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KPMG report: Initial impressions of corporate alternative minimum tax provision in draft Senate reconciliation bill

Update: The provisions described below were substantially modified during Senate consideration and passage of the reconciliation bill on August 7, 2022. A future KPMG report will describe these changes.

As previously reported, Senator Joe Manchin (D-WV) on July 27, 2022, announced that he had reached an agreement with Senate Majority Leader Chuck Schumer (D-NY) on tax, climate change, energy, and health care provisions to be included in the *Inflation Reduction Act of 2022* (the Senate bill), currently in draft form.

The draft Senate bill proposes a new 15% corporate alternative minimum tax (Corporate AMT) on the "adjusted financial statement income" (AFSI) of certain large corporations (very generally, and described in greater detail below, corporations reporting at least $1 billion average adjusted pre-tax net income on their consolidated financial statements), for tax years beginning after December 31, 2022.

Versions of this Corporate AMT proposal were included in both the "Build Back Better Act" (BBBA) bill that passed the House on November 19, 2021 (the "House BBBA") and revised updated legislative text Senate Finance Committee Chairman Ron Wyden (D-OR) released relating to the BBBA on December 11, 2021 (the "SFC BBBA Draft"). The current draft Senate bill Corporate AMT proposal is almost identical to the version included in the SFC BBBA Draft. Read the **KPMG report on the House-passed version of the BBBA** [PDF 2.4 MB] and read ***TaxNewsFlash*** for a discussion of the Senate Finance Committee's prior BBBA legislative text (December 2021).

This report provides high-level, preliminary observations regarding the Corporate AMT proposal based on the draft legislative text of the Senate bill released on July 27, 2022. **Keep in mind that legislative text could be modified during the legislative process and that the ultimate outcome of the legislative process is inherently uncertain.**

Read ***TaxNewsFlash*** for more detail and a link to the draft legislative text.

KPMG observation

The proposed Corporate AMT would apply only to certain large corporations that have, or are part of certain related groups that have, considerable financial statement income. The Congressional Research Service (CRS), in a report released August 1, 2022, suggests that "[r]elatively few corporations would be affected by the tax." The CRS report states, based on an analysis by the Joint Committee of Taxation, that about 150 taxpayers would be subject to the Corporate AMT each year. The report also indicates that the Corporate AMT would raise an additional $313 billion in corporate revenue over the 10-year budget window, about half of which would be collected from manufacturing businesses. The CRS report's projected revenue estimate is consistent with an estimate released by the Congressional Budget Office (CBO) on August 3, 2022, and is nearly identical to the projected revenue estimate for the Corporate AMT proposal that was contained in the House BBBA.

Under the proposal, taxpayers could owe Corporate AMT whenever they have significant permanent or temporary book-tax differences that cause book income to exceed taxable income in a given year. These differences could arise from, among other things:

- Excess tax benefits with respect to share-based payments, including stock options
- Accelerated tax depreciation and depletion
- Accrued liabilities
- Acquired deductible temporary differences and net operating losses (NOLs), notwithstanding regulatory authority to address corporate reorganizations

Although timing differences generally would reverse so that the indefinite Corporate AMT credit carryforward could help to ameliorate their impact over time, there are a number of circumstances when this may not be the case, including, for example, when due to the ordering of when an item is recognized for book and tax purposes, the existence of an AMT credit carryforward is less useful than would be the case for an AMT credit carryback. This would be the case, for example, when a taxpayer recognizes an expense for a significant nonrecurring item, such as a new lawsuit or industrial accident, for book purposes for a liability that becomes deductible in a subsequent year. Another reason that timing differences may be converted to permanent differences is the lack of transition rules to account, for example, for deferred tax assets that exist on transition for expenses that have been recognized prior to the effective date for book purposes but that are not yet deductible for tax purposes. An extreme version of this latter issue exists for pre-2020 NOLs, for which the proposal includes no transition relief.

Finally, foreign-derived intangible income (FDII), by itself, could cause a taxpayer to owe corporate AMT. Even if FDII alone would not cause a taxpayer to owe corporate AMT (which is the more likely scenario for the vast majority of taxpayers), the FDII deduction could help to bring a taxpayer closer to the 15% rate such that, in combination with other items discussed above, a taxpayer could find itself owing Corporate AMT.

The draft Senate bill would provide significant regulatory authority with respect to certain aspects of the Corporate AMT. Thus, in many respects the operation of the Corporate AMT would depend on Treasury's decisions in implementing the regime.

The 2017 tax legislation commonly known as the "Tax Cut and Jobs Act" (TCJA) repealed the prior corporate alternative minimum tax (Former AMT) for tax years beginning after December 31, 2017. The proposed new Corporate AMT tax base calculation would use financial statement income as its starting point—a major distinction from the Former AMT. However, in other ways, the Corporate AMT would operate similarly to the Former AMT. For example, like the Former AMT, the Corporate AMT would be based on the excess of "tentative minimum tax" over regular tax, and payment of the Corporate AMT would give rise to a tax credit that could be used against regular tax in excess of tentative minimum tax in future years. Thus, as with the Former AMT, at least conceptually the Corporate AMT can be thought of as requiring certain taxpayers to prepay their regular tax but not as increasing cumulative federal income tax liability.

