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# Treasury Releases Guidance on 15% Corporate Minimum Tax, 1% Tax on Stock Buybacks

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On December 27, 2022, Treasury released Notices 2023-7 and 2023-2 (the "Notices"). The Notices provide initial guidance on the 15% corporate minimum tax on the book income of large corporations (the "CAMT") and the non-deductible 1% excise tax on certain corporate stock buybacks by publicly traded companies (the "Buyback Tax") that were included in the Inflation Reduction Act (the "IRA").[1] The CAMT and the Buyback Tax both are effective January 1, 2023. The CAMT Notice provides immediate guidance on time-sensitive areas of uncertainty, such as tax-free transactions that may give rise to financial statement income, and requests comments on over 30 specific interpretative issues. The Buyback Tax Notice provides helpful guidance in several areas but subjects a wider range of transactions to the tax than many had hoped.

The Notices are intended to provide interim guidance until proposed Treasury Regulations are promulgated. Until such time, Taxpayers can rely on the Notices.

## CAMT Notice

### Key Takeaways

The CAMT Notice addresses the following items which are outlined in greater detail below.

- **Future Mark-to-Market Guidance**. While the Notice does not provide guidance regarding the book/tax difference that can be created when assets are marked to market for financial accounting purposes but not tax purposes (leading to the potential for CAMT on unrealized gains), Treasury and IRS indicated that subsequent interim guidance will be issued to address this issue and helpfully noted that the upcoming guidance would be intended to help avoid "substantial unintended adverse consequences to the insurance industry and certain other industries." The Notice

[1] For more information on the Inflation Reduction Act of 2022, please see our client update at: https://www.debevoise.com/insights/publications/2022/08/senate-passes-15-corporate-minimum-tax.

specifically asks for comments on what type of guidance should be issued to address this issue.

- **Relief for Tax-Free and Certain Other Transactions**. The Notice provides relief in a number of situations where book/tax disparities could arise. In these situations, pursuant to the Notice, book income would essentially be adjusted to match (or more closely match) taxable income for purposes of the CAMT. These adjustments generally would apply to book income generated by (i) fully tax-free or tax-deferred transactions, (ii) certain cancellation of indebtedness transactions where income is exempt from regular tax and (iii) emergence from bankruptcy. The relief, among other things, would remove obstacles to effecting tax-free/tax-deferred transactions, such as tax-free split-offs. In addition, adjustments generally would be made to match book depreciation to the more accelerated tax depreciation with respect to tangible property.

- **Clarification in Determination of Applicable Corporation Status**. The Notice provides additional clarifications and rules relevant to the determination of applicable corporation status, including rules relevant to a corporation that is (i) a member of a tax consolidated group, (ii) a partner of a partnership or (iii) a member of a group that acquires new members (or a new group) or has members leave the group.

- **Safe Harbor for Small Corporations**. The Notice provides a safe harbor for smaller corporations to test whether they are applicable corporations using a simplified method of determining AFSI.

### Mark-to-Market Financial Statement Items

- Items that are marked to market for financial statement purposes (but not tax purposes) may produce temporary book-to-tax income differences that are subject to CAMT. The application of CAMT to unrealized mark-to-market income would amount to a tax on unrealized gains.

- The CAMT Notice does not provide guidance on financial statement mark-to-market issues, but it includes a helpful statement that Treasury expects to issue additional interim guidance on these issues, intended to help avoid "substantial unintended adverse consequences to the insurance industry and certain other industries."

- Topics to be covered by future mark-to-market guidance include the treatment of certain items reflected in Other Comprehensive Income on an applicable financial statement, and the treatment of embedded derivatives under reinsurance contracts. Relief in these areas, all of which have the potential to cause significant timing-based

volatility in the minimum tax calculation, will be helpful to insurance groups and other taxpayers that mark assets to market on their balance sheets but do not do so (and may not be permitted to do so) for tax purposes.

**Comment**: The IRS jumping ahead on this important issue should provide meaningful comfort to taxpayers with significant mark-to-market gains on their financials that future interim and final guidance will mitigate unintended CAMT friction in relation to such financial gains.

## Relief for Tax-Free Transactions

- The CAMT Notice provides immediate relief for taxpayers that engage in tax-free transactions, called "Covered Nonrecognition Transactions," that result in financial accounting gain. Applicable financial statement ("AFS") gain or loss resulting from these transactions is not taken into account for purposes of calculating a taxpayer's applicable financial statement income ("AFSI"). In addition, any resulting increase or decrease in the financial accounting basis will be disregarded when calculating AFSI gain or loss from a future disposition of such property.

