Tax Insights
from Washington National Tax Services

Key highlights of the CAMT proposed regulations

September 20, 2024

In brief

What happened?

Treasury and the IRS on September 12, 2024, issued proposed regulations on the application of the corporate alternative minimum tax (CAMT). Enacted in 2022, the Inflation Reduction Act (IRA) imposes a 15% minimum tax based on the adjusted financial statement income (AFSI) of an ‘applicable corporation.’ The CAMT is effective for tax years beginning after December 31, 2022.

The IRS also issued Notice 2024-66, which incorporates the relief for CAMT estimated tax penalties provided in Notice 2024-33 and Notice 2024-47 by waiving the addition to tax under Section 6655(a) relating to the CAMT for a tax year that begins after December 31, 2023, and before January 1, 2025.

Why is it relevant?

Spanning more than 600 pages, the proposed regulations expand on the interim guidance issued in Notice 2023-7, Notice 2023-20, Notice 2023-64, and Notice 2024-10 by providing detailed rules and examples on AFSI adjustment computations, such as those required for depreciation and amortization, identifying applicable corporations that are subject to the CAMT, as well as other important topics, including special rules for controlled foreign corporations (CFCs), foreign-parented multinational groups (FPMGs), consolidated groups, and partnerships with corporate partners. The proposed regulations introduce many new defined terms and attributes that taxpayers will need to track.

The issuance of the proposed regulations coincides with the finalization of the federal income tax returns of corporations for the 2023 tax year and just before the due date of the third quarterly installment of estimated federal income taxes for the 2024 calendar tax year.

This PwC Insight provides key highlights of the proposed regulations – look for additional PwC Insights in the coming days that will provide further analysis of the new rules.

Action to consider

Taxpayers and other affected entities should examine how the complex rules set forth in the proposed regulations may affect positions taken in previous tax years that were based on the interim guidance or a reasonable interpretation of the statute. Although the effective date for many provisions of the proposed regulations is for tax years ending after September 13, 2024, other provisions will not be effective until publication of final regulations in the Federal Register. Treasury and the IRS are requesting comments on several specific topics. Taxpayers should consider submitting comments on key issues by December 12, 2024, or to request to speak at a hearing scheduled for January 16, 2025.

PwC professionals will discuss the CAMT guidance on a Tax Readiness webcast on October 8, 2024 [Register here].

In detail

Background

The CAMT imposes a 15% minimum tax on the AFSI of an applicable corporation, defined as a corporation (other than an S corporation, regulated investment company, or real estate investment trust) that meets one of two 'AFSI tests' in one or more tax years before the current tax year ending after December 31, 2021. A CAMT entity is generally an entity that is regarded for regular tax purposes.

Key highlights of proposed regulations

The proposed regulations provide detailed rules and examples on AFSI adjustment computations, special rules for CFCs, FPMGs, consolidated groups, partnerships with corporate partners, and other important provisions, parts of which are summarized below.

Adjustments to AFSI

Section 56A(a) generally provides that AFSI means the net income or loss on the taxpayer's applicable financial statement (AFS), with certain adjustments set forth in Section 56A(c). The proposed regulations provide additional guidance on adjustments to AFSI, some of which are highlighted below.

AFSI adjustment for non-consolidated domestic corporations (Prop. Regs. 1.56A-18 and 1.56A-19)

Significantly, under the proposed regulations, the AFSI computation of an entity that owns stock in another domestic corporation that is not a member of the CAMT entity's tax consolidated group generally is required to disregard any amounts included in its financial statement income (FSI) that results from holding the stock (e.g., the FSI of the shareholder CAMT entity that results from application of the equity method or fair value method with respect to the stock). However, the proposed regulations provide that a CAMT entity would have to regard amounts that result from certain transactions with respect to the stock (e.g., distributions or sale of stock) and to recognize gains or losses reflected in its FSI that result from the remeasurement (to fair value) of its existing or remaining stock in a domestic corporation when it acquires or disposes of some (but not all) stock in that subsidiary in a covered recognition transaction. Thus, the CAMT entity must include in its AFSI the effect of distributions from the corporation (considering CAMT retained earnings) and of the sale of the corporation's stock (considering CAMT basis).

Observation: The proposed regulations provide that equity earnings and mark-to-market adjustments made with respect to investments in stock of another domestic corporation that is not a member of the CAMT entity's tax consolidated group is generally disregarded for purposes of determining AFSI.

AFSI adjustments for depreciation (Prop. Reg. 1.56A-15)

Under Section 56A(c)(13), taxpayers must generally reduce AFSI for depreciation deductions allowed under Section 167 with respect to Section 168 property and disregard any amount of depreciation expense that is taken into account on the taxpayer's AFS with respect to such property. According to the preamble to the proposed regulations, Treasury and the IRS designed the rules to mimic the regular tax treatment of all Section 168 property to the extent of the timing and amount of regular tax basis recovery with respect to the Section 168 property. As a result, the proposed regulations apply the principle that the application of Section 56A(c)(13) should not provide the CAMT entity with a better result with respect to Section 168 property for AFSI purposes than for regular tax purposes.

The proposed regulations expand on the interim guidance to provide that AFSI adjustments for depreciation apply not only to property 'depreciated' under Section 168, but also to property that is 'depreciable' under Section 168. As a result, depreciation adjustments under the proposed regulations are required for: (1) property not yet placed in service but would be depreciable under Section 168 once placed in service and (2) property eligible for bonus depreciation even if a taxpayer has elected out of bonus depreciation. In addition, the proposed regulations clarify that Section 168 property includes only the portion of the cost that is depreciable property under Sections 167 and 168, and not the portion of the basis that is otherwise deductible under other sections of the Code (e.g., immediate deductions provided by Sections 162 for deductible repairs, 179, 179C, or 181 for qualified films). Finally, consistent with the rule provided by the interim guidance, an AFSI depreciation adjustment is required for property placed in service prior to the effective date of CAMT (that is, prior to January 1, 2023).