As noted above, the Corporate AMT proposal in the Senate bill resembles prior proposals in the House BBBA and the SFC BBBA Draft. However, both the House BBBA and the SFC BBBA Draft also included numerous additional proposed tax changes that are not currently part of the Senate bill. As such, the Senate bill would have to be corrected for cross-references (for example, to section 163(n)) that depended on other changes absent from the current Senate bill. Furthermore, the House BBBA and the SFC BBBA Draft would have made changes to the aggregation rules in section 52 that are not included in the current Senate bill. The presence or absence of modifications to such aggregation rules in any enacted legislation may affect the scope of the Corporate AMT's application.

A U.S. income tax based on the book income of corporations is not a new idea, and similar proposals have been made from time to time. A version of such a tax was in place from 1987-1989, as a positive AMT preference item in the Former AMT regime. The 1986 Tax Reform Act had imposed a requirement that the AMT income for corporate taxpayers be adjusted by certain "book income adjustments." In particular, AMT income for corporate taxpayers generally was increased by 50% of the amount by which the corporation's adjusted net book income exceeded its AMT income for the tax year. A compromise in the 1986 conference agreement made the adjustment applicable only to tax years beginning in 1987, 1988, and 1989, and supplanted it with the "adjusted current earnings" (or "ACE") adjustment for tax years beginning after 1989. This tax was heavily criticized, including by Treasury officials, as having "a detrimental effect on the quality of financial reporting," being a "one-way street," and overtaxing firms (due to timing differences and because the adjustment only could be positive adjustment).

Taxpayers potentially subject to the Corporate AMT

Applicable corporation—in general

The proposed Corporate AMT would apply to an "applicable corporation"—any corporation, other than an S corporation, regulated investment company, or real estate investment trust that meets the "average annual adjusted financial statement income test" (Income Test) in one or more tax years ending after December 31, 2021, but prior to the tax year at issue (e.g., if a corporation first met the Income Test in its 2022 tax year, it would be an applicable corporation beginning in its 2023 tax year).

KPMG observation

The "applicable corporation" definition in proposed section 59(k) does not, by its terms, limit the scope of such term only to companies that owe U.S. tax (i.e., domestic corporations and foreign corporations with U.S. ECI). However, the mechanics of the proposed Corporate AMT seem to achieve this result. Specifically, as described below, an applicable corporation's tentative minimum tax would be limited to the excess of: (1) 15% of the applicable corporation's adjusted financial statement income (AFSI) (as determined under proposed section 56A for the tax year; over (2) the Corporate AMT foreign tax credit for the tax year.

As discussed in greater detail below, a foreign corporation's AFSI only includes its adjusted book profits that relate to U.S. ECI. As such, a foreign corporation without U.S. ECI would not appear to be subject to the Corporate AMT proposal.

In general, the Income Test would be met for a tax year if the average annual AFSI of a corporation in the three tax years ending with the tax year at issue exceeds $1 billion (subject to certain adjustments for newly formed corporations, predecessor corporations, and short tax years).

Solely for purposes of the Income Test, aggregation rules would apply to determine a corporation's three-year average AFSI. Specifically, for purposes of the Income Test a corporation's AFSI includes the AFSI of all persons treated as a single employer with that corporation under section 52(a) and (b). In general, section 52(a) provides for aggregation of a controlled group of corporations meeting a more than 50% common ownership standard under section 1563(a). Section 52(b) provides a similar rule for corporate and non-corporate organizations (partnerships, trusts, estates, and sole proprietorships) conducting trades or businesses. Generally, these aggregation rules would apply (with some exceptions for U.S.-parented groups with less-than-wholly-owned foreign affiliates) to count all of the adjusted book profits of domestic and foreign entities connected through greater than 50% ownership towards the $1 billion AFSI threshold test.

If the corporation is a member of a foreign-parented international financial reporting group (IFRG), the $1 billion AFSI threshold requirement (subject to certain very subtle and often immaterial modifications) would be supplemented by a special $100 million AFSI test that would only take into account the group's U.S.-related AFSI (i.e., U.S. ECI-related adjusted book profits of foreign corporations and AFSI of domestic corporations, including CFC income) (together, the "foreign-parented IFRG" rule). The additional $100 million test for U.S.-related AFSI would apply based on the same average three-year period rule as applies to the $1 billion test.

The definition of an IFRG cross-references proposed section 163(n), which, as noted above, is absent from the Senate bill. Proposed section 163(n)(3), as included in the House BBBA and SFC BBBA Draft, would provide that an IFRG means two or more entities included in the same "applicable financial statement" (described below) with respect to the same tax year if either: (1) at least one entity is a foreign corporation with U.S. ECI; or (2) one entity is a domestic entity and another entity is foreign. Presumably, the Senate bill text would be updated to directly define an IFRG, incorporating the same definition that was provided in proposed section 163(n) of the House BBBA and the SFC BBBA Draft.

KPMG observation

Generally, the foreign-parented IFRG rule would preclude the Corporate AMT proposal from applying to certain foreign-parented groups that have substantial aggregate adjusted book income but relatively small (i.e., less than $100 million) U.S.-related adjusted book income.

