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M&A Tax Talk
CAMT: Corporate alternative minimum tax

The Inflation Reduction Act of 2022 was signed into law by President Biden on August 16, 2022 and included a 15-percent corporate alternative minimum tax ("CAMT") for corporations. The CAMT is effective for taxable years beginning after December 31, 2022. The CAMT generally is focused on corporations (or groups of corporations) that have significant financial statement income but are not viewed as having significant U.S. federal income tax liabilities.

On December 27, 2022, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") released Notice 2023-7, which announced forthcoming proposed Treasury regulations for CAMT and provided interim clarifying guidance that can be relied on by taxpayers. Treasury and the IRS generally expect that the proposed Treasury regulations will be consistent with Notice 2023-7 and will apply to taxable years beginning after December 31, 2022. Additional interim guidance is expected.[1]

The CAMT is a new, complex provision and raises many issues regarding whether CAMT applies and, if so, how to determine any CAMT liability. The CAMT has certain rules and features that could impact M&A activity.

CAMT Overview

The CAMT imposes a 15 percent tax on the "adjusted financial statement income" or "AFSI" of an "applicable corporation" where the amount of such tax (less any available CAMT foreign tax credits) exceeds the regular U.S. federal income tax liability of the applicable corporation plus any "base erosion and anti-abuse tax" or "BEAT" liability. Any CAMT paid is creditable against any regular U.S. federal income tax or BEAT liability for a subsequent taxable year.

AFSI generally is financial statement net income or loss set forth on the "applicable financial statement" of the applicable corporation (e.g., a Form 10-K), subject to certain adjustments. An applicable corporation is any corporation (other than an S corporation, a RIC, or a REIT) which meets the average annual AFSI test ("AFSI Test") for one or more preceding taxable years that end after December 31, 2021. The AFSI Test is met for a taxable year if the average annual AFSI (determined without regard to financial statement net operating loss carryforwards ("FSNOLs")) for the three-year period ending with such year exceeds $1 billion.

Solely for purposes of determining applicable corporation status, all AFSI of persons treated as a single employer with such corporation under section 52(a) or (b) is treated as AFSI of such corporation. For foreign-parented multinational groups ("FPMG"), a U.S. corporate subsidiary meets the AFSI Test for a taxable year if (i) the average annual AFSI of the entire FPMG exceeds $1 billion, and (ii) the average annual AFSI of the U.S. corporate subsidiary (generally together with other U.S. corporate subsidiaries) is at least $100 million. Notice 2023-7 provides a safe harbor rule that generally looks to financial statement income (i.e., without adjustments to get to AFSI) and lowers the $1 billion threshold to $500 million, and the $100 million threshold to $50 million.

Under statutory rules, a corporation generally retains applicable corporation status regardless of AFSI amounts for subsequent taxable years. However, as discussed below, Notice 2023-7 terminates applicable corporation status in connection with certain M&A transactions (although the CAMT may still ultimately apply).

Certain differences between financial accounting and U.S. federal income tax rules may impact whether a corporation is an applicable corporation or has a CAMT liability. For example, mandatory capitalization under section 174 can be a large temporary difference that increases taxable income relative to financial accounting income. In addition, intangible assets have different amortization periods and rules for financial accounting and tax purposes. For example, goodwill is not amortizable for financial accounting purposes (although may be subject to impairment), while acquired goodwill is amortizable over 15 years for tax purposes. In contrast, AFSI is adjusted to take into account tax depreciation for tangible assets subject to sections 167 and 168, which creates parity with regular U.S. federal income tax and thus does not create a difference.[2] Finally, certain permanent differences can have a significant impact.

[1] Treasury and the IRS issued Notice 2023-20 on February 17, 2023, which contains certain guidance with respect to the application of the CAMT to the insurance industry. In addition, Treasury and the IRS issued Notice 2023-42 on June 7, 2023, which grants penalty relief for corporations that do not pay estimated tax related to the CAMT.

[2] AFSI is also adjusted to take into account amortization under section 197 with respect to a "qualified wireless spectrum."

For example, net operating losses for U.S. federal income tax purposes for taxable years prior to 2020 can be carried forward (indefinitely for net operating losses generated in 2018 or later) while only FSNOLs generated in 2020 or later can be taken into account for CAMT purposes. In addition, deductions for equity-based compensation (e.g., non-qualified stock options and RSUs) could have significant permanent differences where the value of the underlying stock has increased since the grant date. Some of the foregoing items could be impacted by M&A activity such as a stepped-up basis for goodwill for U.S. federal income tax purposes pursuant to an asset acquisition (or deemed asset acquisition) that can be amortized.

Notice 2023-7

Notice 2023-7 generally has two categories of guidance relating to M&A activity: (i) AFSI computations for section 368 reorganizations and section 355 transactions, and (ii) applicable corporation status for target corporations and spun-off corporations.

