMT credit, X's year 3 regular tax liability is $60 ($120 of pre-credit regular tax - $60 of AMT credit).

To summarize, column 5 of Table 2 shows that all of the $110 of minimum tax credit attributable to the year 1 net AMT is used. In year 2, $50 is used since the year 2 regular tax was $50, and because of the $500 AFS NOL for year 2, the TMT was $0. The remaining $60 is used in year 3 to reduce the $120 of regular tax, and, but for the $500 AFS NOL carryforward from year 2 allowed by section 56A(d), none of the credit could have been used in year 3 because the $120 of regular tax otherwise did not exceed the year 3 TMT.

To avoid unnecessary complexity, Example 4 assumes that X incurs no BEAT for years 1-3. If X had been subject to the BEAT for one or more of those tax years,[30] the amount of its BEAT would be any excess of (1) the base erosion minimum tax amount (that is, the product of the applicable BEAT rate [currently 10 percent for most taxpayers][31] multiplied by X's modified taxable income[32] for the year), over (2) X's adjusted regular tax liability for the year.[33] A corporation's adjusted regular tax liability is generally its regular tax liability, as determined under section 26(b), reduced (but not below zero) by specified tax credits, including the FTC but *not* including the minimum tax credit allowed under section 53.[34] This means that although determining whether X is subject to the BEAT (and if so, calculating the amount of BEAT for any given tax year) involves rather complicated calculations, there should be no unwarranted circularity in applying the limitation of section 53(c) and (e).

[30] The BEAT applies to a corporation (other than a real estate investment trust, regulated investment company, or S corporation) for a tax year (the current year) if the corporation's average annual gross receipts for the three-tax-year period ending with the preceding tax year are at least $500 million and its base erosion percentage for the current year is at least 3 percent (2 percent for banks and registered securities dealers). Reg. section 1.59A-2(d)(1) and (e)(1). Determining whether a corporate taxpayer satisfies the second of these two requirements requires time and effort. *See* reg. sections 1.59A-1(b)(12) and (17) (rules for determining foreign related parties); 1.59A-2(e)(3) (rules for determining the base erosion percentage); and 1.59A-3(b) and (c) (rules for determining base erosion tax benefits).

[31] *See* section 59A(b)(1)(A) and (b)(2)(A); and reg. section 1.59A-4(c)(1)(ii). The general BEAT rate increases to 12.5 percent for tax years beginning after December 31, 2025.

[32] See reg. section 1.59A-4(b), defining modified taxable income for a tax year as the sum of (1) taxable income for the year as determined under section 63(a), except that the income may not be reduced below zero by any allowed NOL deduction under section 172, plus (2) any base erosion tax benefits defined in reg. section 1.59A-3(c)(1) originated during the year, plus (3) the base erosion percentage (defined in reg. section 1.59A-2(e)(3)) of the lesser of any NOL deduction allowed under section 172 for the year or taxable income without regard to the deduction. For this purpose, the base erosion percentage is determined as of the tax year in which the NOL was originated.

[33] *See* reg. section 1.59A-4(b)(2).

[34] See section 59A(b)(1)(B), which, for tax years beginning before December 31, 2025, reduces regular tax liability by any excess of (1) the credits allowed under chapter 1 of the IRC (which include the FTC allowed under section 27 as well as the minimum tax credit allowed under section 53) over (2) the sum of (A) the research credit allowed under section 41 plus (B) 80 percent of the lesser of the base erosion minimum tax amount and business credits subject to section 38 listed in section 59A(b)(4), such as the low-income housing credit and renewable energy credit, and (b)(2)(B), which reduces regular tax liability by all allowed credits under chapter 1 for tax years beginning after December 31, 2025. However, subdivisions (i)(C) and (ii) of reg. section 1.59A-5(b)(3) exclude credits allowed under sections 33, 37, and 53 from the list of credits reducing regular tax liability for purposes of determining a taxpayer's base erosion minimum tax amount.

In any event, in determining the aggregate federal tax liability payable for a tax year (the current year) ending after December 31, 2022, the calculations required by sections 53, 55, 56A, 59, and 59A to be undertaken by a corporation (whether or not the corporation is an applicable corporation under section 59(k) for the current year) that has incurred net AMT under the IRA BMT for one or more prior tax years ending after December 31, 2022, can be summarized as follows.

Pre-steps: Before undertaking the calculation of its aggregate federal tax liability for the current year, the corporation must ascertain whether (1) the net AMT under the IRA BMT incurred by the corporation in prior tax years exceeds any section 53(b) minimum tax credits attributable to the net AMT used in prior tax years (the excess net AMT carryover), and (2) whether the corporation is subject to the BEAT for the current year. It is assumed that the corporation has an excess net AMT carryover and is subject to the BEAT.

Step 1: The amount of the corporation's current-year adjusted regular tax liability for BEAT computation purposes is determined, which, as noted above, generally will be its regular tax liability for the current year, as determined under section 26(b), reduced by allowed credits to the extent required by section 59A(b) and reg. section 1.59A-5(b). Notably, the minimum tax credit allowed under section 53 receives favorable treatment and is not taken into account for purposes of this calculation.

Step 2: The modified taxable income of the corporation for the current year (1) is determined under reg. section 1.59A-4(b) and (2) is then multiplied by the BEAT rate in effect for the corporation for the current year. That product is then reduced, but not below zero, by the corporation's adjusted regular tax liability determined under step 1 to arrive at the corporation's base erosion minimum tax (BEMT) amount for the current year.

Step 3: The corporation's regular tax liability for the current year, as determined under section 26(b) (a calculation also made in step 1 for BEAT computation purposes), is reduced by any allowed tax credits described in section 53(c)(1) (generally all credits allowed under sections 27 through section 52 other than the refundable credits described in sections 31 through 37), resulting in the corporation's regular tax amount. Note that the regular tax amount usually differs from the adjusted regular tax liability determined for BEAT computation purposes in step 1 as a result of the different matrices of regular tax credits taken into account under section 53(c)(1) and reg. section 1.59A-4(b)(2).

Step 4: The BEMT amount determined in steps 1 and 2 is added to the regular tax amount determined in step 3 to produce the aggregate amount (the combined non-BMT amount) used to calculate the corporation's current-year net AMT or current-year section 53(c)(1) limitation in step 6.

Step 5: The corporation's TMT for the current year (the current TMT) is determined. As noted above, the current TMT will be $0 under section 55(b)(2)(B) if the corporation is not an applicable corporation under section 59(k) for the current year, and it will be a positive amount under section 55(b)(2)(A) if the corporation is an applicable corporation for the current year. The determination of TMT for an applicable corporation is discussed in Section III.B.2.b.i, *supra*.

Step 6: The current TMT determined in step 5 is subtracted from the combined non-BMT amount determined in step 4. If the difference is positive, that amount is the corporation's section 53(c)(1) limitation for the current year (the BMT credit limitation amount). If the difference is negative, which can happen only if the corporation is an applicable corporation for the current year, the negative amount is the net AMT incurred for the current year (the current-year net AMT).

Step 7: If Step 6 results in a BMT credit limitation amount (that is, if the combined non-BMT amount exceeds the current TMT), the amount of minimum tax credit allowable under section 53(c)(1) for the current year (the allowable BMT credit) is the lesser of (1) the BMT credit limitation amount and (2) the excess net AMT carryover. If step 6 results in current-year net AMT, that amount increases the total federal tax payable by the corporation for the current year under step 8.

Step 8: Finally, the total federal tax payable by the corporation for the current year is determined under one of the following two alternative computations, depending on the outcome of step 6:

(1) If Step 6 results in a BMT credit limitation (that is, is a positive amount), the total federal tax liability payable for the current year equals:

(A) the sum of (i) the BEMT amount determined in steps 1 and 2, plus (ii) any excess of the regular tax amount determined in step 3 over the aggregate amount of any credits, other than the minimum tax credit of section 53, allowed to the corporation for the current year that are not taken into account in determining the regular tax amount in step 3, minus

(B) the lesser of (i) the allowable BMT credit determined in step 7 and (ii) the amount determined in step 8(1)(A).[35]

(2) If step 6 results in current-year net AMT (that is, is a negative amount), the total federal tax liability equals the sum of:

(A) the current-year net AMT, plus

(B) the BEMT amount determined in steps 1 and 2, plus

(C) any excess of the regular tax amount determined in step 3 over the aggregate amount of any credits, other than the minimum tax credit of section 53, allowed to the corporation for the current year that are not taken into account in determining the regular tax amount in step 3.

If the corporation's total federal tax liability is determined under the first alternative calculation (step 8(1)), the amount of the minimum tax credit under section 53 allowed in step 8(1)(B) reduces its excess net AMT carryover to subsequent tax years. On the other hand, if the corporation's total federal tax liability is determined under the second alternative (step 8(2)), the current-year net AMT increases the excess net AMT carryover to subsequent tax years.

As noted above, the calculations are rather complicated. Of significant interest is the fact that if the corporation's combined BEAT and regular tax liability for the current year, as determined under section 53(c)(1), exceeds its TMT for the current year, the minimum tax credit allowed under section 53 reduces both BEAT and regular tax in determining the corporation's total federal tax liability for the current year. On the other hand, whether the combined BEAT and regular tax liability exceeds TMT, resulting in an allowable minimum tax credit, or is less than TMT, resulting in net AMT in lieu of a minimum tax credit, other allowable credits (for example, the ITC and research credit) reduce only regular tax. Query whether this will affect future business credit behavior Congress may not have anticipated.

For example, business credits designed by Congress to encourage specific investments or economic activity generally are subject to section 38. The limitation in section 38(c)(1) effectively prevents those business credits from reducing BEAT or net AMT.[36] Some business credits subject to section 38, such as the 25 percent "advanced manufacturing facility" credit of section 48D,[37] allow an election to receive a cash refund to avoid deferral of the benefit of the credit under section

[35]Any minimum tax credit allowed under section 53(c)(1) that exceeds the sum of a corporation's base erosion minimum tax amount and regular tax liability after reduction for all regular tax credits (not just those described in section 53(c)(1)) is not refundable. Former section 53(e)(1), allowing a refund of a corporation's minimum tax credit, was retroactively added to section 53 by section 2305 of the Coronavirus Aid, Relief, and Economic Security Act of 2020 and was limited to tax years beginning in 2018 or 2019. There is no other provision in section 53 allowing a refund of corporate minimum tax credit.

[36]Section 38(c)(1) limits the amount of a business credit for a tax year to any excess of (1) the sum of the regular tax liability and the tax imposed by section 55, reduced by tax credits allowed under sections 21 through 30D, over (2) the greater of (A) the TMT determined under section 55(b)(2) for the tax year for applicable corporations, and (B) 25 percent of any excess regular tax liability for the tax year, as defined in section 26(b) but reduced by any credits allowed under sections 21 through 30D, over $25,000. Thus, while section 38(a) allows a credit against "tax imposed by this chapter," which includes the IRA BMT imposed by section 55 and BEAT, the net impact of section 38(c)(1) is to ensure that the business credit does not exceed the portion of the applicable corporation's total tax liability for the tax year represented by its regular tax (reduced by credits, including the FTC, described in sections 21-30D).

[37]Sections 46(a)(6) and 48D(a) allow a credit subject to section 38 equal to 25 percent of a taxpayer's qualified investment in an advanced manufacturing facility (*i.e.*, a facility designed to manufacture semiconductors or equipment used to manufacture semiconductors) placed in service during the tax year.

38(c)(1).[38] Given the potential diminution in the portion of a large corporation's aggregate federal tax liability for post-2022 tax years represented by the regular tax after the enactment of the BEAT and IRA BMT, provisions under which business tax credits subject to section 38 can be converted into cash rather than used to reduce regular tax liability likely will be widely used by large corporate taxpayers. We suspect this is one of the "unintended consequences" of the IRA BMT.

b. Succession under section 381 and impact of ownership change.

The minimum tax credit is expressly stated in section 381(c)(25) to be an attribute to which an acquiring corporation in a section 381(a) transaction may succeed, and in section 383(a)(2)(B) to be an attribute subject to limitation in connection with an ownership change within the meaning of section 382(g) for the applicable corporation. Thus, any pre-change minimum tax credit will be allowed to reduce post-change regular tax or BEAT to the extent of the lesser of (1) the section 383 limitation applicable to the minimum tax credit[39] and (2) the limitation in section 53(c) (that is, the amount by which the sum of the regular tax plus any BEAT incurred for the post-change tax year exceeds the TMT for the tax year).

If, in connection with an ownership change within the meaning of section 382(g), the secretary also determines that it is no longer appropriate to treat the corporation as an applicable corporation under section 59(k)(1)(C), presumably a pre-change minimum tax credit can continue to be used to reduce the corporation's regular tax or BEAT incurred in post-change tax years, subject to the limitation in section 383.[40]

c. SRLY limitation.