For example, assume that Foreign Parent (FP) is a corporation that wholly-owns two corporate subsidiaries—U.S. Sub (USS) and Foreign Sub (FS)—all members of the same IFRG. Further assume that the combined average annual adjusted book profits of FP and FS are equal to $1 billion and USS's average annual AFSI (including CFC income) is $50 million for the applicable testing period. If none of the average annual adjusted book profits of FP and FS relates to U.S. ECI, then USS would not be considered an applicable corporation under the foreign-parented IFRG rule. While the foreign-parented multinational group would satisfy the more than $1 billion average annual AFSI requirement, only USS's $50 million AFSI would count for purposes of applying the special $100 million U.S.-related AFSI requirement.

Once a corporation satisfies the Income Test in any tax year ending after December 31, 2021, the corporation generally would continue to be an applicable corporation even if its income subsequently declines. The Senate bill does provide that a corporation that previously met the requirements under the Income Test would no longer be considered an applicable corporation if: (1) either (a) there is a change in ownership with respect to such corporation or (b) there is a consistent reduction in AFSI below the relevant threshold; and (2) the Secretary determines it would not be appropriate to continue to treat the corporation as an applicable corporation.

KPMG observation

The exception to applicable corporation status for a corporation that has previously met the Income Test appears to require some form of affirmative guidance from Treasury; it is unclear whether the guidance would be categorical (such as a revenue procedure) or individualized (such as a determination letter or private ruling letter). The proposal does not, however, indicate what factors should be considered in determining whether it is appropriate to continue to treat a corporation as an applicable corporation.

The proposed Senate bill does not define the term "change in ownership" for this purpose. Existing section 382 provides a complex regime to determine when a corporation experiences an "ownership change," but the Senate bill does not cross-reference section 382.

The Income Test and AFSI

The Income Test would be based on the corporation's AFSI for each tax year in the testing period. A corporation's AFSI calculation would generally start with the net income or loss reported on its "applicable financial statement" (AFS). A corporation's AFS would be defined (subject to modification by Treasury) by reference to section 451(b)(3) and would generally include GAAP, IFRS, or other financial statements used for reporting to a governmental agency such as the SEC or a foreign equivalent. Further, if a corporation's financial results are reported on an AFS for a group of entities, such statement would be considered the corporation's AFS.

KPMG observation

The term "net income" for financial reporting purposes may refer to the "net income" line on the financial statement and not total comprehensive income, which would also include certain categories of income (e.g., certain hedging and pension plan income) that are not included in that line.

As described in more detail below, AFSI would not simply be the aggregate net income reported on the consolidated financial statements. Rather, the adjustments that would be involved in calculating AFSI could require separate calculations not normally undertaken in calculating consolidated financial results.

KPMG observation

In the context of assessing "applicable corporation" status, the proposal shares similarities to certain rules that apply when determining base erosion and anti-abuse tax (BEAT) "applicable taxpayer" status. Like the BEAT, the Corporate AMT proposal would use a three-year tax period when applying the income threshold tests. The drafting of the three-year tax period rule in the proposal is less clear than in the BEAT, but it seems that both rules operate to treat a corporation as an in-scope entity if the relevant gross receipts (in BEAT) or income thresholds (in the Corporate AMT proposal) are met based on an annual average of those items during the three preceding tax years. Also, similar to the BEAT gross receipts threshold test, the proposal contains an entity aggregation rule for determining applicable corporation status that applies section 1563 group ownership rules as modified by section 52.

While BEAT's entity aggregation rule does not distinguish foreign corporations with U.S. ECI from foreign corporations without U.S. ECI when identifying a taxpayer's aggregate group, the BEAT gross receipts threshold test only includes gross receipts of a foreign corporation to the extent taken into account in determining its U.S. ECI. In contrast, the proposed Corporate AMT general Income Test appears to also include the taxpayer's pro rata share of *all* CFC income.

Adjustments to financial statement income

The following additional rules would apply in determining the extent to which a corporation's AFSI would include income from entities related to or affiliated with that corporation (subject to adjustments for omissions or duplications in guidance to be provided by Treasury):

- If a corporation reports its taxable income as part of a consolidated group, items that are properly allocable to other members would be considered part of the corporation's AFSI.

KPMG observation

This provision appears to treat all members of a consolidated group as a "single entity" for purposes of the Corporate AMT. This, however, raises a number of issues, including how the statutory provision would apply when a subsidiary leaves a consolidated group. For example, the provision would require that, for purposes of computing a taxpayer's AFSI, the taxpayer take into account items on the taxpayer's AFS which are properly allocable to members of the same consolidated group. Under this rule, a subsidiary could potentially be an applicable corporation as a result of the consolidated group's income, and it could retain "applicable corporation" status even after it departs from the consolidated group and would not meet the Income Test separately. However, the provision would grant Treasury the authority to provide exceptions to "single entity" treatment. Similar issues arose under the BEAT rules and were the subject of a number of different proposed (often controversial) approaches before final regulations were adopted.

