

## **Complex Calculations: Exploring the Corporate AMT**

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## Complex Calculations: Exploring the Corporate AMT

This Q&A is based on a recent interview of Rayth Myers and Enrica Ma, both with Ernst & Young LLP's National Tax Department in Washington, by Barbara Kirchheimer of EY US's tax technical knowledge group. Myers is a senior manager in EY's accounting periods, methods, and credits practice, and Ma is a principal in the international tax and transaction services practice.

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**Question:** The corporate alternative minimum tax was enacted as part of the Inflation Reduction Act (P.L. 117-169). Can you provide a brief overview before we delve into the details?

**Rayth Myers:** The corporate AMT is a 15 percent tax based on a taxpayer's adjusted financial statement income (AFSI), which is effectively book income with some adjustments. It applies to companies that report more than \$1 billion in profits to shareholders, which for purposes of the tax means those with average AFSI exceeding \$1 billion for any three consecutive years preceding the tax year. This includes foreign-parented companies with profits of more than \$100 million if the aggregate foreign-parented group has more than \$1 billion in profits. It is effective for tax years beginning after December 31, 2022, so companies will have to deal with it this year.

**Q:** What will companies need to do to prepare for this tax that they are not already doing?

**Myers:** The corporate AMT will require companies to compute two separate calculations

for federal income tax purposes and pay the greater of the tentative minimum tax under the corporate AMT or their regular tax liability. Essentially, a taxpayer will pay the greater of 15 percent of their AFSI or 21 percent of their taxable income.

We are still figuring out the details of how it will work. The IRS and Treasury issued some narrow guidance for companies in December 2022 (Notice 2023-7, 2023-3 IRB 390) and February 2023 (Notice 2023-20, 2023-10 IRB 1) that addresses some of the more time-sensitive concerns, including providing a simplified method for determining whether a company is an "applicable corporation" for purposes of the corporate AMT and how to apply the relevant depreciation adjustment for section 168 property. However, we anticipate more guidance to address additional issues taxpayers are facing.

**Q:** Having now had some time to analyze this new tax, where do you think corporate taxpayers will experience the greatest challenges?

**Enrica Ma:** For companies that may be subject to the corporate AMT, they need to compute their potential corporate AMT liability by first determining their AFSI. The corporate AMT rules require various adjustments to determine the AFSI. One of these adjustments involves taking into account dividends received from unconsolidated subsidiaries, including controlled foreign corporations. One issue we've discovered is the potential for duplication — double counting — of distributions from CFCs in computing the corporate AMT. Under the law, the Treasury Department has the authority to provide rules to prevent duplication of any item, but there are open questions about what constitutes duplication for purposes of the corporate AMT in the context of CFC distributions.

Corporations will need to consider this issue, particularly when their CFCs regularly make distributions of their earnings either to upper-tier

CFCs or back to the U.S. corporation. In those situations, it is not entirely clear whether distributions of previously taxed earnings by a CFC to other CFCs can be excluded from the computation of AFSI for corporate AMT purposes. It's also unclear whether distributions of previously taxed earnings that were included in income prior to the enactment of the corporate AMT rules (that is, before 2023) can be excluded from the computation. Part of the question is what the word "dividend" means in this context and whether distribution of pre-2023 earnings is considered "duplication."

There are convincing arguments — and in some situations, good policy reasons — for not counting the distributions as part of the income, but the statutory language does not provide a clear answer. We understand that clarifying this issue is one of Treasury's and the IRS's top priorities in forthcoming guidance.

**Q:** Are there other international tax issues that companies should be evaluating?

**Ma:** Yes, another area that may present challenges is the corporate AMT's foreign tax credit, particularly which foreign taxes can be included to calculate it. This corporate AMT FTC differs from the FTCs we are used to dealing with under section 904. Certain concepts, such as basketing or limitations, do not apply here.

That said, there is some intersection between the different FTC rules. For example, the corporate AMT FTC is available only if the taxpayer elects to credit the regular FTCs. If the taxpayer deducts the regular FTCs instead, they won't qualify for the corporate AMT FTC. Also, the corporate AMT FTCs must qualify as foreign income taxes under section 901.

Creditable foreign income taxes paid or accrued by CFCs are limited to 15 percent of the taxpayer's pro rata share of its CFCs' income, while creditable foreign income taxes paid or accrued by domestic corporations are not limited. To be eligible for the corporate AMT FTC, the foreign taxes — whether paid or accrued by the domestic corporations or CFCs — need to meet both prongs of a two-prong test.

**Q:** Can you explain how companies can meet that test?

**Ma:** The foreign taxes must be paid or accrued by the corporation to meet the first prong, and to

meet the second prong, the taxes must be taken into account on the applicable financial statement. But there is some uncertainty about how to apply the two-prong test, particularly when there are temporary book-tax differences, and there may be several different approaches.

We know what "paid or accrued (for Federal income tax purposes)" in the first prong means. But there is some uncertainty around how to apply the tax concept of "paid or accrued" in the first prong together with the tax-related items reported on the financial statement in the second prong to determine the corporate AMT FTCs that would meet this two-prong test.