- Covered Nonrecognition Transactions are defined broadly to include transactions that qualify for nonrecognition treatment for U.S. federal income tax purposes under the corporate spin-off, split-off, reorganization, formation and liquidation rules, as well as in relation to contributions and distributions to partnerships and LLCs.

- Importantly, a Covered Nonrecognition Transaction must not result in any amount of recognized gain or loss with regard to the relevant corporation or partnership. Accordingly, until additional guidance is issued, a transaction that is taxable in part to the relevant corporation or partnership because of the receipt of cash or other property would not be protected by these rules. The Treasury and IRS have requested further comments on this issue.

  **Comment**: The guidance aligns the CAMT rules with U.S. federal income tax principles by preventing a tax-free transaction that results in a book income or loss event from affecting the calculation of AFSI. Some asymmetry remains between the book minimum tax rules and nonrecognition under the Code, however, as the relief does not extend to partially tax-free transactions, for which any financial accounting gain or loss or basis increase or decrease will still impact AFSI despite the lack of corresponding tax gain or loss. In requesting comments on this issue, the Treasury and IRS seem amenable to achieving consistency across nonrecognition transactions.

- **Protection for spin-offs and split-offs that include deleveraging transactions**. In an example dealing with a split-off that includes a deleveraging transaction involving

a transfer of spinco cash and securities to the distributing corporation's creditors which is tax free to distributing under Sections 361(b) and 361(c)(3), the transactions qualify as a Covered Nonrecognition Transaction. This is so even if the creditors take into account income, as the Covered Nonrecognition Transaction rules only look to tax treatment of the relevant corporation (or partnership).

- **Series of transactions with some taxable components**. Each component transaction that is part of a series of transactions is tested separately to qualify for Covered Nonrecognition Transaction status based on all relevant provisions of the Code and general principles of tax law, such as the step transaction doctrine. For example, in a spin-off that is preceded by a tax-free contribution of assets and liabilities to the spinco, a tax on the distributing corporation attributable to a failed tax-free transfer of spinco securities to the distributing corporation's creditors will not cause the other steps to fail to qualify as a Covered Nonrecognition Transaction.

  On the other hand, the Notice provides an example where a partner contributes property to a partnership and the partnership distributes cash to the partner that is recast for tax purposes as a part disguised sale and part tax-free contribution. The Notice concludes that the component parts (contribution and distribution) are stepped together as one transaction resulting in a single transaction that is in part a taxable transaction and therefore the whole transaction fails to qualify as a Covered Nonrecognition Transaction.

## Relief for Distressed Companies

- The interim guidance relieves an AFS Group from taking into account any accounting gain or loss attributable to cancellation of debt ("COD") income to the extent such COD income is excluded from taxable income for U.S. federal income tax purposes when calculating AFSI of the group in the taxable year in which the COD income arises.

- If COD income is excluded from the AFS Group's AFSI based on this rule, the interim guidance provides that the AFS Group's tax attributes must be adjusted for purposes of the CAMT by the excluded COD amount under the principles contained in Sections 108 and 1017 of the Code.

- An AFS Group that includes a party emerging from bankruptcy must exclude from its AFSI calculation any resulting financial accounting gain or loss in the taxable year in which the emergence from bankruptcy occurred (and any resulting increase or decrease in basis).

**Comment**: The guidance generally aligns the CAMT rules with U.S. federal income tax principles surrounding debt relief and distress, but it is not exhaustive. The CAMT Notice includes a request for comments on the application of these rules to distressed companies, including with regard to determining what and how tax attributes should be adjusted for purposes of the CAMT relative to the COD amount.

## Adjustments to AFSI for Depreciation and Certain Tax Credits

- The CAMT Notice provides that AFSI is adjusted to take into account tax depreciation rather than book depreciation with respect to tangible assets (as well as certain computer software and film, television and theatrical productions). Similar adjustments are made with respect to dispositions of tangible properties so that AFSI takes into account the tax gain or loss rather than book gain or loss. With respect to dispositions, the adjustment takes into account all book/tax differences since the property was placed in service (even if prior to the January 1, 2023 effective date).

- The Notice provides that amounts that a taxpayer receives from monetizing certain clean energy investment tax credits under the new "direct pay" or tax credit transfer provisions of the IRA are to be disregarded in determining AFSI. Similar adjustments are also to be made for the monetization of tax credits for investments in semiconductor manufacturing enacted as part of the 2022 Creating Helpful Incentives to Produce Semiconductors ("CHIPS") Act.

  **Comment**: These adjustments highlight the way in which the CAMT preserves tax preferences for certain types of investments (such as tangible property and computer software) but not others. While these depreciation rules are generally taxpayer-friendly for assets placed in service after 2022 (or assets with meaningful useful tax depreciation), they apply equally to pre-existing assets. For new assets, a taxpayer will have downward adjustments to AFSI while the assets are tax depreciated and upward adjustments upon disposition (to the extent of any remaining book/tax difference in basis). For pre-existing assets that were fully tax depreciated, these rules may result only in an upward adjustment to AFSI upon disposition of the assets.

## Distributive Share of Partnership Income for Applicable Corporation Test

- The Notice clarifies that, if a taxpayer is a partner in a partnership, then, solely for purposes of determining whether the taxpayer is an applicable corporation, the AFSI of the taxpayer is determined without regard to the distributive share adjustment.

  **Comment**: There was some confusion as to whether this was the correct reading of Section 59(k)(1), and the CAMT Notice confirms that it is. The implication is that where the taxpayer and a partnership are not aggregated as a "single employer" under Section 52, whether the AFSI of the partnership will be included in the AFSI of the

taxpayer for purposes of determining whether the taxpayer is an applicable corporation will depend on whether the partnership is consolidated with the partner for financial reporting purposes.

### Income Reported on Consolidated Financial Statements; Consolidated Income Tax Groups

- If the financial results of a CAMT taxpayer are reported on the AFS of a group of entities, the portion of the AFSI allocated to the taxpayer is determined by relying on the taxpayer's source documents that were used to create the consolidated AFS. The Notice clarifies that the AFSI of the taxpayer takes into account items that are eliminated in consolidation.

- The Notice sensibly clarifies that consolidated federal income tax groups are treated as a single taxpayer for purposes of the CAMT.

### Combining and Separating Groups/Testing Periods

- The Notice provides insight into how entities that are moved from one AFS Group to another will factor into the Applicable Corporation Test. The guidance provides that in a transaction where an Acquirer AFS Group purchases an entire Target AFS Group, the AFSIs of the two groups are combined for purposes of the three-year AFSI threshold test, which is only tested for the Acquirer AFS Group (i.e., if acquirer and target both have AFSI of $600 million, after acquisition the AFSI of the consolidated group is $1.2 billion).

- In a transaction where an Acquirer AFS Group purchases a portion, but not all, of a Target AFS Group, the Target AFS Group may use any reasonable method to determine the amount of Target AFS Group's AFSI to allocate to the acquired entity(ies). This amount will then be included by *both* the Acquirer AFS Group and Target AFS Group for purposes of calculating each of their three-year AFSI threshold tests (i.e., if Acquirer AFS Group has AFSI of $800 million and Target AFS Group has an aggregate AFSI of $1 billion prior to the transaction, and Acquirer AFS Group acquires a target that is allocated $300 million of the Target AFS Group AFSI, Acquirer AFS Group's AFSI will now be $1.1 billion even through the Target AFS Group's AFSI will remain at $1 billion).

- In a transaction where there is a distribution/spin-off, the AFSI allocated to the distributed entity will be counted by both the distributee and distributor in each of their three-year AFSI threshold tests.

  **Comment**: The amount of AFSI allocated to Target or a distributed entity can be a point for negotiation (although buyer seems to have more at stake than seller).

Although these rules result in double counting of target's AFSI, it is worth noting that this only applies to the test of whether a taxpayer is an "applicable corporation" but does not impact the calculation of the actual CAMT. In addition, although not entirely clear, these rules do not seem to prorate for a transaction occurring in the middle of the year.

### Safe Harbor for Small Corporations

- The Notice provides a new one-year safe harbor for determining whether a corporation is an "applicable corporation" subject to the CAMT. Under this safe harbor, a corporation with average applicable financial statement income of less than $500 million for the prior three-year financial statement periods calculated using a "simplified method" is not subject to the CAMT. The "simplified method" still requires certain complex adjustments. For example, it is necessary to back out transactions between entities that are consolidated for financial statement purposes but not treated as a single employer for tax purposes. However, it does not require the full set of adjustments required under the standard rules for determining AFSI.

## Buyback Tax Notice

### Corporate Liquidations and SPACs

- The Notice provides that the Buyback Tax generally does not apply to complete corporate liquidations, except to minority owners of a public company that has an 80% or greater shareholder.

  **Comment**: The Notice effectively provides relief to special purpose acquisition companies ("SPACs") that issued shares to the public for cash, but did not acquire an operating business within a specified time frame and are subsequently required to be liquidated. However, repurchases in connection with a de-SPAC transaction, in which the repurchasing company generally does not liquidate, would still be subject to the Buyback Tax.

### Preferred Stock Repurchases

- The Notice clarifies that the Buyback Tax applies not only to a repurchase of publicly traded common stock, but also to a redemption of a public corporation's non-traded stock, such as preferred stock, without grandfathering existing issuances.

  **Comment**: The Notice may adversely impact the market for private investment in public equity ("PIPEs"). PIPEs became particularly attractive during the initial impact of COVID-19 on the financial markets. PIPEs are commonly structured as

redeemable preferred equity. Where feasible, public companies may prefer to issue debt rather than preferred stock to mitigate the potential application of the Buyback Tax.

### Taxable Acquisitions; Leveraged Buyouts

- The Notice confirms that upon the taxable acquisition of a public company, the use of cash that is sourced from the public company itself to fund the acquisition is subject to the Buyback Tax, including, in the case of a leveraged buyout, where some of the cash is funded by new debt incurred by the public company.

  **Comment**: Buyers should consider financing the acquisition of a public target at the level of the acquirer, rather than pushing debt into the former public target (as is typically the case), in order to mitigate application of the Buyback Tax.

### Tax-Free Corporate Acquisitions

- The Notice provides that tax-free corporate acquisitions are substantially similar to stock buybacks, and therefore that any cash or other property subject to tax received by the shareholder of a public corporation in such transactions (subject to a narrowly drawn exception for cash and property treated as dividends) is subject to the Buyback Tax.

  **Comment**: The approach taken by the Notice to tax-free reorganizations is likely to attract comments. Pursuant to the Notice, all of the cash received by public shareholders in a tax-free transaction is subject to the Buyback Tax, while cash received by public shareholders in taxable corporate acquisitions is subject to the Buyback Tax only to the extent the acquisition is treated as funded by the public company's cash.

### Spin-Offs and Split-Offs

- Under the Notice, spin-offs where public shareholders receive a pro rata distribution of stock of a subsidiary of the public company generally are not subject to the Buyback Tax. Split-offs where some, but not all, public shareholders receive a distribution of stock of a subsidiary of the public company are generally subject to the Buyback Tax to the extent the public shareholders receive cash in connection with the split-off.

### Presumption Against Dividend Treatment

- To the extent that a repurchase transaction is treated as a dividend for tax purposes, the repurchase is not subject to the Buyback Tax. The Notice presumes that repurchases are not taxed as a dividend unless the public company provides sufficient

evidence on a shareholder-by-shareholder basis (including a certification from the shareholder) that the shareholder treats the repurchase as a dividend for federal income tax purposes.

**Comment**: In the context of a public company that is widely held, providing sufficient evidence to rebut this presumption on a shareholder-by-shareholder basis, especially by requiring a certification from a shareholder, may introduce administrative complexity and cost.

## Netting of Stock Issuances and Repurchases

- The Notice provides guidance on the application of the netting rule for the Buyback Tax, which allows a public company to count within the same taxable year any stock issuances against any stock repurchases that are subject to the Buyback Tax.

- The Notice allows public companies that do not follow a calendar-year tax year to net stock issuances made at any time during their 2022-2023 tax year against their 2022-2023 stock repurchases.

  **Comment**: Public companies should consider whether stock redemptions can be timed to occur in the same tax year as stock issuances to minimize the application of the Buyback Tax.

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Please do not hesitate to contact us with any questions.

## NEW YORK

Michael Bolotin
mbolotin@debevoise.com

Erin Cleary
ecleary@debevoise.com

Stephen M. Jordan
sjordan@debevoise.com

Rafael Kariyev
rkariyev@debevoise.com

Peter F.G. Schuur
pfgschuur@debevoise.com

Gregory A. Arutiunov
garutiunov@debevoise.com

Samuel D. Krawiecz
sdkrawiecz@debevoise.com

Erasmo A. Perez
eaperez@debevoise.com

David R. Rock
drrock@debevoise.com

Cameron E. Rotblat
cerotblat@debevoise.com

Elliott Tuchman
etuchman@debevoise.com


## LONDON

Cécile Beurrier
cbeurrier@debevoise.com

**HONG KONG**

Mai T. Shapiro
mtshapiro@debevoise.com

**HONG KONG**

Sophia Huang
shuang@debevoise.com