- If the financial results of a taxpayer are reported on the AFS for a "group of entities," the proposal would apply "rules similar to the rules of section 451(b)(5)."
- If a taxpayer corporation held an interest in another corporation not included on the taxpayer's consolidated return, the taxpayer corporation's AFSI with respect to that other corporation would include only dividends and certain other amounts includible in gross income (but excluding subpart F and GILTI income) or deductible as a loss for U.S. tax purposes by the taxpayer.

KPMG observation

The proposed rule's updated language regarding the treatment of a taxpayer's interest in a non-consolidated corporation for purposes of determining the taxpayer's AFSI seems intended to favorably resolve ambiguity that had existed as to the treatment of taxpayers that apply a mark-to-market method as to strategic investments under the House BBBA and SFC BBBA versions.

These prior versions of the proposed rule explicitly provided that a taxpayer's AFSI would be adjusted as necessary to disregard the **earnings** of corporations that are not in the taxpayer's consolidated return except to the extent those earnings were received as dividends or otherwise required to be included in gross income. While this reference to excluding the undistributed "earnings" of non-consolidated corporations would clearly reverse-out equity method accounting treatment when determining a taxpayer's AFSI, there was ambiguity regarding the application of this rule in situations when a long-term, strategic investment, such as an investment with less than 20% ownership in corporate stock, may be accounted for using the fair value accounting method. If a holder reports the lower-tier investment under the fair value method for financial reporting purposes, the holder would use a mark-to-market method to report the change in value of the lower-tier corporation. This generally would not match, or even necessarily correspond with, the lower-tier corporation's earnings during such period. Because the fair value method is not tied to the earnings of the lower-tier corporation, it seems that the statutory language used in both the House BBBA and the SFC BBBA draft rule (stating that AFSI "shall take into account" the earnings of any non-consolidated corporation only to the extent of dividends received) would not, by its terms, apply to disregard the fair value method when determining a taxpayer's AFSI.

The Senate bill appears to address this ambiguity by not tying the adjustment solely to the earnings of the non-consolidated corporations. Instead, the proposed rule eliminates the reference to "earnings" of the non-consolidated corporation and adds that the rule more broadly applies to the determination of AFSI "with respect to" such corporation. This ostensibly would apply to any mark-to-market adjustments made by the taxpayer on its applicable financial statement with respect to a non-consolidated corporation. With respect to amounts taken into account for non-consolidated corporations, the Senate bill further would add the phrase "and other amounts which are includible in gross income or deductible as a loss under this chapter," which seems to indicate that mark-to-market adjustments made for tax purposes (for example, by a dealer in securities under section 475) would be taken into account in determining AFSI, in addition to any dividends.

Tax professionals believe that this apparent harmonization of the treatment of taxpayers that apply the equity method versus the fair value method as to strategic investments seems appropriate.

An applicable corporation that is a partner in a partnership ("corporate partner") would generally be required to adjust its AFSI to take into account "only" such corporate partner's distributive share of AFSI of the partnership. The AFSI of a partnership is the partnership's net income or loss set forth on such partnership's AFS (i.e., an applicable financial statement as defined in section 451(b)(3)), adjusted under rules similar to the rules applicable to determination of a corporation's AFSI. It is worth noting that these rules with respect to corporate partners and partnerships were included in the SFC BBBA Draft but differ from the rules with respect to corporate partners and partnerships included in the House BBBA.

KPMG observation

The proposed Corporate AMT rules with respect to corporate partners and partnerships make clear that partnership income may be included in the Corporate AMT base. The proposed statutory language, notably the use of "only," arguably creates uncertainty as to whether a corporate partner who does not include a partnership AFSI's in its own AFSI would be required to increase such corporate partner's AFSI under the rule. Regulations could clarify the issue.

Internal partnership of large corporations and third-party joint ventures may be affected and need to carefully consider the proposed Corporate AMT.

As another threshold matter, it is unclear that certain partnerships would have an AFS. As discussed above, only certain financial statements are AFSs. The financial statements of certain partnerships are neither prepared in accordance with GAAP (or IFRS) nor audited. The definition of AFS would appear to require Secretarial guidance for such financial statements to constitute AFSs.

The rules make clear that when a corporate partner and partnership are consolidated for financial reporting purposes, the corporate partner's AFSI is "adjusted to only take into account" a "distributive share" of the partnership's AFSI. As there exist situations when the GAAP or other financial reporting rules result in 100% of the partnership's non-adjusted financial statement income being included on the corporate partner's non-adjusted financial statement income, this rule, with the use of "only," along with a regulatory grant to address "duplications and omissions," appears aimed at preventing the "double-counting" of partnership income.

However, the proposed Corporate AMT's "distributive share" rule raises interpretive and policy questions.

The proposed Corporate AMT is silent as to the meaning of distributive share. According to tax professionals, it has been their experience, to date, most partnership financial statements do not provide a partner's share (distributive or otherwise) of financial statement income. Instead, total financial statement income (for all partners or for all general partners and all limited partners) is generally reported.