Observation: Some of these rules generally are unfavorable to taxpayers. For instance, the exclusion from Section 168 of the portion of basis that is deductible under other sections of the Code is unfavorable because a taxpayer would recover basis pursuant to its book depreciation method for purposes of determining AFSI even though this same basis is generally recovered as a deduction for regular tax purposes. Taxpayers subject to CAMT may consider whether to elect to apply Section 168 instead of claiming deductions under Sections 162 or 181. Similarly, bonus or accelerated depreciation claimed by a taxpayer prior to the effective date of CAMT would not be factored into the taxpayer's AFSI depreciation adjustment, though this approach provides parity with regular tax.

To simplify the computation of the AFSI depreciation adjustment under Section 56A(c)(13), several commentators from capital-intensive industries (e.g., regulated utilities) had requested that the adjustment include repairs expenditures with respect to such property that are deductible for regular tax purposes but that are capitalized and depreciated for AFS purposes. The government declined to adopt these requests, however, and the proposed regulations provide that the AFSI depreciation adjustment under Section 56A(c)(13) does not apply to deductible repair expenditures that are made with respect to Section 168 property, because the repair expenditures would not be depreciable under Section 168. The preamble to the proposed regulations notes that Treasury and the IRS continue to study this issue and encourage taxpayers to submit additional comments.

Observation: While this rule remains unchanged from Notice 2023-7, taxpayers should be aware that if a taxpayer deducts an expenditure as a repair for regular tax purposes but capitalizes it as an improvement for AFS purposes, then depreciation expense that is taken into account on the taxpayer's AFS with respect such property may not be disregarded. Said differently, the corresponding book depreciation amount should not be added back for AFSI purposes.

The proposed regulations provide that depreciation that has been capitalized into inventory is not recovered until the inventory is sold, which aligns the deduction for AFSI purposes with the timing of the income from the sale of the inventory for regular tax purposes. Additionally, special rules determine tax cost of goods sold (COGS) depreciation and covered book COGS depreciation adjustments, as well as simplifying methods for FIFO and LIFO method taxpayers to determine depreciation in ending inventory for purposes of computing the tax COGS depreciation and covered book COGS depreciation adjustments to AFSI.

Observation: Largely unchanged from Notice 2023-64, this rule in the proposed regulations would prevent mismatches where depreciation might be taken into account for tax purposes but is not yet reflected in AFSI if the inventory remains unsold. Under the proposed rules, a CAMT entity is generally required to apply the method(s) of accounting under Section 263A that the CAMT entity uses for regular tax purposes (and, in the case of inventory property, the method(s) of accounting that the CAMT entity uses to identify and value inventories under Sections 471 and 472) to determine the COGS depreciation adjustment. While the proposed rules do not appear to explicitly require proper capitalization of costs under Sections 471 and 263A as under the cost offset method of Reg. 1.451-3, the rules appear to contemplate a consistent application of a CAMT entity’s inventory method of accounting. Lastly, while the simplifying methods are welcome news to many taxpayers, they could present an additional layer of complexity.

The proposed regulations expand the meaning of tax depreciation Section 481(a) adjustment for a change in method of accounting for depreciation for any item of Section 168 property that impacts the timing of when depreciation is taken into account in computing taxable income, including a change in method of accounting from deducting depreciation of Section 168 property to capitalizing such depreciation under Section 263A or another capitalization provision, or vice versa. Under the proposed regulations, AFSI of a CAMT entity would be increased by any positive tax depreciation Section 481(a) adjustment generally over four tax years beginning with the year of change and reduced by any negative adjustment entirely in the year of change.

Observation: The original meaning of tax depreciation Section 481(a) adjustment from Notice 2023-64 appears to be retained but expanded to prevent depreciation of Section 168 property from being duplicated in, or omitted from, AFSI. Moreover, the proposed regulations provide that a tax depreciation Section 481(a) adjustment is taken into account in the same manner that it is taken into account in computing taxable income (generally one tax year if negative and four tax years if positive).

The proposed regulations introduce new terms 'tax capitalization method change' and 'tax capitalization method change AFSI adjustment' for a CAMT entity’s change in method of accounting made for regular tax purposes from deducting a cost as an expense (e.g., repair) to capitalizing and depreciating that cost under Sections 167 and 168, and vice versa. As a result, a CAMT entity would be required (1) to begin or cease making AFSI depreciation adjustments under Section 56A(c)(13) beginning in the year of change to prevent any omission or duplication as a result of a tax capitalization method change, and (2) to make an AFSI depreciation adjustment (increase or decrease) as of the beginning of the year of change for the difference between: (i) the cumulative amount of adjustments made to AFSI with respect to the cost(s) subject to the tax capitalization method change and (ii) the cumulative amount of adjustments to AFSI that would have been made if the new method of accounting had been applied for those tax years. Similar to a tax depreciation Section 481(a) adjustment, a positive tax capitalization method change AFSI adjustment generally would increase AFSI ratably over four tax years beginning with the year of change, while a negative adjustment would reduce AFSI in the year of change by the full amount of the adjustment.

Observation: The proposed rules appear to be a response to a comment requested by the government in Notice 2023-64 regarding depreciation-related AFSI adjustments where the government appears to want a CAMT entity's change in method of accounting to capitalize costs to the basis of Section 168 property (e.g., under Sections 263(a) or 263A) to result in an overall AFSI-neutral outcome to prevent duplications or omissions of AFSI.

