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by Jonathan Galin, Monisha C. Santamaria, and Natalie Tucker

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by Jonathan Galin, Monisha C. Santamaria, and Natalie Tucker

Jonathan Galin

Monisha C. Santamaria

Natalie Tucker

Jonathan Galin is a managing director in the Washington National Tax (WNT) international tax group of KPMG LLP, Monisha C. Santamaria is a principal in the WNT passthroughs group, and Natalie Tucker is a partner in the WNT methods group. The authors thank Ronald Dabrowski for his helpful comments.

In this article, the third in a series, the authors reference the familiar game Candy Land as a guide to help taxpayers navigate the corporate alternative minimum tax system. This installment focuses on the uncertain rules for the 2023 tax year.

This is the third article in the CAMTyland Adventures series,[1] which is intended to assist taxpayers in better understanding the requirements of the corporate alternative minimum tax (CAMT) — a minimum tax based on financial statement income that is imposed on applicable corporations.[2]

While CAMTyland's broad contours have been constructed, players will need to travel through CAMTyland's stations for the 2023 tax year while the rules are still under construction and during which time the application of certain rules is seemingly optional.[3] This presents both challenges and opportunities.

Our adventures in this article address the specific challenges and opportunities faced by "scope bubble corporations" — corporations close to the $1 billion average annual adjusted financial statement income (AFSI) threshold who may or may not be in scope based on the game's many rules and, possibly, multiple playbooks.

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[1] *See* Monisha C. Santamaria et al., "CAMTyland Adventures, Part I: How to Play the Game — Corporate Alternative Minimum Tax Basics," *Tax Notes Int'l*, July 24, 2023, p. 367; and Monisha C. Santamaria et al., "CAMTyland Adventures, Part II: 'Right-Sizing' in the Licorice Lagoon," *Tax Notes Int'l*, July 31, 2023, p. 515.

[2] The CAMT is effective for tax years beginning after December 31, 2022; *see* section 10101(f) of P.L. 117-169 (commonly referred to as the "Inflation Reduction Act of 2022").

[3] *See* IRS, "2023 Draft Instructions for Form 4626" (Dec. 20, 2023) ("Interim Guidance: Certain rules described in these instructions are interim rules from notices published in the Internal Revenue Bulletin. *Taxpayers are not required to apply such interim rules but may optionally rely on them for a limited period of time (including 2023).* Taxpayers should complete Form 4626 in a manner that reflects the interim rules they have chosen to rely on.") (emphasis added).

CAMTyland Challenges

CAMTyland is not an intuitive game. A key challenge is that a scope bubble corporation player may not realize that it *must* play the game.[4] Further, the game path (that is, substantive determination and compliance burden) for a scope bubble corporation that purports to be out of scope (that is, not an applicable corporation) may be long — and longer than the game path for a corporation that is in scope (that is, an applicable corporation).

As a preliminary matter, a taxpayer should remember that AFSI, and especially scope AFSI, can exceed book financial statement income (FSI); thus, FSI of less than $1 billion does not mean that a taxpayer can forfeit its turn in CAMTyland. There are several fact patterns that could cause AFSI to exceed FSI. For example, AFSI can exceed FSI because of the treatment of equity interests (for example, a nontax consolidated subsidiary pays out dividends in a year in which this subsidiary's corporate owner reports a loss on its financial statements for its equity interest); foreign subsidiaries that, in the aggregate, generate an adjusted net loss; covered nonrecognition transactions in a previous year;[5] intercompany gains and losses with members outside the tax consolidated group; adjustments for depreciation and disposal(s) of section 168 property; repairs capitalized for federal income tax purposes; book impairments regarding corporate equity or section 168 property; certain derivatives;[6] and differences in fiscal and tax years.