Thus, the IRS and taxpayers would need to determine how to calculate a corporate partner's distributive share for purposes of Corporate AMT. Multiple approaches could be used to determine distributive share. Guidance could, among other options, instruct taxpayers to: (1) apply the waterfall in a partnership agreement to AFSI (i.e., create a "parallel and separate" system in a manner somewhat similar to the Former AMT); (2) look to the corporate partner's share of section 704(b) income; or (3) look to the corporate partner's share of taxable income (which would have the impact of taking into account section 704(c) and thus tax attributes). Guidance could also specify the relevant period (e.g., tax year, financial statement year, life of the partnership) over which the distributive share would be determined. The lack of clarity until guidance is issued could result in modeling challenges for taxpayers seeking to quantify the impact of the proposed Corporate AMT: the different approaches could yield vastly different results.

Furthermore, all of the possible approaches identified above could be viewed to divorce the Corporate AMT from the underlying economics, arguably frustrating the policy goals of the AMT. For example, none of the approaches appears to align tax and economics when partners share income and loss differently and there is income for AFSI purposes and a loss for tax purposes (or vice versa).

- If a corporation is a U.S. shareholder of one or more CFCs, the AFSI of such corporation would be adjusted to take into account the corporation's pro rata share (determined under section 951(a)(2) principles) of the net income or loss as computed on the AFS for each CFC. The pro rata share would include all CFC income without regard to whether such income is subpart F, GILTI, or section 245A exempt. The corporation's pro rata share of net income and loss from each CFC is netted for purposes of the Corporate AMT calculation and not computed on a country-by-country basis. However, to the extent that a corporation's pro rata share of net income and loss from CFCs would result in a negative adjustment to the corporation's AFSI, such negative adjustment would be disallowed and carried forward (and applied) to the corporation's next tax year.

KPMG observation

This item appears to conflict with the provision that would limit the inclusion of a CFC's earnings in the AFSI of its U.S. shareholder to the amount paid in dividends. This appears to be a drafting glitch; the AFSI rules appear intended to include income earned indirectly through a CFC, regardless of whether distributed in the form of a dividend.

KPMG observation

The proposal to allow a taxpayer to use CFC losses in one jurisdiction to offset CFC income in a separate jurisdiction in the same tax year is similar to the operation of section 951A. Unlike the GILTI regime, however, the Corporate AMT proposal would establish CFC NOLs that may be used in future years to reduce the taxpayer's pro rata share of future year CFC net income.

Also, unlike the regular U.S. tax system, the taxpayer's AFSI would be adjusted by its pro rata share of CFC income without regard to whether such income is otherwise includible under section 951 or section 951A.

KPMG observation

While the House BBBA and the SFC BBBA Draft proposed substantial changes to the GILTI regime, including increasing the tax rate to 15% and reducing the carve-out rate for tangible depreciable property (from 10% to 5%), the Senate bill does not propose any modifications to GILTI. Accordingly, it is curious that the Corporate AMT proposal would continue to subject a U.S. shareholder corporation's pro-rata share of CFC-level earnings to a 15% rate of tax (before taking into account credit for foreign taxes paid), which is generally higher than rate of tax applied to CFC-level earnings under the GILTI regime (currently 10.5%, inclusive of the section 250 deduction). The rate differential on CFC-level earnings between the Corporate AMT proposal and the GILTI regime could potentially result in permanent differences attributable to CFC-level earnings.

- A corporation would be required to adjust its AFSI to take into account any AFSI of a disregarded entity (DRE) owned by the corporation that is not otherwise included in the corporation's AFS.

KPMG observation

This rule seems intended to ensure that all of the AFSI of foreign hybrid entities and other DREs is treated as AFSI of the entities' owners. However, this appears to be surplusage given the reference to section 451(b)(5) for purposes of determining how to treat financial results of a taxpayer that are reported on a consolidated financial statement for a "group of entities," as noted above. Because section 451(b)(5) and the regulations thereunder start with the single consolidated financial statement and find items attributable to the "taxpayer" (a U.S. tax concept which includes a DRE as part of its owner, as opposed to the concept an "entity" which can exist without regard to U.S. check-the-box fictions), it is never going to be necessary to look to the separate financial statement of a DRE.

- In the case of an organization subject to tax under section 511, AFSI would include only AFSI: (1) of an unrelated trade or business; or (2) derived from debt-financed property and treated as unrelated business taxable income.

KPMG observation

This provision was introduced in the SFC BBBA Draft.

Additional adjustments to AFS include (but are not limited to):

- Adjustments to account for AFS that cover periods different than the corporation's tax year
- Adjustments to increase a corporation's AFSI for foreign income taxes taken into account on the corporation's AFS, to the extent the corporation elects to claim foreign tax credits
- In the case of a foreign corporation, the principles of section 882 generally apply to include only ECI in the determination of AFSI
- Adjustments to prevent the omission or duplication of items
- Adjustments to take into account minority ownership of members of a consolidated group
- Adjustments to carry out the principles of the corporate liquidation, organization, and reorganization rules, and the rules relating to partnership contributions and distributions

KPMG observation

The explicit reference to the application of section 882 principles seems to confirm that a foreign corporation's AFSI would be limited to the items of book income or loss that relate to U.S. ECI. As such, foreign corporations without U.S. ECI would not have AFSI. It is unclear how section 882 principles would be applied in the financial accounting context to parallel the application of the U.S. ECI rules for U.S. taxable income purposes, and it could potentially require extensive additional work to reconstruct financial accounts in accordance with a principle that has heretofore only applied in the U.S. tax accounting realm.