The proposed regulations generally retain the same concept of redetermining gain or loss taken into account in a CAMT entity's FSI when it disposes of Section 168 property by requiring use of the CAMT basis instead of the AFS basis, with certain modifications for certain adjustments to decrease CAMT basis upon disposition for amounts allowed as federal tax credits. In addition, for a disposition for regular tax purposes in an intercompany transaction defined in Reg. 1.1502-13(b)(1)(i), the proposed regulations would provide that the AFSI adjustment would be deferred until the tax year in which the FSI of the tax consolidated group includes the selling member's FSI gain or loss.

Observation: The proposed CAMT basis determination rule related to tax credits appears to prevent double benefits of offsetting CAMT liability with the credit and recovering additional CAMT basis equal to the amount of the credit upon the disposition of the property. It is also notable that while the proposed regulations seem to emphasize that federal income tax treatment is generally not relevant for determining AFSI, the proposed disposition rule appears to adopt the single-entity treatment in Reg. 1.1502-13.

AFSI adjustments for certain federal and foreign income taxes (Prop. Reg. 1.56A-8)

For purposes of determining whether a corporation is an applicable corporation, Treasury and the IRS are of the view that AFSI should be determined on a pre-tax basis for all taxpayers, regardless of whether the taxpayer chooses to claim foreign tax credits (FTCs) for the tax year. Accordingly, for purposes of determining whether a corporation is an applicable corporation, the proposed regulations would adjust AFSI to disregard any applicable income taxes that are taken into account in a CAMT entity's AFS.

Applicable income taxes include both federal and foreign income taxes in a CAMT entity's AFS that are recorded as current tax expense (or benefit), as deferred tax expense (or benefit), or through increases or decreases to other AFS accounts of the CAMT entity (e.g., AFS accounts used to account for FSI from investments in other CAMT entities, for Section 168 property, or for other items of income and expense). The proposed regulations define federal income taxes to mean any taxes imposed by subtitle A of the Code and to include amounts allowed as credits against taxes imposed by subtitle A, including credit amounts that are generated by a partnership and passed through to a partner. Foreign income tax is defined to have the meaning provided in Reg. 1.901-2.

If an applicable corporation does not claim an FTC for the tax year and is not eligible to claim a CAMT FTC, the proposed regulations would allow the applicable corporation to reduce its AFSI by the amount of foreign income taxes it deducts for regular tax purposes under Section 164 for the tax year. This deduction is allowed for foreign income taxes, including those paid by disregarded entities and partnerships in which the corporation holds an interest.

Applicable income taxes are considered taken into account in an AFS of a CAMT entity if any journal entry has been recorded in the books and records used to determine an amount in the AFS of the CAMT entity for any year, or in another AFS that includes the CAMT entity, to reflect such taxes. Applicable income taxes are considered taken into account in an AFS of a CAMT entity even if the taxes do not increase or decrease the CAMT entity's FSI at the time of the journal entry. Further, if applicable income taxes are taken into account in a partnership's AFS, they also are considered taken into account in any AFS of the partnership's partners.

Observation: Relief for deductions for foreign income taxes is a welcome provision as the general rule of Section 56A(c)(5) did not apply to foreign taxes on the taxpayer's AFS if the taxpayer did not choose to claim an FTC.

Partnerships

The proposed regulations provide significant guidance on partnership-related CAMT issues, not all of which are summarized here. This guidance generally can be divided into four principal areas: (1) rules for determining a partner's share of partnership AFSI; (2) rules for the determination of a partner's CAMT basis in its partnership interest, which facilitate a partner's determination of AFSI amounts related to sales or exchanges of partnership interests; (3) rules addressing contributions of property to and distributions of property from partnerships: (4) and partnership reporting rules.

Distributive share rules (Prop. Reg. 1.56A-5(c) and (e))

For purposes of determining AFSI, a partner generally takes into account only its 'distributive share' of a partnership's AFSI. The proposed regulations provide that, because AFSI is based on income reported for AFS purposes rather than taxable income, a partner's distributive share of AFSI is based on "the share of the partnership's FSI that the CAMT entity reports on its AFS with respect to such investment rather than on the CAMT entity's allocations of partnership items for regular tax purposes." The proposed regulations take a 'bottom-up' rather than 'top-down' approach to the distributive share determination pursuant to which the partnership calculates its AFSI and allocates it to the partners. In the case of tiered partnerships, the rules make it clear that the lowest partnership in the ownership chain must determine its AFSI before the partnerships above it in the chain make the determination.

The proposed regulations detail six steps that each partner must take to determine its share of a partnership's AFSI. Step one instructs the partner to disregard its FSI amount with respect to its partnership investment for the tax year. In step two, the partner determines its 'distributive share percentage' by dividing the disregarded FSI amount determined in step one by 100% of the partnership's FSI (in the case of a partner accounting for its investment under the equity method or hypothetical liquidation at book value under the equity method) or the total change in the fair value of the partnership's assets for the tax year (as determined by the CAMT entity for purposes of determining the CAMT entity's share of the total change in its AFS in the case where it accounts for its investment under the fair value method). In step three, the partnership calculates its modified AFSI. The partner's share of modified FSI is determined in step four by multiplying the step two percentage by the step three amount. In step five, the partner adjusts modified FSI by separately stated amounts (which include, for example, Section 743(b) adjustments for Section 168 depreciable property and wireless spectrum amortization and GILTI and subpart F amounts) to arrive at its share of partnership AFSI. Finally, in step six, the partner includes its share of partnership AFSI in its AFSI, which may need to be further adjusted under certain circumstances. In the case of tiered partnerships, the six steps must be repeated by each partnership that owns an interest in another partnership, beginning at the bottom of the ownership chain.