Is there an SRLY limitation on excess section 53(b) credits brought into a consolidated group from an SRLY, as defined in reg. section 1.1502-1(f)?[41] Based on reg. section 1.1502-55(h)(4)(iii)(A), which predates the repeal of the 1986 AMT by the Tax Cuts and Jobs Act and has not been amended to reflect either that repeal or the enactment of the IRA BMT, an SRLY limitation will be applied to an excess section 53(b) minimum tax credit arising in an SRLY and brought into a consolidated group by a new member. One would expect the limitation to be the excess of "(1) the aggregate for all consolidated return years of the member's contributions to the consolidated section 53(c) limitation for each consolidated return year, reduced by (2) the aggregate of the member's minimum tax credits arising and absorbed in all consolidated return years (whether or not absorbed by the member)." In determining the amount of the limitation, reg. section 1.1502-55(h)(4)(iii)(B) also indicates that the following computational rules will apply:

> (1) . . . A member's contribution to the consolidated section 53(c) limitation for a consolidated return year equals the member's share of the consolidated net regular tax liability [plus, in the context of the IRA BEAT, its share of consolidated BEAT][42] minus its share of consolidated tentative minimum tax. The group computes the member's shares by applying to the respective consolidated amounts the principles of section 1552 and

[38] Section 48D(d) provides an election by the taxpayer to be treated as if it paid federal income tax equal to the credit amount, thereby transforming the credit from a business credit subject to limitation under section 38 (including section 38(c)(1)) into a potentially refundable tax payment. Thus, because the deemed payment of tax equal to the amount of the credit exceeds the federal income tax due for the tax year, a cash refund is available under section 6402(a).

[39] Reg. section 1.383-1(b) indicates that the section 383 limitation on the minimum tax credit would be "the tax liability of the new loss corporation for the post-change year which is attributable to so much of the corporation's taxable income that would be reduced by allowing as a deduction its section 382 limitation remaining after accounting for the use of pre-change losses."

[40] Because section 55(b)(2)(B) provides that the TMT of a corporation that is not an applicable corporation is $0, there is no section 53(c) limitation on a corporation's pre-change minimum tax credit.

[41] Reg. section 1.1502-1(f)(1) generally defines SRLY as "any separate return year of a member or of a predecessor of a member," and reg. section 1.1502-1(e) defines separate return year as "a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group." Exceptions from the definition of SRLY are set forth in reg. section 1.1502-1(f)(2).

[42] The existing rules under section 1552 and reg. section 1.1502-33(d) provide no guidance regarding the allocation of consolidated BEAT among members of a consolidated group. Thus, new guidance will be required for this aspect of a SRLY limitation on excess section 53(b) credits brought into a consolidated group from one or more SRLYs.

the percentage method under section 1.1502-33(d)(3), assuming a 100 percent allocation of any decreased tax liability. The group makes proper adjustments so that taxes and credits not taken into account in computing the limitation under section 53(c) are not taken into account in computing the member's share of the consolidated net regular tax, etc. (*See*, for example, the taxes described in section 26(b) that are disregarded in computing regular tax liability.)

(2) . . . For a consolidated return year for which consolidated tentative minimum tax is greater than consolidated regular tax liability, the group reduces the member's share of the consolidated tentative minimum tax by the member's share of the consolidated alternative minimum tax for the year. The group determines the member's share of consolidated alternative minimum tax for a year using the same method it uses to determine the member's share of the consolidated minimum tax credits for the year.

(3) . . . For purposes of computing the limitation under this paragraph (h)(4)(iii), the consolidated return years of the group include only those years, including the year to which a credit is carried, that the member has been continuously included in the group's consolidated return, but exclude any years after the year to which the credit is carried.

(4) . . . The SRLY subgroup principles under section 1.1502-21(c)(2) apply for purposes of this paragraph (h)(4)(iii). The predecessor and successor principles under section 1.1502-21(f) also apply for purposes of this paragraph (h)(4)(iii).

(5) . . . The [section 382 overlap] principles under section 1.1502-21(g) apply for purposes of this paragraph (h)(4)(iii). For example, an overlap of this paragraph (h)(4)(iii) and the application of section 383 with respect to a credit carryover occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 383 credit limitation with respect to that carryover (the section 383 event), with the result that the limitation of this paragraph (h)(4)(iii) does not apply. See sections 1.1502-21(g)(2)(ii)(A) and 1.383-1; see also section 1.1502-21(g)(4) (subgroup rules).

While significant amendments of the computational rules of reg. section 1.1502-55(h)(4)(iii)(B) are required to reflect the new BMT enacted by the IRA, the full panoply of SRLY limitation rules, including the overlap exception of reg. section 1.1502-21(g) and the SRLY subgroup rules of reg. section 1.1502-21(c)(2), likely will be brought to bear on excess section 53(b) minimum tax credits carried by one or more new members into a consolidated group, to the extent those excess credits originate in one or more SRLYs, as defined in reg. section 1.1502-1(f).

C. Guidance Under the IRA BMT

As was true regarding the book income adjustment required by the 1986 AMT, discussed in Section II.B of part 1 of the report, the IRA BMT presents difficult issues, some of which are similar to those presented by the 1986 AMT and many of which will require guidance. The following discussion in this Section III.C addresses mechanics in the computation of net AMT for which guidance is needed and issues that will be difficult, or impossible, to resolve through guidance.

1. Concerns regarding book-tax conformity in general.

Complete book-tax conformity occurs when there is only one income statement for both tax and financial reporting purposes (that is, "when the two measures are conformed such that a company reports only one (and the same) income measure to stakeholders and the tax authorities").[43] An applicable corporation incurring net AMT for a tax year under the IRA BMT arguably is in a state of partial book-tax conformity — its AFS for financial reporting purposes, subject to the adjustments prescribed in

[43]Michelle Hanlon, "The Possible Weakening of Financial Accounting From Tax Reforms," 96 *Acct. Rev.* 389, 391 (Sept. 2021).

sections 56A and 59, does double duty as its tax return whenever its TMT for a tax year exceeds the sum of its regular tax, determined without regard to credits other than the FTC, plus its BEAT for the tax year. A commentator has expressed three concerns regarding book-tax conformity that merit consideration:

> The opponents of book-tax conformity, however, have serious and valid concerns, three of which are as follows. First, in response to book-tax conformity, companies may alter their reporting behavior in order to achieve lower taxation.[44] Thus, it would not be that they report a measure of income that faithfully represents the economics of the transactions for the reporting period, but rather report lower income than they should in order to avoid taxation. This would likely not just be a reduction in upward earnings management, but rather a loss of managers' private information to external stakeholders, including the capital markets, about performance.
>
> . . . Second, governments could end up exerting too much influence over financial accounting standards. It is questionable whether governments (e.g., the U.S. Congress) would relinquish control of taxing rights. Thus, although some proposals are to eliminate the tax code and just tax financial accounting income (or use financial accounting income as a backstop), it seems more likely that governments would take more control of the conformed number and financial accounting standards in the process.
>
> . . . Third, the task would be much more complex than proponents surmise. For example, it is not the case that book income is always higher than taxable income. Many firms report accounting losses. Would there be net operating loss carryforwards in a conformed system (there are for tax purposes now, but not for financial accounting)? In addition, the consolidation and intercompany investment rules for financial accounting and tax purposes are different (for domestic and foreign entities, equity method investments, mark-to-market method investments, etc.) and the notion of conforming even for just the U.S. consolidated group is not as simple as it seems (even the OECD's required country-by-country reports do not take into account eliminations).[45]

A paranoid taxpayer might be tempted to view the IRA BMT as the experimental first step toward a more complete book-tax conformity. It is experimental because, as mentioned in Section I of part 1 of the report, only an estimated 150 taxpayers (30 percent of all *Fortune* 500 companies) will be subject to the IRA BMT. It could be viewed as a first step because, if the IRA BMT raises a significant portion of the revenue needed to fund the portion of the IRA expenditures projected by the Joint Committee on Taxation,[46] that success may move Congress to take a second step of lowering the average annual AFSI threshold for applicable corporation status from $1 billion to a substantially lower number — say, $30 million — which would dramatically expand the universe of corporations subject to the IRA BMT. Additional steps might include increasing the 15 percent rate in section 55(b)(2)(A) to, say, 20 percent, and adding more adjustments to section 56A to eliminate additional timing differences in favor of the regular tax timing approach that often accelerates the inclusion of items of income while deferring deductions. If this is indeed the trend, at some point the regular tax incentives to make specific investments (found in the sections of the IRC addressing business tax credits, depreciation, etc.)

[44]This is the tax neutrality concern discussed in Section II.B of part 1, and Section III.C.3, *infra*.

[45]Hanlon, *supra* note 43, at 392-393.

[46]*See* Thomas Barthold memorandum, "Proposed Book Minimum Tax Analysis by Industry," JCT (July 28, 2022).

will barely be worth the paper on which they are printed.[47]

2. Understating AFSI and the formulation of an antiabuse rule.

Perhaps the most significant concern regarding the administration of the IRA BMT is the one that may have led Congress to give the 1986 book income adjustment a short life of only three years: Applicable corporations will be motivated to understate book income in their AFSs to avoid or reduce minimum tax. The IRS lacks a sufficient number of trained CPAs with the expertise to effectively audit AFSs and challenge reporting positions taken in those financial statements. Further, because general tax principles, and the clear reflection of income and antiabuse provisions of the IRC (such as sections 269 and 482) do not apply to AFSs, the IRS and the courts arguably lack the tools required to prevent this loss of revenue.

This tax avoidance concern likely will result in an antiabuse regulation issued by the IRS under the authority granted in section 56A(c)(15) or (e). That rule might be similar to the following:

> Adjustments to AFSI for a tax year shall be made if (1) an item is omitted, taken into account more than once, or subjected to extraordinary financial accounting treatment not typically provided for such an item, in determining the net income or loss stated in the AFS of a taxpayer for such tax year, and (2) a principal purpose of that inclusion, omission, or treatment is the avoidance or reduction of minimum tax imposed under section 55(a).

Such a broad antiabuse rule is untenable. In virtually every financial statement of a publicly traded corporation made a part of its annual report to shareholders on Form 10-K, substantial thought is given to the effect that reporting material items will have on, among other things, earnings per share, relationships with suppliers and customers, relationships with lenders and other creditors, relationships with regulators, and tax liabilities and the corporation's ETR.[48] The phrase "*a* principal purpose of tax avoidance" requires only that significant thought be given to the tax impact of taking or not taking an item into account, and the treatment of the item if taken into account, in preparing the AFS for a tax year.[49] Thus, if the only standard for determining whether the antiavoidance rule is violated is whether "a" principal purpose for taking or not taking a material item into account, or the treatment of the item, in preparing an AFS is IRA BMT reduction, the rule will almost always apply to require adjustments. Because there is no legislative history illuminating the purposes of the IRA BMT, without guidance from Treasury indicating when a reduction or avoidance of minimum tax is contrary to one or more of the purposes for imposing the tax, such a broad antiabuse rule risks invalidity on grounds of vagueness.[50]

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[47] In other words, a fourth concern might be whether it makes sense to leave investment incentives in the IRC for regular tax purposes (*e.g.*, an immediate deduction of the cost of specified depreciable property) while attacking their use by means of a BMT:

> Whatever the reason that a company's tax is "too low" in the eyes of the Biden administration (international tax planning and rules, equity-based compensation, depreciation rules, etc.), those rules should be evaluated directly and not addressed stealthily by a book minimum tax. In addition, it is important to not counteract investment incentive effects in the tax code with a book minimum tax. For example, the immediate deduction of fixed asset costs is allowed, at times, to incentivize investment. However, the book minimum tax would offset this incentive, leaving fewer investment incentives in the tax code.

Hanlon, *supra* note 43, at 396, n.31.

[48] ETR, or "effective tax rate," is an accounting term referring to the company's total income tax expense (as reported within the financial statements) divided by pretax financial statement net book income.

[49] *See Santa Fe Pacific Corp. v. Central States, Southeast and Southwest Areas Pensions Fund*, 22 F.3d 725, 727-728 (7th Cir. 1994) (a principal purpose means any purpose that weighed heavily in the taxpayer's thinking).

[50] *See, e.g., Trans City Life Insurance Co. v. Commissioner*, 106 T.C. 274 (1996), in which the Tax Court held that section 845(b) (providing "if the Secretary determines that any reinsurance contract has a significant tax avoidance effect on any party to such contract, the Secretary may make proper adjustments with respect to such party to eliminate such tax avoidance effect") was enforceable before the issuance of regulations because "the term 'significant tax avoidance effect' has a discernible meaning taking into account *the relevant legislative history* and other aids to its interpretation." (Emphasis added.) The court found that the legislative history of section 845(b) (H.R. Conf. Rep. No. 98-861, at 1063 (1984)) provides that "a tax avoidance effect is significant 'if the transaction is designed so that the tax benefits enjoyed by one or both parties to the contract are disproportionate to the risk transferred between the parties,'" and that the legislative history requires seven factors to be considered in weighing the economic substance of a reinsurance contract against tax benefits. Because this weighing of economic substance versus the tax benefit of the "small life insurance company deduction" provided a sufficient standard to apply section 845(b) without additional guidance in a regulation, the Tax Court agreed with the taxpayer that the reinsurance contracts did not violate section 845(b). *See also Estate of Neumann v. Commissioner*, 106 T.C. 216 (1996); and *H. Enterprises International Inc. v. Commissioner*, 105 T.C. 71, 81-85 (1995).

Consequently, the antiabuse rule should include a requirement, in addition to a principal purpose of tax avoidance or reduction, that ties the tax-reducing inclusion, omission, or accounting treatment to a violation of one or more policies underlying the IRA BMT.[51] An approach used in other contexts, like the intercompany transaction regulations issued under section 1502,[52] would be to begin the section 56A regulation with a statement of its purposes, such as:

> **Sample reg. section 1.56A-1(a):** *Purposes*. The purposes of this section are to (1) adjust the net income or loss shown on the taxpayer's applicable financial statement for a tax year in a manner consistent with the applicable provisions of sections 56A and 59; (2) disregard differences in the timing of book items and their corresponding or related regular tax items that are not expressly addressed in section 56A or section 59; (3) ensure that the net income or loss shown on the applicable financial statement for a tax year does not omit or duplicate one or more material book items relevant to the determination of net income or loss under the applicable financial reporting standards and does not vary significantly from the amount of net income or loss that would be reported if all material book items were accounted for under such standards unless such variance is appropriate under the surrounding facts and circumstances; and (4) ensure the corporate minimum tax is determined, assessed, and collected in a manner that is consistent with the policies underlying the provisions described in section 56A(c)(15)(B) and other nonrecognition provisions of the Code that are similar in their scope and intent to those so described.

Then an antiabuse rule similar to the following could be adopted:

> **Sample reg. section 1.56A-1(h):** *Antiabuse rule*. If one or more material items relevant to the determination of a taxpayer's net income or loss stated in its applicable financial statement for a tax year is omitted, duplicated, or otherwise treated in a manner inconsistent with the purposes of this section and a principal purpose for such duplication, omission, or treatment is to avoid or reduce tax liability under section 55(a) or to avoid treatment as an applicable corporation under section 59(k), then appropriate adjustments shall be made.

Under this approach, even if reducing AFSI is a principal purpose for applying an accounting treatment to a book item that radically differs from the treatment typically applied to those items under generally accepted accounting principles or international financial reporting standards, the treatment should be allowed if the taxpayer can establish that either (1) the aggregate net book income or loss for the period or periods does not significantly vary from the aggregate net book income or loss that would have existed if GAAP or IFRS treatment had been applied to all material items, or (2) the treatment is appropriate in light of special circumstances.

In addition to an antiabuse rule that allows reductions in AFSI even though the taxpayer has carefully considered the tax impact of the reduction, one or more examples of permissible reductions should be given. For example, if a book loss will be taken into account in tax year 1, but the related regular tax deduction for the loss will be taken into account in tax year 2, the taxpayer's acceleration of book income items from tax year 2 to tax year 1 for a principal purpose of reducing the impact of the timing difference should be consistent with the purposes of the regulations because there is no omission or duplication of

[51] One of the lessons taught by the *Trans City Life*, 106 T.C. 274, decision is that mere tax avoidance or reduction is not a sufficient standard for adjusting AFSI. Rather, the tax avoidance or reduction also must be contrary to the legislative intent of the statute, with discernible standards for determining when the tax avoidance or reduction justifies an adjustment. Because the IRA has no legislative history, it is up to Treasury to inform taxpayers of the policies underlying the BMT.

[52] *See, e.g.*, reg. section 1.1502-13(a)(1) ("*Purpose.* This section provides rules for taking into account items of income, gain, deduction, and loss of members from intercompany transactions. The purpose of this section is to provide rules to clearly reflect the taxable income (and tax liability) of the group as a whole by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income (or consolidated tax liability).") and (h)(1) ("If a transaction is engaged in or structured with a principal purpose to avoid the purposes of this section (including, for example, by avoiding treatment as an intercompany transaction), adjustments must be made to carry out the purposes of this section.").

book items, and net book income or loss for tax years 1 and 2 in the aggregate does not significantly vary from the net book income or loss without the acceleration.

3. Timing differences.

Timing differences can produce difficulties in the administration of the IRA BMT, a few of which are discussed in this Section III.C.3.

a. Discretionary timing differences.

As was true with the book income adjustment of the 1986 AMT, discussed in Section II.B of part 1 of the report, the IRA BMT suffers from an uneven playing field and a skewing of tax neutrality. However, these shortcomings are inherent in any BMT and can be remedied only by repealing the IRA BMT — they cannot be remedied by guidance.

To illustrate, the example from the Boris Bittker and James Eustice treatise,[53] discussed in Section II.B of part 1, is restated as Example 5 below, with slight modifications to bridge the 34-year gap (1989-2023) between the two corporate minimum tax statutes:

Example 5: *Disparate treatment of similarly situated taxpayers in 2023*. Each of Corp. A and Corp. B is a calendar-year domestic corporation that uses GAAP in preparing its AFSs and that satisfies the applicable corporation requirements of section 59(k) for the tax year beginning January 1, 2023. While all of A's stock is privately owned by a single family, all of B's stock is widely held by thousands of investors, registered with the SEC, and publicly traded on the New York Stock Exchange. Otherwise, (1) the 2023 financial history and operations of A and B are identical in every respect; (2) each of A and B has taxable income for 2023 of zero; (3) each of A and B receives $500 of tax-exempt interest in 2023 and is advised of a potential tort claim of $1,000; (4) A reports no positive AFSI for 2023 because, in compliance with Financial Accounting Standards Board Accounting Standard Codification (ASC) 450-20,[54] it creates a contingency reserve of $500 for the tort liability that offsets its $500 of tax-exempt interest income; (5) B, on the other hand, reports AFSI of $500 for 2023 because it chooses not to set up a reserve for the contingent tort liability due to concerns regarding the disclosure issues relating to the reserve;[55] and (6) neither A nor B incurs BEAT for 2023. Thus, A incurs no federal tax liability for 2023, whereas B incurs $75 of net AMT (TMT of $75 [(AFSI of $500 * 15 percent) - the corporate AMT FTC of $0] - [the sum of $0 regular tax + $0 BEAT]).[56]

Example 6: *Equalization in 2024*. As in 2023, each of A and B has no regular taxable income and $500 of tax-exempt interest income in 2024. Also, each of A and B settles the $1,000 tort liability in 2024 through a payment of $300 to the plaintiff and has no other items of income or deduction for IRA BMT purposes in 2024. Because A settles the contingent liability for $200 less than the $500 2023 reserve, A's AFSI for 2024 is $700 ($500 of tax-exempt interest + $200 of recapture), resulting in net AMT of $105 (15 percent * $700). On the other hand, B, which chose not to reserve for the contingent liability in 2023, has AFSI for 2024 of $200 ($500 of tax-exempt interest - a $300 deduction for the settlement of the tort liability), resulting in net AMT of $30 (15 percent * $200). Thus, A and B are equalized after 2024, with each incurring $105 of aggregate net AMT for 2023 and 2024. The unfairness is that B pays $75 of its $105 of total net AMT at least one year earlier than A,

[53] Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, para. 5.08[4] (2015, with updates through Nov. 2020).

[54] As discussed in Section III.A.1 of part 1 of the report, FASB ASC 450-20 requires the accrual of contingent liabilities reasonably estimable as to amount and subject to contingencies that are probable to occur (historically interpreted to be events generally considered to have a 75 percent or greater probability of occurring). Further, ASC 450-20 requires disclosure of liabilities subject to "reasonably possible" contingencies, including the nature of the contingency and an "estimate of the possible loss or range of loss or a statement that such an estimate cannot be made."

[55] The principal concerns regarding the disclosure required by ASC 450-20 in connection with contingent liability accruals are that (1) it may require divulging information that prejudices companies in litigation (such as accruals or insurance coverage), including potential waiver of the attorney-client privilege and protections afforded by the work product doctrine; (2) it may require the disclosure of constantly changing and uncertain information that may confuse investors; and (3) it may expose the company to the risk of future securities or "satellite" litigation for allegedly misleading information contained in a premature disclosure that proves to be inaccurate. The latter two concerns are minimal for privately owned companies but huge for publicly traded corporations.

[56] Section 55(a).

thus costing B $4.50 of interest expense (or lost interest income) if A borrows the $75 at 6 percent per year and repays the loan after one year.

Although the foregoing examples are an oversimplification, they illustrate a problem that will occur as a result of the IRA BMT and the fact that many GAAP or IFRS adjustments to book income, such as reserves against contingent liabilities, allow significant discretion to taxpayers' management. Further, the exercise of that discretion will be influenced by factors having nothing to do with tax policy. One of those factors, implicit in the foregoing examples, is that because A is privately owned, its management does not have to contend with pressure from bankers, analysts, employees with stock compensation, and shareholders to maintain or grow earnings per share to avoid an adverse impact on the trading price of A's stock. In sharp contrast, because B's shares are publicly traded, B's management must balance that pressure against the benefit of a lower ETR. Thus, A's management has more latitude to be conservative in booking a reserve for contingent liabilities than B's management.

Finally, there is no question that both A's and B's managements will be encouraged by the IRA BMT to be conservative in booking the contingent liability reserve. A counterweight in A's case is that a high reserve may encourage others to assert tort claims against A or discourage the current claimant from settling out of court. Thus, the IRA BMT cannot avoid diminishing the policy of tax neutrality — it provides an incentive for large corporate taxpayers to be conservative in booking discretionary charges against book income.

To summarize, in addition to the concern that corporate taxpayers would understate their book income to avoid AMT, the IRA BMT seems to have created two significant problems. First, because GAAP allows some items to be booked on an AFS based in part on the exercise of discretionary judgment by a corporate taxpayer's management, using book income to measure a corporate taxpayer's tax liability embodies a significant risk of inequitable administration in which similarly situated taxpayers are not afforded similar tax treatment — the playing field is not level.

Second, basing a corporation's federal tax liability on its book income can, in light of the discretion allowed under GAAP and IFRS in the determination of items of book expense (such as contingent liability reserves), have a distorting influence on taxpayer behavior that violates principles of tax neutrality and may undermine the GAAP and IFRS goal of accurately reflecting the performance of the corporation. Tax neutrality is a major concern in the case of the IRA BMT because the behavior affected by the minimum tax is the uniform, accurate, and consistent reporting of financial results designed to provide stakeholders with information otherwise available only to management, without which the fair and efficient operation of capital markets would not be possible. As one financial accounting expert puts it:

> As we all know, the accounting standard setters operate apart from the government (and are not funded by the government) to provide a more independent standard-setting process and resulting set of standards. If governments or other types of tax rule-setting organizations (e.g., the Organisation for Economic Co-operation and Development) require financial accounting income to be used either completely or partially in the computation of taxable income, or the same parties otherwise exert influence over the accounting standards, the standard-setting process will be less independent. Moreover, also as a result of government involvement, the standard-setting process and resulting standards will be less focused on measurement based on economic events and faithful representation of those events, but rather will be used with the aim of tax revenue collection (and/or income allocation across jurisdictions) and possibly subject to more lobbying from business interests. *In addition, companies will likely alter their reporting behavior if financial accounting and taxable incomes are more conformed, more explicitly linked, or financial accounting income is used as part of the taxable income computation.* We have some research evidence on increased book-tax conformity and the market effects. I review this evidence below. *In sum, the*

evidence is generally consistent with increased conformity resulting in a greater deferral of income and in a loss of information to the capital markets. However, we do not have all the answers and more research is needed.

. . . I argue that the issue of book-tax conformity and of Congress influencing and affecting accounting standards via tax reform (or tax rule changes) poses a serious threat to financial accounting and financial reporting quality.[57] [Emphasis added.]

b. Matching pre-effective date items with corresponding post-effective date items.

A taxpayer subject to the IRA BMT may suffer the same fate as the taxpayer in *CSX*,[58] discussed in Section II.B of part 1. A taxpayer that becomes subject to the IRA BMT soon after its effective date (tax years beginning after December 31, 2022) may find that it has incurred a book charge in a tax year beginning before January 1, 2023, a year in which there is no BMT, while the related deduction or deductions for regular tax purposes are taken into account in one or more tax years beginning after December 31, 2022, years in which the IRA BMT is in effect.[59] Because the book charge reduces the taxpayer's book earnings without any possibility of generating a BMT benefit if the taxpayer has sufficient book earnings from other sources to absorb the charge,[60] the taxpayer may find itself in the *CSX* predicament, as illustrated by Example 7.

Example 7: *Pre-effective-date book loss for worthless subsidiary stock resulting in post-effective date net AMT*. P, the common parent of a calendar-year consolidated group (P Group) satisfying the applicable corporation requirements of section 59(k) for its tax year beginning January 1, 2023, bought all the stock of T, a software developer, in 2019 for $500 million. As a result, T became a member of the P Group with $1.1 billion of third-party liabilities and mostly intangible assets with an aggregate regular tax basis of $400 million. In accordance with FASB Statement 141, T's assets were recorded on the P Group's consolidated financial statement at $1.35 billion (fair value of $1.6 billion - a deferred tax liability of $250 million [21 percent * $1.2 billion of built-in gain]). Shortly after joining the P Group, T's business began to experience problems, and on June 30, 2021, after P had infused an additional $200 million of capital into T, T's management placed T under the protection of a bankruptcy court by filing a voluntary bankruptcy petition. A plan of reorganization could not be negotiated with T's third-party creditors. So on October 1, 2022, a plan of complete liquidation of T was approved by T's creditors and the bankruptcy court, under which bids were sought for purchasers of T's assets.

As a result of the implementation of the liquidation plan, the P Group was required to take a book loss of $1.55 billion (original book basis of T's assets of $1.35 billion + the $200 million of additional capital contributions) on its 2022 consolidated financial statement, resulting in $400 million of net book income for 2022 ($1.95 billion of net book income from other sources - a $1.55 billion book loss from the write-off of the investment in T). Because T remains a member of the P Group for all of 2022, and none of the three alternative transactions described in reg. section 1.1502-19(c)(1)(iii) occurs in 2022, P is not allowed

[57] Hanlon, *supra* note 43, at 390 (footnotes omitted). The author further notes: "When interacting in the policy circles, one quickly notices the surprise by many about how important accounting is to firm decision-making. If the effects on accounting are not understood or even considered by those informing and writing tax policy, then tax policy can adversely affect financial reporting." *Id.* at 391 (footnotes omitted).

[58] *CSX Corp. v. United States*, 124 F.3d 643 (4th Cir. 1997), *rev'g* 929 F. Supp. 223 (E.D. Va. 1996).

[59] The AFS NOL carryforward allowed by section 56A(d) eases the problem somewhat. If the book charge is required for a tax year ending after December 31, 2019, any net book loss for the year, after making the adjustments required by section 56A(c), is allowed to carry forward and offset up to 80 percent of any AFSI for a tax year during which the corporation is subject to the IRA BMT. *See* section 56A(d)(3). If, however, the book charge does not result in a post-adjustment net book loss, as in Example 7 in the accompanying text, the mismatch is a permanent change.

[60] As discussed in Section III.B.2.a.xii, *supra*, if the book charge exceeds the taxpayer's book income from other sources and happens to fall within a tax year beginning after December 31, 2019, the charge may result in an AFS NOL carryforward that may provide the taxpayer some relief for the later tax year in which the corresponding regular tax deduction is allowed that otherwise results in TMT in excess of regular tax.

a worthless stock deduction under section 165(g) in 2022.[61]

T receives an acceptable offer for its assets in February 2023. On March 15, 2023, T sells all its assets for $900 million, recognizing $300 million of gain; uses the proceeds to discharge all its outstanding debts; and dissolves, distributing nothing to its sole shareholder, P. Under section 165(g)(3) and reg. sections 1.1502-36(c) and 1.1502-80(c)(1), P is entitled to an ordinary loss deduction of $700 million ($500 million of original stock basis + $200 million of later capital contributions to T + $300 million of gain on the sale of T's assets, for which a positive investment adjustment to the T stock basis is allowed under reg. section 1.1502-32(b), and - a $300 million stock basis reduction required under reg. section 1.1502-36(c)). This loss reduces the P Group's consolidated taxable income for 2023 to $1.2 billion ($1.9 billion of consolidated taxable income from other source - the $700 million worthless stock loss). Thus, the P Group's regular tax for 2023 is $252 million (21 percent of $1.2 billion of consolidated taxable income).

For 2023 P also has AFSI of $2 billion, after making all adjustments allowed under sections 56A and 59, and hence incurs a net AMT of $48 million [(15 percent * $2 billion of AFSI = $300 million) - $0 corporate AMT FTC = $300 million of TMT); $300 million TMT - $252 million regular tax = $48 million net AMT]. Accordingly, the total federal tax liability of the P Group for 2023 is $300 million ($252 million of regular tax + $48 million of net AMT).

If the $1.55 billion book charge for the impairment of the investment in T had been taken into account in 2023 rather than 2022, matching the $700 million worthless stock deduction for regular tax purposes, the P Group would have AFSI of only $450 million ($2 billion of net book income from other sources - the $1.55 billion book loss), would have TMT of $67.5 million ([15 percent * $450 million of AFSI] - $0 corporate AMT FTC = $67.5 million of TMT), and hence would have incurred no net AMT ($67.5 million of TMT does not exceed $252 million of regular tax). Thus, the timing difference between the book loss and corresponding regular tax deduction costs the P Group $48 million in federal tax liability. Further, because the matching book loss occurred before the regular tax loss and in a tax year during which T is not subject to the IRA BMT, this timing difference has become a permanent difference — the P Group will never recover the $48 million net AMT as a result of a reduction in AFSI caused by the $1.55 billion book charge.[62]

A similar problem can arise in the case of an advance payment under a contract for delivery of goods or services required under section 451 to be included in income for regular tax purposes in a tax year beginning before January 1, 2023, but recorded for financial accounting purposes in the AFS for a tax year beginning after December 31, 2022.

Example 8: *Pre-effective date taxable income followed by duplication of the item in post-effective date AFSI.* P, a calendar-year applicable corporation for its tax year beginning January 1, 2023, is engaged in the business of providing consulting services and receives a $500 million advance payment (within the meaning of reg. section 1.451-8(a)(1)) in July 2022 attributable to services required to be rendered under a consulting agreement in 2023. For financial accounting purposes, none of the advance payment is recorded on P's AFS for 2022, and the entire $500 million advance payment will be recorded on P's AFS for 2023. P does not file its return for 2022 in a manner reflecting an election under section 451(c)(1)(B) and reg. section 1.451-8(c) to defer the inclusion of the advance payment to 2023 for regular tax purposes and, in any event, can elect deferral only by seeking a change in accounting method, which P does not wish to do.[63]

[61] *See* reg. section 1.1502-80(c)(1) ("Subsidiary stock is not treated as worthless under section 165 until immediately before the earlier of the time — (i) The stock is worthless within the meaning of section 1.1502-19(c)(1)(iii); or (ii) The subsidiary for any reason ceases to be a member of the group.").

[62] The IRS may again point out, as it did in the preamble to T.D. 8307, discussed in Section II.B of part 1, that all is not lost because the P Group now has a minimum tax credit carryforward of $48 million that under section 53 can reduce excess regular tax, as reduced by all allowable tax credits, over TMT in future tax years. This may be a bitter pill for the P Group if it typically experiences high annual AFSI.

[63] Section 451(c)(1)(A) and reg. section 1.451-8(b) generally require an accrual-method taxpayer to include an advance payment, as defined in reg. section 1.451-8(a)(1), in income no later than the tax year of receipt. Section 451(c)(1)(B) and reg. section 1.451-8(c) allow an election to defer inclusion of the portion of advance payment not reported in AFS for the tax year of receipt to the tax year after the tax year of receipt. The election is available only for a taxpayer with an AFS and only to the extent the taxpayer can determine the amount taken into account as AFS revenue for the tax year of receipt.

Accordingly, P must include the entire $500 million advance payment in its 2022 gross income for regular tax purposes under section 451(c)(1)(A) and reg. section 1.451-8(b).

For 2023, P's first tax year to which the IRA BMT applies, the $500 million advance payment is included in P's AFS and hence its AFSI. Thus, the same item of income subject to regular tax in 2022 will be subject to net AMT in 2023 to the extent 15 percent of P's AFSI for 2023 exceeds its regular tax for 2023.

A corporate taxpayer subject to the IRA BMT in 2023 may find itself in a position similar to those illustrated in examples 7 and 8, particularly in the worthless stock loss context. This is because the book charge for an investment in an insolvent subsidiary under GAAP or IFRS almost always must be taken into account in a tax year ending before the tax year in which the regular tax deduction is allowed under section 165(g)(3) and, if the insolvent corporation is a member of a consolidated group, under reg. section 1.1502-80(c)(1). While section 56A(c)(15)(A) authorizes regulations "to prevent the omission or duplication of any item" (similar to former section 56(f)(2)(I), addressed in *CSX*), the IRS will likely adopt a rule similar to former reg. section 1.56-1(d) (upheld in *CSX*) to the effect that those timing differences are disregarded for purposes of section 56A(c)(15)(A).

Perhaps this rule is appropriate in the context of timing differences between a book item and its related regular tax item when both items are taken into account in a tax year beginning after December 31, 2022. In those cases, the applicable corporation will have had time to take inventory of items subject to timing differences, will better understand the repercussions of a timing difference, and may be able to soften its impact. Two ways to soften its impact are by accelerating book income items to the tax year in which the book charge is taken into account or electing deferral of an advance payment for regular tax purposes under section 451(c)(1)(B) and reg. section 1.451-8(g). That permissible planning likely will not be practicable if the book charge or regular tax income is taken into account in a tax year ending before the effective date of the IRA BMT, simply because corporate taxpayers will have had no opportunity to investigate the IRA BMT consequences of all material timing differences for items normally required to be taken into account for book or regular tax purposes in tax years beginning before January 1, 2023. Accordingly, the IRS should at least consider allowing (1) an applicable corporation in a position similar to the P Group's position in Example 7 to make a one-time election, solely for purposes of section 56A, under which a book charge taken into account in the AFS for a pre-IRA BMT tax year is treated as taken into account in the same post-IRA BMT tax year that the related regular tax deduction is taken into account; and (2) an applicable corporation in a position similar to the P Group's position in Example 8 to make a one-time election to amend its federal income tax return filed for the pre-IRA BMT tax year of receipt of an advance payment to defer the inclusion of the advance payment to the next succeeding, post-IRA BMT tax year to the extent the payment is required to be reflected in AFSI for that succeeding tax year, without having to seek a change in accounting method.

4. Permanent differences.

The distinction between temporary and permanent differences is relevant primarily in calculating a company's ETR for presentation in the company's financial statements.[64] A corporation that has only temporary differences and no permanent differences generally has an ETR equal to the maximum statutory tax rate under section 11.

On the other hand, because permanent differences change the total amount of tax to be paid over time, they cause a company's ETR to differ from the statutory tax rate. Thus, a net positive permanent difference (for example, attributable to tax-exempt interest income) will reduce the ETR to a rate below the maximum statutory rate under section 11, whereas a net negative permanent difference (for example, a large nondeductible, noncapital expense that must be accrued and deducted in determining net book income under GAAP or IFRS) will increase

[64] As noted in Section III.C.2, *supra*, ETR is an accounting term referring to the company's total income tax expense (as reported within the financial statements) divided by pretax financial statement net book income.

the ETR to a rate above the maximum statutory rate under section 11.[65]

In the context of applicable corporations, the stock of which is widely held and publicly traded, the pressure from shareholders and other stakeholders to grow or maintain earnings per share encourages management to increase net book income without materially increasing the ETR. Principles of tax neutrality would indicate that to the greatest extent practicable, adjustments under section 56A(c) (particularly adjustments under regulations adopted under section 56A(c)(15)(A) or (e)) to net book income or loss shown in the AFS for a tax year should not prevent or otherwise influence discretionary treatment allowed under GAAP or IFRS to create or increase a net positive permanent difference that lowers the ETR, or to avoid or decrease a net negative permanent difference that increases the ETR.

On the other hand, reducing ETR to increase earnings per share shouldn't qualify as a business purpose for structuring an acquisition that makes available a deduction, credit, or other allowance that otherwise would not have been available when the reduction in ETR is expected to result from the use of the deduction, credit, or other allowance. Consider Example 9.

Example 9: *Acquisition of profitable corporation to use minimum tax credit*. P, a publicly traded applicable corporation subject to the IRA BMT, manufactures orange juice. For year 1, P incurs a net AMT of $300 million, resulting in a minimum tax credit carryforward of $300 million under section 53(b). P's ETR for year 1 is 15 percent, determined without treating P's minimum tax credit of $300 million as a deferred tax asset. T, an unrelated calendar-year corporation that is not an applicable corporation, is the largest orange grower in Florida. P projects that for year 2, T will generate taxable income of at least $1 billion from business operations, none of which will be recognized built-in gain within the meaning of section 384(c)(1).[66] For principal purposes of (1) increasing P's cash flow by that of T, (2) increasing P's earnings per share by both adding T's book earnings to those of P and lowering P's ETR, and (3) securing a source of raw materials for P's orange juice business, T merges into P, with P surviving, on the first day of year 2. Under that merger, T's shareholders exchange all the outstanding T stock for 60 percent cash and 40 percent P common stock (representing 20 percent of the outstanding P stock). The merger qualifies as a reorganization under section 368(a)(1)(A), under which neither P (under section 1032) nor T (under section 361) recognizes gain or loss.

For year 2, (1) P has taxable income of $1.6 billion (of which $1 billion was attributable to T's business); (2) P's net book income, as shown in its year 2 AFS, is $1 billion, consisting of $1.1 billion of positive net book income generated by T's operations and a $100 million net book loss originated by P's operations; (3) P's AFSI, after making all adjustments required by section 56A(c), is $900 million; and (4) P has no tax credits other than the $300 million minimum tax credit carryforward from year 1. Consequently, the tax results for year 2 are:

- P's pre-credit regular tax liability is $336 million (21 percent * $1.6 billion);
- P's TMT is $135 million (15 percent * $900 million);
- P incurs no net AMT because its $135 million TMT doesn't exceed its $336 million regular tax liability;
- Under section 53(c) and (e), P is allowed to use $201 million (the excess of P's $336 million regular tax for year 2 over its $135 million TMT for year 2) of its $300 million minimum tax credit carryover from year 1 as a credit against its year 2 tax liability;
- P's net tax liability for year 2 is therefore $135 million ($336 million regular tax - a $201 million allowable minimum tax credit); thus,

[65] For example, an applicable corporation incurring no book expenses for a tax year and whose only gross income is tax-exempt interest income incurs only net AMT and hence has an ETR of 15 percent. In contrast, an applicable corporation that (1) incurs only book expenses for a tax year that are nondeductible, noncapital expenses for regular tax purposes equal to 40 percent of its gross income and (2) whose only gross income is ordinary income from the performance of services incurs only regular tax (in the amount of 21 percent of its book income, but payable out of net book income equal to 60 percent of its book income) and hence has an ETR of 35 percent (21 percent/60 percent).

[66] Section 384(d) extends the loss limitation of section 384(a) to excess credits, generally preventing the use of pre-acquisition credits of the loss corporation (P in Example 9) against the income tax attributable to recognized built-in gains of the gain corporation (T in Example 9).

- P's ETR for year 2 is 13.5 percent ($135 million of total tax expense divided by net book income of $1 billion).

P also has a $99 million minimum tax credit carryforward to year 3 (the $300 million credit from year 1 - the $201 million of credit used in year 2).

Regarding the foregoing example, the IRS might attack the use of the minimum tax credit to offset P's regular tax attributable to the $1 billion of taxable income generated by T's year 2 business operations under section 269(a)(2) (acquisition of T assets with a carryover basis for "the" principal purpose of tax avoidance achieved by using a minimum tax credit carryforward that, without the T acquisition, would not have been available). This line of attack seems dubious in light of the significant business reasons for the acquisition, including increasing P's cash flow and book income as well as the strategic reasons for acquiring the T business. Nevertheless, lowering P's ETR *per se* should not be a counterbalancing business purpose because a reduction in ETR under these facts is achievable only by using the minimum tax credit carryforward.

5. Acquisition accounting issues.

Returning to the discussion of accounting for acquisitions in Section III.A.2 of part 1 of the report, repeating the example, with slight modifications, is helpful in understanding the mechanics required to account for income taxes under purchase accounting.

Example 10: *Purchase accounting valuation adjustment*. On March 31, 2024, P, a calendar-year applicable corporation for 2024, purchases all the stock of T from T's shareholders for $650 million in cash, resulting in T's becoming a member of the P consolidated group, effective April 1, 2024. At the time of the purchase, T has a single liability (a mortgage debt) of $400 million and owns a single asset, a manufacturing facility, with a tax basis of $300 million and appraised value of $1 billion. No elections are made under section 336(e), 338(g), or 338(h)(10). Under FASB ASC 805-740-25-3, assuming T's regular tax rate is 21 percent, P must record a DTL of $147 million (21 percent of the $700 excess of the $1 billion value of the plant over its $300 million tax basis),[67] and T is therefore treated as having goodwill with a book value of $197 million ($50 million + $147 million).

Several months after T joins the P consolidated group, T sells its manufacturing facility, constituting all of T's tangible assets, for $1 billion cash to an unrelated buyer planning on continuing the T operations, and T retains no intangible assets other than, potentially, goodwill. T then dissolves under applicable state corporate law.

Like the adjustment to AFSI required by section 56A(c)(5) (summarized in Section III.B.2.a.v of part 1 of the report), former section 56(f)(2)(B) and former reg. section 1.56-1(d)(3)(i),[68] interpreting the business untaxed reported profits (BURP) adjustment of the 1986 AMT, provided that net book income must be adjusted to disregard (that is, add back) any federal or foreign income tax expense that is directly or indirectly taken into account in determining the taxpayer's net book income.[69] Former reg. section 1.56-1(d)(3)(iii) states, however, that a valuation adjustment, such as the valuation adjustment required by FASB Accounting Principles Board Opinion No. 16, paragraph 89 (or FASB ASC 805-740-25-3) for a business combination, is not treated as an income tax expense for purposes of reg. section 1.56-1(d)(3)(i), although any income tax expense incurred on a disposition of the asset

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[67] Importantly, the valuation adjustment creating the $147 million DTL is based on the regular tax rate of 21 percent, not the IRA TMT rate of 15 percent. Thus, there is no risk of circularity (of the kind discussed in sections III.A.3 and III.B.2.a.v of part 1) in applying the IRA BMT to the tax year in which the facility is sold.

[68] See T.D. 8307, which finalized former reg. section 1.56-1T as former reg. section 1.56-1 and discussed many of the comments received and considered by the IRS.

[69] Former reg. section 1.56-1(d)(3)(i) states: "Net book income for purposes of this paragraph (d) must be adjusted to disregard (for example, by adding back) any Federal income taxes or income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States that are directly or indirectly taken into account on the taxpayer's applicable financial statement." *See also Doyon Ltd. v. United States*, 37 Fed. Cl. 10 (1996) (in response to the plaintiff's argument that federal income tax benefits are "taxes" that must be disregarded, the court held the "plain and ordinary meaning" of tax permits only items of tax expense to be disregarded under former section 56(f)(2)(B) and reg. section 1.56-1(d)(3)(i)).

subject to the valuation allowance is taken into account as an income tax expense requiring an adjustment to net book income.[70]

In Example 10, if FASB APB Opinion No. 16, paragraph 89 had applied to treat the $147 million DTL attributable to the $700 million gain built into the plant as reducing the book value of the plant from $1 billion to $853 million, a later sale of the plant by T for its appraised value of $1 billion would, under the BURP rules, result in book income of $147 million (purchase price of $1 billion - book value of $853 million), net book income of $0 ($147 million of book income - federal income tax expense of $147 million), and adjusted net book income of $147 million ($0 net book income + the $147 million positive adjustment required by former reg. section 1.56-1(d)(3)(i) to disregard the $147 million of federal income tax expense that reduces the $147 million of book income to $0 of net book income).[71]

Under FASB ASC 805-740-25-3, it appears that the $147 million DTL is not reflected as a reduction in the book value of the plant but instead is reflected as goodwill acquired by P's "assumption" of the DTL and payment of $50 million of additional purchase price exceeding the $1 billion value of the plant. Because the sale of the plant effectively eliminates the $147 million DTL, presumably T's amount realized on the sale is $1.147 billion (the $1 billion purchase price for the plant + the $147 million "discharge" of the DTL). Thus, assuming the regulations under section 56A(c)(5) follow former reg. section 1.56-1(d)(3), the IRA BMT net consequence of the sale likely is unchanged from the BURP net consequence of $147 million of adjusted net book income (or AFSI).[72]

As also discussed in Section III.A.2 of part 1, effective for accounting periods beginning after December 15, 2001, FASB Statement 142 was issued to change the treatment of goodwill of an acquired entity from a wasting asset to an asset of indefinite duration and to require more detailed information regarding the acquired entity's intangible assets, including goodwill. In lieu of amortization, Statement 142 "provides specific guidance for testing goodwill for impairment. Goodwill will be tested for impairment at least annually using a two-step process that begins with an estimation of the fair value of a reporting unit."

On July 11, 2019, FASB issued an invitation to comment on its reconsideration of using amortization to account for goodwill. In December 2020, after evaluating the responses, FASB indicated that it had tentatively decided to reintroduce amortization over a 10-year default period or over a longer period, not to exceed 25 years, determined using a list of factors. In contrast, the International Accounting Standards Board, which had also begun to reconsider amortization, tentatively decided in December 2017 not to reintroduce amortization but to instead study ways to improve the impairment system.[73] In a survey released in December 2021, 58 percent of the members of the CFA Institute, an organization of chartered financial analysts, supported retainment of the impairment system with improvements, 90 percent supported the use

[70] Former reg. section 1.56-1(d)(3)(iii) states: "Income tax expense under paragraph (d)(3)(i) of this section does not include valuation adjustments such as the valuation adjustments related to purchase accounting described in Accounting Principles Board (APB) Opinion No. 16, paragraph 89. However, income tax expense does include the tax associated with any gain or loss on the sale or other disposition of any asset the basis of which was adjusted under paragraph 89 of Opinion 16."

[71] See former reg. section 1.56-1(d)(3)(iv), Example 6, in which (1) corporation A acquires an asset worth $10,000 from corporation B in a carryover basis transaction; (2) the basis of the asset is $7,000; (3) assuming a 30 percent tax rate for A, the asset is recorded at $9,100 ($10,000 appraised value - ($3,000 difference between the appraised value and the tax basis * 30 percent)) under APB Opinion No. 16, paragraph 89; and (4) A sells the asset for $10,000. Example 6 concludes: (1) A recognizes a book gain of $900 on the sale; (2) because A incurs income tax expense of $900 (($10,000 sales proceeds - $7,000 tax basis) * 30 percent), A has no net book income from the sale; and (3) because A's income tax expense includes the $900 of income tax expense attributable to the effects of the valuation adjustment made in accordance with APB Opinion No. 16, paragraph 89, A's adjusted net book income with respect to its asset sale is $900 ($0 of net book income + $900 adjustment for income tax expense).

[72] In other words, the P consolidated group takes into account (1) book income of $147 million ($1.147 billion purchase price - book value of $1 billion), (2) net book income of $0 ($147 million of book income - federal income tax expense of $147 million), and (3) AFSI of $147 million ($0 net book income + a $147 million positive adjustment under section 56A(c)(5) to disregard the book reduction for federal income tax expense).

P should also be entitled to a $197 million reduction in AFSI for the elimination of the goodwill because the sale of the plant, T's only tangible asset, to a buyer planning on continuing the T operation should be treated under GAAP as a permanent impairment of goodwill. *See* FASB Accounting Standards Update 2017-04 (adopted January 2017, effective for SEC reporting companies for accounting periods beginning after December 15, 2019; for other public business entities for periods beginning after December 15, 2020; and for all entities for periods beginning after December 15, 2021).

[73] *See* IASB Agenda Paper 18, Goodwill and Impairment (Dec. 14, 2017, confirmed June 17, 2019).

of the same approach by FASB and the IASB in accounting for goodwill, and 94 percent supported the same standards for measuring the value of goodwill. In a statement released February 22, 2022, the SEC's acting chief accountant urged FASB and its overseer, the trustees of the Financial Accounting Foundation, to carefully consider the comments of all interested parties, including investors and other stakeholders who use financial statements, and to articulate the impact those comments have on the standards implemented by FASB. Ultimately, though, on June 15, 2022, FASB unanimously voted to remove the goodwill project from its agenda, in effect leaving the existing accounting rules for goodwill in place.

The foregoing developments indicate that the IASB and FASB could have moved toward greater divergence in the accounting for goodwill, with the IASB continuing with an impairment system and FASB possibly reinstating amortization. Had this in fact occurred, a critical space in the IRA BMT playing field would have become even more skewed, with taxpayers that use GAAP amortizing the book value of acquired goodwill over a 10- to 25-year period and taxpayers that use the IFRS obtaining no book deduction for goodwill absent impairment under IFRS standards. Given that the book value of goodwill determined under the residual allocation method used under both the IFRS and GAAP typically is material, any divergence may force the IRS's hand to implement a regulatory adjustment requiring all applicable corporations to use the same method of accounting for goodwill.