In addition, certain modifications to AFSI would apply for purposes of calculating the Corporate AMT of an applicable corporation but not for purposes of the Income Test.

Consistent with the SFC Draft BBBA (but not the House BBBA) proposal, the Senate bill would adjust AFSI to disregard book income, costs, or expense relating to certain defined benefit plans and foreign deferred compensation plans. This adjustment would allow for book numbers to be backed out of the calculation, and amounts taken into account for tax purposes to be used instead.

Financial statement net operating losses

The Corporate AMT would include a reduction to AFSI for "financial statement net operating losses" (FS NOLs). Specifically, AFSI would be reduced by the lesser of: (1) the aggregate amount of the corporation's FS NOL carryovers; and (2) 80% of the AFSI computed without regard to FS NOL carryovers. FS NOL carryovers would arise from AFSI net losses for tax years ending after December 31, 2019. An FS NOL could be carried over indefinitely.

KPMG observation

A corporation can generate FS NOLs in tax years prior to the first tax year in which the Corporate AMT could apply. For example, if a calendar year corporate taxpayer has AFSI of $1 billion in both 2020 and 2021, but a loss of $750 million in 2022, the taxpayer would have an FS NOL carryover from 2022 available to reduce AFSI in subsequent years. Conversely, if that calendar year taxpayer had the loss of $750 million in 2020, and then AFSI income of $1 billion in both 2021 and 2022, it appears that the 2020 loss may be absorbed in 2021 prior to the first tax year, 2023, in which the Corporate AMT could apply.

Further, a corporation may become an applicable corporation after the effective date of the Corporate AMT regime, due to revenue growth or acquisitions. It appears that such a corporation could generate FS NOLs in tax years prior to becoming subject to the Corporate AMT, and that these FS NOLs would be reduced by AFSI in later periods. Thus, seemingly, a corporation that becomes subject to the Corporate AMT at any point would need to calculate its FS NOLs (and any offset of those NOLs against financial statement income) for all tax years ending after December 31, 2019.

For regular tax purposes, the use of net operating losses (NOLs) can become subject to limitation following an "ownership change" within the meaning of section 382, and NOLs may be reduced as a result of the exclusion of cancellation of indebtedness income from gross income under section 108. Similarly, the use of NOLs imported into a consolidated group can become subject to the separate return limitation year (SRLY) limitation. The Senate bill proposal does not provide for any similar rules or coordinating adjustments to these regular tax provisions (although it would provide broad regulatory authority to Treasury to potentially address these points).

Further, for regular tax purposes, a member of a consolidated group that contributes to a consolidated NOL can have a portion of that loss allocated to it when it leaves the group (such as when the member is sold to an unrelated buyer). The Senate bill proposal would grant authority for regulations as necessary to carry out the purposes of the AFSI rules, which presumably would include regulations that address many of the issues raised by FS NOL carryovers.

The Senate bill proposal would also provide Treasury with broad authority to promulgate regulations to provide other adjustments to AFSI that are necessary to carry out the purposes of the Corporate AMT.

Calculation of Corporate AMT liability

The Senate bill proposal provides that an applicable corporation would be liable for the Corporate AMT to the extent its "tentative minimum tax" exceeds its regular U.S. federal income tax liability (including the BEAT under section 59A), prior to taking into consideration general business credits under section 38. An applicable corporation's tentative minimum tax would equal 15% of the applicable corporation's current year AFSI over the applicable corporation's eligible Corporate AMT foreign tax credits.

Corporate AMT foreign tax credit

If the taxpayer chooses to claim a foreign tax credit (FTC) under section 901 for the year, the Corporate AMT FTC for the year would be the sum of two amounts:

- The lesser of (1) the corporation's pro-rata share of section 901 creditable foreign taxes paid or accrued (for federal income tax purposes) by its CFCs that are taken into account on the AFS of the CFCs, or (2) 15% of the CFCs' net income for the year as reported on the CFCs' AFS; **and**

- The total amount of section 901 creditable foreign taxes paid or accrued (for federal income tax purposes) by the taxpayer and taken into account on the taxpayer's AFS.

KPMG observation

Although the Corporate AMT FTC would use section 901 creditable taxes to determine the base amount of foreign taxes paid, it is noteworthy that the proposal does not cross-reference the section 904 foreign tax credit limitation rules at all. As such, the Corporate AMT FTC, unlike section 901 FTCs, would not appear to be limited to U.S. tax on the relevant foreign source income nor would there be any limit on cross-crediting among low-tax and high-tax jurisdictions.

KPMG observation

The proposal's restriction on CFC taxes to 15% of CFC income for purposes of determining the amount of the Corporate AMT FTC is in stark contrast to the treatment of foreign taxes paid by the applicable corporation directly or with respect to a DRE, which are subject to no limit. The policy rationale for treating taxes paid by a CFC differently to taxes paid by a taxpayer on behalf of a DRE is unclear. Nonetheless, it appears generally that applicable corporations with high-tax CFCs might be in a worse position under the proposal, as compared with those that organize their high-tax foreign operations through DREs, which may encourage taxpayers to check the box on their CFCs to treat them as DREs.

KPMG observation

As discussed above, under the proposal, the AFSI of an applicable corporation includes the AFSI of a DRE owned by the applicable corporation and this appears to be the case under the basic rules of new section 56A(c)(2)(A) and section 451(b)(5) even before application of the special rule for DREs contained in new section 56A(c)(6), which appears to be surplusage. Thus, FTCs of the DRE could be available even if the DRE is treated as a separate entity from the corporation in preparing the AFS. Clarification of this point might, nevertheless, be helpful.

KPMG observation

There is ambiguity concerning which year taxes are taken into account in the Corporate AMT computation when the year of tax accrual for financial accounting purposes does not match the year such taxes are paid or accrued for regular tax purposes. While not clear, when such timing mismatch occurs, it seems that the taxes would be taken into account in the later year because the rule appears to require that the taxes: (1) be taken into account on the financials; **and** (2) to have been paid or accrued for U.S. tax purposes.

To the extent the credit for taxes paid by CFCs in the year is reduced because of the 15% limitation, the excess foreign taxes are allowed as a carryover in any of the first five succeeding tax years.

General business credits

The Senate bill proposal would make amendments to section 38 (General Business Credit (GBC)) to take into account the Corporate AMT. The Senate bill would limit the availability of GBCs to $25,000 plus 75% of a taxpayer's net income tax that exceeds $25,000. This generally follows the current law paradigm for the ability to use GBCs. For this purpose, net income tax means the sum of regular tax liability and the AMT, reduced by credits allowed under Subpart A and B of Part IV of the Code (Credits Against Tax). Section 901 foreign tax credits are included among the taxes described under Subpart B.

KPMG observation

Both the House BBBA and the SFC BBBA Draft would have amended section 38(c)(1) to take into account section 59A taxes in "net income tax," along with regular taxes and the Corporate AMT. This change to section 38(c)(1) was in the BBBA inbound international provision (section 128131(a)(6) of the SFC BBBA Draft and section 138131(a)(6) of the House BBBA), which the Senate bill does not include. Consequently, the Senate bill is less generous with respect to allowable GBCs than the BBBA would have been. It is not clear if this result is intentional or a drafting error.

KPMG observation

As in computing net income tax, both the AMT FTC (which is part of the AMT calculation) and section 901 credits that reduce regular tax liability would be taken into consideration. The fact that GBCs can potentially be used to satisfy a new corporate minimum tax is very significant because with the Former AMT:

- GBCs were generally not available to offset any corporate AMT
- If a taxpayer had no AMT liability, the taxpayer generally could not use GBCs to reduce its tax liability below its tentative minimum tax. For example, if a corporate taxpayer had a regular tax liability of $10 million and a tentative minimum tax of $8 million, the taxpayer would not have any AMT liability, but generally would not be allowed to claim GBCs in an amount that would reduce its tax liability below the tentative minimum tax threshold of $8 million.

KPMG observation

It is perhaps noteworthy that there is no special treatment under this proposal for the section 250 deduction for FDII (generally applicable to sales or services provided to foreign persons and/or outside the United States). Thus, in contrast, to the treatment of GBCs where favorable treatment is generally preserved under the Corporate AMT, a taxpayer that would otherwise benefit from section 250 may lose significant benefits under the proposal.

Corporate AMT credit

Applicable corporations would also be allowed to claim a credit for Corporate AMT paid against regular tax in future years, but the credit could not reduce that future year's tax liability below the computed Corporate AMT for that year.

KPMG observation

As noted previously, the proposed Corporate AMT credit mechanism is similar to the AMT credit provided by the Former AMT regime and would similarly cause the proposed Corporate AMT to be (at least theoretically) seen as an acceleration of regular tax liability.

Under the Former AMT, a taxpayer's ability to use minimum tax credit carryovers could become limited under the rules of section 383, following a section 382 ownership change. The Senate bill proposal would place the proposed Corporate AMT credit within the framework of section 53, which sets forth the rules that applied to the Former AMT (and that continue to apply to certain noncorporate taxpayers after the repeal of the Former AMT). Thus, Corporate AMT credit carryovers would be expected to be subject to a section 383 limitation following an ownership change.

Regulatory grant with respect to partnerships

The proposed Corporate AMT instructs the Secretary of the Treasury to issue "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.''

KPMG observation

This regulatory directive suggests congressional awareness that the interaction of proposed Corporate AMT and the partnership tax rules is complex. The application of the Former AMT raised a number of vexing issues in the partnership context—including with respect to a partner's basis in its partnership interest ("outside basis"), the partnership's basis in its assets ("inside basis"), gain or loss upon distributions, and the gain or loss upon the sale or exchange of partnership interests.

Some of these issues appear present with respect to the proposed Corporate AMT. Furthermore, aspects of the proposed Corporate AMT, including the rule allowing applicable corporations to claim a credit for Corporate AMT paid against regular tax, subject to certain limitations (discussed below), may be viewed to introduce additional complexities. For example, it is unclear if there are outside basis consequences when a corporate partner has Corporate AMT liability a result of partnership AFSI.