For scope bubble corporations that discover along CAMTyland's game path that they are applicable corporations, in-scope status can result in substantive CAMT liability. This is true even when it is not intuitive that the taxpayer would have any CAMT liability. Indeed, a scope bubble corporation cannot automatically bypass CAMTyland or be sent on a rainbow trail merely because its effective tax rate equals or exceeds (and is expected to always equal or exceed) 21 percent. An "effective tax rate" is a financial accounting term and is generally calculated by dividing a company's total income tax expense (as reported within the financial statements) by the company's earnings before taxes.[7] Because a company's CAMT AFSI base may differ significantly from its financial statement earnings before taxes, a taxpayer that has an ETR exceeding 21 percent may still be an applicable corporation and still have a CAMT liability, notwithstanding that the applicable tax rate under CAMT is "only" 15 percent. Also, while permanent differences[8] cause a company's ETR to differ from the statutory federal income tax rate (that is, because they change the amount of federal income tax to be paid in perpetuity), temporary differences[9] do not affect the ETR calculation (for example, a company with no permanent differences but a few temporary differences will have an ETR equal to the statutory federal income tax rate). Hence, temporary differences that cause AFSI to be higher than regular taxable income in a given year potentially may force a taxpayer to take a turn as a CAMTyland payer.

For example, assume that Gingerbread Corporation is a scope bubble corporation.

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[4]*See id*. at 1 (Dec. 20, 2023) (indicating that all corporations other than S corporations, regulated investment companies, and real estate investment trusts — for example, exempt organizations — must either determine they are eligible for the simplified method or comply with extensive CAMT reporting obligations).

[5]Section 3 of Notice 2023-7, 2023-3 IRB 390 (under the regulatory authority in section 56A(c)(15)), introduced additional adjustments to AFSI relating to certain nonrecognition transactions (that is, transactions that do not result in any gain or loss for federal income tax purposes under section 332, 337, 351, 354, 355, 367, 361, 368, 721, 731, or 1032 (or combination thereof)).

[6]Derivatives embedded in reinsurance and changes in the value of an insurer's investments for certain policies may cause scope AFSI to exceed FSI.

[7]Under Financial Accounting Standards Board Accounting Standards Codification (ASC) 740-10-50-12, a public company must "disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems." Under ASC 740-10-50-13, a nonpublic company, while not required to disclose such a reconciliation, must disclose the nature of any significant reconciling items but may omit a numerical reconciliation. FASB is an independent body that establishes the financial accounting and reporting standards for public and private companies (and not-for-profit organizations) that follow U.S. generally accepted accounting principles. *See* FASB, "About the FASB."

[8]Permanent differences are book-tax differences caused by including an item of income or expense for one reporting system but not the other (for example, the exclusion from taxable income of interest on tax-exempt bonds or the disallowance of entertainment expenses for federal income tax purposes).

[9]Timing differences are book-tax differences caused by differences in the timing of income or expense recognition between the two reporting systems (for example, accelerated depreciation or bad debt reserves).

Gingerbread: Taxable Income vs. AFSI

Book Income Before Federal and Foreign Income Taxes	Taxable Income $1 Billion	AFSI $1 Billion
Less repair and maintenance costs deductible for tax, but capitalized for books	($50 million)	-
Less legal settlement expense recognized in an earlier year for books	($175 million)	-
Less deferred revenue recognized for books, recognized in an earlier year for tax	($250 million)	-
Less accelerated depreciation on section 168 property, net of book depreciation addback*	($150 million)	($150 million)
Tentative taxable income/AFSI	**$375 million**	**$850 million**
Use of NOL carryforward	($300 million)	-
Taxable income/AFSI	$75 million	$850 million
Tax rate	21%	15%
Liability	**$15.75 million**	**$127.5 million**

*Section 56A(c)(13) provides that AFSI is reduced by federal income tax depreciation deductions allowed under section 167 regarding section 168 property and is increased by book depreciation expense for this section 168 property. As a result, if a taxpayer's federal income tax depreciation deductions for this section 168 property were *less than* the taxpayer's book depreciation expense relating to this property in a given tax year (for example, if the property was immediately expensed in a prior tax year for federal income tax purposes yet has not been fully depreciated for book purposes), then the net adjustment under section 56A(c)(13) would *increase* the taxpayer's AFSI.