Observation: The distributive share rule clarifies that taxpayers accounting for investments in partnerships on a fair value (or mark-to-market) basis only include a share of the partnership's AFSI, and not the change in value, in most circumstances. However, the proposed regulations differ from Notice 2023-64 for situations in which the partnership's AFS is the partnership's federal income tax return (e.g., because the partnership has no other applicable financial statement). Notice 2023-64 indicated the partnership's AFSI would be its taxable income if the tax return was its AFS. However, the proposed regulations require the partner to treat its FSI with respect to the partnership as its distributive share amount. Thus, a CAMT entity using fair value accounting would pick up the unrealized gains and losses included in its FSI with respect to such partnership investment in its AFSI. In that situation, presumably the partnership in which the CAMT entity invested would not need to request any additional information from lower-tier partnerships.

AFSI amounts outside of distributive share of partnership AFSI (Prop. Reg. 1.56A-5(d))

The proposed regulations clarify that the language in the statute instructing a partner to take into account only its distributive share of a partnership's AFSI "does not mean that a CAMT entity may disregard all amounts with respect to a partnership investment that are outside of the 'distributive share amount.'" Thus, the regulations provide rules for calculating AFSI amounts relating to transfers, sales or exchanges, or deconsolidations of partnership investments that are not taken into account under the distributive share rule. In order to adjust FSI amounts from such transactions to arrive at AFSI, the gain or loss determinations must be made using 'CAMT basis.' The proposed regulations provide rules for determining a partner's 'CAMT basis' in a partnership interest. Under the proposed regulations, a CAMT entity's basis in its partnership investment is equal to the CAMT entity's AFS basis in the partnership investment as of the first day of the partnership's first tax year ending after December 31, 2019, in which the CAMT entity held its interest in the partnership. This CAMT basis is then increased by a partner's distributive share of AFSI, reduced by its share of negative AFSI, and increased or decreased to take into account contributions and distributions of property (discussed below).

Observation: The determination of CAMT basis in partnership interests, which will require five years of adjustments (through the end of 2024) will be a significant undertaking for many taxpayers and their advisors. In order to prepare for CAMT calculations with respect to tax years ending in 2024, taxpayers should consider starting the calculation work as soon as practicable.

Treatment of full and partial nonrecognition transactions (Prop. Reg. 1.56A-20)

The proposed regulations contain rules addressing "adjustments to apply certain subchapter K principles" in connection with contributions to and distributions from partnerships. In general, these rules require the CAMT entity, any other partner in the relevant partnership, and the partnership itself to each include in its AFSI any income, expense, gain, or loss reflected in FSI as a result of the contribution to or distribution from the partnership. Rather than adopting subchapter K principles with respect to contributions and distributions, e.g., Section 704(c) and mixing bowl rules, Treasury and IRS adopted a 'deferred sale method' that applies in the case of any deferred gain or loss reflected in the contributor's FSI to which Section 721(a) would otherwise apply. Such deferred amount generally has to be taken into the contributor's AFSI ratably (on a monthly basis) over a period that depends on the type of property contributed. Acceleration rules apply upon the occurrence of certain events. A similar deferred sale rule applies to distributions, requiring the partners to include the partnership's deferred gain as an adjustment to their distributive shares of modified FSI to arrive at their distributive share of partnership AFSI. Like the deferred gain on contribution, this amount is also bled in over time (at different rates depending on the property distributed). For CAMT deferred sale calculations, the proposed regulations generally ignore the Section 752 liability allocation rules; instead, liabilities are taken into account in the manner the partners and partnership treat them for AFS purposes.

Observation: In the case of part-sale-part-contribution transactions, e.g., partial disguised sales of property to a partnership, many practitioners expressed concern around the 'cliff rule' in Notice 2023-7, which would have required a partner to include all of the FSI related to any contribution to a partnership that was not wholly tax free under Section 721(a). The proposed regulations permit partially taxable contributions to be split and the deferred sale method to apply to the nontaxable portion. The Treasury originally introduced the deferred sale method in the proposed Section 704(c) regulations. They replaced it with the remedial allocation method in the final regulations. Here, the Treasury may have adopted the deferred sale method to avoid duplicating all of the Section 704(c) regulations.

Partnership reporting requirements (Prop. Regs. 1.56A-5 and 1.56A-20)

With respect to reporting rules, the proposed regulations require an entity that needs CAMT information from a partnership to request the information from the partnership within 30 days of the close of the partnership tax year. In the case of tiered partnerships, rules require an upper-tier to request information from a lower-tier. The CAMT reporting information must be requested by the upper-tier partnership by the later of the 30th day after the close of the tax year to which the information request relates or 14 days after the date the upper-tier partnership receives an information request from a partner. Once a request for information has been made by a CAMT entity, the partnership is required to provide the CAMT information until it receives notification from the CAMT entity that it no longer needs the information. The rules addressing contributions to and distributions from partnerships have their own reporting requirements, which require the partnership to provide the partners the information they need to comply with the deferred sale approach, including recovery periods used to depreciate deferred sale property and the date of disposition events and acceleration events.

Observation: Although a partnership is only required to report CAMT information if it receives a request from a partner, the partnership reporting requirements are burdensome and will affect any partnership in which a corporation potentially subject to CAMT directly or indirectly owns an interest. Partnerships subject to the requirements will be required to track and report new information, essentially maintaining a fourth set of books and records for CAMT in addition to the financial, tax, and 704(b) books and records. Because CAMT information will be reported to the IRS on form 1065 and Schedule K-1, it will be a Bipartisan Budget Act (BBA) item, and failure to properly report such information may result in penalties. The proposed regulations provide that for the 2023 tax year, a partnership that receives a request for information after the preparation of its Schedules K and K-1 may provide the information to the partner on a separate statement.

International Tax

The proposed regulations provide additional guidance on CAMT issues that impact taxpayers operating in different jurisdictions, some of which are summarized below.