Certain Tax-Free Transactions

Notice 2023-7 attempts to create parity between ASFI and regular U.S. federal income tax by eliminating financial statement gain or loss for AFSI purposes relating to tax-free section 368(a) reorganizations and section 355 split-offs. Without this rule, these transactions could create significant AFSI, which in turn could result in a significant CAMT liability or cause a corporation to become an applicable corporation. Since the financial accounting gain or loss is eliminated for AFSI purposes, Notice 2023-7 provides that the assets of the target or split-off corporation have a carryover basis for AFSI purposes (i.e., no "free" basis step-up).

As a result, taxpayers will need to separately track basis for CAMT purposes, which results in three parallel basis tracking workstreams (regular U.S. federal income tax, CAMT, and financial accounting). For example, for AFSI purposes, if a depreciable asset is acquired in a section 368(a) reorganization and later sold, the basis of the asset would be the carryover basis as adjusted for any post-acquisition depreciation. Notice 2023-7 does not contain any guidance relating to when taxpayers must start tracking carryover basis for AFSI purposes. For example, if a section 368(a) reorganization occurred in 2018 (i.e., before the CAMT was enacted), would any asset basis step-up for financial accounting purposes need to be eliminated for AFSI purposes?

Transactions that are tax-free for U.S. federal income tax purposes will need to be analyzed to determine whether these financial accounting gain/loss elimination and carryover basis rules apply. Notice 2023-7 also provides that certain transactions may have tax-free and taxable components, and the financial accounting gain/loss elimination and carryover basis rules may apply to the tax-free components.

For financial accounting purposes, a taxable sale of target corporation stock generally results in gain or loss as well as a basis step-up for the target corporation's assets under purchase accounting. If the target corporation is publicly traded, most target shareholders generally would not be expected to have any CAMT consequences from the stock sale. Notice 2023-7 does not eliminate this basis step-up for AFSI purposes but future guidance may do so (i.e., step-up may be viewed as "free").

Applicable Corporation Status

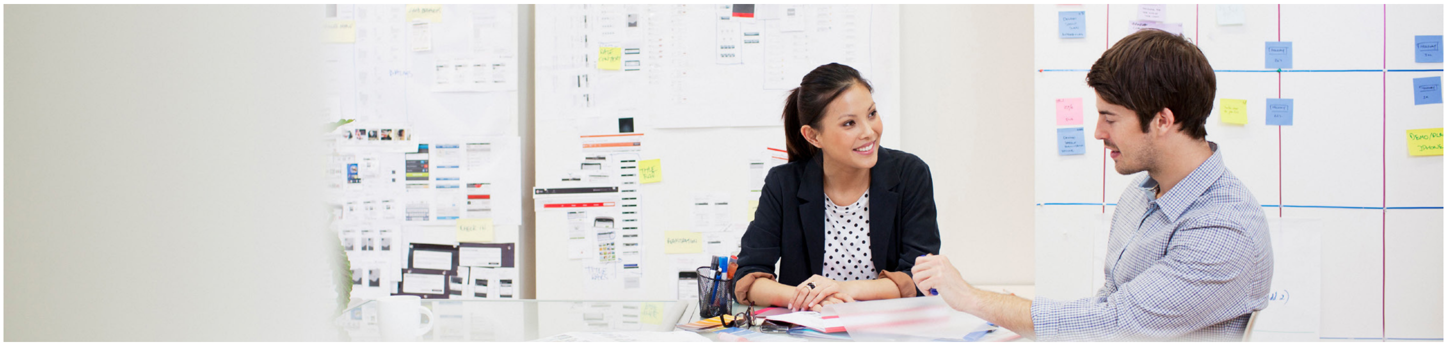
Notice 2023-7 contains rules regarding applicable corporation status following certain disposal transactions, which apply regardless of whether the transaction is tax-free for U.S. federal income tax purposes.

In general, if a target corporation is acquired by another corporation, (i) any applicable corporation status of the target corporation is terminated, and (ii) the AFSI of the target corporation for the preceding three-year period is included in the AFSI Test of the acquiring corporation. Thus, the acquiring corporation would need to take into account AFSI of the target corporation for pre-acquisition periods.

In addition, if the target corporation is acquired out of a corporate group, (i) a portion of the AFSI of the corporate group for the prior three-year period is allocated to the target corporation (currently, based on any reasonable method), (ii) such allocated AFSI is included in the AFSI Test of the acquiring corporation, and (iii) AFSI of the selling corporate group is not reduced (i.e., applicable corporation status not impacted – double counting).

Further, if stock of a corporation is distributed in a section 355 transaction, (i) any applicable corporation status of such corporation is terminated, (ii) the corporation will be allocated AFSI for the prior three-year period for purposes of a stand-alone AFSI Test, and (iii) the AFSI of the distributing corporate group is not reduced (i.e., applicable corporation status not impacted – double counting).

