Corporate book minimum tax to be effective for 2023

August 17, 2022

In brief

The recently enacted Inflation Reduction Act imposes a corporate alternative minimum tax (AMT) based on financial statement income (book minimum tax, or BMT). The BMT is effective for tax years beginning after December 31, 2022.

This provision imposes a 15% minimum tax on adjusted financial statement income (AFSI) for corporations with average annual AFSI over a three-tax year period in excess of $1 billion. However, the BMT increases a taxpayer’s tax only to the extent that the tentative minimum tax exceeds regular tax plus base erosion and anti-abuse tax (BEAT).

For your consideration: The legislation leaves a number of determinations to Treasury, both explicitly and implicitly. Potentially affected taxpayers should expect extensive regulations interpreting and supplementing these provisions. If the IRS and Treasury do not issue guidance before the BMT’s effective date, taxpayers may need to take positions based on a reasonable interpretation of the statute. Companies should start preparing as soon as possible for the 2023 effective date.

In detail

To evaluate the impact of the BMT on its overall tax liability, a taxpayer must determine:

(1) Is the company an applicable corporation?

(2) What is the company’s AFSI?

(3) Will the company be required to pay AMT (is tentative minimum tax greater than regular tax plus BEAT)?
Applicable corporation

In general

An “applicable corporation” subject to the BMT for a tax year is a corporation (other than an S corporation, regulated investment company, or real estate investment trust) that meets an AFSI test in one or more tax years before the current tax year and ending after December 31, 2021. A corporation meets the AFSI test if its average AFSI over the three tax years ending with the relevant tax year exceeds $1 billion. A corporation tests whether it is an applicable corporation based on whether it meets the AFSI test in the tax year prior to the current tax year.

Observation: A calendar-year taxpayer would determine if it is an applicable corporation for 2023 by determining its average AFSI for 2020, 2021, and 2022. Once a taxpayer is an applicable corporation, it remains an applicable corporation for all tax years in the future (unless Treasury provides an exemption).

To determine if a corporation is an applicable corporation, AFSI is determined with adjustments to financial statement income, generally excepting the adjustment for financial statement net operating loss (NOL) carryovers (and excepting certain other adjustments if the corporation is a member of a foreign-parented multinational group and for purposes of the aggregation rule, discussed below). Thus, a corporation must compute AFSI to make the initial determination of whether it is an applicable corporation.

Observation: Accordingly, a corporation cannot determine whether it is an applicable corporation based solely on its financial statements because the AFSI adjustments may reduce or increase its three-year average AFSI below or above the $1 billion threshold.

The three-year AFSI test applies to a corporation that has been in existence for fewer than three years based on the number of years the corporation has been in existence, and is annualized for a short tax year.

Corporation with a foreign parent

A corporation that is a member of a foreign-parented multinational group must apply a two-part test. It is an applicable corporation if (1) the three-year average AFSI of all members of the group exceeds $1 billion and (2) the three-year average AFSI of US members of the group (and disregarded entities owned by members of the group), US trades or business of foreign group members that are not subsidiaries of US members, and foreign subsidiaries of US members exceeds $100 million. In determining the AFSI of all members of the group for purposes of the $1 billion test, AFSI is determined without the adjustments relating to a partner’s distributive share of partnership AFSI, certain items of foreign income, effectively connected income, and defined benefit pension plans.

A foreign-parented multinational group for this purpose is two or more entities (at least one domestic corporation and one foreign corporation) that are included in the same applicable financial statement (AFS) and either have a common foreign corporate parent or are treated (as determined by Treasury) as having a common parent that is a foreign corporation. For this purpose, a US trade or business of a foreign corporation is treated as a separate domestic corporation wholly owned by the foreign corporation.

Aggregation rule

A corporation’s AFSI is aggregated with the AFSI of all persons treated as a single employer under Section 52(a) or 52(b) to determine if the corporation is an applicable corporation. Therefore, a corporation’s AFSI includes the AFSI of all members of the corporation’s controlled group and the AFSI of all trades or businesses (including partnerships) under common control with the corporation.
Observation: Some taxpayers have interpreted the current aggregation rules of Section 52(b) to not apply to a partnership fund that is solely organized to acquire stock of corporations, because the fund does not conduct a trade or business under Section 162. At one point, the bill would have amended Section 52(b) to treat income-producing activities under Section 212 as a trade or business for aggregation purposes, which would have applied the aggregation rules to these entities. However, this amendment is not in the bill passed by the Senate or the enacted legislation.