Example

Assume that Corporate Partner's basis in Partnership is $0 on January 1, 2026. In 2026, Corporate Partner is allocated $0 in taxable income from Partnership and Corporate Partner's distributive share of AFSI of the Partnership is $100,000. Assume Corporate Partner has no taxable income or AFSI from any other source in 2026.

In 2027, Corporate Partner has no distributive share of AFSI of the Partnership and sells its interest in Partnership for $100,000, generating $100,000 in AFSI. Assume Corporate Partner has no taxable income or AFSI from any other source in 2027.

Corporate Partner would generally be expected to pay $15,000 under the Corporate AMT in 2026. If Corporate Partner's tax basis in the Partnership did not increase and Corporate Partner sold its interest in Partnership for $100,000 on January 1, 2027, Corporate Partner would include $100,000 in taxable income in 2027, and, assuming a 21% effective tax rate, have a $21,000 tentative tax liability. The rule providing that a credit for Corporate AMT may not reduce that future year tax liability below the computed Corporate AMT for that year would apply, and Corporate Partner would have a $15,000 tax liability and a 30% combined rate. This result seems inappropriate given the goal to avoid double taxation.

Similar, and possibly additional, issues would arise if Corporate Partner transferred its interest in Partnership in a non-recognition transaction.

KPMG observation

Interaction of Corporate AMT and Pillar Two

Corporate AMT's application to the U.S. profits of a U.S.-based MNE

The Corporate AMT proposal might be viewed as part of an effort by lawmakers to insulate income earned in the United States from another country's Undertaxed Profits Rule (UTPR), which could apply to U.S.-parented multinational groups with €750 million or more of revenue. However, under the Pillar Two Model Rules, avoiding the application of a UTPR would require establishing that the ETR of the U.S. entities in an MNE Group (excluding DREs and branches that are tax resident or have a taxable presence in another country) is at least 15%, as measured based on the Pillar Two rules.

The Corporate AMT proposal shares some similarities with the Pillar Two ETR calculation, in that both use financial accounting income as the starting point for the tax base and apply 15% as the minimum rate of tax. The scope and technical design of the proposed Corporate AMT, however, deviates from the Pillar Two framework in material ways. With respect to scope, Pillar Two uses a much lower threshold, so that a large population of taxpayers would be outside the scope of the Corporate AMT and within the scope of Pillar Two. As a result, this population of taxpayers with exposure to additional tax under a UTPR would be unaffected by the enactment of the Corporate AMT. Furthermore, even for those taxpayers within the scope of both the Corporate AMT proposal and Pillar Two, there are material differences as to how the two frameworks compute tax liability. For example, the Corporate AMT proposal would allow general business credits to reduce the Corporate AMT liability, whereas Pillar Two generally does not allow these non-refundable credits (with a potential narrow exception for entities to which equity method accounting applies). As a result of this deviation, U.S. Corporate AMT taxpayers could still have an ETR that is lower than 15% for Pillar Two purposes and thus be exposed to the UTPR.

Given the differences, in particular with respect to scope and the treatment of general business credits, it seems unlikely the Corporate AMT proposal would be considered a Qualified Domestic Minimum Top-up Tax (QDMTT) under the Pillar Two framework. It is notable, however, that while the Corporate AMT is more favorable than Pillar Two as it relates to general business credits, it is less favorable in other respects, including the treatment of accelerated tax depreciation, book-tax differences related to stock-based compensation, and recovering pre-2020 net operating losses. As discussed below, some of these differences that could drive liability under the Corporate AMT could have knock-on effects in Pillar Two when the AMT credit carryforward is used in later years to reduce tax liability.

Corporate AMT's application to the foreign profits of a U.S.-based MNE

The Corporate AMT, as proposed, is unlikely to be considered a qualified Income Inclusion Rule (IIR) with respect to its application to foreign earnings. Like the GILTI regime, it aggregates income, losses, and taxes across all CFCs, whereas Pillar Two only allows income, losses, and taxes to be aggregated on a country-by-country basis. Instead, the proposed Corporate AMT, similar to GILTI, is likely be treated as a "CFC Tax Regime" for Pillar Two purposes, so that any taxes paid with respect to foreign earnings would be "pushed down" to the jurisdiction that earned the underlying income, using a to-be-developed allocation method, and taken into account in computing the ETR in that jurisdiction for purposes of the IIR and UTPR. The interaction of CFC Tax Regimes and QDMTTs is not yet resolved.

Other interactions

Initial modeling suggests there may also be a non-intuitive interaction between the Corporate AMT's credit carryforward mechanism and the Pillar Two deferred tax accounting rules. In particular, Pillar Two contains a special rule that disregards deferred tax assets related to the generation and use of tax credits. This special rule would seem to disregard the deferred tax asset that is recorded for the Corporate AMT credit carryforward for purposes of computing the Pillar Two ETR. Therefore, if a taxpayer pays Corporate AMT, creates a credit carryforward (and a deferred tax asset related to that carryforward), and then in a future year uses the carryforward, that future year may be exposed to top-up tax under Pillar Two because the reversal of the deferred tax asset related to the Corporate AMT carryforward is disregarded so that it does not increase Covered Taxes for Pillar Two purposes. Similar results are being observed with respect to Pillar Two and other credit carryforwards, including foreign tax credit carryforwards.

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