The magnitude of these rules depends on the particular corporations (and groups) involved. For example, if the acquiring corporation is already an applicable corporation, then an acquisition would not impact its applicable corporation status. In addition, if the acquiring corporation and target corporation would otherwise meet the AFSI Test post-acquisition, these grouping rules may have the effect of accelerating CAMT liability. In contrast, if the acquiring corporation is not already an applicable corporation, then the acquisition could result in a situation where the applicable corporation status of a target corporation terminates (i.e., acquired out of a corporate group) and the acquiring corporation and the target corporation do not meet the AFSI Test.



The foregoing rules require further guidance. For example, Notice 2023-7 refers to the acquisition of a target corporation or its assets but does not specify whether this means mergers (and non-merger section 368(a) asset reorganizations) or could also include the target corporation selling a portion of its assets and remaining in existence. Additionally, while the statutory rules state that a corporation remains an applicable corporation unless it undergoes an ownership change (and Treasury and the IRS determine that it is appropriate to terminate applicable corporation status), neither the statutory rules nor the Notice provide any guidance as to what quantum of ownership change is necessary.

FSNOLs

While FSNOLs are disregarded for applicable corporation determinations, FSNOLs generated after December 31, 2019 can be carried forward indefinitely and offset up to 80 percent of AFSI for a taxable year. Neither the statutory rules nor Notice 2023-7 provide any guidance for FSNOLs with respect to M&A activity. For example, would any FSNOLs of a target corporation continue to be available (and would it matter whether the transaction was tax-free or taxable) and, if so, would the FSNOLs be subject to limitation (e.g., section 382 principles)? In addition, if a target corporation is acquired out of a corporate group, would FSNOLs be allocated to the target corporation (e.g., similar to allocations for consolidated groups)?

Additional M&A Considerations

CAMT can potentially be relevant to M&A activity in additional ways. For example, if an acquiring corporation that pays CAMT due to significantly higher AFSI than regular U.S. federal taxable income (e.g., based on some of the differences discussed above), the acquisition of a target corporation that does not pay CAMT and has sufficient regular U.S. federal taxable income could result in the combined business not having a CAMT liability (i.e., a reduction in overall U.S. federal income tax liability). In such case, the target corporation could be more attractive to an acquiring corporation with a CAMT liability as compared to an acquiring corporation without a CAMT liability. Similarly, a target corporation that pays CAMT could be more attractive to an acquiring corporation that does not pay CAMT and does not expect the combined business to pay CAMT. Further, a target corporation that has CAMT credits may be attractive to an acquiring corporation that does not pay CAMT (subject to limitations under section 383).

When modeling CAMT, consider (i) only FSNOLs generated in taxable years after December 31, 2019 can be used to offset AFSI, (ii) AFSI of a "controlled foreign corporation" or "CFC" is generally the financial statement income of the CFC (i.e., not the GILTI tested income or Subpart F income of the CFC), and (iii) the portion of the taxpayer's depreciation deduction allowed for tax purposes may be substituted for book depreciation when calculating AFSI.

Note, any portion of a cost that a taxpayer does not depreciate for tax purposes (e.g., depreciation for qualified computer software for which the taxpayer elects to forgo bonus depreciation) is not subject to adjustment for AFSI purposes as provided in the Notice 2023-7.

In addition, the AFSI consequences of pre-acquisition and post-acquisition restructurings will need to be analyzed to determine any impact on applicable corporation status and CAMT liability. Moreover, when performing due diligence, determinations with respect to applicable corporation status and CAMT liability will need to be analyzed and tax and accounting practitioners will need to work together to sort through the CAMT rules.

Given that the CAMT rules are new and there is limited interim guidance, there may be uncertainty as to the application of the CAMT rules, which may create additional risk with respect to pre-closing tax liabilities for tax years beginning after December 31, 2022, as well as for modeling the tax profile of the combined business.

In sum, the new CAMT can impact M&A activity in several different ways and will likely require additional modeling and diligence. Moreover, additional guidance is expected from the Treasury and IRS and taxpayers will need to stay up to date.

Want to learn more?
Reach out to our contacts below.

Ethan Harris
Washington National Tax
Tax Principal
Deloitte Tax LLP
ethanharris@deloitte.com

Preston Pittman
Washington National Tax
Tax Manager
Deloitte Tax LLP
prpittman@deloitte.com

Lindsay Wietfeld
Mergers & Acquisitions
Tax Partner
Deloitte Tax LLP
lwietfeld@deloitte.com

Jess Williams
Mergers & Acquisitions
Tax Senior Manager
Deloitte Tax LLP
jrwilliams@deloitte.com