Note: The aggregation rule on pages 2 and 3 of the enrolled bill reflects the rule included in the bill as originally proposed in the Senate. The amendments appear in a later section of the bill in Sections 13903 and 13904 on pages 197 and 198. The language of the aggregation rule as passed by the Senate and ultimately enacted appears at the top of page 198.

A taxpayer’s AFSI for purposes of the aggregation rule is determined without the adjustments relating to a partner’s distributive share of partnership AFSI and to defined benefit pension plans.

Observation: These aggregation rules apply solely to determine if a taxpayer is an applicable corporation and do not determine the amount of a taxpayer’s AFSI potentially subject to the 15% minimum tax.

Exceptions

An applicable corporation does not include a corporation that (1) has a change in ownership or (2) does not meet the AFSI test for the most recent tax year and an additional number (to be determined by Treasury) of consecutive tax years. In either case, Treasury also must determine that it is not appropriate to continue to treat the corporation as an applicable corporation.

A corporation that is excepted from the definition of applicable corporation under these rules may be an applicable corporation and subject to the BMT if it meets the average AFSI test for a later tax year.

Observation: The BMT provides Treasury with several grants of regulatory authority, with little statutory direction as to how the regulations should be crafted. When coupled with the lack of legislative history to the Inflation Reduction Act, the scope of the BMT will be determine in significant part by future Treasury regulations.

Computing AFSI

“Adjusted financial statement income” is defined as the net income or loss on a taxpayer’s AFS for a tax year, with certain adjustments. A taxpayer’s AFSI is not aggregated with the AFSI of other taxpayers to determine the amount potentially subject to the 15% minimum tax, which is imposed on the taxpayer’s individual AFSI.

“Applicable financial statement” has the same meaning as under Section 451(b)(3) and the related regulations, which provide generally that an AFS is a financial statement prepared in accordance with GAAP or IFRS, reported to the SEC, or otherwise used for reporting to shareholders or credit purposes; or as otherwise specified by Treasury in regulations or other guidance.

To determine AFSI, a taxpayer’s AFS is adjusted as follows.

1. Appropriate adjustments are required for financial reporting years that do not coincide with the tax year.

2. If the financial results of a taxpayer are reported on the AFS for a group of entities, rules similar to the rules of Section 451(b)(5) apply.
Observation: Treasury may look to the regulations under Section 451(b)(5) to implement this rule. Under those regulations, the AFS of a taxpayer whose financial results are reported on an AFS for a group of entities (consolidated AFS) generally is the consolidated AFS. If a consolidated AFS does not separately list items for the taxpayer, the portion of the AFSI allocable to the taxpayer is determined by relying on the taxpayer’s separate source documents that were used to create the consolidated AFS and includes amounts subsequently eliminated in the consolidated AFS. A taxpayer whose results are reported on a consolidated AFS with entities that are not subject to the BMT (or are separately subject to BMT) will need to reconstruct a stand-alone AFS to compute its AFSI, which as a practical matter may be difficult to perform, especially if the separate corporation does not maintain its own financial statements.

(3) The AFSI of an affiliated group of corporations filing a consolidated return takes into account items on the group’s AFS that are properly allocated to members of the group.

(4) For items received from a corporation that is not on a consolidated return with a taxpayer, the taxpayer’s AFSI takes into account only the dividends received from the other corporation and other amounts includible in gross income (other than subpart F and global intangible low-taxed income inclusions) or deductible as a loss with respect to the other corporation.

(5) The AFSI of a partner in a partnership is limited to a distributive share of a partnership’s AFSI (the net income or loss reported on the partnership’s AFS with the required adjustments).

(6) AFSI is adjusted to take into account a taxpayer’s pro rata share (determined under rules similar to Section 951(a)(2), concerning subpart F income) of items taken into account as net income or loss on the AFS (as adjusted to determine AFSI) of each controlled foreign corporation (CFC) of which the taxpayer is a US shareholder, but if the adjustment is negative the amount of the adjustment is carried forward to the next tax year.