6. Adjustments for some nonrecognition provisions.

Section 56A(c)(15) states:

> The Secretary shall issue regulations or other guidance to provide for such adjustments to adjusted financial statement income as the Secretary determines necessary to carry out the purposes of this section, including adjustments — . . . (B) to carry out the principles of part II of subchapter C of this chapter (relating to corporate liquidations), part III of subchapter C of this chapter (relating to corporate organizations and reorganizations), and part II of subchapter K of this chapter (relating to partnership contributions and distributions).

This authorization of regulations must be based on the premise that (1) book income or loss shown in an AFS can include gain or loss that is not recognized for regular tax purposes, and (2) allowing that gain or loss to be taken into account in determining net AMT undermines a key tax policy judgment that either (A) because of an absence of any "cashing in" on a winning or losing investment, it is appropriate to allow the gain or loss to continue to be deferred by preserving the item through proper adjustments to the basis of successor assets, or (B) for complete liquidations under sections 332(a) and 337(a), the parent corporation's significant ownership of the liquidated subsidiary's stock justifies treating the two corporations as a single entity and thus defers the gain or loss by preserving the subsidiary's asset basis in the hands of the parent corporation.

Section 56A(c)(15)(B) does not cover all transactions in which gain or loss is taken into account for financial accounting purposes but not for regular tax purposes. In addition to the potential inconsistent book and regular tax treatment of various transactions typically involving non-stock assets — such as like-kind exchanges subject to the nonrecognition rules of section 1031 and involuntary conversions subject to the nonrecognition rules of section 1033, to which the regulatory adjustment authorized by section 56A(c)(15)(B) arguably should be extended[74] — an example involving an important variety of divisive stock transactions frequently used by corporations, both large and small, to address a variety of business exigencies was, shortly after the enactment of the IRA, brought to the attention of the IRS as requiring a prompt extension of the regulatory adjustment. Surprisingly enough, even though a split-off, in

[74] In the absence of legislative history, it is not entirely clear that nonrecognition rules applicable to asset exchanges not involving both corporate stock (or equity interests in a partnership) and a "mere change" in the form of ownership of a business, such as sections 1031 and 1032, are within the scope of section 56A(c)(15)(B). However, there is no question that divisive transactions to which section 355 applies involve both corporate stock and a "mere change" in the form of ownership of a business.

which D distributes shares of C stock to D shareholders in redemption of outstanding shares of D stock, results in no gain or loss being recognized by D (under section 355(c) or 361) or by the distributee-shareholders of D (under section 355(a) for regular tax purposes, financial accounting principles such as GAAP generally require D to take into account book gain or loss. By contrast, no book gain or loss is required under GAAP to be taken into account by D in connection with a pro rata spinoff in which no shares of D stock are surrendered.[75] An August 18, 2022, comment letter to the IRS stated that the "highly technical accounting nuance" between splits and spins should not result in some transactions triggering applicability of the IRA BMT, that such an application would be "inconsistent with the Congressional intention underlying section 355 to allow compelling corporate separations to be implemented on a tax-free basis," and that "there should be no controversy that an otherwise tax-free 'split-off' transaction should be treated comparably to a tax-free 'spin-off' transaction."[76]

Section 56A(c)(15) gives the IRS general authority to issue regulatory guidance providing for "such adjustments to adjusted financial statement income as the Secretary determines necessary to carry out the purposes of this section." The use of the word "including" to link this general grant of power to the more limited illustrations of the use of the power in subparagraphs (A) and (B) should not be interpreted as limiting the general grant of authority to those specific instances.[77] Further, section 56A(e) (authorizing guidance to carry out the purposes of section 56A) should provide a firm basis for issuing regulations expanding the scope of section 56A(c)(15)(B) to provide for adjustments carrying out the purposes of nonrecognition provisions not enumerated in subparagraph (B). Thus, there appear to be no meaningful concerns preventing the IRS from at least publishing a notice in the near future indicating its intent to propose regulations under section 56A(c)(15) and (e) that provide the guidance required by section 56A(c)(15)(B) regarding adjustments for specific nonrecognition transactions, including (1) the expansion of the regulatory list in subparagraph (B) to cover, *inter alia*, divisive transactions to which either section 355 applies or both sections 355 and 361 apply, and (2) any conditions to the application of an adjustment or special circumstances under which an adjustment would not apply.

7. Stock-based compensation.

As discussed in Section III.A.1.a of part 1 of the report, nonqualified deferred compensation expenses are accrued as the employee earns the income for financial statement purposes but generally are not deductible for regular tax purposes until included in the gross income of the employee (that is, generally when paid by the employer).[78] This timing difference can be significantly exacerbated and can become a permanent difference that adversely (or favorably) affects ETR (discussed in Section III.C.4, *supra*), in the context of deferred compensation payable in stock or cash measured by changes in the value of stock, particularly

[75]It is interesting that the financial accounting rule seems to follow the ancient federal income tax distinction, totally demolished by TRA 1986, between a corporation's distribution of appreciated property to shareholders in exchange for nothing (no gain realized) versus a transfer of appreciated property for consideration (gain realized), referred to as the *General Utilities* doctrine in honor of *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935). Thus, in addition to being a distinction without a difference, imposing BMT on split-offs but not spinoffs would seem to partially revive a general tax doctrine Congress thought it eliminated 36 years ago.

[76]EY Letter to Treasury and the IRS regarding the corporate AMT and its effect on tax-free divisive transactions (Aug. 18, 2022). *See also* Chandra Wallace, "EY Seeks Fast Relief Exempting Split-Offs From Corporate AMT," *Tax Notes Federal*, Aug. 22, 2022, p. 1296. Another example might be a distribution by a partnership in complete or partial liquidation of the distributee-partner's interest that is tax free under section 731(a) but results in book income or loss to the partnership or distributee-partner.

[77]*See, e.g.*, *Ford v. United States*, 273 U.S. 593, 611, 612 (1927) (in which the Supreme Court warned that "great caution is requisite in dealing with" *expressio unius est exclusio alterius*, and that the "maxim properly applies only when in the natural association of ideas in the mind of the reader that which is expressed is so set over by way of strong contrast to that which is omitted that the contrast enforces the affirmative inference that that which is omitted must be intended to have opposite and contrary treatment"). There is no legislative history or "natural association of ideas" suggesting Congress intended to limit the broad grant of authority in section 56A(c)(15) to the narrow examples of the use of that authority in subparagraphs (A) and (B).

[78]*See* section 404(a)(5); and reg. section 1.404(b)-1T (amounts paid within two and a half months of the year in which the amounts were earned by the employee generally are deductible when accrued for financial statement purposes).

when the stock is volatile because of market conditions. Not only do the tax years in which the issuer incurs a reduction in book earnings attributable to the stock-based compensation normally *precede* the tax years in which the issuer is entitled to the corresponding regular tax deduction, but the *amount* of the book income reduction may differ significantly from the amount of the corresponding regular tax deduction.

Example 11: *Exercise of nonqualified stock option*. X, a calendar-year applicable corporation for 2023 and 2024 whose stock is publicly traded, granted to A, a key employee, a nonqualified option to purchase 10,000 shares of X stock at a strike price of $25 per share in 2020, when the market value of the X stock was $20 per share. At the time of grant, the option did not have a "readily ascertainable fair market value" as defined in reg. section 1.83-7(b). The option became exercisable in full in 2023, after A completed her three full years of service in the employ of X. At the time of vesting, the market value of one share of X stock was $50. In 2024 A exercises the option, paying X $250,000 in exchange for 10,000 shares of X stock. At the time of exercise, the FMV of the X stock was $75 per share. When issued to A, A's 10,000 X shares were not subject to a substantial risk of forfeiture or any other contractual restriction and were registered and eligible for sale in market transactions.

For 2023 X has $1 million of AFSI and $500,000 of regular taxable income, determined without regard to any compensation deduction attributable to the stock option.

For 2024 X again has $1 million of AFSI and $500,000 of regular taxable income, determined without regard to any compensation deduction attributable to the stock option.

2023 result. Under ASC 710-10-30, A is treated as receiving compensation equal to the option spread on the 10,000 shares ($250,000, or the excess $500,000 value of the X stock at the time of vesting over the $250,000 exercise price) for book purposes on the date in 2023 when the option fully vested, which is the first time the option was fully exercisable, and A is entitled to hold all benefits and burdens of ownership of the 10,000 X shares against payment of the strike price. Thus, $250,000 of compensation is deemed paid to A by X in 2023, which reduces X's $1 million of 2023 AFSI from other sources to $750,000. On the other hand, X's regular taxable income of $500,000 for 2023 from other sources is not reduced by the vesting of the stock option because the timing of the income and deduction for regular tax purposes is deferred under section 83 and reg. section 1.83-7 until A exercises the option. X has no deductions, credits, or other allowances reducing either its regular tax liability or its net AMT for 2023. Thus, for 2023 X has TMT of $112,500 ([15 percent * $750,000 of AFSI] - $0 AMT FTC). X's regular tax is $105,000 (21 percent * $500,000). Therefore, X's net AMT for 2023 is $7,500 (TMT of $112,500 - regular tax of $105,000), and its total tax liability for 2023 is $112,500 ($105,000 of regular tax + $7,500 of net AMT).

2024 result. For regular tax purposes, A is treated as receiving $500,000 of stock-based compensation in 2024 when she exercises the option, acquiring 10,000 shares of X stock worth $750,000 in exchange for the $250,000 exercise price. Consequently, X is entitled to an ordinary deduction of $500,000 under section 162 for regular tax purposes in 2024. For GAAP purposes, however, X has no further deduction for the deferred stock compensation beyond the $250,000 deduction allowed for 2023. For 2024 X's AFSI and regular taxable income from other sources is the same as for 2023 ($1 million of AFSI and $500,000 of regular taxable income with no deductions, credits, or other allowances). The $500,000 section 162 deduction allowed for regular tax purposes eliminates X's regular tax for 2024. X's TMT is $150,000 ([15 percent * $1 million of AFSI] - $0 AMT FTC). Thus, X's net AMT for 2024 is $150,000 (TMT of $150,000 - regular tax of $0), which is also its total tax liability for 2024.

In Example 11, because the timing of the financial reporting deduction does not match the timing of the regular tax deduction for the compensatory transfer of X stock, the amount of the book deduction allowed in 2023 ($250,000) is half the amount of the regular tax deduction allowed in 2024 ($500,000) due to the rapid growth in the value of the X shares over the period following the vesting of the option up to the date of exercise. As a result, the total federal tax liability for both tax years of $262,500 ($112,500 for 2023 plus $150,000 for 2024) is $37,500 greater than the total federal tax liability for both tax years of $225,000 that would have been incurred if the timing of the book deduction had matched that of the regular tax deduction, resulting in no book deduction in 2023 and a $500,000 book deduction in 2024.[79] The $37,500 excess of the $262,500 total tax under the facts of Example 11 over the $225,000 total tax that would have been incurred if the timing had matched is a permanent difference solely attributable to the $37,500 increase in the TMT benefit of the additional $250,000 book deduction allowed by the timing match (15 percent of $500,000 minus 15 percent of $250,000 = $37,500). Thus, the ETR impact of the timing mismatch for 2023 and 2024 is a permanent increase in ETR of 1.875 percentage points ($37,500/$2 million of net book income) that will not be reversed by ETR reductions in future tax years.

The 1.875 percentage-point permanent increase in ETR could have gone the other way if the X stock value had been $75 per share when the option vested in 2023 and $50 per share when the option was exercised in 2024. The point to be taken from Example 11 is that a timing difference regarding an item of book income or deduction that is also an item of regular tax income or deduction can metamorphize into a permanent difference that beneficially or adversely affects ETR whenever the factual basis for determining the amount of item can vary over time. The most frequently encountered examples involving this risk likely will involve compensation payable in property other than cash, or measured by appreciation or depreciation in the value of property other than cash, and is a risk borne by both the service recipient (X in the example) and the service provider (for example, imagine that A is an applicable corporation rendering consulting services and earns the right to exercise the option by rendering specified services for three consecutive years under a consulting agreement).

Another possible example is an acquisition of assets used in a trade or business, or of stock of a corporation conducting a trade or business, in which all or part of purchase price payable by the purchasing corporation is contingent, such as an earn-out based on future profits or gross income derived from the post-acquisition operation of the trade or business over a period of time. Financial reporting standards may require the purchasing corporation to value the contingent consideration as of the date of the purchase for purposes of determining the book value of the acquired assets,[80] whereas the applicable regular tax rules usually defer the determination of the portion of the asset (or stock) basis attributable to the contingent consideration until the contingent payment becomes fixed and determinable due to satisfaction of the contingency.[81] Thus, book depreciation and amortization for the acquired business may be substantially greater than regular tax depreciation and amortization in earlier tax years. As the contingencies are satisfied, however, and regular tax depreciation and amortization deductions become allowable, any differences between the amounts of the earlier book charges and later regular tax deductions may be reflected under applicable financial reporting standards as increases or decreases in net book income for the later tax years. If so, the timing differences should not

[79] If the timing of the book deduction had been deferred to the date in 2024 on which the option is exercised, (1) the book deduction for 2023 would have been $0, resulting in total federal tax of $150,000 (TMT of $150,000 [15 percent of $1 million], regular tax of $105,000 [unchanged], net AMT of $45,000 [$150,000 TMT - $105,000 regular tax], and total tax of $150,000 [$45,000 net AMT + $105,000 regular tax]); and (2) the book deduction for 2024 would have been $500,000, resulting in total federal tax of $75,000 (TMT of $75,000 [15 percent of $500,000], regular tax of $0 [unchanged], net AMT of $75,000 [$75,000 TMT - $0 regular tax], and total tax of $75,000 [$75,000 net AMT + $0 regular tax]). Thus, the total federal tax for both tax years would be $225,000 ($150,000 for 2023 + $75,000 for 2024).

[80] Effective for accounting periods beginning on or after December 15, 2008, FASB Statement 141 was revised to, among other things, require "the acquirer to recognize contingent consideration at the acquisition date, measured at its fair value at that date. Under [former] Statement 141, in contrast, contingent consideration obligations usually were not recognized at the acquisition date. Rather, they usually were recognized when the contingency was resolved and consideration was issued or became issuable."

[81] *See, e.g.*, *Associated Patentees Inc. v. Commissioner*, 4 T.C. 979 (1945) (taxpayer acquired patents in exchange for 80 percent of the annual income it received from licensing the patents and attempted to value patents and amortize that value; court held it was not possible to determine taxpayer's cost basis in patents because the purchase price was contingent and allowed taxpayer instead to deduct payments actually made each year as amortization of purchaser's cost basis in the patents); Rev. Rul. 55-675, 1955-2 C.B. 567 (taxpayer acquired assets in exchange for its assumption of liabilities under a lease, including contingent obligations; the IRS concludes, "no amount is to be included in cost with respect to those obligations which are so contingent and indefinite that they are not susceptible to present valuation until such time as they become fixed and absolute and capable of determination with reasonable accuracy").

produce meaningful permanent differences that affect the acquiring corporation's ETR.

8. Section 481 adjustments.

As mentioned in Section III.A.1.a of part 1, issues concerning the financial reporting treatment of section 481 adjustments arise under the IRA BMT. Section 481 was enacted as part of the 1954 code to facilitate a taxpayer's adoption of a new method of accounting under section 446(e).[82] Before its enactment, taxpayers were hesitant to change an accounting method, which then, as now, required the commissioner's consent, because of the potentially significant income inclusion the IRS required before consenting to the change.[83]

Generally, a section 481 adjustment[84] is determined at the beginning of the tax year of change to be the aggregate amount of net income or expense that would have been reported in tax years before the tax year of change if the taxpayer had been on the new method in those prior years.[85] Section 481(a) generally requires the full amount of the adjustment to be taken into account in the tax year of change.

Recognizing the hardship faced by taxpayers under this general rule, Congress enacted two spread-back exceptions in section 481(b) for cases in which the adjustment would result in an increase in taxable income of more than $3,000. The exceptions take the form of alternative computations of tax liability, all of which is payable for the tax year of change. Each of the alternatives is based on (1) allocating the section 481 adjustment over the year of change and prior years, (2) determining the increase in tax arising in each of those years, and (3) limiting the tax attributable to the adjustment to the sum of those increases.[86]

In addition to the spread-back alternatives of section 481(b), which merely alter the amount of tax payable in the year of change, section 481(c) and reg. section 1.481-5 authorize an alternative allowing the commissioner to agree to a taxpayer's spreading the adjustment over the tax year of change and subsequent years. The spread forward of the section 481 adjustment is intended to serve several purposes: (1) avoiding the harsh financial consequences of including the entire adjustment in income in the year of change; (2) reducing the distortion of income that would result if the entire adjustment were made in the year of change; and (3) encouraging taxpayers to apply for changes in accounting methods earlier rather than later to obtain the favorable benefits of the spread and to avoid the risk of either losing the spread or having it reduced if the change is required on audit.[87] Also, because any additional federal income tax due as a result of the change in accounting method is spread over the year of change and future tax years without an interest charge on the deferred tax, the disruption of taxpayer cash flow is minimized.

To encourage prompt voluntary applications for changes from improper accounting methods, Rev. Proc. 92-20, 1992-1 C.B. 685,[88] employs a menu of incentives under which taxpayers receive

[82] As noted in Section III.A.1.a of part 1, the rules applicable to changes in accounting methods are found in sections 446(e) and 481. The regulations under section 446(e) set forth the procedures for carrying out section 446(e)'s prohibition on changing a method of accounting without the commissioner's approval. *See* reg. section 1.446-1(e)(2)(i) ("Except as otherwise expressly provided in chapter 1 of the Code and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. Consent must be secured whether or not such method is proper or is permitted under the Internal Revenue Code or the regulations thereunder.").

[83] Steve Gertzman, George Hani, and Jim Gadwood, *Federal Tax Accounting*, para. 8.04 (2021).

[84] Section 481 sets forth the adjustments required to give effect to an accounting method change, the manner in which the adjustments are taken into account in determining income, and the method of determining the tax resulting from the adjustments. The section 481 adjustments are designed to avoid the omission or duplication of items of income and expense. *See Huffman v. Commissioner*, 518 F.3d 357 (6th Cir. 2008).

[85] *See Hudson v. Commissioner*, T.C. Memo. 1996-106 (the section 481 adjustment relates to net income at the beginning of the year of change, not to income later taken into account).

[86] Gertzman, Hani, and Gadwood, *supra* note 83, at para. 8.04[2]. The first exception spreads the adjustments ratably over the tax year of change and prior two years and may be used only if the method being changed was used in the two years immediately before the year of change. Section 481(b)(1); reg. section 1.481-2(a) and (c). Under the second exception, the taxpayer recomputes its taxable income under the new method of accounting for all consecutive years immediately preceding the year of change for which those computations can be made. To the extent the entire amount of the adjustment cannot be allocated to those consecutive prior years, any remaining balance of the adjustment is allocated to the year of change. Additional rules address (1) a limitation on the tax attributable to inclusion of the section 481 adjustment in the year of change; (2) the treatment of NOL carrybacks and carryforwards; and (3) determinations of underpayments and overpayments of tax.

[87] Gertzman, Hani, and Gadwood, *supra* note 83, at para. 8.04[3].

[88] Rev. Proc. 92-20, 1992-1 C.B. 685, section 1. Rev. Proc. 92-20 was superseded and modified by Rev. Proc. 97-27, 1997-1 C.B. 680, effective for applications for change filed on or after May 15, 1997.

more favorable terms and conditions for voluntary changes from improper methods than they do if the application for change is filed after contact by the IRS. Nevertheless, if contact is made by the IRS, filing an application immediately thereafter results in more favorable terms and conditions than if the change were not made voluntarily by the taxpayer but instead made by the agents on audit. Also, the revenue procedure includes provisions designed to ensure that changes from methods of accounting prohibited by amendments to the code or required by those amendments will not be made on more favorable terms and conditions by a taxpayer that delays making the change than a taxpayer that makes the change immediately under the applicable code provision.[89] Generally, at the risk of grossly oversimplifying an extremely complex revenue procedure, if a taxpayer timely requests a change before contact by the IRS or during a brief window after contact, a favorable section 481 adjustment (that is, a net negative adjustment) is taken into account under Rev. Proc. 92-20 in the year of the change, while an unfavorable (that is, net positive) adjustment is spread over a three- to six-year period beginning with the year of change.

The more significant issues section 481 raises regarding the IRA BMT are (1) whether there are (or should be) financial reporting equivalents of positive or negative adjustments resulting from changes in an accounting method; (2) if so, whether the amounts, attributes (for example, character or source), and timing of the adjustments for IRA BMT purposes are the same as they are for regular tax purposes; and (3) if the amounts, attributes, or timing differ, how and why they differ.

A related question is whether the origin of, or underlying reason for, the change matters (or should matter) for IRA BMT purposes. For example, should the existence, amount, attributes, or timing of a book adjustment be different, depending on whether the adjustment occurs (1) solely for a change in a regular tax accounting method that has no effect on items reported in an AFS such as, presumably, a change in accounting for capitalizable costs under section 263A,[90] given the existence of different financial accounting standards for capitalization of costs; (2) because of the taxpayer's adoption of a new financial accounting method, such as switching from GAAP to the IFRS or vice versa; (3) because of a change in underlying financial accounting rules; or (4) as a result of the correction of an error in an AFS requiring a restatement of the AFS?

Finally, if there is a book equivalent of a net positive (or unfavorable) section 481 adjustment resulting from a change in an accounting method for regular tax purposes, and the entire net positive adjustment is taken into account for financial reporting purposes in the year of change but deferred under Rev. Proc. 92-20 or some other procedure and taken into account ratably over a period of years for regular tax purposes, the IRS should consider a regulatory adjustment to the timing of the book item to match the timing of the section 481 adjustment for regular tax purposes. Otherwise, the IRA BMT will operate to undermine the purposes for which Rev. Proc. 92-20 was issued by discouraging applicable corporations from seeking a change in method before being required to do so on audit. It would appear that either or both section 56A(c)(15) ("the Secretary shall issue regulations or other guidance to provide for such adjustments to adjusted financial statement income as the Secretary determines necessary to carry out the purposes of this section") and section 56A(e) (authorizing guidance to carry out the purposes of section 56A) provide sufficient authorization for that adjustment.

9. Application of sections 382, 383, and 384.

Extensive guidance is required regarding the application of sections 382, 383, and 384 to favorable IRA BMT attributes, such as excess section 53(b) minimum tax credits and AFS NOL carryforwards in connection with an ownership change described in section 382(g) or an acquisition described in section 384(a). In particular, guidance is needed for determining, among other things:

[89] Gertzman, Hani, and Gadwood, *supra* note 83, at para. 8.06[3].

[90] Rev. Proc. 94-49, 1994-2 C.B. 705, not Rev. Proc. 92-20, governs changes in accounting for costs under section 263A.

- whether, as discussed in Section III.B.2.a.xii, *supra*, a separate and asynchronous section 382 limitation should apply to an AFS NOL carryforward after an ownership change under section 382(g) instead of a single section 382 limitation that is coordinated with the limitations under sections 382 and 383 on pre-change losses, capital losses, and credits as determined for regular tax purposes; and
- when a net unrealized built-in gain or loss, as defined in section 382(h)(3), and a recognized built-in gain or loss, as defined in section 382(h)(2) and supplemented by section 382(h)(6), exist for IRA BMT purposes.

10. Consolidated return guidance.

Specific areas in which consolidated return guidance is required have been discussed in sections III.B.2.a.xii and III.B.3.c, *supra* (whether SRLY rules are needed for AFS NOL carryforwards and excess section 53(b) minimum tax credits). Perhaps the most important area in which extensive guidance is required is touched on in the summary of section 56A(c)(2)(B) in Section III.B.2.a.ii in part 1. The statute provides that the AFSI of a consolidated group "shall take into account items on the group's applicable financial statement which are properly allocable to members of such group." What is needed is general guidance regarding the determination of the AFSI of a consolidated group.

Determining the AFSI, TMT, and net AMT of each member of a consolidated group on a separate-entity basis would seem to be an inefficient and overcomplicated approach for several reasons, including the following:

- First, the regular tax liability and any BEAT of a consolidated group are determined under reg. section 1.1502-2(a) based on the group's consolidated taxable income, determined under reg. section 1.1502-11, and the treatment of the group as a single corporation for purposes of section 59A under reg. section 1.1502-59A(b)(1). If each member's AFSI, TMT, and net AMT were determined on a separate-entity basis, it would be necessary to allocate among the members the group's consolidated regular tax determined under reg. sections 1.1502-2(a) and 1.1502-11 and consolidated BEAT determined under reg. section 1.1502-59A(b)(1), perhaps using the tax-sharing principles of reg. section 1.1502-32(b)(3)(iv)(D), for each tax year for which the group is subject to the IRA BMT.
- Second, if the net book income or loss of each member is not separately stated in a separate or consolidated AFS for the tax year but instead is combined with the performance of all members in a consolidated AFS, rules must be written for determining the net book income or loss of each member, perhaps based on source documents provided by each member to prepare the consolidated AFS, including rules governing when book items of different members that are eliminated in the consolidated AFS must be reinstated for determining those members' net book income or loss for the tax year.
- Third, for those members having positive AFSI after reduction for AFS NOL absorption, each member's corporate AMT FTC for the tax year must be determined, which again may prove difficult if the AFS is a consolidated statement that does not separately state each member's creditable foreign tax expense.

Such a separate-entity approach, in addition to being cumbersome, may overstate or understate items of net book income or loss from the amounts that would be reported in the AFS if the consolidated group were a single corporation. It may also present other problems, such as the treatment of section 56A(c) adjustments resulting from intercompany transfers of depreciable or amortizable assets and the allocation of adjustments under section 56A(c)(11) for defined benefit pension plans sponsored by multiple members. It seems preferable to follow the single-entity application of the BEAT in reg. section 1.1502-59A and prop. reg. section 1.1502-55's single-entity determination of the 1986 AMT.

Assuming the government will opt for single-entity determinations of AFSI, AFS NOL carryforwards, TMT, net AMT, and excess section 53(b) minimum tax credits in the consolidated return context, one might anticipate consolidated return guidance addressing, among countless other issues,[91] the following key, consolidated net AMT computational issues:

- *AFS selection*. For purposes of ascertaining a consolidated group's items of net book income or loss in determining its consolidated AFSI or consolidated AFS NOL (that is, its "tentative" consolidated AFSI or "tentative" consolidated AFS NOL) for a tax year, presumably, a consolidated AFS covering the entire consolidated group will be preferred over consolidating AFSs of equal priority used in preparing the consolidated AFS. Additional consolidated section 59(k) rules may be required to piece together a unified or deemed consolidated AFS for split groups in which there are members or subgroups with separate qualifying financial statements and no global consolidated statement.
- *Tentative consolidated AFSI determination*. In determining a group's tentative consolidated AFSI (or tentative consolidated AFS NOL), presumably the book items taken into account in the AFS generally would be aggregated, perhaps similar to the BEAT approach of reg. section 1.1502-59A(b)(1), after which the adjustments required by section 56A(c) would be made on an aggregate basis to those items in arriving at tentative consolidated AFSI (or tentative consolidated AFS NOL). Difficult decisions are required in connection with guidance regarding the computation of consolidated AFSI and consolidated AFS NOL, the most difficult of which may be rules regarding the treatment of book items attributable to intercompany transactions. A blanket disregard of book items attributable to an intercompany transaction, as seems to have been done in the BEAT context,[92] goes too far by eliminating items otherwise required to be reflected in AFSI. Rather, a more nuanced approach is needed to in effect redetermine the items as if the transaction took place between divisions of a single corporation.
- *"Applicable corporation" status.* Because section 56A(d) is disregarded in determining AFSI under section 59(k)(1)(D), for each of the three consolidated return years falling within the testing period discussed in Section III.B.1 of part 1, no further computations are needed under section 56A to determine a consolidated group's status under section 59(k) as an applicable consolidated group. However, solely for purposes of determining applicable consolidated group status, tentative AFSI may have to be further modified to comply with the requirement in section 59(k)(1)(D) that adjustments for partnerships (section 56A(c)(2)(D)) and some pension plans (section 56A(c)(11)) be eliminated.[93]

On the other hand, for purposes of determining an applicable consolidated group's consolidated net AMT and consolidated excess section 53(b) minimum tax credit use, additional calculations are required under sections 56A and 55, so we continue:

- *Consolidated AFS NOL carryforward*. If the aggregation of book items and section 56A(c) adjustments results in a tentative consolidated AFS NOL, the tentative NOL presumably would be added to any consolidated AFS NOL carryforward from the prior year and become part of the consolidated AFS NOL carryforward to the following year.

[91] To name just a few additional issues: (1) fashioning a workable, parallel investment adjustment system to prevent the double taxation of AFSI and double deduction of AFS NOLs; (2) ensuring the unified loss rule of reg. section 1.1502-36 adequately fulfills its role of guarding against noneconomic book loss and duplicative book deductions in connection with transfers of member stock; (3) fashioning rules for allocating consolidated AFS NOL carryovers and consolidated excess section 53(b) minimum tax credits when a member contributing to the attribute leaves the consolidated group; (4) fashioning appropriate SRLY limitations for consolidated excess section 53(b) minimum tax credits and AFS NOL carryforwards; and (5) ensuring that the consolidated section 382 regulations appropriately apply to pre-change consolidated excess section 53(b) minimum tax credits and pre-change consolidated AFS NOL carryovers. Discussion of these and related consolidated return issues is far beyond the scope of this report.

[92] The penultimate statement of reg. section 1.1502-59A(b)(1) is: "To ensure that intercompany transactions (as defined in section 1.1502-13(b)(1)(i)) do not affect the consolidated group's base erosion percentage or base erosion minimum tax amount, *items resulting from intercompany transactions* are not taken into account in making such computations under section 59A." (Emphasis added.) A literal interpretation of this rule in connection with S's sale to B of a depreciable asset, generating $100 of annual depreciation for S, is that any depreciation allowed to B is disregarded.

[93] These adjustments are discussed in Section III.B.1 of part 1.

- *Net consolidated AFSI*. If the aggregation of book items and section 56A(c) adjustments results in tentative consolidated AFSI, presumably the tentative consolidated AFSI would be reduced by the lesser of (1) any consolidated AFS NOL carryforward from the prior year, and (2) 80 percent of that tentative consolidated AFSI. The resulting net consolidated AFSI would be used to determine the group's consolidated TMT for the year. Any consolidated AFS NOL carryforward not used in determining net consolidated AFSI because of the 80 percent limitation would carry forward to the following year.
- *Consolidated TMT determination*. Presumably, the group's consolidated AMT FTC under section 59(l) will be determined on an aggregate basis. In that regard, the "lesser of" CFC FTC rules of section 59(l)(1)(A) likely should be applied separately to each CFC owned by group members, with the results then being totaled.[94] In any case, the consolidated AMT FTC for the year, however determined, would be subtracted from 15 percent of the net consolidated AFSI to obtain the consolidated TMT for the year.

Once consolidated TMT is determined for a consolidated return year, the rest is easy. If the consolidated TMT exceeds the sum of the consolidated regular tax liability and consolidated BEAT, consolidated net AMT is incurred and paid along with the BEAT and consolidated regular tax liability (net of any allowed credits not taken into account in determining the consolidated net AMT), and any consolidated excess section 53(b) minimum tax credit available for the year is increased by the consolidated net AMT. If the sum of the consolidated regular tax liability and consolidated BEAT exceeds the consolidated TMT, any consolidated excess section 53(b) minimum tax credit available for the year reduces the consolidated tax due for the year to the extent of that excess.

IV. Closing Thoughts

Many issues are arising under the IRA BMT, some of which can be resolved by appropriate guidance (for example, expanding section 56A(c)(15)(B) to cover nonrecognition transactions not included in the statutory list, such as split-offs), others that may be partially resolved by guidance (for example, a reasonable antiavoidance rule designed to prevent understatements of AFSI or TMT contrary to the purposes of the IRA BMT), and still others with which the IRS and taxpayers will simply have to cope unless the IRA BMT is repealed (for example, the general lack of a level playing field, depending primarily on whether the taxpayer's stock is privately held or publicly traded, and the general skewing of tax neutrality regarding decisions involving the accounting treatment of items of income or loss and the deleterious impact of this lack of neutrality on securities reporting policies and the capital markets). While it is impossible to predict the direction the IRS will take in issuing future guidance, the guidance likely will leave many issues hanging and almost certainly will not make every large corporate taxpayer happy.

On balance, the IRA BMT, being so heavily oriented toward, and grounded in, temporary and permanent differences between the book treatment and regular tax treatment of items, is far more problematic in terms of both tax policy and securities disclosure policies than the BURP adjustment under the 1986 AMT, discussed in Section II.A and B of part 1 of this report. Key policy questions not addressed, or only touched on, in the report include the following:

- Is Congress unintentionally delegating the power to craft tax legislation to FASB and the IASB by tying an income tax to financial outcomes under standards developed by the boards? If so, is it a violation of the Constitution for an elected branch of

[94] As discussed in Section III.B.2.b.i, *supra*, section 59(l)(1)(A) allows an applicable corporation to include in its corporate AMT FTC the lesser of (1) its pro rata share of creditable foreign taxes taken into account on the AFS of each CFC for which the applicable corporation is a U.S. shareholder, to the extent those taxes are paid or accrued for regular tax purposes for that tax year; or (2) the product of the rate set forth in section 55(b)(2)(A)(i) (15 percent) times the amount of the adjustment under section 56A(c)(3) (the CFC's net book income shown on its AFS for the tax year, subject to adjustments similar to those described in section 56A(c)). Because the 15 percent limitation is designed to restrict a CFC's FTC to the AMT attributable to the AFSI created by the CFC, the better approach is to apply section 59(l)(1)(A) separately to each CFC and then aggregate the AMT FTCs allowed under the separate application of the rule.

government to delegate one of its critical powers to an unelected group of individuals appointed to develop financial disclosure standards having only a tangential connection to tax policy?[95]
- Will tax considerations ultimately trump disclosure policies in the crafting of financial reporting standards, and if so, how will this affect the capital markets?
- Is the playing field unfairly slanted in favor of closely held corporations that have less pressure to maintain or increase earnings per share?
- How serious an issue is the principle of tax neutrality in the context of a taxing statute that is not intended to encourage or discourage behavior but still may have unintended, deleterious consequences that impede securities disclosure policies?

While Congress might have been better advised to seek a different means of raising revenue, large corporate taxpayers should assume that the IRA BMT will remain a permanent addition to the code and begin, as soon as practicable, the due diligence required to make current and future adjustments reducing the amount of net AMT incurred in tax years beginning after December 31, 2022. This due diligence likely should include:

- Estimating the first tax year, if any, beginning after December 31, 2022, for which the company expects to be an applicable corporation. This involves the time-consuming process of (1) ascertaining the company's AFS for each tax year within the three-year section 59(k) testing period if more than one financial statement is prepared for each tax year, (2) developing the means required to determine the AFSI-equivalent of CFCs and partnerships in which the company owns equity, and (3) undertaking any adjustments required by section 56A(c) to the net book income or loss shown on the AFS for each relevant tax year.
- Estimating the impact of material book earnings charges, such as the $954 million restructuring charge addressed in *CSX*, that may occur or have occurred in one or more tax years beginning before the first tax year for which the company is expected to be an applicable corporation.
  - For example, if there was a material charge for a prior tax year, did it result in an AFS NOL carryforward originated in a tax year ending after 2019, and if so, how much of the carryforward is expected to remain for the first tax year for which the company is expected to be an applicable corporation?
  - If the tax year in which the material charge accrues for financial reporting purposes is still open, is it possible to accelerate book income items that normally would fall into later tax years to be taken into account in the tax year of the charge?
- Taking inventory of contracts involving advance payments for which a deferral election may be available under section 451(c)(1)(B) and reg. section 1.451-8(c).
- Evaluating contingent liabilities and other items for which discretionary book treatment is available (for example, a reserve for contingent tort or breach of contract liabilities).
- Estimating book-tax differences, DTAs, DTLs, and valuation allowances that may arise if acquisitions in the planning stage are completed and that now exist for completed acquisitions.
- Estimating the amount of corporate AMT FTCs that will be available in future tax years to reduce TMT.
- Reviewing all items listed on Schedule M-1 of the return to identify book-tax differences, including stock-based compensation.

[95]Doubtless, Congress did not intentionally cede its taxing authority to FASB or the IASB by enacting the IRA BMT. Nonetheless, by determining the amount of net AMT due under the IRA BMT primarily on the basis of financial outcomes under standards developed by FASB or the IASB, and given the authority of FASB and the IASB to change or supplement those standards *sua sponte*, the enactment of the IRA BMT has shifted to FASB and the IASB a meaningful degree of responsibility and power to determine both the scope of the BMT and the amount of net AMT owed by an applicable corporation. Also, there is authority invalidating legislation authorizing a group of private citizens to devise regulatory standards, particularly when the regulatory power could be exercised without notice and a hearing. *See A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935); *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936).

Finally, because the IRA BMT was not "born to die" by way of a built-in expiration date — unlike the BURP adjustment of the 1986 AMT — its continuation as a part of the IRC will depend on the will of future Congresses, tempered by unpredictable external factors, including court challenges, measurable impacts on capital markets, revenue raised by the tax, and "plain old" politics. While no one can tell us whether the IRA BMT will have a long or short reign, there is considerable trepidation at its birth. ■