**Q:** Can you give examples of those outstanding questions?

**Ma:** Sure. For purposes of the two-prong test, do we take into account only current tax expenses recorded on the financial statement? Or do we need to take into account both current tax expenses and deferred tax expenses or benefits on the financial statement? Also, does this rule require some later-in-time determination between the two prongs, or do the two prongs have to be met in the same year? These are just some of the open questions.

I would suggest, at a minimum, that tax professionals will need to have some level of understanding of financial statement concepts to apply many of the corporate AMT rules, and that itself could be quite challenging.

**Q:** How are you advising clients to approach these unknowns and complexities?

**Ma:** My advice always starts with the importance of modeling all the potential scenarios. Regarding the impact of distributions of previously taxed earnings to corporate AMT, there can be different modeling scenarios. One scenario may give companies a favorable result, but others may not. Given the uncertainties in applying part of the corporate AMT rules, I would suggest examining all the potential scenarios so they can prepare for a range of tax outcomes. Companies that run various scenarios can sometimes find ways to manage, or at least prepare for, their tax obligation.

Also, for some companies, this modeling exercise can point them to areas where they might want to focus their communications with Treasury and the IRS. Sometimes policymakers

may inadvertently be unaware of the practical business impacts of legislative changes. This kind of dialogue can ultimately lead to a more sound tax policy. Treasury has asked for business input on the corporate AMT, so companies should consider being part of that conversation.

**Q:** Rayth, following up on Enrica's comments, what have you been focusing on in your client discussions about the corporate AMT?

**Myers:** I would echo how important it is to start modeling sooner rather than later, starting from ground zero — determining the applicable financial statement and the applicable aggregated group for the taxpayer. In some cases, it takes significant effort just to determine the AFSI, which is used for both determining whether the corporate AMT applies and, if so, for calculating the tentative minimum tax amount and corresponding corporate AMT liability.

**Q:** What is involved in determining the AFSI?

**Myers:** It involves taking steps to really understand the organizational structure, including the financial statements of each entity in the organization. Tracking down those financial statements may involve coordination between the U.S. tax team and their international and accounting colleagues in ways they've never had to coordinate before.

These issues may be especially complicated for foreign-parented multinational companies, in part because the information needed to perform the U.S. calculations often sits in the foreign country and may not be as readily accessible to the tax department performing the calculations. For example, it may be complicated to identify what consolidation entries are made or the exchange rates used by the foreign parent.

These are just a couple of the reasons it can be so challenging to determine the starting point for computing the tax. Questions exist as to what's the right source for determining net income.

**Q:** And I'll ask you the same question I asked Enrica: What are you telling clients they can or should do now?

**Myers:** As we discussed, Treasury is expected to provide more guidance on the corporate AMT, but companies cannot afford to wait to begin performing more detailed calculations to determine their tax profile and the corporate AMT impact. When the Inflation Reduction Act was

first enacted, we saw some companies begin doing high-level calculations with summary data for various adjustments required to compute AFSI. But with the first quarter of 2023 behind us, it's time for companies to begin refining their models and calculations with more specificity.

This exercise can help companies think through process and tracking issues inherent in the calculations. For example, how are companies going to track fixed assets to comply with the depreciation adjustment? Companies are realizing this is much more than just book-tax depreciation differences; it also covers basis and expense differences, dispositions of property, and tracking depreciation included in inventories and cost of goods sold. As a result, it is much more complicated to implement, and companies that start identifying processes earlier will likely be better off.

**Q:** So companies need to get a handle on how to identify and track this information they'll need going forward. Anything else?

**Myers:** A second reason to get started is that the process can help identify company-specific issues. This can benefit companies by permitting them to consider the best method for implementing the statute — for example, all the different types of items they include in the category of other comprehensive income. I also agree with Enrica that if specific issues come up during a company's modeling, it's worth considering providing comments the IRS and Treasury can consider when they release subsequent rounds of guidance.

**Q:** Any final thoughts, Rayth?

**Myers:** The corporate AMT is in effect for 2023 tax years, and corporations need to begin refining their AFSI calculations to determine both applicable corporation status and the tentative minimum tax. Taxpayers cannot wait for every issue to be addressed. Because of the adjustments required under section 56A, applicable financial statement amounts cannot simply be pulled to calculate AFSI and the potential corporate AMT liability. The calculations will be complex because of the difficulty in identifying and tracking book-tax differences in source data, particularly when information is located outside the United States.

**Q:** And Enrica, any final thoughts?

**Ma:** For multinationals subject to the corporate AMT, it will be important to pay attention to how it interacts with OECD pillar 2 global anti-base-erosion rules. The expectation has been that the corporate AMT would constitute part of the covered taxes for global anti-base-erosion purposes, and there is an open question as to whether corporate AMT would be considered a CFC regime.

Administrative guidance released by the OECD in February provides a simplified allocation methodology that is applicable to global intangible low-taxed income as a blended CFC tax regime. However, based on the administrative guidance's description, the corporate AMT on a CFC's book income is not eligible for the simplified allocation methodology. So the open questions are whether a portion of a taxpayer's corporate AMT liability is treated as a CFC tax and, if so, how that portion would be allocated to constituent entities for pillar 2 purposes.

We are looking forward not only to the U.S. corporate AMT guidance but also to OECD pillar 2 guidance that could help companies determine how their corporate AMT liability could impact their overall pillar 2 liability. All these rules will be interrelated and important for U.S. multinational corporations to navigate for many years to come. ■

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