Gingerbread's FSI before federal and foreign income taxes is $1 billion, and its only book-tax differences are the following temporary differences:

- $50 million for repair and maintenance costs deducted for tax and capitalized for books;
- $175 million for legal settlement costs related to litigation settled during the year that was deducted for tax but expensed for books in a previous tax year;
- $250 million for deferred revenue recognized for books that was included in taxable income in a previous tax year; and
- $150 million for accelerated depreciation on section 168 property, net of book depreciation.

Gingerbread also has $300 million in net operating loss carryovers for federal income tax purposes[10] but zero financial statement NOL carryovers for CAMT purposes.[11] Gingerbread has no foreign tax credits for federal income tax or CAMT purposes.

Gingerbread's ETR is 21 percent because all its book-tax differences are temporary differences, and its regular tax liability for the year is $15.75 million.[12] Gingerbread's CAMT liability for the year, however, is $127.5 million[13] (a difference of $111.75 million). Thus, Gingerbread's CAMT liability greatly exceeds its regular tax liability in

[10] *See* section 172.

[11] Section 56A(d) provides for a reduction to AFSI for financial statement NOLs. Specifically, for CAMT liability purposes only, AFSI for a particular tax year is reduced by the lesser of: (1) the aggregate amount of the corporation's financial statement NOL carryovers to the year or (2) 80 percent of the AFSI for the tax year computed without regard to financial statement NOL carryovers. A financial statement NOL is the amount of an AFSI loss (determined without regard to a financial statement NOL) for tax years ending after December 31, 2019. Financial statement NOL carryovers can be carried over indefinitely. Notice 2023-64, 2023-40 IRB 974, favorably confirms that a corporation that becomes an applicable corporation (whether in 2023 or later) can have a financial statement NOL carryover equal to net AFSI losses for tax years ending after 2019 (that is, the financial statement NOL carryover is determined without regard to whether the corporation was an applicable corporation for any prior tax year).

[12] 21 percent * $75 million.

[13] 15 percent * $850 million.

the current year even though Gingerbread's ETR is 21 percent.

Scope Bubble Corporations: The Need to 'Prove the Negative'

Even if a scope bubble corporation "knows" it is a winner (meaning it is convinced of its nonapplicable corporation status or that even if it is an applicable corporation, there is no CAMT liability due), it generally must "prove the negative" to its auditor (for income tax provision purposes) and the IRS (via the completion of draft Form 4626).

As illustrated by the draft IRS Form 4626 and accompanying draft instructions, the compliance burden imposed on scope bubble corporations to demonstrate their out-of-scope status for CAMT purposes often will exceed the compliance burden for in-scope taxpayers when computing CAMT liability. Indeed, a scope bubble corporation that purports to be out of scope (that is, not an applicable corporation) will have to report its scope AFSI for three tax years, as well as the members of its section 52 single-employer group or foreign-parented multinational group and certain information (for example, net income) of each such member. A scope bubble corporation who discovers that it is in scope (that is, an applicable corporation) will need to know its AFSI for four years and apply two sets of rules to compute AFSI.[14]

CAMTyland Game Plan

Upon embarking on its CAMTyland journey, a taxpayer should first identify and complete the CAMT register of entities relevant to the tested corporation. This can require identifying members of the taxpayer's tax consolidated group, book consolidated group, section 52 single-employer group, and foreign-parented multinational group.[15] This information is required by the draft version of Form 4626, and the draft instructions clarify that the information must be enumerated on the form.[16]

Second, the taxpayer should identify its correct applicable financial statement (AFS). If the taxpayer is a Form 10-K filer with the SEC[17] or is book consolidated on a Form 10-K, the Form 10-K will generally be the taxpayer's AFS. Special considerations exist in the inbound context. For example, under Notice 2023-64, 2023-40 IRB 974, and Notice 2024-10, 2024-3 IRB 406, the AFS for a U.S. inbound corporation generally appears to be the foreign parent's consolidated financial statements, even if these financial statements are not prepared in accordance with U.S. generally accepted accounting principles (for example, they are prepared according to international financial reporting standards)[18] and the U.S. inbound corporation prepares its own separate financial statements under U.S. GAAP. Numerous complications may arise from this rule when determining the taxpayer's CAMT liability. There are key differences between U.S. GAAP and IFRS,[19] and a U.S. inbound corporation will likely need to compute U.S. GAAP to IFRS adjustments in determining its FSI and AFSI.

