ACT Alliance for Competitive Taxation

July 26, 2023

Tom West
Deputy Assistant Secretary for Business Tax
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Corporate Alternative Minimum Tax ("CAMT")

Dear Mr. West:

The Alliance for Competitive Taxation ("ACT") is a coalition of leading American companies from a wide range of industries that supports a globally competitive U.S. corporate tax system.

This submission identifies issues arising under the recently enacted Corporate Alternative Minimum Tax ("CAMT") and Notice 2023-07 related to items that are mark-to-market items for financial statement purposes but not for federal income tax purposes and recommends approaches for addressing these issues. ACT may submit additional recommendations as its member companies continue to analyze the potential effects of the legislation and interpretive guidance.

ACT thanks the Treasury and Internal Revenue Service ("IRS") for responding to issues addressed in ACT's prior submissions of September 30, 2022, and March 20, 2023, and reaffirms its request that the Treasury and IRS provide guidance on issues that have not yet been addressed. We appreciate that the CAMT raises many novel issues and commend Treasury and the IRS for the guidance issued to date to address certain time-sensitive issues. We note that many of the issues still to be addressed, including those that are the subject of this submission as well as others (such as the appropriate treatment of corporate distributions), have a potentially distortive or chilling effect on taxpayer behavior. We respectfully request that guidance addressing these issues be provided as promptly as possible.

ACT representatives would be pleased to discuss the issues addressed in this submission with the staffs of the Treasury and IRS.

Yours sincerely,

Alliance for Competitive Taxation

cc: Krishna Vallabhaneni, Tax Legislative Counsel, U.S. Treasury Department
Brett York, Deputy Tax Legislative Counsel, U.S. Treasury Department
William M. Paul, Principal Deputy Chief Counsel, Internal Revenue Service
Helen Hubbard, Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service

ACT Alliance for Competitive Taxation

ALLIANCE FOR COMPETITIVE TAXATION RECOMMENDATIONS REGARDING THE TREATMENT OF MARKED-TO-MARKET ITEMS AND RELATED ISSUES UNDER CAMT

I. INTRODUCTION

Notice 2023-7 requests comments on future guidance needed to avoid "substantial unintended adverse consequences" that could arise under the CAMT from the marking to market of items for financial statement purposes but not for income tax purposes. Questions 16–19 of Section 9.02 of Notice 2023-7 request comments on the treatment of unrealized gains (or losses), including items included in other comprehensive income ("OCI") in financial statements.

This document sets forth ACT's comments on the CAMT relating to the treatment of items that are "marked to market" for financial statement purposes, but not for U.S. federal income tax purposes, in determining applicable financial statement income ("AFSI") under section 56A.[1]

We respectfully request the issuance of guidance that adjusts the computation of AFSI for unrealized gains and losses that are taken into account (i.e., "marked to fair market value" or "revalued") for financial statement purposes but not for regular income tax purposes.

II. PRELIMINARY MATTERS

a. GUIDING PRINCIPLES

Our recommendations regarding mark-to-market treatment are driven by five main principles:

(1) *Comprehensiveness* – identifying the categories of adjustments that should be made as a conceptual matter, regardless of the applicable accounting principles (such as U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards ("IFRS"), etc.) utilized by the taxpayer;

(2) *Completeness* – ensuring there is no duplication or omission of items of income or loss as a result of excluding "marks to market" from AFSI;

(3) *Symmetry* – preventing "substantial unintended adverse consequences" resulting from the inclusion in AFSI of only part of related (offsetting) transactions;

(4) *Administrability* – focusing on those computational adjustments that are easily identifiable on the taxpayer's books and records, with limited "rework" for periods before the effective date of the CAMT.

(5) *Legislative Intent* – limiting the application of the CAMT to taxpayers whose book income exceeds their taxable income because of aggressive tax avoidance and not because of fluctuations in the fair market value of assets reported on their financial statements.

[1] For the avoidance of doubt, except as noted, all the recommendations below relate to circumstances where items are marked to market (or afforded similar treatment) for financial statement purposes but are not so treated for U.S. federal income tax purposes. Our recommendations are not intended to apply to items with respect to which a taxpayer is subject to mark-to-market treatment for both financial statement and U.S. federal income tax purposes (except as discussed below), nor are these recommendations intended to apply to fact patterns in which a taxpayer is subject to mark-to-market treatment for U.S. federal income tax purposes but is not subject to such treatment for purposes of its financial statements.

b. **ADJUSTING AFSI TO EXCLUDE MARKS TO MARKET IS CONSISTENT WITH THE PURPOSES OF CAMT AND U.S. FEDERAL INCOME TAX POLICY**

The CAMT has its origins in a proposal included in the President's Fiscal Year 2022 Budget Proposal. According to the Treasury Greenbook, the CAMT was intended as "a targeted approach to ensure that the most aggressive corporate tax avoiders bear meaningful federal income tax liabilities."[2]

The differences between financial statement income and taxable income related to items marked to market for book (but not tax) purposes arise from changes in the fair market value of assets and market rates (*e.g.,* interest rates, foreign currency rates, or securities prices), and not from tax avoidance techniques – i.e., the intended target of the CAMT legislation.

Including these unrealized gains in AFSI would effectively put taxpayers on a mark-to-market basis for purposes of computing their U.S. federal income tax liability. Congress has been reluctant to adopt broad-based mark-to-market methods of accounting for purposes of determining liability for income taxes and has adopted such regimes only in limited situations where taxpayers are likely to have access to liquidity.[3]

ACT notes the OECD global minimum tax (Pillar Two) Model Rules allow a five-year election (on a jurisdictional basis) to use the realization method of accounting for purposes of measuring minimum taxable income with respect to assets and liabilities that are subject to fair value or impairment accounting in the Consolidated Financial Statements.[4]

Treasury and the IRS have sufficiently broad regulatory authority under Sections 56A(c)(15) and 56A(e) to exclude mark-to-market items from AFSI.

c. **FINANCIAL ACCOUNTING MARK-TO-MARKET REGIMES**

Various accounting regimes require or permit taxpayers to include in their profit and loss statement items that have not yet been realized for federal income tax purposes. These regimes may be referred to by a variety of terms, including "mark-to-market", currency revaluation, impairment, or one-time "mark" events.

In general, these regimes fall into four main categories:[5]

(1) *Mark-to-market regimes* such as the rules for derivatives under Accounting Standards Codification ("ASC") 815, held for sale securities, trading securities, investment company accounting, assets for which the taxpayer has elected the "fair value option," minority investments, embedded derivatives, etc.;

(2) *Currency revaluation regimes* where unrealized foreign currency gains and losses are taken into account on an annual basis, but the underlying instrument is not otherwise "marked" to market to reflect changes in other factors such as interest rates;

(3) *Impairment regimes* where the asset is "impaired" and losses are taken into account on a current basis to the extent the fair market value of the asset is less than its book value, but

[2] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals,* May 2021, p. 21.
[3] *Compare* limited mark-to-market regimes under sections 475 and 1256 versus unsuccessful proposals for marking to market derivatives by Senator Ron Wyden (D-OR) (Modernization of Derivatives Tax Act, S.2621, 117th Congress and S.1005, 115th Congress) and Representative Dave Camp (R-MI) (Section 3401 of the Tax Reform Act of 2014, H.R. 1, 113th Congress).
[4] *See* OECD (2022), *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, OECD, Paris, Article 3.2.5.
[5] We would be happy to discuss with Treasury and IRS any of the technical details of these various categories.

gains generally are not recognized when the asset appreciates over its book value; and

(4) *One-time "mark" events* such as corporate spin-offs, acquisitions, and reorganizations.

III. REQUESTED GUIDANCE

a. OVERALL REQUEST – EXCLUDE MARKED ITEMS FROM THE COMPUTATION OF AFSI ON AN ELECTIVE BASIS

ACT requests Treasury and the IRS provide guidance permitting a taxpayer (at its election) to adjust AFSI to exclude any item of income (or loss) that is taken into account on a marked-to-market basis (or otherwise adjusted to fair market value) under relevant financial accounting rules, but that is not included in taxable income (or loss) on a marked-to-market basis for U.S. federal income tax purposes.

We believe this mark-to-market guidance should apply without regard to whether the taxpayer is *required* to apply mark-to-market (or similar) treatment under the relevant financial accounting standard or, rather, is merely *permitted* to do so. The same potential distortions and inappropriate outcomes can occur because of differences in timing between financial accounting and income tax principles regardless of whether taxpayers are required under the financial accounting rules to apply mark-to-market or similar concepts or are merely permitted to do so.[6]

ACT believes this guidance is warranted to prevent taxpayers from being pushed in or out of CAMT based on market volatility (for example, from fluctuations in interest rates, foreign currency exchange rates, or in the fair market value of assets).

Further, ACT believes that excluding from AFSI marked-to-market income (or loss) that is not included in taxable income on a marked-to-market basis is consistent with other specific areas on which guidance has been requested under CAMT, including the treatment of (i) retained interests from spin-offs, and (ii) held for sale securities by taxpayers that are not section 475 dealers, which similarly involve gain or loss that is included in book income but not in taxable income on a marked-to-market basis.

ACT believes the foregoing recommendation should apply broadly to all applicable corporations and for all purposes of the CAMT, including for determination of status as an applicable corporation. However, Treasury and the IRS should also consider whether and to what extent additional guidance should be provided for certain entities (such as those using investment company accounting, insurance companies, partnerships, etc.).

b. EXCLUDE OTHER COMPREHENSIVE INCOME (OCI) FROM AFSI UNLESS INCLUDED IN TAXABLE INCOME

In each of ACT's prior submissions on the CAMT, we requested that an item included in OCI should be excluded from AFSI except to the extent it is included in regular taxable income. The rationale for this OCI request is similar to the rationale for our above request with respect to items that are marked to market (or treated similarly) for financial statement purposes. In both situations, a mismatch in the treatment of an item for purposes of the CAMT compared to its treatment for regular tax purposes has the potential to create distortive results, giving rise to significant CAMT liabilities despite the lack of any tax

[6] We further note that, in many circumstances, a taxpayer subject to the CAMT may have previously made a policy choice to apply mark-to-market or similar concepts for financial accounting purposes and may now effectively be required to continue such treatment absent a change in circumstances that would justify deviating from its prior policy choice. In addition, we are not aware of any circumstances in which a taxpayer who is subject to the CAMT would obtain a more favorable tax outcome by (a) electing mark-to-market treatment for financial accounting purposes and then (b) electing out of such mark-to-market treatment for purposes of computing its CAMT liability. Accordingly, we believe the election we are recommending should be available regardless of whether the taxpayer has elected mark-to-market or similar treatment for financial accounting purposes or is required to adopt such treatment under the relevant financial accounting rules.

avoidance. Accordingly, we again respectfully request that Treasury and the IRS provide guidance that includes in AFSI an item included in OCI only to the extent it is included in taxable income.[7]

C. AREAS FOR IMPLEMENTATION GUIDANCE

ACT recognizes that implementation of the requested guidance must both align with the intent of the CAMT and be administrable by the IRS and taxpayers. The areas identified below for implementation guidance are intended to aid with administrability while maintaining the integrity of the CAMT regime.

i. ELECTION MECHANIC GUIDANCE

As noted, ACT recommends that the exclusion from AFSI of mark-to-market income (or loss) that has not been included in regular taxable income be made at the election of the taxpayer, rather than being required for all taxpayers. We believe that these adjustments to AFSI should be elective because systems, data, and capacity limitations may make these adjustments challenging for some taxpayers to implement. In other circumstances, eliminating the potential distortive effects of mark-to-market accounting may not have a material effect on the taxpayer's CAMT liability, such that relief is unnecessary. Making the adjustment elective ensures that taxpayers are not required to make such adjustments in these circumstances.

ACT recognizes that guidance will be needed to impose limits on such an elective approach. For example, providing an unfettered election would permit taxpayers to apply mark-to-market accounting for purposes of computing their tax liability in circumstances where doing so would reduce the taxpayer's AFSI, while electing out of such treatment in circumstances where applying mark-to-market accounting would increase AFSI.