Observation: It appears that whether there is a ‘negative adjustment’ is based on the aggregate amount of the taxpayer’s pro rata share of income and loss of each CFC (i.e., the taxpayer’s pro rata shares from all CFCs are netted). Regulations may clarify this issue.

(7) To determine AFSI of a foreign corporation, the principles of Section 882, dealing with effectively connected income, apply.

(8) AFSI takes into account the AFSI of disregarded entities owned by the taxpayer.

(9) AFSI of an Alaska native corporation is adjusted to allow certain cost recovery, depletion, and deductions.

(10) For cooperatives, AFSI is reduced for patronage dividends and per-unit retain allocations to the extent the amounts were not taken into account in determining AFSI.

(11) Certain items reported on a taxpayer’s AFS are disregarded in determining AFSI.

   a) Federal income taxes, and income, war profits, or excess profits taxes relating to a foreign country or US possession, taken into account on the taxpayer’s AFS;

   b) Amounts treated as a payment of certain credits;

   c) Income related to mortgage servicing contracts if the income is included in financial statement income earlier than the income is required to be recognized for tax purposes; and
d) Income of a tax-exempt entity, except unrelated trade or business taxable income is not disregarded.

**Observation:** The Inflation Reduction Act does not by its terms prevent double counting of gain and dividend income with respect to CFCs, but instead clarifies that dividends may be included in AFSI, authorizes regulations to prevent double counting, and seeks to ensure that deductible stock losses are not ignored in determining AFSI.

AFSI also is decreased by the lesser of (1) the aggregate amount of financial statement NOL carryovers to the tax year or (2) 80% of AFSI computed without regard to financial statement NOLs. A financial statement NOL for any tax year may be carried indefinitely to each tax year following the tax year of loss. “Financial statement NOL” is defined as the amount of net loss on the corporation’s AFS after applying the AFSI adjustments, for tax years ending after December 31, 2019.

**Observation:** While financial statement NOLs generated in a given tax year are taken into account in determining whether a taxpayer is an applicable corporation under the three-year average AFSI test, it appears that financial statement NOL carryovers are utilized in tax years when a taxpayer is not an applicable corporation. For example, a calendar-year taxpayer has AFSI of negative $6 billion in 2020, $3 billion in 2021, and $4 billion in 2022. The taxpayer determines that it is not an applicable corporation in 2023 because the three-year average AFSI is only $0.33 billion. However, if the taxpayer becomes an applicable corporation in 2024, its financial statement NOL still would be reduced under the financial statement NOL carryforward rules for its AFSI generated in 2021 and 2022.

In significant changes from the original House-passed legislation, the Inflation Reduction Act provides for AFSI adjustments related to defined benefit pension plans and certain depreciation and amortization. AFSI is adjusted to disregard book income, cost, or expense related to a covered benefit plan (e.g., mark-to-market adjustments related to a defined benefit plan). However, in connection with a covered benefit plan, AFSI is increased by the amount included in the corporation’s gross income under other tax provisions and reduced by deductions allowed under other tax provisions.

For depreciable property subject to Section 168 and qualified wireless spectrum amortizable under Section 197, AFSI is:

1. Reduced by deductions allowed in computing taxable income for the tax year with respect to the property or qualified wireless spectrum; and

2. Appropriately adjusted to (a) disregard the depreciation of the property or amortization of the qualified wireless spectrum that is taken into account on the taxpayer’s AFS and (b) take into account other items Treasury specifies to properly account for the property or qualified wireless spectrum.

**Observation:** Guidance may be necessary to clarify that “property subject to Section 168” includes all property eligible for bonus depreciation under Section 168, including property otherwise depreciated under Section 167 (e.g., acquired computer software). Because the statute refers to “deductions allowed” for depreciation, it is unclear if the AFSI adjustment for depreciation includes depreciation capitalized to inventory under Section 263A and recovered through cost of goods sold.