AFSI adjustments and basis determinations with respect to foreign corporations (Prop. Reg. 1.56A-4)

A taxpayer's AFSI for a corporation that is not a member of the taxpayer's tax consolidated group generally only considers dividends and other amounts that are includible in gross income or deductible as a loss (other than inclusions of subpart F income and GILTI). The AFSI of a taxpayer that is a US shareholder of one or more CFCs is adjusted to also include the taxpayer's pro rata share of items taken into account in computing the net income or loss set forth on the AFS of each CFC with respect to which the taxpayer is a US shareholder.

The proposed regulations provide rules for AFSI adjustments that arise solely from a CAMT entity's ownership of stock in a foreign corporation, how CAMT basis should be determined in transactions involving foreign corporations, including 'covered asset transactions,' elections made under Section 338(g), the impact of push-down accounting, adjusting AFSI in certain circumstances when basis in foreign stock received is determined under Section 358, and adjusting modified FSI of a partnership in certain circumstances when the partnership distributes stock of a foreign corporation.

Because regular tax rules apply to both distributions by CFCs and transfers of stock of CFCs, the proposed regulations would require taxpayers to rely on certain regular tax rules for determining both the earnings and profits (E&P) of foreign corporations and the basis of the stock of foreign corporations.

Observation: The preamble explains that ownership of stock of all foreign corporations should be subject to the same rules to avoid the need for, and complexity arising from, rules addressing foreign corporations' transition into and out of CFC status.

AFSI adjustments for ownership of foreign stock (Prop. Reg. 1.56A-4(c))

Consistent with Notice 2024-10, the proposed regulations would require a CAMT entity, in calculating AFSI, to disregard any items of income, expense, gain, and loss resulting from ownership of stock of the foreign corporation, including any items that result from acquiring or transferring such stock, reflected in the CAMT entity's FSI. Income, deductions, and other tax-related items resulting from foreign stock ownership, calculated under regular tax rules (excluding Sections 951, 951A, 250 and 78), are included in AFSI.

Observation: These welcomed provisions are intended to address double-counting issues with respect to distributions by CFCs and transfers of stock of CFCs that could result if a US shareholder includes in AFSI the amount of a dividend received from earnings associated with adjusted net income or loss that the US shareholder also includes in AFSI. The provisions would also address situations where an upper-tier CFC includes in adjusted net income or loss the amount of a dividend received from a lower-tier CFC from earnings associated with adjusted net income or loss that the US shareholder includes in AFSI with respect to the lower-tier CFC.

Any AFSI consequences of a distribution in respect of, or transfer of, stock of a foreign corporation would be determined, as applicable, by reference to the E&P of the foreign corporation for regular tax purposes or the basis in such stock for regular tax purposes. CAMT retained earnings of a domestic corporation would not carry over to a foreign corporation under Section 381(c)(2) because CAMT retained earnings are not relevant in determining AFSI in respect of ownership of stock of foreign corporations.

Observation: The proposed regulations introduce many new defined terms and attributes that taxpayers will need to track including CAMT retained earnings and CAMT current earnings. CAMT current earnings is the AFSI of the corporate CAMT entity for the tax year, with certain prescribed adjustments. CAMT retained earnings is the sum of a CAMT entity's E&P at the beginning of the first tax year of the CAMT entity beginning after December 31, 2019 (even if negative), and the CAMT entity's cumulative amount of CAMT current earnings (taking into account all of the CAMT entity's tax years beginning after December 31, 2019).

CAMT FTC (Prop. Reg. 1.59-4)

The proposed regulations provide guidance for determining the FTC allowed in determining CAMT liability. Under the proposed regulations, an applicable corporation that elects to take an FTC for regular tax purposes would be eligible for a CAMT FTC determined by reference to the eligible taxes paid by the applicable corporation, certain creditable foreign tax expenditures of a partnership allocated to the applicable corporation, and the applicable corporation's pro rata share of taxes of CFCs (limited to an amount generally equal to 15% of the applicable corporation's AFSI adjustment for its aggregate pro rata share of CFC net income or loss). Importantly, in determining the eligible taxes paid by the applicable corporation, the creditable foreign tax expenditures allocated to the applicable corporation, and the applicable corporation's pro rata share of taxes of CFCs, virtually every FTC disallowance, suspension, and limitation applicable for regular tax purposes, other than the limitations under Sections 904 and 960(d), must be taken into account. This includes the disallowances, suspensions, and limitations under Sections 245A(d) and (e), 901(e)-(f) and (i)-(m), 907, 908, 909, 965(g), 999, and 6038(c). This also includes certain limitations that can arise with respect to taxes of CFCs deemed paid under Section 960(a) with respect to subpart F inclusions.

Observation: The proposed limitations on foreign income taxes eligible for the CAMT FTC do not appear in the CAMT statutory framework and represent a marked departure from most taxpayers' and tax practitioners' expectations based on the enacted legislation. Treasury and the IRS have indicated they are of the view that the policies underlying these disallowances and suspensions for regular tax purposes apply equally in the context of the CAMT FTC. Additional consideration may be warranted as to the relevance of those policies in the CAMT context, particularly in light of Congress's decision to legislate specific limitations on the CAMT FTC to the exclusion of incorporating other limitations applicable to the regular tax FTC, the differences between AFSI and taxable income, and the different policy objectives of CAMT and regular tax.

Rules for foreign-parented multinational groups (FPMG) (Prop. Reg. 1.59-3)

The proposed regulations provide guidance for determining whether a corporation is a member of an FPMG, what is an FPMG, what constitutes an FPMG common parent, how a controlling interest is defined, rules on the applicable financial accounting standard used to determine whether an upper-tier entity has a controlling interest in a lower-tier entity, and other new terms.

The proposed regulations would define an FPMG as two or more entities, one of which is the corporation, if: (1) at least one of the entities is a domestic corporation and at least one of the entities is a foreign corporation; (2) the entities are included in the same AFS for that tax year; and (3) one of the entities is an FPMG common parent. An FPMG common parent would be an ultimate parent that is a foreign corporation. An ultimate parent is an entity that has a controlling interest in at least one other entity and no other entity has a controlling interest in the parent. A controlling interest is generally based on the entity's applicable financial accounting standard.

Observation: The proposed regulations broadly expand the scope of an FPMG. Members of groups that include foreign corporations with a non-corporate parent may be brought into the scope of the FPMG rules under the proposed regulations. As a result, the more expansive $1 billion threshold applicable to FPMGs may cause more corporations to come within the scope of CAMT under the proposed regulations than under the statute.

Mergers & Acquisitions

Section 56A(a) generally requires AFSI to be determined based on the taxpayer's AFS which generally implements CAMT by following financial accounting principles rather than regular tax rules except as otherwise provided in the proposed regulations.

Transactions involving domestic corporations (Prop. Regs. 1.56A-18 and 1.56A-19)

The proposed regulations generally provide for different treatment in recognition versus nonrecognition transactions with respect to domestic corporations. For a CAMT entity that is a party to a transaction that results in the recognition of any amount of gain or loss for regular tax purposes (a 'covered recognition transaction'), the CAMT entity applies the relevant financial accounting principles (and not the regular tax rules) to the covered recognition transaction. In contrast, if the CAMT entity qualifies solely for nonrecognition treatment with respect to a transaction (a 'covered nonrecognition transaction') under a relevant Code section, including acquisitive and divisive reorganizations, Section 351 formations, and Section 332 liquidations, the CAMT entity would generally determine its AFSI from the transaction by applying regular tax rules using CAMT inputs (such as CAMT basis and CAMT retained earnings).

Observation: These rules are intended to result in a deferral of AFSI to the CAMT entity in non-recognition transactions by allowing tax rules to govern treatment (including basis and attribute implications but by substituting basis (the 'CAMT basis') and attributes determined under CAMT principles for tax basis and attributes) for wholly covered nonrecognition transactions.

Observation: While a Section 304 transaction in some instance is bifurcated into two steps for tax purposes -- (1) a stock-for-stock transaction qualifying for nonrecognition under Section 351 (a covered nonrecognition transaction for CAMT purposes) and (2) a redemption transaction (usually a distribution and covered recognition transaction for CAMT purposes) -- the proposed regulations provide that the Section 304 transaction is simply a covered recognition transaction on the transfer of stock and AFS rules would prevail for CAMT purposes.

If a transaction results in the recognition of any amount of gain or loss for regular tax purposes, the CAMT entity would apply the relevant financial accounting principles (and not the applicable section of the Code) to the covered recognition transaction (referred to as the 'cliff effect'). However, the cliff effect is inapplicable if all non-stock consideration transferred by the acquiror corporation (i.e., boot) is ’purged’ in a manner that qualifies the target corporation solely for nonrecognition treatment under regular tax rules.

Observation: The 'cliff effect' appears to have potential for creating AFSI in Section 351 transactions with boot, or in divisive D reorganizations where the value of boot or securities issued exceeds the basis of the property transferred. It does not appear to affect acquisitive asset reorganizations, which generally require all boot to be purged and therefore characterizing the exchange between acquiror and target as covered nonrecognition transactions.

Consistent with Notice 2023-7, the determination of whether a transaction qualifies as a covered nonrecognition transaction is made on a party-by-party and component transaction-by-component transaction basis. A component transaction means an element of the transaction the regular tax consequences of which are determined solely with regard to one party. For example, a Section 351 exchange can be a covered nonrecognition transaction with respect to the Section 351 transferee and certain Section 351 transferors and also can be a covered recognition transaction with respect to the Section 351 transferee and other Section 351 transferors.

Consolidated return matters (Prop. Reg. 1.1502-56A)

Consistent with Notice 2023-7, the proposed regulations provide that members of a tax consolidated group are treated as a single CAMT entity for purposes of determining AFSI and CAMT liability.

Consistent with Notice 2023-64, when the consolidated AFS for a tax year includes the items (i.e., income, expense, gain, and loss) solely of members of a tax consolidated group, the group’s FSI for the year equals the FSI on the group’s consolidated AFS for the year. If the consolidated group’s AFS takes into account members that are not part of the tax consolidated group, the group’s FSI for the tax year is determined from the consolidated AFS by treating all members of the group as a single CAMT entity.

Thus, for example, a tax consolidated group’s FSI would be determined by taking into account each AFS consolidation entry that eliminates (i) a transaction between members and (ii) one member’s investment in another member, but not taking into account consolidation entries eliminating (i) a transaction between a member and a non-member, (ii) a member’s investment in a non-member, and (iii) a non-member’s investment in a member. These eliminating AFS consolidation entries would be taken into account only as long as the relevant members continue to be members of the same tax consolidated group at the end of the tax year and if any relevant property continues to be held by the tax consolidated group at the end of the tax year.

CAMT stock basis is adjusted under the proposed regulations to take into account financial accounting adjustments to the AFS basis of subsidiary member stock. The preamble notes that the proposed adjustments generally conform with the stock basis adjustment rules applicable for regular tax purposes under Reg. 1.1502-32.

Observation: These adjustments are necessary as the proposed regulations effectively impose a single level of CAMT on the earnings and operations of a tax consolidated group. To ensure that the same economic income or loss is not duplicated in computing the AFSI of a tax consolidated group, the CAMT basis of subsidiary member stock is adjusted to reflect the member’s income or loss items for purposes of the CAMT.

The proposed regulations provide rules for allocating CAMT liability among members of a tax consolidated group based on the percentage of AFSI attributable to each member for the year. The preamble notes that the allocation rule is based upon, and is intended to operate in a manner consistent with, the allocation rules in Reg. 1.1502-21(b)(2). Similarly, the proposed regulations tentatively provide that rules regarding the use of consolidated financial statement net operating loss (FSNOL) carryovers to offset the AFSI of a tax consolidated group would be based upon, and that are intended to operate in a manner consistent with, the rules in Reg. 1.1502-21(b) relating to CNOLs.

Insurance companies

Much of the guidance for insurance companies in the proposed regulations is found in Prop. Reg. 1.56A-22, which is built on the interim guidance provided in Notice 2023-20, with respect to covered variable contracts, covered reinsurance contracts, and certain fresh start basis adjustments.

AFSI adjustments for covered variable contracts (Prop. Reg. 1.56A-22(c))

The proposed regulations address the treatment of certain insurance contracts, including covered variable contracts, in which the insurance company's obligations to the contract holders and corresponding reserves depend on the value of designated investment assets. The proposed regulations are designed to prevent mismatches in AFSI by ensuring that both the gains or losses on the assets and the corresponding changes in liabilities are taken into account, consistent with the insurance company's FSI.

Observation: Under Notice 2023-20, the approach was to exclude from AFSI the changes in obligations to contract holders to the extent that related gains or losses on supporting assets were excluded from AFSI under the adjustments required by the CAMT rules. The proposed regulations simplify this approach by 'turning off' certain AFSI adjustments for these contracts. Specifically, the proposed regulations explain that Prop. Regs. 1.56A-4, 1.56A-5, and 1.56A-18 through 1.56A-20 would not apply to exclude gains or losses on assets supporting covered variable contracts from AFSI if these gains or losses result in changes in the obligations to contract holders and are included in FSI. This change is designed to streamline administration by eliminating the need for multiple adjustments. The proposed regulations also broaden the application of these rules by defining covered variable contracts more generally.

AFSI adjustments for covered reinsurance agreements (Prop. Reg. 1.56A-22(d))

The proposed regulations also address adjustments for covered reinsurance agreements, which include funds withheld reinsurance and modified coinsurance agreements. In these agreements, the ceding company retains the investment assets supporting the reinsured obligations, creating a payable to the reinsurer. The proposed regulations are designed to prevent mismatches in AFSI by excluding changes in the payable or receivable from AFSI that correspond to unrealized gains or losses in the withheld assets.

Observation: Notice 2023-20 provided interim guidance to address this mismatch by excluding from AFSI any changes in the payable or receivable that corresponded to unrealized gains or losses in withheld assets. The proposed regulations maintain this approach but add clarity and detail. The proposed regulations specify that if a covered insurance company elects to account for the reinsurance agreement at fair value for AFS purposes, or if it accounts for both the payable/receivable and the reinsurance agreement at fair value, then the general exclusion does not apply.

Use of fresh start basis (Prop. Reg. 1.56A-22(e))

The proposed regulations include provisions for using a fresh start basis for certain entities that became fully subject to federal taxation due to legislative changes. This fresh start basis allows these entities to reset the adjusted basis of their assets to fair value as of the date they became fully taxable. Absent relief, the CAMT could apply to an entity solely because the 'fresh start' basis applies only for regular tax purposes but not for purposes of AFS net income.

Observation: Notice 2023-20 provided interim guidance on this issue, stating that these entities should use the adjusted basis rules provided by specific legislative acts. The proposed regulations reiterate this guidance, specifying that entities, like the Federal Home Loan Mortgage Corporation and existing Blue Cross or Blue Shield organizations, for purposes of determining their FSI, should determine the CAMT basis of assets according to the relevant legislative provisions that made them subject to tax and provided for a step-up in basis upon that transition.

Observation: Although the proposed regulations cover a lot of ground, there still are many insurance-specific issues that remain to be addressed. There also are many non-insurance provisions contained in the proposed regulations that could impact insurance companies.

Other provisions

AFSI adjustments for covered benefit plans (Prop. Reg. 1.56A-13)

The proposed regulations provide certain adjustments to AFSI for 'covered benefit plans,' which generally include (i) a defined benefit plan described in Section 401(a) with a trust exempt from tax under Section 501(a) and which is not a multiemployer plan; (ii) a Section 404A qualified foreign plan; or (iii) a plan that under the accounting standards that apply to the AFS is treated as a defined benefit plan that provides post-employment benefits other than pension benefits.

Observation: The proposed regulations address adjustments to AFSI for benefit plans that meet very specific requirements, which may include domestic or foreign broad-based employee plans. Taxpayers will need to determine which, if any, such plans are subject to these adjustments as well as the amounts, income, or deductions that are required to be disregarded, increased, or reduced, respectively in connection with the plan.

AFSI adjustments for hedging transactions and hedged items (Prop. Reg. 1.56A-24)

The proposed regulations provide certain adjustments to AFSI for an AFSI hedge or the related item. An 'AFSI hedge' generally includes transactions that qualify as hedging transactions under a variety of tax hedging regimes (such as Section 1221(b) and Section 988(d)) for regular tax purposes, hedging transactions for financial accounting purposes, and hedging transactions that qualify as both, subject to certain exclusions. The rules also define a 'hedged item' and a 'fair value measurement adjustment.' The latter of these generally refers to any mark (for financial statement purposes) of either a hedging contract or the hedged item that affects the FSI. The proposed regulations contain general rules for modifying AFSI, dependent on whether the AFSI hedge, the hedged item or both are subject to fair value measurement adjustments. The rules also include specific rules for net investment hedges and several examples to illustrate the application of these rules.

Observation: The application of the proposed regulations depends on understanding both the regular tax and financial statement presentation of both the hedge and the hedged items. Companies with derivatives and hedging transactions should review the proposed regulations to assess the impact on their specific fact patterns.

Difference in AFS year and tax year (Prop. Reg. 1.56A-3)

The proposed regulations provide rules under Section 56A(c)(1) for adjustments that are made to AFSI if a CAMT entity’s AFS covers a period other than the tax year. The rules would require the CAMT entity to compute FSI and AFSI as if the financial reporting period were the same as the tax year by applying an 'interim closing of the books' method based on the accounting standards that the CAMT entity uses to prepare the AFS.

Observation: The proposed rules appear to mirror the provision in Reg. 1.451-3(h)(4)(i)(A) in computing AFS revenue for the tax year when the AFS covers mismatched reportable periods.

Potential transition rules to implement final regulations

The preamble states that Treasury and the IRS are considering three different transition rules that may apply under the final regulations:

- Transition-year adjustment approach. A CAMT entity would be required to redetermine the cumulative amount of AFSI as of the beginning of the transition year, and redetermine any relevant CAMT attribute, as if the entity had first applied the rules in the final regulations in its first tax year beginning after December 31, 2019.

- Cut-off transition approach. The transition to the final regulations for certain AFSI adjustments and CAMT attributes would be implemented on a cut-off basis, similar to the approach set forth in Section 2.07 of Rev. Proc. 2015-13.

- Fresh-start transition approach. The transition to the final regulations for certain rules would be implemented using a fresh start transition approach with the relevant CAMT attribute redetermined as of the beginning of the transition year, as if the entity had first applied the rules in the final regulations in its first tax year beginning after December 31, 2019 (that is, no transition year adjustment to AFSI as of the beginning of the transition year).

Observation: The preamble notes that the government welcomes comments on these transition approaches, so taxpayers should consider providing input as to how the government can administer this process to encourage compliance with the final regulations.

Potential consent procedures for making AFSI-only changes

The preamble also indicates that for tax years beginning after the transition year, Treasury and the IRS are considering rules and procedures to address a change in the treatment of an item for AFSI purposes under the final regulations that involves either determining the proper time or amount of the item to prevent duplications or omissions of amounts in AFSI (AFSI-only change). According to the preamble, an AFSI-only change generally would include a change to begin making an AFSI adjustment, a change to properly determine the amount of an AFSI adjustment, or a change to take the AFSI adjustment into account in the appropriate tax year (e.g., adjustments related to a partner's distributive share of a partnership's AFSI, adjustments with respect to depreciation of Section 168 property, etc.).

Observation: The government appears to be considering various approaches to administer this process (e.g., advance consent similar to those required under Section 446(e) and Rev. Proc. 2015-13, automatic consent, streamlined procedures, availability of audit protection, spread periods, etc.). While it is too early to contemplate how the government will administer this AFSI-only change process, current and potential CAMT entities should consider submitting comments that can result in administrable procedural rules that encourage voluntary compliance with the final regulations.

See also

- **Policy on Demand:** International tax focus on new CAMT regulations (September 17, 2024)
- **Policy on Demand:** Latest on election numbers and the new CAMT regulations (September 16, 2024) *(discussion on CAMT regulations starts at 2:24)*
- **Insight:** Proposed guidance addresses broad range of CAMT issues (September 12, 2024)
- Accounting Methods Spotlight Q2 2024 (June 27, 2024)
- **Insight:** IRS releases CAMT guidance for certain CFC distributions and additional rules for determining an AFS (December 15, 2023)
- **Insight:** Notice 2023-64 provides interim CAMT guidance on key issues (September 12, 2023)
- **Insight:** IRS addresses key insurance issues under the corporate alternative minimum tax (February 22, 2023)
- **Insight:** Interim guidance clarifies certain key issues under new corporate AMT (January 6, 2023)

Let's talk

For a deeper discussion of how the CAMT proposed regulations might affect your business, please contact one of the PwC professionals listed below:

Federal Tax Services

Christine Turgeon
(973) 202-6615
christine.turgeon@pwc.com

George Manousos
(202) 302-0942
george.manousos@pwc.com

Jason Black
(954) 895-8200
jason.m.black@pwc.com

Tax Policy Services

Rohit Kumar
(202) 841-8300
rohit.kumar@pwc.com

Pat Brown
(203) 550-5783
pat.brown@pwc.com

Janice Mays
(202) 603-0641
janice.a.mays@pwc.com

International Tax Services

Nita Asher
(202) 870-2462
nita.asher@pwc.com

Aaron Junge
(202) 739-1053
aaron.junge@pwc.com

Wade Sutton
(202) 657-7461
wade.sutton@pwc.com

Mergers & Acquisitions—Sub C

Olivia Orobona
(202) 549-5127
olivia.ley.orobona@pwc.com

Matt Lamorena
(202) 215-6478
matthew.lamorena@pwc.com

Horacio Sobol
(202) 281-8514
horacio.sobol@pwc.com

Mergers & Acquisitions—Sub K

Mike Hauswirth
(202) 213-2729
michael.j.hauswirth@pwc.com

Robert Honigman
(301) 351-2867
robert.honigman@pwc.com

Jennifer Wyatt
(312) 953-5599
jennifer.a.wyatt@pwc.com

Insurance Tax Services

Matthew Lodes
(314) 724-7117
matthew.j.lodes@pwc.com

Surjya Mitra
(703) 855-9357
surjya.mitra@pwc.com

Financial Products

Rebecca Lee
(202) 280-5721
rebecca.e.lee@pwc.com

Laura Valestin
(262) 893-5146
laura.valestin@pwc.com

Compensation and Benefits Tax

Veena Murthy
(202) 579-8829
veena.k.murthy@pwc.com