A critical aspect of the guidance, therefore, will be the scope of assets covered by any election. ACT believes it would be appropriate to provide asset (and liability) consistency rules to prevent taxpayers from choosing to apply the election to certain assets (or related liabilities) while forgoing the election for other similar assets (and related liabilities). Accordingly, we recommend that guidance provide that a taxpayer must choose whether or not to apply the election (consistently) to each separate subcategory of mark-to-market regimes listed in Section II.c above[8] as well as, separately, to all currency-related assets and liabilities that are marked to market for financial accounting purposes, and to all corporate spin-offs, acquisitions, and reorganizations.[9] Because impairment regimes reduce AFSI (but not regular tax), we recommend that an election to exclude any other category (or subcategory) of mark-to-market items should be treated as an election to exclude impairments from AFSI.

In addition to limiting the scope of assets and liabilities covered by any election, guidance should address election mechanics, including:

- Timing of the election for each category or subcategory of assets (*e.g.,* on a timely filed federal income tax return for the first year after the issuance of guidance in which the taxpayer holds a material amount of assets in the category or subcategory of assets for which an election is available); and

[7] For the avoidance of doubt, ACT recommends that, if an OCI item is excluded from taxable income, it should also be excluded from AFSI, consistent with the floor colloquy between Senator Wyden and Senator Cardin.

[8] Including ASC 815 derivatives, held for sale securities, trading securities, assets subject to investment company accounting, assets for which the taxpayer has elected the "fair value option," minority investments, embedded derivatives, etc.

[9] In theory, guidance could take an even broader approach to asset consistency, such as requiring that a taxpayer make the election consistently across <u>all</u> assets and liabilities that are subject to mark-to-market or similar accounting treatment. For many taxpayers, however, the potential distortions of including mark-to-market adjustments in AFSI may be insignificant for certain categories of assets but potentially material for other asset categories, and the administrative burden of requiring taxpayers to eliminate all mark-to-market and similar adjustments (including ones that do not cause distortions) may be significant. ACT believes that requiring consistency by type of asset as described in the accompanying text strikes an appropriate balance.

- Revocation or change in election (*e.g.,* only after 60 months after the effective date of an election or, if earlier, only with the consent of the Commissioner).

For purposes of these elections, each applicable corporation should be treated as the taxpayer, and the elections should be effective with respect to all income or loss reported in its AFSI (except as provided in guidance).

ii. **ELECTION EFFECTIVE DATE GUIDANCE**

ACT requests guidance provide that the elective adjustments to AFSI be made available to taxpayers for marks to market (or other required adjustments to fair market value) included in AFSI for tax years beginning (or, for purposes of section 59(k), changes in value occurring) on or after the effective date of section 56A.[10]

This request is informed by both technical and practical considerations. From a technical standpoint, requiring the adjustments to AFSI be made only with respect to marks to market occurring simultaneously with the effective date of the provision ensures that the AFSI is not artificially increased or decreased by amounts related to years prior to the effective date of the provisions. Importantly, this approach would be consistent with other accounting balances that are not otherwise marked to fair market value. For example, certain accrued liabilities may be present on the accounting balance sheet prior to the effective date of section 56A. If the taxpayer is relieved of those liabilities subsequent to the effective date of section 56A, then such relief may represent financial statement income. Despite the fact that such liabilities may have been accrued as book expense in a period prior to the effective date of section 56A, such income will be included in the calculation of AFSI if such income is recognized for financial statement purposes subsequent to the effective date.

From a practical standpoint, historic basis data, maintained on an entity-by-entity or asset-by- asset basis back to the date of acquisition of the asset or position, may be difficult if not impossible for taxpayers to determine. Further, such data may be administratively burdensome for the IRS to audit.

iii. **CORRELATIVE ADJUSTMENT GUIDANCE**

If marks to market (or other periodic required fair market value adjustments) are excluded from the calculation of AFSI, then ACT requests guidance regarding any related adjustments the taxpayer may be responsible for making to items of income, gain, deduction, or loss to ensure that there are not duplications or omissions from the taxpayer's lifetime AFSI.
Examples of such adjustments may include:

- Accounting basis adjustments for accrued items: If the marks to market on a debt instrument held for sale for financial statement purposes (but not for tax) are excluded from the computation of AFSI, then the taxpayer must make appropriate adjustments to the accounting basis of the instrument to ensure that the basis of the debt instrument reflects any interest accrued but not yet paid (including discount) or principal payments received (to the extent such amounts are not otherwise included in the applicable financial statements).