Once a taxpayer has identified its correct AFS, it must identify the correct FSI starting number. Under Notice 2023-64, FSI is the net income or loss of the taxpayer, as set forth on the taxpayer's AFS for the tax year. FSI includes all items of income, expense, gain, and loss reflected in net income on the AFS for the tax year, including nonrecurring items and income or loss from discontinued operations. FSI does not include amounts reflected in places other than net income on the AFS, like amounts reflected in retained earnings and other comprehensive income. Items of income, expense, gain, or loss need not be

[14] An applicable corporation will also need to report the members of its section 52 single-employer group or foreign-parented multinational group and certain information (for example, net income) of each such member.

[15] *See* Santamaria et al., "CAMTyland, Part I," *supra* note 1.

[16] *See* IRS, *supra* note 3, at 4, 10, and 11 (indicating "incomplete or nonspecific responses, including phrases such as 'available upon request' are not a sufficient response"). The instructions indicate that a taxpayer that purports to be an applicable corporation must enumerate the members of its section 52 single-employer group or foreign-parented multinational group even though such memberships are not relevant to the taxpayer's CAMT liability analysis.

[17] Form 10-K is the annual report that must be filed with the U.S. SEC by most domestic public companies. *See* Form 10-K.

[18] *See* IFRS, "IFRS — Home."

[19] For a side-by-side comparison, see KPMG, "Handbook: IFRS® Compared to US GAAP" (Nov. 2023).

recognized, realized, or otherwise considered for regular tax purposes to be included in AFSI.

Once a taxpayer has identified the correct starting FSI number, it must play again. If it is a member of a book consolidated group and the consolidated AFS is the taxpayer's AFS, the taxpayer must traverse a series of complex and burdensome rules for allocating FSI from a consolidated AFS.[20] These rules generally require most entities to crack and repack the consolidated AFS for both CAMT scope and liability determination purposes. This may involve identifying intercompany items and eliminations of certain intercompany transactions, as well as creating a "right-sized" financial statement. However, while right-sizing the consolidated net income is generally required by Notice 2023-64 (as well as the draft Form 4626 and related form instructions) and certain right-sizing adjustments must be reflected on specific lines on the draft Form 4626,[21] taxpayers have significant flexibility in determining how much, if any, of the interim guidance they choose to rely on for 2023, which may allow for the use of a simpler approach.[22] For example, the draft 2023 Form 4626 instructions may be read to suggest that there is flexibility regarding consolidation entries for 2023.[23]

Once a taxpayer has determined, allocated, and right-sized its FSI, it will need to make a number of adjustments under section 56A(c) (and the notices issued to date,[24] if desirable) to arrive at AFSI. The draft 2023 Form 4626 requires a taxpayer to separately list the amount of each AFSI adjustment. Significant work may be required to calculate the amounts for various AFSI adjustments, even when the draft form instructions indicate the resulting number can be reflected in a single line and without a supporting schedule. For example, the adjustment for depreciation is reflected on a single line.[25] Notice 2023-7, 2023-3 IRB 390, as modified by Notice 2023-64, breaks down the adjustment for depreciation into six component parts and requires additional adjustments if an asset is disposed of or transferred. Further, because the adjustments are made to the right-sized numbers, a single line on draft Form 4626 may be based on multiple financial statements (if one or more includable entities exist).

