

IRS releases proposed regulations on the corporate alternative minimum tax

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On September 12, 2024, the U.S. Treasury Department and the Internal Revenue Service released proposed regulations addressing the application of the corporate alternative minimum tax that was enacted as part of the Inflation Reduction Act of 2022. This update highlights certain considerations that are relevant when structuring and executing transformative corporate transactions and restructurings, setting up partnership structures, and taking advantage of certain tax credits.

Background

On September 12, 2024, the U.S. Treasury Department (Treasury) and the Internal Revenue Service (IRS) released proposed regulations (the [Proposed Regulations](#)) addressing the application of the corporate alternative minimum tax (CAMT) that was enacted as part of the Inflation Reduction Act of 2022. The Proposed Regulations took over two years to complete. CAMT generally imposes a 15% minimum tax on the adjusted financial statement income (AFSI) of the very largest corporate taxpayers – those with over \$1 billion of AFSI for three consecutive years. We described the statute and some of the prior guidance in earlier client updates that can be accessed [here](#) and [here](#).

Our federal corporate income tax system is premised on the notion that taxes should be levied on income, and in the case of gains, generally only upon realization. In defining the income tax base, our tax system begins with a broad definition of income, and applies various adjustments to accommodate specific policy goals or other notions of fairness. Measurement of income is consistent from year to year, and from taxpayer to taxpayer, for example by requiring taxpayers to track the basis in their assets so that gain not realized in one year can be recognized into income in a later year, and by giving cost basis in an asset to an acquirer when another taxpayer recognizes economic income on a transfer of that asset.

By contrast, financial statements prepared under U.S. GAAP (or another relevant accounting standard) serve an entirely different purpose – to fairly present to shareholders and various other stakeholders the financial health of a reporting group as a snapshot based on the reporting period. In contrast to the tax system's approach to measuring income, accounting standards are not wedded to the concept of realization, instead reflecting reasonable assumptions about future events, nor do they require the same sort of reporting consistency year over year or across different taxpayers. In enacting the CAMT, Congress stipulated that the CAMT tax base would begin with financial statement income and make various adjustments to incorporate some (but not all) regular tax principles.

By incorporating regular tax principles into CAMT, Congress set on a collision course two fundamentally different approaches to measuring income, and raised the possibility of a third regime for measuring income that would represent a hybrid between these two approaches. Congress left to Treasury (with little principled guidance) difficult decisions about just how comprehensive that hybrid regime would need to be, and included only a limited set of mandatory statutory adjustments to financial statement income. Treasury has since been grappling with the unenviable task of making sense of the statute and designing this new hybrid regime.

Over the past couple years since the statute was enacted, Treasury has issued various pieces of interim guidance, and now the Proposed Regulations represent Treasury's first piece of comprehensive guidance under the statute. This guidance involves an even more significant departure from financial statement income than was expressly contemplated

by Congress or even by Treasury in its prior guidance. The package is long, intricate and complex because it essentially creates a completely separate CAMT tax regime (touching or modifying nearly every part of the Code) that will not only require taxpayers to calculate their CAMT income and loss, but also to track from one year to the next (and, in some cases, one taxpayer to the next) various CAMT-specific items, like CAMT basis and CAMT retained earnings, which are not ordinarily tracked for financial reporting purposes. One feature of the new regime is that it toggles, depending on the circumstances, between basing a particular measurement of CAMT income on financial statement items (i.e., basis, earnings, income), regular tax items, or a newly-created set of CAMT items. As a result, this entirely new regime will undoubtedly impose on taxpayers significant administrative and compliance burdens, as it has departed very significantly from both financial statement income and regular tax income principles.

In this client update, we highlight certain considerations that will be relevant when structuring and executing transformative corporate transactions and restructurings, setting up partnership structures, and taking advantage of certain tax credits.

Corporate reorganizations and acquisitions

When structuring and effecting M&A transactions, taxpayers that are large enough to be subject to CAMT must take into account both the CAMT consequences of any anticipated transaction, as well as the regular tax consequences. The Proposed Regulations contain a detailed and intricate set of rules to determine the CAMT consequences of corporate transactions, which can vary quite dramatically depending on the specific structure of, and identity of the parties to, the transaction. We describe below certain features of the Proposed Regulations to which taxpayers and their advisors should pay particular attention because they could pose pitfalls when unheeded, but could potentially allow for planning opportunities when properly understood.

Specific principles apply to certain transactions involving foreign corporations, and they differ from how transactions involving domestic corporations are treated. More specifically, the Proposed Regulations define two categories of “Covered Asset Transactions”: the first category includes certain distributions, liquidations, Section 351 transactions, tax-free reorganizations and spin-offs that involve transfers of assets by or to a foreign corporation, while the second category includes similar types of transactions involving transfers of foreign stock to or by a domestic corporation.

The Proposed Regulations provide specific rules for determining AFSI and CAMT basis consequences of Covered Asset Transactions, sometimes tracking the regular tax system and sometimes making various adjustments. For example, in determining the AFSI consequences of a transfer of assets other than stock of a foreign corporation in a Covered Asset Transaction, financial accounting income and loss items are ignored and, instead, the corresponding regular tax items are taken into account, except that these items are recomputed using CAMT basis, rather than regular tax basis. In addition, purchase accounting and push down accounting rules are generally switched off for purchases of foreign corporate stock.

The Proposed Regulations provide a different set of rules for determining the CAMT consequences of specified transactions between domestic corporate “CAMT entities” (defined to include all regarded entities, including pass-through entities) and individuals or other CAMT entities (including a CAMT entity that is a shareholder of a domestic corporate CAMT entity).

The Proposed Regulations articulate the general principle that AFSI resulting from these corporate transactions is determined according to financial accounting principles, unless otherwise specified in the Proposed Regulations. One exception provides that if a CAMT entity is a shareholder in a domestic corporation, and its role in a transaction is purely as a shareholder (and not as a party to the transaction), the CAMT entity will determine its AFSI under the regular tax rules, using CAMT inputs (like CAMT retained earnings and CAMT basis), rather than regular tax inputs. Examples of these types of transactions include dividend distributions, redemptions, stock distributions, and certain distributions and exchanges that are part of a reorganization transaction (and governed by Section 354 or 356).

This rule does not apply, however, if the CAMT entity is a party to a transaction involving a domestic corporation (like a Section 351 transaction, a disposition or an acquisition, or a transfer to a SpinCo in a Section 355 / D reorganization transaction). The CAMT consequences of these corporate transactions are determined under financial accounting principles (using CAMT inputs, such as CAMT retained earnings), *unless* the transaction qualifies solely for nonrecognition of gain and loss under the regular tax rules, in which case the CAMT consequences are determined by applying the regular tax rules (also with CAMT inputs). Apparently, a single dollar of gain recognition can make the difference between using financial accounting principles versus regular tax principles – a phenomenon the Proposed Regulations refer to as the “cliff effect.”

The Proposed Regulations also switch off purchase accounting and push down accounting for acquisitions of domestic corporate stock that might otherwise have applied in a taxpayer’s financial statements. In addition, they provide specific

rules to apply to various other specified categories of transactions, sometimes using financial accounting inputs and principles, and sometimes regular tax inputs and principles.

In light of these intricate and heavily fact dependent rules for determining the CAMT consequences of corporate transactions, it will be especially important for taxpayers and their advisors to carefully analyze proposed transactions to plan for the CAMT consequences – both to identify potential pitfalls and planning opportunities and simply to be able to fulfill their compliance obligations by accurately tracking their CAMT items. Taxpayers must pay careful attention to preparatory steps, even those that do not typically have regular tax consequences, as these may have (somewhat unexpected) CAMT consequences. These issues should be addressed early in the process of any M&A transaction, as tax due diligence is being completed and the transaction documents are being negotiated, as post-closing information sharing provisions may need to be incorporated.

In light of the “cliff effect” described above, taxpayers engaging in transactions qualifying for tax-free status under the regular tax rules must pay careful attention to whether “boot” is paid (or could be deemed to be paid) in a reorganization, or whether boot is entirely “purged” in a Section 355 transaction involving a D reorganization, as the CAMT consequences of these transactions could diverge quite significantly from both the financial accounting consequences and the regular tax consequences. One rather curious example of this is in an otherwise mundane fully tax-free transaction that includes fractional shares that are cashed out as part of the exchange.

As described above, the CAMT consequences of a transaction often turn on (but do not necessarily track) the regular tax consequences of the transaction, and can be very sensitive to certain details (like whether any boot is paid) that are not necessarily as significant to the regular tax treatment. For this reason, taxpayers seeking ruling requests regarding the regular tax consequences of a transaction should consider whether additional rulings would be advisable to determine CAMT consequences. Notably, the IRS and Treasury have recently announced substantial changes to the IRS’s practice of issuing private letter rulings for spin-offs,¹ which have introduced uncertainty around the availability of tax-free treatment for certain spin-offs, particularly those involving liability management transactions (including debt-for-debt and debt-for-equity exchanges). This uncertainty may prove especially troubling for CAMT taxpayers grappling with both the regular tax and CAMT consequences of their proposed spin-off.

Partnerships

Taxpayers that are large enough to be subject to CAMT and that are members of partnerships, or that are considering making investments in partnerships, need to consider the rules in the Proposed Regulations carefully in connection with their investments. Treasury adopted an entirely new approach in the Proposed Regulations, both with respect to allocations of income from the partnerships and transactions with the partnership, and this approach bears little resemblance to either the financial statement income of the CAMT entity *or* the entity’s taxable income under regular tax rules.

The allocation rules specifically might produce results that are unexpected, particularly as they relate to partnerships with complicated income allocation provisions. The Proposed Regulations look to the partnership’s income in the aggregate, and apply a fixed percentage of that income to the CAMT entity partner based in part on the method the partner uses on its financial statements to report its partnership investment. Accordingly, partnerships that issue tracking interests, and partnerships with “targeted” allocations, catch-up provisions, or complicated waterfalls, may trigger significantly different CAMT results for their partners as compared to regular tax treatment. Because the CAMT allocation rules apply to partnership income in the aggregate, the newly proposed rules could create significant disparities in income reporting for investors in partnerships that currently allocate income for tax purposes on an item-specific basis. For example, tax equity investments in renewable energy projects frequently allocate different items during a taxable year in different proportions. An aggregate approach would override those arrangements for purposes of the CAMT.

Moreover, CAMT entities considering making investments in, or taking distributions from, partnerships may be surprised to discover that the Proposed Regulations do not adopt the nonrecognition rules of subchapter K to report these transactions, nor do they follow the taxpayer’s financial statement income. Instead, the Proposed Regulations introduce something entirely new: those transactions are treated as “deferred sales” and “deferred distributions” under which the gain or loss of the partnership and the partners are included in income *ratably* over a recovery period (which differs depending on the types of assets, but could measure 15 years or more in some cases). Common investment structures that are made through partnerships, mixing bowls, joint ventures, internal reorganization transactions, and other investment structures that previously relied on a complete tax deferral (or included partnerships as one element of an overall plan) could be significantly impacted by these modified deferral rules.

Finally, the Proposed Regulations add a significant new compliance burden and presumption onto partnerships with partners that are subject to CAMT, including to comply with tax audits at the partnership level. In order to properly track

the consequences of these investments, the Proposed Regulations require the CAMT entity partner to proactively request information from its investment partnerships within 30 days of the close of a tax year (and once the request is made for one year, the partnership must provide information for that year and every year thereafter), backstopped by a penalty regime. If information is not provided, the partner must make a good faith effort to determine its own consequences.

Restructuring

The Proposed Regulations applicable to restructuring transactions add new factors for a distressed company to consider in restructuring its operations. These factors may move the needle and add time and complexity to the process of making key restructuring decisions, including whether it makes sense to incur the costs of restructuring in-court versus out-of-court, and whether the distressed company should pursue a restructuring that triggers a tax basis-step up (commonly known as a Bruno's structure). The tax costs and benefits of these options now must take into account the CAMT overlay, which could lead to entirely different results.

On in-court vs. out-of-court, the Proposed Regulations follow the same approach as regular tax law in providing a complete exemption for cancellation of indebtedness income for in-court restructurings, but only a partial exemption for out-of-court restructurings based on the "insolvency" amount of the company. The insolvency rule adopted by the Proposed Regulations creates a hybrid approach to that calculation, relying on financial statement income to determine the amount of debt discharge, but looking to tax concepts to measure insolvency. As a result, depending on the timing of debt discharge recognition under financial statement rules, a company may recognize significantly higher CAMT debt discharge income than it does taxable income, or may have only a partial exemption for CAMT income inclusion even if it has a complete exemption from taxable income. As one bright spot, the Proposed Regulations adopt a new blanket exemption for debt discharge income incurred in connection with a covered nonrecognition transaction. However, see discussions in part B above regarding the "cliff effect" of boot that could turn off nonrecognition treatment for CAMT purposes.

The Proposed Regulations adopt attribute reduction rules in the case of debt discharges that are meant to follow corresponding general tax principles. They include some modifications intended to prevent the two sets of rules from generating significantly disproportionate outcomes with respect to their impact on the basis of assets that, for other CAMT purposes, is supposed to be the same as tax basis.

Regarding emergence structures, the "fresh start" rules adopted by the Proposed Regulations only provide partial relief. One notable exception to the "fresh start" principle is that an entity experiencing a change in ownership as a result of a restructuring does not automatically lose its status as an applicable corporation. Instead, such a corporation still needs to apply the normal status termination rules whereby, if the corporation is the parent of its group, it can only shed its applicable corporation status if its AFSI does not exceed the \$1 billion three-year threshold for five consecutive taxable years (generally lowered to three years if the corporation is not the parent and leaves its former group). It is not entirely clear, however, how this rule could apply if a new entity acquires all of the distressed entity's assets in a Bruno's transaction.

Restructuring transactions continue to raise potential timing and double-counting issues between CAMT and regular tax rules. These issues could arise, notably, in circumstances where financial statement deductions occur in earlier years than tax deductions, because while the Code creates a tax attribute carryforward in years where CAMT exceeds regular tax liability (for use to reduce regular tax liability in future years), they do not provide the reverse if regular tax liability exceeds CAMT in earlier years. Accordingly, CAMT deductions which arise in earlier years than tax deductions could result in double taxation of the same economic item. This can also occur in circumstances post-reorganization, if for example a CAMT net operating loss or deduction is not subject to limitation but the corresponding tax item is (including under Section 382).

Manufacturing and energy tax credits

CAMT treatment of advanced manufacturing and energy tax credits under the Proposed Regulations generally follow their regular tax treatment. The tax credits granted under the CHIPS and Science Act and the Inflation Reduction Act are disregarded for purposes of determining AFSI when it is applied against taxes owed, including amounts treated as tax-exempt income. Consistent with the direct payment of energy tax credits, the amounts a seller receives from the transfer of tax credits are disregarded for purposes of determining AFSI. Additionally, buyers will not recognize any amount of applicable tax credits claimed against taxes for purposes of determining AFSI. To the extent tax credits are recaptured, AFSI is generally adjusted to include income from such recaptured tax credits (including income generated through an indemnity or insurance).

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¹ See Notice 2024-38; Revenue Procedure 2024-24.