- Accounting basis adjustments for asset disposals: More generally, differences between the financial accounting treatment of an asset and its treatment under the CAMT will require adjustments to the financial accounting basis of the asset to determine the appropriate basis for AFSI purposes. For example, if a certain asset is impaired (i.e., written down to fair market value in certain circumstances) or otherwise marked to fair market value (either as an increase or

[10] As noted above, we believe that this elective treatment should be applicable for purposes of determining a taxpayer's status as an applicable corporation, as well as for purposes of computing the taxpayer's CAMT liability, and therefore the election should be made available as of the beginning of the period described in section 59(k)(1)(B).

decrease in fair market value) for accounting purposes and the taxpayer elects to eliminate these mark-to-market adjustments for purposes of its CAMT calculation, then for purposes of determining AFSI the basis of such asset that is applicable upon disposal of the asset (or other realization event for CAMT purposes) would be the accounting basis as per the financial statements, adjusted for changes in fair market value that were not previously recognized as a result of making the election described herein.[11] This conforming basis adjustment would be necessary to avoid inappropriate duplication or omission of income in the computation of the CAMT.[12]

IV. Preventing Substantial Unintended Adverse Consequences

The recommendations set forth herein are needed in order to avoid "substantial unintended adverse consequences." Further, ACT is not aware of any situation in which these recommendations would give rise to substantial unintended adverse consequences.

If mark-to-market items are not excluded from AFSI, then taxpayers would be exposed to potentially significant, erratic, unanticipated and uncontrollable CAMT liabilities as a result of the volatility of the securities and commodities markets and interest rates and currency exchange rates, which can affect the value of their assets and liabilities. Taxpayers may not have sufficient cash to pay these CAMT liabilities, and thus may be forced to sell assets or borrow funds (if such borrowings are available) to pay the tax on their unrealized gains. As discussed above, Congress did not intend for the CAMT to produce these outcomes.

Failure to provide the requested guidance regarding marked-to-market positions would also distort investment decisions. Existing rules and other anticipated guidance will exclude many but not all categories of mark-to-market items from AFSI. For example, marked-to-market income and loss from portfolio stock investments and partnership interests are excluded from AFSI under the statute, while marked-to-market income and loss from investments in real estate, foreign currencies, and precious metals are not.

As noted above, ACT is not aware of any situation in which our recommendations would give rise to substantial unintended adverse consequences. As a conceptual matter, excluding mark-to-market income (or loss) from AFSI should not result in any mismatches so long as the guidance includes our recommendations above, specifically: (i) exclude mark-to-market income (or loss) from AFSI except to the extent such income (or loss) is included in taxable income on a marked-to-market basis and (ii) exclude items included in OCI except to the extent such OCI items are included in taxable income.

Taxpayers and their tax advisors have already had an extensive period of time to consider the implications of the CAMT and have requested relief for situations that result in unintended adverse consequences, including as a result of situations where one position is marked to market and a related position is not. Our proposed approach should not give rise to further cases of substantial unintended adverse consequences, for the reasons described above. However, in the event that some unanticipated situation is not adequately addressed, the comment period under any proposed guidance would provide an opportunity for adversely affected persons to come forward and have their situation addressed in the final guidance.

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[11] To illustrate, if an asset originally acquired at $100 is impaired down to $90 for financial statement purposes and is later sold for $105, then the financial statements will reflect a gain of $15. If this asset is not impaired for determining AFSI for CAMT, then appropriate adjustments must be made so that only $5 of gain is included in the determination of AFSI in the year of sale.

[12] For completeness, we note that other fact patterns would also present a similar need to adjust the taxpayer's accounting basis for purposes of determining AFSI. For example, a taxpayer may be required for financial accounting purposes to make periodic adjustments to the basis of certain assets through OCI. To the extent such periodic adjustments are not included in the taxpayer's AFSI computation, the taxpayer should similarly need to adjust its accounting basis for purposes of determining AFSI.