**Observation:** The adjustment to AFSI for tax depreciation means that depreciation for property to which Section 168 applies, including bonus depreciation under Section 168(k), has the same effect on the tax base for the BMT and on the regular tax in any tax year. Thus, the rule is beneficial in a tax year when total depreciation deductions for the property for tax purposes exceed total depreciation for book purposes. However, for a taxpayer for which book depreciation in the current year exceeds tax depreciation, the adjustment could be disadvantageous.
Operation within BMT

A taxpayer that meets the three-year average AFSI test—and thus is an applicable corporation—nonetheless will be liable to pay the 15% minimum tax only if its tentative minimum tax exceeds its regular tax plus BEAT.

Observation: Absent transitional relief, timing differences between tax and financial reporting for items (in addition to depreciation) incurred before the effective date of the BMT may increase AFSI and tentative tax when those timing differences reverse in later years.

AMT FTC

The legislation adds a new corporate AMT FTC, which is available to an applicable corporation that claims an FTC for the tax year. The AMT FTC reduces 15% of a taxpayer’s AFSI to arrive at the tentative minimum tax.

The AMT FTC is the sum of:

(1) The lesser of:

   (a) The aggregate of an applicable corporation’s pro rata share (as determined under Section 56A(c)(3)) of the amount of income, war profits, and excess profits taxes imposed by a foreign country or US possession that are taken into account in the AFS of, and paid or accrued for federal income tax purposes by, each CFC in which the corporation is a US shareholder; or

   (b) The aggregate of the applicable corporation’s pro rata share of the adjusted AFSI (as determined under Section 56A(c)(3)) of CFCs in which the corporation is a US shareholder, multiplied by 15%; plus

(2) For a domestic corporation, the amount of income, war profits, and excess profits taxes imposed by a foreign country or US possession to the extent that taxes are taken into account on the corporation’s AFS and paid or accrued for federal income tax purposes.

A taxpayer may carry over the excess of the amount in (1)(a) over (1)(b), above, for five succeeding tax years. The carryover increases the amount in (1)(a), above, in a tax year in which the taxpayer claims the AMT FTC to the extent not previously taken into account.

Observation: It appears that the AMT FTC would apply (without an FTC limitation) to direct foreign income taxes and the taxpayer’s pro rata share of creditable foreign taxes from a foreign partnership. Foreign income taxes paid by CFCs would be creditable as well, but subject to an FTC limitation equal to 15% of the taxpayer’s pro rata share of the net income or loss of its CFCs (grossed up for foreign income taxes).

General business credit

The Inflation Reduction Act amends the general business credit limit to provide that the credit for a tax year may not exceed the excess of the taxpayer’s net income tax over 25% of the amount of the taxpayer’s net income tax that exceeds $25,000.

Observation: Under the corporate AMT as in effect before the 2017 tax reform act, the general business credit was limited by a taxpayer’s tentative minimum tax as well as by the taxpayer’s net regular tax liability. As a result of the tentative minimum tax limitation, taxpayers could not receive the full benefit of their general business credits. Because taxpayers may utilize their general business credits against both their regular tax liability and the BMT under the new legislation, the value of general business credits (e.g., the research tax credit) is preserved.
Minimum tax credit

In a tax year when a taxpayer pays BMT because tentative minimum tax exceeds regular tax plus BEAT, the taxpayer will generate a minimum tax credit, which may be carried forward indefinitely and claimed against regular tax in future years (to the extent regular tax exceeds BMT plus BEAT).

Tax accounting implications

Prior to US tax reform in 2017, the United States had an AMT regime that was explicitly addressed in US GAAP. When there is both a regular tax system and an alternative minimum tax system with the ability to generate a credit against regular tax liabilities in future years, ASC 740 requires deferred taxes to be measured using the regular tax rate even if the company anticipates remaining subject to the AMT system for the foreseeable future (see ASC 740-10-30-10 through 30-11 and ASC 740-10-55-31 through 55-33). ASC 740 also provides that a deferred tax asset should be recognized for the AMT credit carryforward. The accounting guidance requires companies to consider the realization of the AMT credit carryforward deferred tax asset similar to any other deferred tax asset.
Let’s talk

For a deeper discussion of how the BMT might affect your business, please contact:

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