When devising a CAMTyland game plan (and upon finding licorice), players should keep in mind the enormous flexibility taxpayers have for 2023 — and the fact that Treasury and the IRS acknowledge this optionality.[26] Thus, if a taxpayer's preliminary scope AFSI calculation for 2023 yields a number that is slightly above the $1 billion threshold, the taxpayer may want to consider whether a different reasonable approach, consistently applied, could be used in

[20] *See* section 5.02(3)(c) of Notice 2023-64.

[21] *See* IRS, *supra* note 3, at 5 and 7.

[22] Taxpayers appear to have certain flexibility when applying CAMTyland's particular rules in 2023. Treasury and the IRS anticipate publishing proposed regulations that will apply for tax years beginning on or after January 1. Accordingly, taxpayers may rely on reasonable interpretations of the statute and, at their discretion, the notices issued to date when applying CAMT regarding their 2023 tax year.

[23] *See* IRS, *supra* note 3, at 1 (discussion of interim rules from notices) and 5 and 7 (discussion of line 1d).

[24] Guidance issued to date includes Notice 2023-7 (initial CAMT guidance and scope determination safe harbor; *see* KPMG, "Initial Observations on CAMT Guidance" (Jan. 4, 2023)); Notice 2023-20, 2023-10 IRB 523 (guidance for the insurance industry; *see* KPMG, "Observations From Notice 2023-20" (Feb. 21, 2023)); Notice 2023-42, 2023-26 IRB 1085 (2023 estimated tax payment relief; *see* KPMG, "Relief for Corporations That Did Not Pay Estimated CAMT" (June 7, 2023)); Notice 2023-64, modifying and clarifying Notice 2023-7 (among other guidance, lists financial statements that meet the definition of an AFS, provides priority rules for identifying an AFS, and provides general rules for determining FSI and AFSI; *see* KPMG, "New CAMT Guidance in Notice 2023-64" (Sept. 28, 2023)); Notice 2024-10 (providing guidance on the treatment of controlled foreign corporation dividends in determining AFSI and the AFS determination for tax consolidated group members; *see* KPMG, "Interim Guidance on Corporate Alternative Minimum Tax" (Dec. 15, 2023)); and draft Form 4626, *supra* note 3 (requires extensive information reporting; *see* KPMG, "Updated Draft CAMT Form" (Nov. 17, 2023)).

[25] *See* Part I, line 2k and Part II, line 2n of the draft 2023 Form 4626, *supra* note 3.

[26] *See* IRS, *supra* note 3, at 1 ("Interim Guidance: Certain rules described in these instructions are interim rules from notices published in the Internal Revenue Bulletin. *Taxpayers are not required to apply such interim rules but may optionally rely on them for a limited period of time (including 2023).* Taxpayers should complete Form 4626 in a manner that reflects the interim rules they have chosen to rely on.") (emphasis added).

one or more areas with apparent flexibility for 2023.[27]

Conclusion

Today's CAMTyland Adventure outlines the challenges and opportunities a scope bubble corporation may find on the game path. It also provides a game plan for scope bubble corporations to ensure that any CAMT substantive and compliance obligations can be satisfied. While the game path and draft Form 4626 reporting obligations for these scope bubble corporations may seem daunting, proactive efforts will help make CAMTyland more manageable — even for young players. If a taxpayer's preliminary scope determination indicates that applicable corporation status will be a close call, the taxpayer should take steps now to try to prevent being stuck in the molasses swamp too close to bedtime.[28] ■

[27] For example, if a taxpayer is a partner in a partnership that is not a member of its section 52 single-employer group or foreign-parented multinational group, determining the "correct" amount of partnership income inclusion for 2023 CAMT scope determination purposes is an area in which multiple reasonable approaches exist. Further, scope bubble corporations may want to consider "traditional" accounting methods planning (that is, accelerating deductions and deferring income) to either receive an increased cash tax benefit for 2023 or maximize future CAMT flexibility. Particularly for scope bubble corporations, commencing CAMT data gap analyses and directional modeling now is critical to navigating the regime's myriad of challenges and complexities presented in this initial year.

[28] The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP.