INTERNAL REVENUE
BULLETIN

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2024–42
October 15, 2024

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG-112129-23, page 787.

This notice of proposed rulemaking (NPRM) provides rules that would address the application of the corporate alternative minimum tax (CAMT) that is imposed on the adjusted financial statement income (AFSI) of certain corporations based on their applicable financial statement (AFS) for taxable years beginning after December 31, 2022. The proposed regulations would provide definitions and general rules regarding the determination of AFSI. The proposed regulations also would provide guidance regarding identification of an AFS, various statutory and regulatory adjustments made in determining AFSI, the determination of whether a corporation is an applicable corporation subject to the CAMT, including rules for members of a foreign parented multinational group (FPMG), and the determination of the CAMT foreign tax credit. The proposed regulations also would provide guidance on the application of the CAMT to affiliated corporations filing a consolidated income tax return.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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Part IV

Notice of Proposed Rulemaking

REG-112129-23

Corporate Alternative Minimum Tax Applicable After 2022

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This notice of proposed rulemaking provides proposed regulations that would address the application of the corporate alternative minimum tax, which is imposed on the adjusted financial statement income of certain corporations based on their applicable financial statements for applicable taxable years beginning after 2022. The proposed regulations would affect taxpayers that are applicable corporations, certain taxpayers that own interests in applicable corporations, and certain entities in which applicable corporations hold interests. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments on this proposed rule must be received by December 12, 2024. A public hearing on these proposed regulations is scheduled to be held on January 16, 2025, at 10 a.m. Eastern Time (ET). Requests to speak and outlines of topics to be discussed at the public hearing must be received by December 12, 2024. If no outlines are received by December 12, 2024, the public hearing will be cancelled. Requests to attend the public hearing must be received by 5 p.m. ET on January 14, 2025.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at https://www.regulations.gov (indicate IRS and REG-112129-23) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-112129-23), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning proposed §§1.56A-1, 1.56A-9, and 1.56A-23, except for paragraphs (e) and (f), Madeline Padner at (202) 317-7006, concerning proposed §§1.56A-2 and 1.56A-3, Frank Dunham III at (202) 317-7009, concerning proposed §§1.56A-11, 1.56A-12, and 1.59-2, except for paragraphs (e), (f) and (h), John Aramburu at (202) 317-7006, concerning proposed §1.56A-17, James Yu at (202) 317-4718, and concerning proposed §§1.56A-15 and 1.56A-16, except for issues related to partnerships, C. Dylan Durham at (202) 317-7005, each of the Office of Associate Chief Counsel (Income Tax and Accounting), and for issues related to partnerships, Yosef Koppel, Elizabeth Zanet, or Brian Barrett of the Office of Associate Chief Counsel (Passthroughs and Special Industries), at (202) 317-6850; concerning proposed §1.56A-4, Daren J. Gottlieb at (202) 317-6937, concerning proposed §1.56A-6, Dylan J. Steiner at (202) 317-6934, concerning proposed §1.56A-7, Ryan Connery at (202) 317-6933, concerning proposed §§1.56A-8 and 1.59-4, John J. Lee at (202) 317-6936, concerning proposed §1.56A-26(d), Michelle L. Ng at (202) 317-6939, concerning proposed §1.56A-27, Joel Deuth at (202) 317-6938, and concerning proposed §1.59-3, Karen Walny at (202) 317-6938, each of the Office of Associate Chief Counsel (International); concerning proposed §§1.56A-18, 1.56A-19, 1.56A-21, 1.56A-26, 1.1502-2, 1.1502-3, 1.1502-53, 1.1502-55, and 1.1502-56A, Jeremy Aron-Dine, William W. Burhop, or John Lovelace, concerning proposed §§1.56A-23(e) and (f) and 1.59-2(f) and (h), Jeremy Aron-Dine and William W. Burhop, each of the Office of Associate Chief Counsel (Corporate) at (202) 317-3181; concerning proposed §1.56A-13, Diane Bloom at 202-317-6301, concerning proposed §1.56A-14, Seth Groman at 202-317-5640, and concerning proposed §1.59-2(e), Chris Dellana at 202-317-4726, each of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes); concerning proposed §§1.56A-5, 1.56A-10, and 1.56A-20, Yosef Koppel, Elizabeth Zanet, or Brian Barrett, each of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 317-6850; concerning proposed §1.56A-22, Ian Follansbee at (202) 317-6995, concerning proposed §§1.56A-24 and 1.56A-25, Vanessa Mekpong at (202) 317-6842, each of the Office of Associate Chief Counsel (Financial Institutions and Products); concerning submissions of comments or the public hearing, the Publications and Regulations Section, (202) 317-6901 (not toll-free numbers) or by email at publichearings@irs.gov (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed additions and amendments to 26 CFR part 1 (Income Tax Regulations) addressing the application of the corporate alternative minimum tax (CAMT) imposed by section 55 of the Internal Revenue Code (Code), as amended by the enactment of section 10101 of Public Law 117-169, 136 Stat. 1818, 1818-1828 (August 16, 2022), commonly known as the Inflation Reduction Act of 2022 (IRA). The proposed additions and amendments are issued under section 56A, as added to the Code by the IRA, section 59 of the Code, as amended by the IRA, and section 1502 of the Code (proposed regulations), pursuant to the express delegations of authority provided under those sections. The express delegations relied upon are referenced in the parts

of the Explanation of Provisions section of this preamble describing the individual sections of the proposed regulations. The proposed regulations are also issued under the express delegation of authority under section 7805 of the Code.

Background

I. *Overview*

As amended by section 10101 of the IRA, section 55 imposes the CAMT based on the adjusted financial statement income, as determined under section 56A (AFSI), of an applicable corporation, as determined under section 59, for taxable years beginning after December 31, 2022. In general, under section 59(k), a corporation is an applicable corporation subject to the CAMT for a taxable year if it meets an average annual AFSI test for one or more taxable years that (i) are before that taxable year, and (ii) end after December 31, 2021.

Section 55(a) provides that, for the taxable year of an applicable corporation, the amount of CAMT equals the excess (if any) of (i) the tentative minimum tax for the taxable year, over (ii) the sum of the regular tax, as defined in section 55(c), for the taxable year plus the tax imposed under section 59A (commonly referred to as the base erosion and anti-abuse tax, or BEAT). Section 55(b)(2)(A) provides that, in the case of an applicable corporation, the tentative minimum tax for the taxable year is the excess of (i) 15 percent of AFSI for the taxable year, over (ii) the CAMT foreign tax credit, as determined under section 59(l), for the taxable year. In the case of any corporation that is not an applicable corporation, section 55(b)(2)(B) provides that the tentative minimum tax for the taxable year is zero.

II. *AFSI Under Section 56A*

A. *Adjusted financial statement income; applicable financial statement*

Section 56A(a) provides that, for purposes of sections 55 through 59 of the Code, the term "AFSI" means, with respect to any corporation for any taxable year, the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement (AFS) for that taxable year, adjusted as provided in section 56A. For purposes of section 56A, section 56A(b) provides that the term "AFS" means, with respect to any taxable year, an AFS, as defined in section 451(b)(3) of the Code or as specified by the Secretary in regulations or other guidance, that covers that taxable year.

B. *Adjustments to AFSI*

Section 56A(c) provides general adjustments to be made to AFSI. Section 56A(c)(1) provides that appropriate adjustments are to be made to AFSI in any case in which an AFS covers a period other than the taxable year. Section 56A(c)(2) provides special rules for related entities. Section 56A(c)(2)(A) provides that, if the financial results of a taxpayer are reported on the AFS for a group of entities (financial statement group), rules similar to the rules of section 451(b)(5) apply. Section 451(b)(5) provides that, in such a situation, the consolidated financial statement of the financial statement group is treated as the AFS of the taxpayer. However, for purposes of section 451(b)(5), if the taxpayer's financial results are also reported on a separate financial statement that is of equal or higher priority to the consolidated financial statement, then the taxpayer's AFS is the separate financial statement. *See* §1.451-3(h)(1)(i). Section 1.451-3(h)(2) and (3) provide rules under section 451(b)(5) for determining the extent to which income reflected on the consolidated financial statement and the underlying source documents is allocable to the taxpayer for purposes of applying the rules under section 451(b).

Section 56A(c)(2)(B) provides a general rule that, if the taxpayer is part of an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return for Federal income tax purposes (tax consolidated group) for any taxable year, AFSI for that group for that taxable year must take into account items on the group's AFS that are properly allocable to members of that group. However, section 56A(c)(2)(B) authorizes the Secretary to prescribe by regulation exceptions to that general rule.

Section 56A(c)(2)(C) provides that, in the case of any corporation that is not included on a consolidated return with the taxpayer, AFSI of the taxpayer with respect to that other corporation is determined by only taking into account dividends received from that other corporation (reduced to the extent provided by the Secretary in regulations or other guidance) and other amounts that are includible in gross income or deductible as a loss under chapter 1 of the Code (chapter 1), other than amounts required to be included under sections 951 and 951A of the Code or such other amounts as provided by the Secretary, with respect to that other corporation.

Section 56A(c)(2)(D)(i) provides that, except as provided by the Secretary, if the taxpayer is a partner in a partnership, the taxpayer's AFSI with respect to such partnership is adjusted to take into account only the taxpayer's distributive share of such partnership's AFSI. Section 56A(c)(2)(D)(ii) provides that, for purposes of sections 55 through 59, the AFSI of a partnership is the partnership's net income or loss set forth on that partnership's AFS (adjusted under rules similar to the rules set forth in section 56A).

Section 56A(c)(3)(A) provides an adjustment to the AFSI of a taxpayer for any taxable year in which the taxpayer is a United States shareholder (within the meaning of section 951(b) or, if applicable, section 953(c)(1)(A) of the Code (each shareholder, a "U.S. shareholder")) of one or more controlled foreign corporations (each within the meaning of section 957 of the Code or, if applicable, section 953(c)(1)(B)) (CFC). Under this rule, the AFSI of the taxpayer with respect to the CFC (as determined under section 56A(c)(2)(C)) is adjusted to also take into account the taxpayer's pro rata share (determined under rules similar to the rules under section 951(a)(2)) of items taken into account in computing the net income or loss set forth on the AFS (as adjusted under rules similar to those that apply in determining AFSI) of each CFC with respect to which the taxpayer is a U.S. shareholder. Section 56A(c)(3)(B) provides that, if the adjustment determined under section 56A(c)(3)(A) would result in a negative adjustment for the taxable year, (i) no adjustment is made to the taxpayer's AFSI for that year, and (ii) the amount of the adjustment determined under section 56A(c)(3)(A)

for the succeeding taxable year is reduced by an amount equal to the negative amount from the prior taxable year.

Section 56A(c)(4) provides that, in determining the AFSI of a foreign corporation, the principles of section 882 of the Code (which subjects a foreign corporation to Federal income tax on its taxable income that is effectively connected with the conduct of a trade or business within the United States) apply.

Section 56A(c)(5) provides the general rule that AFSI is appropriately adjusted to disregard any Federal income taxes, or income, war profits, or excess profits taxes (within the meaning of section 901 of the Code) with respect to a foreign country or possession of the United States, which are taken into account on the taxpayer's AFS. To the extent provided by the Secretary, this general rule does not apply to such foreign taxes taken into account on the taxpayer's AFS if the taxpayer does not choose to claim a foreign tax credit (FTC) under section 27 of the Code (regular FTC). Section 56A(c)(5) also authorizes the Secretary to prescribe regulations or other guidance on the proper treatment of current and deferred taxes for purposes of section 56A(c)(5), including the time at which such taxes are properly taken into account.

Section 56A(c)(6) requires AFSI to be adjusted to take into account any AFSI of a disregarded entity owned by the taxpayer. Section 56A(c)(7) and (8) provide special rules for cooperatives and Alaska Native Corporations (within the meaning of section 3 of the Alaska Native Claims Settlement Act (ANCSA) (43 USC 1602(m))), respectively.

Section 56A(c)(9) requires AFSI to be appropriately adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A of the Code (subtitle A) pursuant to an election under section 48D(d) or 6417 of the Code and included in the net income or loss set forth on the taxpayer's AFS. However, if such amount is otherwise disregarded under the adjustment rule in section 56A(c)(5) (concerning AFSI adjustments for certain taxes), the adjustment in section 56A(c)(9) does not apply.

Section 56A(c)(10)(A) requires AFSI to be adjusted so as not to include any item of income in connection with a mortgage servicing contract any earlier than when the income is included in gross income under any other provision of chapter 1. Section 56A(c)(10)(B) authorizes the Secretary to provide regulations to prevent the avoidance of taxes imposed by chapter 1 with respect to amounts not representing reasonable compensation (as determined by the Secretary) with respect to a mortgage servicing contract.

Section 56A(c)(11)(A) provides that AFSI is (i) adjusted to disregard any amount of income, cost, or expense that otherwise would be included on the AFS in connection with any covered benefit plan, (ii) increased by any amount of income in connection with any such covered benefit plan that is included in the gross income of the corporation under chapter 1, and (iii) reduced by any deductions allowed under any other provision of chapter 1 with respect to any such covered benefit plan. Section 56A(c)(11)(B) defines the term "covered benefit plan" to mean: (i) a defined benefit plan (other than a multiemployer plan described in section 414(f) of the Code) if the trust that is part of such plan is an employees' trust described in section 401(a) of the Code that is exempt from tax under section 501(a) of the Code; (ii) any qualified foreign plan (as defined in section 404A(e) of the Code); or (iii) any other defined benefit plan that provides post-employment benefits other than pension benefits.

Section 56A(c)(12) requires AFSI to be appropriately adjusted, in the case of an organization subject to tax under section 511 of the Code, to take into account only AFSI (i) of an unrelated trade or business of such organization, as defined in section 513 of the Code, or (ii) derived from debt-financed property, as defined in section 514 of the Code, to the extent that income from such property is treated as unrelated business taxable income.

Section 56A(c)(13)(A) requires AFSI to be reduced by depreciation deductions allowed under section 167 of the Code with respect to property to which section 168 of the Code applies, to the extent of the amount allowed as deductions in computing taxable income for the taxable year. In addition, section 56A(c)(13)(B)(i) requires appropriate adjustments to AFSI to disregard any amount of depreciation expense that is taken into account on the taxpayer's AFS with respect to such property. Section 56A(c)(13)(B)(ii) further provides that AFSI is appropriately adjusted to take into account any other item specified by the Secretary in order to provide that such property is accounted for in the same manner as that property is accounted for under chapter 1.

Section 56A(c)(14)(A)(i) requires AFSI to be reduced by amortization deductions allowed under section 197 of the Code with respect to qualified wireless spectrum, to the extent of the amount allowed as deductions in computing taxable income for the taxable year. Section 56A(c)(14)(A)(ii)(I) requires appropriate adjustments to AFSI to disregard any amount of amortization expense that is taken into account on the taxpayer's AFS with respect to such qualified wireless spectrum. Section 56A(c)(14)(A)(ii)(II) further provides that AFSI is appropriately adjusted to take into account any other item specified by the Secretary in order to provide that such qualified wireless spectrum is accounted for in the same manner as that property is accounted for under chapter 1. Section 56A(c)(14)(B) defines the term "qualified wireless spectrum" as wireless spectrum that is used in the trade or business of a wireless telecommunications carrier and that was acquired after December 31, 2007, and before August 16, 2022.

Section 56A(c)(15) authorizes the Secretary to issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes of section 56A, including adjustments to AFSI (i) to prevent the omission or duplication of any item, and (ii) to carry out the principles of part II of subchapter C (relating to corporate liquidations), part III of subchapter C (relating to corporate organizations and reorganizations), and part II of subchapter K (relating to partnership contributions and distributions) of chapter 1.

C. *Financial statement net operating losses*

Section 56A(d)(1) provides that AFSI (determined after the application of section 56A(c), but without regard to section 56A(d)) is reduced by an amount equal to the lesser of (i) the aggregate amount

of financial statement net operating loss (FSNOL) carryovers to the taxable year, or (ii) 80 percent of AFSI (determined after the application of section 56A(c), but without regard to section 56A(d)). Section 56A(d)(2) provides that the amount of an FSNOL that can be carried forward to a taxable year is the FSNOL remaining (if any) after reducing AFSI in prior taxable years under section 56A(d)(1). An FSNOL is the net loss set forth on a taxpayer's AFS, adjusted as provided by section 56A(c), but without regard to section 56A(d), for taxable years ending after December 31, 2019. *See* section 56A(d)(3).

Section 56A(e) authorizes the Secretary to provide such regulations and other guidance as necessary to carry out the purposes of section 56A, including regulations and other guidance relating to the effect of the rules of section 56A on partnerships with income taken into account by an applicable corporation.

III. *Applicable Corporations Under Section 59(k)*

Section 59(k)(1)(A) provides that, for purposes of sections 55 through 59, the term "applicable corporation" means, with respect to any taxable year, any corporation other than an S corporation (as defined in section 1361(a)(1) of the Code), a regulated investment company (as defined in section 851 of the Code) (RIC), or a real estate investment trust (as defined in section 856 of the Code) (REIT), that meets the average annual AFSI test under section 59(k)(1)(B) (AFSI Test) for one or more taxable years that (i) are prior to that taxable year, and (ii) end after December 31, 2021.

There are two versions of the AFSI Test under section 59(k)(1)(B): one version that applies to corporations that are members of a foreign-parented multinational group (FPMG); and another version that applies to all other corporations. Under section 59(k)(1)(B)(i), a corporation that is not a member of an FPMG meets the AFSI test for a taxable year if the average annual AFSI of that corporation (determined without regard to the adjustment under section 56A(d) for FSNOLs) for the three-taxable-year period ending with that taxable year exceeds $1,000,000,000 (general AFSI test). Under section 59(k)(1)(B)(ii), a corporation that is a member of an FPMG for any taxable year meets the AFSI test for that taxable year if (i) that corporation meets the general AFSI test (determined after applying the rule in section 59(k)(2)) (FPMG $1 billion test), and (ii) the average annual AFSI of that corporation (determined without regard to the rule in section 59(k)(2) and without regard to the adjustment described in section 56A(d) for FSNOLs) for the aforementioned three-taxable-year period is at least $100,000,000.

Solely for purposes of determining whether a corporation is an applicable corporation under section 59(k)(1), section 59(k)(1)(D) provides that all AFSI of persons treated as a single employer with the corporation under section 52(a) or (b) of the Code is treated as AFSI of that corporation.

Section 59(k)(1)(D) also provides that, solely for purposes of determining whether a corporation is an applicable corporation, the AFSI of such corporation must be determined without regard to the partnership distributive share adjustment under section 56A(c)(2)(D)(i) and the adjustments under section 56A(c)(11) pertaining to covered benefit plans (as defined in section 56A(c)(11)(B)). In addition, section 59(k)(2)(A) provides that, solely for purposes of determining whether a corporation that is a member of an FPMG meets the FPMG $1 billion test, (i) the AFSI of such corporation must include the AFSI of all members of the FPMG, and (ii) AFSI is determined without regard to the partnership distributive share adjustment under section 56A(c)(2)(D)(i), the CFC pro rata share adjustment under section 56A(c)(3), the effectively connected income adjustment under section 56A(c)(4), and the adjustments under section 56A(c)(11) pertaining to covered benefit plans.

Section 59(k)(1)(E) provides additional special rules for purposes of determining whether a corporation is an applicable corporation. With regard to a corporation with AFSI for any taxable year of less than 12 months, the AFSI of that corporation (including any predecessor) is annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months composing the short period. *See* section 59(k)(1)(E)(ii) and (iii).

Section 59(k)(1)(E)(i) provides that, if a corporation has been in existence for less than three taxable years, the AFSI tests are applied to that corporation on the basis of the period during which that corporation was in existence. Section 59(k)(1)(E)(iii) provides that a reference in section 59(k)(1)(E) to a corporation includes a reference to any predecessor of such corporation. Accordingly, for purposes of determining whether a corporation was in existence for less than three taxable years and, if so, the period on the basis of which the AFSI Tests are applied to that corporation, the period(s) of existence of any predecessor(s) of such corporation are included. *See* section 59(k)(1)(E)(i) and (iii).

Section 59(k)(1)(C) excludes a corporation from the definition of "applicable corporation" if the following requirements are satisfied. First, the corporation must have either (i) a change in ownership, or (ii) a specified number of consecutive taxable years (as determined by the Secretary, taking into account the taxpayer's facts and circumstances), including the most recent taxable year, in which the corporation does not meet an AFSI test. *See* section 59(k)(1)(C)(i). Second, the Secretary must determine that it would not be appropriate to continue to treat that corporation as an applicable corporation (appropriateness determination). *See* section 59(k)(1)(C)(ii). However, as provided in the last sentence of section 59(k)(1)(C), a corporation that satisfies these two requirements for exclusion from applicable corporation status nonetheless will be treated as an applicable corporation if that corporation subsequently meets an AFSI test for any taxable year beginning after the first taxable year for which an appropriateness determination applies.

For purposes of applying section 59(k)(2)(A), section 59(k)(2)(B) defines an FPMG, with respect to a taxable year, as two or more entities if (i) at least one entity is a domestic corporation and another entity is a foreign corporation, (ii) the entities are included in the same AFS for the year, and (iii) either the common parent of the entities is a foreign corporation or, if there is no common parent, the entities are treated as having a common

parent that is a foreign corporation under rules provided by the Secretary under the authority granted by section 59(k)(2)(D) (the common parent or the entity treated as the common parent, the FPMG Common Parent). For purposes of applying section 59(k)(2), if a foreign corporation is engaged in a trade or business in the United States, that trade or business is treated as a separate domestic corporation that is wholly owned by the foreign corporation. *See* section 59(k)(2)(C).

Section 59(k)(2)(D) authorizes the Secretary to provide regulations or other guidance applying the principles of section 59(k)(2), including rules to determine the entities treated as having an FPMG Common Parent, the entities included in an FPMG, and the FPMG Common Parent.

Section 59(k)(3) authorizes the Secretary to provide regulations or other guidance for purposes of applying section 59(k), including providing a simplified method for determining whether a corporation meets the requirements of section 59(k)(1), and addressing the application of section 59(k) to a corporation that experiences a change in ownership.

IV. *CAMT FTC*

Section 59(l)(1) provides rules for determining the amount of the CAMT FTC for a taxable year if an applicable corporation chooses to claim the Regular FTC for the taxable year. The CAMT FTC of the applicable corporation for a taxable year is the sum of two amounts. The first amount (CFC Taxes) is equal to the lesser of: (i) the aggregate of the applicable corporation's pro rata share (as determined under section 56A(c)(3)) of the amount of income, war profits, and excess profits taxes (within the meaning of section 901) imposed by any foreign country or possession of the United States that are (A) taken into account on the AFS of each CFC with respect to which the applicable corporation is a U.S. shareholder, and (B) paid or accrued (for Federal income tax purposes) by each such CFC; or (ii) 15 percent of the applicable corporation's adjustment under section 56A(c)(3)(A) (CFC FTC Limitation). *See* section 59(l)(1)(A). The second amount is equal to the amount of income, war profits, and excess profits taxes (within the meaning of section 901) imposed by any foreign country or possession of the United States that are (i) taken into account on the AFS of the applicable corporation, and (ii) paid or accrued (for Federal income tax purposes) by the applicable corporation. *See* section 59(l)(1)(B).

Section 59(l)(2) provides that, for any taxable year for which an applicable corporation chooses to claim the Regular FTC, the amount of CFC Taxes for the taxable year in excess of the CFC FTC Limitation for the taxable year is carried forward for up to the five succeeding taxable years and increases the amount of CFC Taxes in any of those succeeding taxable years to the extent not taken into account in a prior taxable year.

Section 59(l)(3) authorizes the Secretary to provide regulations or other guidance as is necessary to carry out the purposes of the CAMT FTC rules in section 59(l).

V. *Consolidated Return Regulations*

Section 1502 authorizes the Secretary to prescribe regulations to clearly reflect the Federal income tax liability of a tax consolidated group and to prevent avoidance of such tax liability. *See* §1.1502-1(h) (defining the term "consolidated group" for Federal income tax purposes). For purposes of carrying out those objectives, section 1502 explicitly permits the Secretary to prescribe rules that may be different from the provisions of chapter 1 that would apply if the corporations composing the tax consolidated group filed separate returns.

VI. *Prior Guidance Relating to the CAMT*

The Treasury Department and the IRS have issued seven notices with respect to the CAMT (CAMT notices).

A. *Notice 2023-7*

On January 17, 2023, the Treasury Department and the IRS published Notice 2023-7, 2023-3 I.R.B. 390, which announced the intention of the Treasury Department and the IRS to issue proposed regulations addressing the application of the CAMT. Notice 2023-7 provides interim guidance on certain issues relating to the CAMT, including issues regarding subchapters C and K of chapter 1, troubled corporations, tax consolidated groups, depreciation of property to which section 168 applies, the treatment of certain Federal income tax credits under the CAMT, and the determination of applicable corporation status in circumstances involving certain partnerships. Notice 2023-7 also describes a simplified method for determining whether a corporation is an applicable corporation subject to the CAMT.

B. *Notice 2023-20*

On March 6, 2023, the Treasury Department and the IRS published Notice 2023-20, 2023-10 I.R.B. 523, to provide interim guidance on the determination of an insurance company's AFSI as it relates to (i) variable contracts (and similar contracts), and (ii) funds withheld reinsurance and modified coinsurance agreements. Notice 2023-20 also provides interim guidance on the determination of AFSI as it relates to the basis of certain assets held by certain previously tax-exempt entities that received a "fresh start" basis adjustment.

C. *Notice 2023-42*

On June 7, 2023, the Treasury Department and the IRS published Notice 2023-42, 2023-26 I.R.B. 1085, to provide relief from the addition to tax under section 6655 of the Code with respect to the tax imposed under section 55(a) (CAMT liability) for any taxable year that begins after December 31, 2022, and before January 1, 2024.

D. *Notice 2023-64*

On October 2, 2023, the Treasury Department and the IRS published Notice 2023-64, 2023-40 I.R.B. 974, to provide additional interim guidance on determining a taxpayer's AFS and AFSI, including guidance applicable to tax consolidated groups and certain foreign corporations. Notice 2023-64 also describes guidance related to (i) AFSI adjustments with respect to depreciation of property to which section 168 applies, (ii) the amortization of qualified wireless spectrum, (iii)

the treatment of certain taxes, (iv) the prevention of certain duplications and omissions, (v) the determination of applicable corporation status, (vi) the CAMT FTC, and (vii) FSNOLs.

E. *Notice 2024-10*

On January 16, 2024, the Treasury Department and the IRS published Notice 2024-10, 2024-3 I.R.B. 406, to provide additional interim guidance on determining the AFSI of a U.S. shareholder if a CFC pays a dividend. Notice 2024-10 also modifies and clarifies interim guidance provided in Notice 2023-64 regarding the AFS of a tax consolidated group.

F. *Notice 2024-33*

On April 15, 2024, the Treasury Department and the IRS issued Notice 2024-33, 2024-18 I.R.B. 959, which provided a limited waiver of the addition to tax under section 6655 to the extent the amount of any underpayment is attributable to a portion of a corporation's CAMT liability. The relief provided in Notice 2024-33 applied only for the purpose of calculating the installment of estimated tax by a corporate taxpayer that was due on or before April 15, 2024, or May 15, 2024 (in the case of a fiscal-year taxpayer with a taxable year beginning in February 2024), with respect to a taxable year that began in 2024.

G. *Notice 2024-47*

On June 13, 2024, the Treasury Department and the IRS issued Notice 2024-47, 2024-27 I.R.B. 1, extending the relief provided in Notice 2024-33. Under Notice 2024-47, the limited waiver of the addition to tax under section 6655 that is attributable to a corporation's CAMT liability was extended to include the calculation of any installment of estimated tax by a corporate taxpayer that was due on or before August 15, 2024, with respect to a taxable year that began in 2024.

H. *Reliance on notices*

Except as provided in the next paragraph, pursuant to section 15.02 of Notice 2023-64, a taxpayer may rely on the interim guidance provided in sections 3 through 7 of Notice 2023-7 (as modified and clarified by Notice 2023-64), sections 3 through 5 of Notice 2023-20, and sections 3 through 14 of Notice 2023-64, for taxable years ending on or before September 13, 2024**.**

Pursuant to section 5.01 of Notice 2024-10, taxpayers may rely on the interim guidance described in section 3 of Notice 2024-10 for Covered CFC Distributions (as defined therein) received on or before September 13, 2024. In addition, pursuant to section 5.02 of Notice 2024-10, taxpayers may rely on the interim guidance described in section 4.02(5)(b) and section 6.02 of Notice 2023-64 (as modified by Notice 2024-10) and section 4.04 of Notice 2024-10 for taxable years ending before September 13, 2024. A taxpayer may not rely on the unmodified text of sections 4.02(5)(b)(i) or 6.02 of Notice 2023-64 for any tax return filed on or after December 15, 2023.

I. *Feedback received*

The Treasury Department and the IRS have received feedback from taxpayers, tax professionals, and other stakeholders regarding the CAMT, including feedback received in response to the CAMT notices. Based on the feedback received, and based on further consideration of sections 55, 56A, 59 and 1502, and the CAMT notices, the Treasury Department and the IRS are proposing these regulations under sections 55, 56A, 59, 1502, and 7805 as described in the Authority section. Certain CAMT issues with respect to which stakeholders have provided feedback, as well as issues on which the Treasury Department and the IRS have further reflected after publication of the CAMT notices, are discussed in the following Explanation of Provisions.

Explanation of Provisions

I. *Proposed §1.56A-1: Adjusted Financial Statement Income (AFSI)*

Pursuant to the authority granted by section 56A(c)(2)(B), (c)(15), and (e), proposed §1.56A-1 would provide definitions and general rules for determining the AFSI of a CAMT entity (that is, any entity identified in section 7701 of the Code and the regulations under section 7701 other than a disregarded entity) for purposes of sections 55 through 59 of the Code.

Proposed §1.56A-1(a) would provide an overview of proposed §1.56A-1 and clarify the scope of the section 56A regulations, which term is defined to mean proposed §§1.56A-1 through 1.56A-27 and §1.1502-56A. Specifically, proposed §1.56A-1(a)(2) would provide that the section 56A regulations apply to determine a CAMT entity's AFSI, as defined in proposed §1.56A-1(b)(1), modified FSI, as defined in proposed §1.56A-1(b)(32) (in the case of a partnership), or adjusted net income or loss, as defined in proposed §1.56A-1(b)(2) (in the case of a CFC), for purposes of sections 55 through 59. Proposed §1.56A-1(a)(2) would also provide that the section 56A regulations apply to any CAMT entity whose AFSI, modified FSI, or adjusted net income or loss, as applicable, is relevant for determining whether that CAMT entity, or any other CAMT entity, is an applicable corporation under section 59(k), or the tentative minimum tax amount under section 55(b)(2)(A) of that CAMT entity, or any other CAMT entity. Significantly, while the definition of "CAMT entity" in proposed §1.56A-1(b)(8) would include any entity identified in section 7701 of the Code and the regulations under section 7701 other than a disregarded entity, not all such entities are applicable corporations, nor are all relevant to the determination of CAMT liability for an applicable corporation, or to the determination of CAMT status.

Proposed §1.56A-1(b) would provide definitions that apply for purposes of the section 56A regulations. Proposed §1.56A-1(b)(1) would provide that the term "adjusted financial statement income" (AFSI) means the CAMT entity's FSI for the taxable year, adjusted as provided in the section 56A regulations.

Proposed §1.56A-1(b)(20) would provide that the term "financial statement income" (FSI) means the net income or loss of the CAMT entity set forth on the income statement included in the CAMT entity's applicable financial statement (AFS) for the taxable year. FSI includes all the CAMT entity's items of income, expense, gain, and loss reflected in the net income or loss set forth on the income statement for the taxable year, including

nonrecurring items and net income or loss from discontinued operations, but does not include items reflected elsewhere in the CAMT entity's AFS, including equity accounts such as retained earnings and other comprehensive income (OCI). OCI is not included in the net income or loss reflected on financial statements prepared in accordance with United States Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). *See* Accounting Standards Codification (ASC) 220-10-20 and International Accounting Standards (IAS) 1.82A. Accordingly, because the determination of FSI starts with the net income or loss set forth on an AFS, OCI would not be included in that determination.[1]

Proposed §1.56A-1(b)(4) would provide that the term "AFS consolidation entries" means the financial accounting journal entries that are made in preparing a consolidated financial statement for a financial statement group in order to present the financial results of that financial statement group as though all members of the financial statement group were a single economic entity. Proposed §1.56A-1(b)(6) would provide that the term "applicable financial statement" (AFS) is defined in proposed §1.56A-2(b). AFS means a CAMT entity's financial statement from which a CAMT entity's FSI and AFSI is determined. Proposed §1.56A-1(b)(7) would provide that the term "CAMT basis" means the basis of an item for purposes of determining AFSI. Except as otherwise provided in the section 56A regulations, the CAMT basis of an item would be the AFS basis of the item, adjusted as provided in the section 56A regulations. Proposed §1.56A-1(b)(22) would provide that the term "for regular tax purposes" means for the purposes of computing a CAMT entity's regular tax liability, as defined under section 26(b) of the Code, or, if the CAMT entity is a pass-through entity or a CFC, the regular tax liability of a direct or indirect owner of the CAMT entity, as applicable.

Proposed §1.56A-1(c) would provide general rules for determining a CAMT entity's FSI, which is the starting point for determining the CAMT entity's AFSI. The rules in proposed §1.56A-1(c) generally would be consistent with section 5 of Notice 2023-64 and section 4 of Notice 2024-10.

Proposed §1.56A-1(c)(1) would provide that FSI includes all items of income, expense, gain, and loss reflected in the net income or loss reported in the CAMT entity's income statement, regardless of the treatment of these items for regular tax purposes. For example, FSI includes gain on a like-kind exchange that qualifies for non-recognition treatment under section 1031.

Proposed §1.56A-1(c)(2) would set forth rules for determining the FSI of a tax consolidated group and CAMT entities that own disregarded entities. If the AFS of each member of the tax consolidated group is not the same consolidated financial statement (as determined under proposed §1.56A-2(g)), the financial results of all CAMT entities reflected in the different AFSs of its members are combined to form a single consolidated financial statement that is treated as the AFS of the tax consolidated group. Adjustments are made to avoid duplication of financial results and to record any AFS consolidation entries that would have been made if such a consolidated financial statement actually had been prepared to the extent not already reflected in the financial results of any member. Proposed §1.56A-1(c)(2)(i) would also provide that additional rules for determining the FSI of a tax consolidated group are under proposed §1.1502-56A. Proposed §1.56A-1(c)(2)(ii) would provide that special rules for determining the FSI of a CAMT entity that owns a disregarded entity or branch are under proposed §1.56A-9.

Proposed §1.56A-1(c)(3) and (4) would provide the rules for determining the entity-level FSI, AFS basis, and balance sheet account amounts for a CAMT entity whose financial results are included in a single consolidated financial statement. It is necessary for a CAMT entity to determine entity-level FSI, AFS basis, and balance sheet account amounts because section 56A and other CAMT provisions require certain AFSI computations or adjustments to be performed at the entity level. For example, *see* section 56A(c)(2)(D), which determines the AFSI of a CAMT entity that is a partner in a partnership; section 56A(c)(3), which adjusts the AFSI of a CAMT entity for any taxable year that the CAMT entity is a U.S. shareholder of one or more CFCs; and section 55, which assesses the CAMT liability for each corporate filer notwithstanding that multiple corporations may be part of the same financial statement group.

Proposed §1.56A-1(c)(3) would set forth rules for determining a CAMT entity's FSI if the CAMT entity's AFS is a consolidated financial statement (consolidated AFS) that reflects FSI for the financial statement group (consolidated FSI). Under the proposed rules, consolidated FSI that is the CAMT entity's FSI must be (i) supported by the CAMT entity's separate books and records, including trial balances, used to create the consolidated AFS, and (ii) generally determined without regard to the financial results of the other financial statement group members. Accordingly, the loss of one member of the financial statement group may not generally offset the income of another member in determining the consolidated FSI that is the CAMT entity's FSI, even though the amounts are reflected in consolidated FSI on a net basis. *See* proposed §1.56A-1(c)(3)(ii).

Additionally, under the proposed rules, the consolidated FSI that is the CAMT entity's FSI would be determined without regard to AFS consolidation entries that are made in preparing the consolidated AFS and that either: eliminate the effect of transactions between the CAMT entity and other CAMT entities that are members of the same financial statement group; or eliminate any income, loss, expense, asset, liability, or other item of the CAMT entity with respect to its investment in another CAMT entity that is a member of the same financial statement group. These elimination entries are disregarded due to the statutory requirement for entity-level AFSI computations. Absent the rules in

[1] *This approach would be consistent with Senator Ron Wyden's August 6, 2022, colloquy with Senator Ben Cardin, stating that OCI is not included in the definition of FSI for the purposes of applying the CAMT. 168 Cong. Rec. S4166 (2022).*

proposed §1.56A-1(c)(3)(iii), items would be improperly omitted from AFSI because they would not be reflected in FSI. If the CAMT entity has an investment in a partnership or domestic corporation that is a member of the same financial statement group, the CAMT entity's FSI with respect to the investment is determined as though the CAMT entity had prepared a separate financial statement in which the investment was properly accounted for under the relevant accounting standards, for example, the Parent-Entity Financial Statement accounting standards described in ASC 810-10-45-11 (unless the CAMT entity already accounts for the investment in this manner in its separate books and records). Under this approach, parent company financial statements present the parent company's investment in its subsidiaries as a single line item on the balance sheet. The amount recorded as the investment reflects the parent's proportionate share of the subsidiary's net assets. Similarly, the parent company financial statements reflect the result of operations of the subsidiary as a single line item reflecting the parent's proportionate results. *See* proposed §1.56A-1(c)(3)(iii). This rule is necessary because the investment account may not be properly maintained in the separate books of the CAMT entity investor, given that the FSI of the partnership or domestic corporation in which it has an investment is already included in the consolidated financial statement.

To prevent amounts from being duplicated or omitted from a CAMT entity's FSI, proposed §1.56A-1(c)(3)(iv) would provide that AFS consolidation entries, other than elimination entries, that relate to one or more CAMT entities that are members of the financial statement group but are not reflected in the separate books and records of the CAMT entities are appropriately allocated or pushed down (or both), as applicable, to each CAMT entity to which the AFS consolidation entries relate and taken into account in each CAMT entity's FSI.

To ensure all items on a consolidated financial statement are properly accounted for by each CAMT entity that is a member of the financial statement group, proposed §1.56A-1(c)(3)(v) would require each CAMT entity to maintain books and records sufficient to demonstrate how the CAMT entity's FSI, determined under the rules in proposed §1.56A-1(c)(3), reconciles to consolidated FSI of the financial statement group.

For reasons similar to those underlying proposed §1.56A-1(c)(3), proposed §1.56A-1(c)(4)(i) would provide that, if a CAMT entity's AFS is a consolidated financial statement, and if the CAMT entity's balance sheet accounts or AFS basis in an item is relevant for determining the CAMT entity's AFSI, then the CAMT entity uses the balance sheet accounts or AFS basis reflected in the CAMT entity's separate books and records used to create the CAMT entity's consolidated financial statement, determined under rules similar to the rules in proposed §1.56A-1(c)(3)(iii) and (iv). Proposed §1.56A-1(c)(4)(ii) would provide, in part, that any adjustments under purchase accounting (as defined in proposed §1.56A-1(b)(35)) or push down accounting (as defined in proposed §1.56A-1(b)(36)) reflected in a CAMT entity's AFS basis, balance sheet accounts, or FSI as a result of the application of proposed §1.56A-1(c)(4)(i) may be disregarded for purposes of determining the CAMT entity's CAMT basis and AFSI under other sections of the section 56A regulations, for example, under proposed §§1.56A-4 and 1.56A-18. *See* parts IV and XVIII of this Explanation of Provisions.

Because it is necessary to determine a CAMT entity's FSI before determining its AFSI, proposed §1.56A-1(c)(5) would provide that proposed §1.56A-1(c) applies before proposed §1.56A-1(d) and (e) and before all other sections of the section 56A regulations, other than proposed §1.56A-2. Accordingly, references to AFS basis and FSI in proposed §1.56A-1(d) and (e) and in proposed §§1.56A-3 through 1.56A-27 mean AFS basis and FSI as determined under the proposed §1.56A-1(c) rules described previously.

Proposed §1.56A-1(c)(6) would provide examples illustrating these rules.

Proposed §1.56A-1(d) would provide general rules for determining a CAMT entity's AFSI under the section 56A regulations. The rules in proposed §1.56A-1(d) for determining AFSI generally would be consistent with section 5 of Notice 2023-64. Accordingly, proposed §1.56A-1(d)(1) would provide that AFSI includes all items of income, expense, gain, and loss reflected in a CAMT entity's FSI regardless of the treatment of these items for regular tax purposes, unless an exception is provided in another section of the section 56A regulations. For example, if a CAMT entity's FSI reflects gain or loss from a transaction that qualifies for nonrecognition treatment for regular tax purposes, then the gain or loss is included in AFSI except as otherwise provided in the section 56A regulations.

Proposed §1.56A-1(d)(2) would limit the adjustments allowed in determining a CAMT entity's AFSI to those provided in the section 56A regulations or in IRB guidance (as defined in proposed §1.56A-1(b)(31)). The section 56A regulations would encompass all statutory AFSI adjustments and any AFSI adjustments provided with the use of the regulatory authority of the Treasury Department and the IRS described in the Authority section. Certain AFSI adjustments are based on the authority granted in section 56A(c)(15), which authorizes "such adjustments to adjusted financial statement income as the Secretary determines necessary to carry out the purposes of this section . . ." Examples of AFSI adjustments based on section 56A(c)(15) authority are those found in proposed §1.56A-21 (regarding troubled companies) and proposed §1.56A-12(b)(2) (regarding the proceeds of certain credit transfers).

Proposed §1.56A-1(d)(3) generally would provide that the AFSI adjustments described in the section 56A regulations, including those adjustments that affect the CAMT basis of an item, are made for taxable years ending after December 31, 2019. However, a transition rule in proposed §1.56A-1(d)(3)(ii) generally would provide that, except as otherwise provided in the section 56A regulations (for example, in §1.56A-15(c)(6) and (e)(2)(ii)(A) for AFSI adjustments for section 168 property), AFSI adjustments that otherwise affect the computation of AFSI in taxable years ending after December 31, 2019, but that arise from a transaction or an event that occurred in a taxable year ending on or before December 31, 2019, are not made. The rules underlying proposed §1.56A-1(d)(3) are derived from the statute. For example, under section 59(k)(1)(A) and (B), a corporation is an applicable corporation for a taxable year

if the average annual adjusted financial statement income of the corporation for a 3-taxable-year period that is prior to such taxable year and that ends after December 31, 2021, exceeds certain thresholds. In addition, section 56A(d)(3) defines a FSNOL as the amount of the net loss on the corporation's AFS for taxable years ending after 2019. The statute generally contemplates that events that occur before 2020 but affect AFSI computations and adjustments in 2020 and later need to be considered in determining AFSI in later years. Such an approach, however, may not be administrable in certain cases. Accordingly, except where it is appropriate to carry out the purposes of section 56A (for example, for section 168 property), the transition rule would neither permit nor require AFSI adjustments with respect to pre-2020 transactions or events.

To prevent duplications and omissions, proposed §1.56A-1(d)(4) generally would provide that, if a gain or loss is reflected in FSI with respect to an item that has a CAMT basis that is different than the item's AFS basis, and if the gain or loss is required to be recognized for AFSI purposes, then the gain or loss reflected in FSI is redetermined for AFSI purposes by reference to the CAMT basis of the item.

Proposed §1.56A-1(e) would provide that a CAMT entity whose AFSI is not expressed in U.S. dollars must translate its AFSI, after having made all other applicable adjustments under the section 56A regulations except for those adjustments that already are expressed in U.S. dollars, to U.S. dollars using the weighted average exchange rate, as defined in §1.989(b)-1, for the CAMT entity's taxable year. See part VI.C. of this Explanation of Provisions for a discussion of the separate rules under proposed §1.56A-6(c)(1) that apply for translating a CFC's adjusted net income or loss to U.S. dollars.

Proposed §1.56A-1(f) would provide that the classification of an entity for regular tax purposes applies for purposes of the section 56A regulations regardless of whether the entity or arrangement is classified differently for AFS purposes. The proposed regulations would follow regular tax principles for purposes of determining whether an organization or other arrangement is treated as an entity separate from its owners, and whether an unincorporated organization or contractual arrangement is treated as a partnership. Accordingly, regardless of the AFS treatment, a participant in a contractual arrangement that rises to the level of an entity classified as a partnership for Federal income tax purposes is treated as owning a partnership investment to which section 56A(c)(2)(D)(i) adjustments may apply. This interpretation is supported by references in section 56A to entity classifications that do not exist for AFS purposes, such as disregarded entities, and provides for administrative consistency in situations in which the financial accounting rules and the Federal income tax rules provide for disparate structural characterizations. For example, the Treasury and the IRS understand that in certain situations IFRS may treat a CAMT entity that is treated as a partner in a partnership for Federal income tax purposes as owning 100 percent of the partnership's equity, while treating another CAMT entity that is also treated as a partner in the partnership for Federal income tax purposes as a lender to that partnership. Although under IFRS a CAMT entity's partnership investment might be treated as that of a lender, the section 56A(c)(2)(D)(i) adjustment applies if the CAMT entity is treated as a partner in the partnership for Federal income tax purposes.

Proposed §1.56A-1(g)(1) would require an applicable corporation to maintain books and records sufficient to demonstrate its compliance with the section 56A regulations, including the identification of the corporation's AFS, the determination of the corporation's FSI (including how FSI reconciles to consolidated FSI if determined under proposed §1.56A-1(c)(3)), the substantiation of any adjustments required by the section 56A regulations, and the substantiation of AFS basis and CAMT basis. Proposed §1.56A-1(h) would require an annual return on Form 4626, *Alternative Minimum Tax-Corporations*, setting forth information in the form and manner as the form or instructions prescribe.

II. *Proposed §1.56A-2: Applicable Financial Statement (AFS)*

Pursuant to the authority granted by section 56A(b), (c)(15), and (e), proposed §1.56A-2 would provide rules under section 56A(b) regarding the meaning and identification of an "applicable financial statement" and under section 56A(c)(2)(A) regarding the priority of consolidated financial statements.

A. *Defining and identifying an AFS*

Section 56A(b) generally defines an "applicable financial statement" (AFS) for any taxable year as an applicable financial statement as defined in section 451(b)(3) or as specified by the Secretary in regulations or other guidance. Section 451(b)(3) and §1.451-3(a)(5), which implements section 451(b)(3), generally provide that a taxpayer's AFS is the taxpayer's financial statement listed therein that has the highest priority. The financial statements listed in §1.451-3(a)(5) are financial statements certified as being prepared in accordance with GAAP or IFRS, or financial statements filed with the Federal or a State government, an agency thereof, or a self-regulatory organization. Under §1.451-3(a)(5), the financial statements that would take the highest priority are those prepared in accordance with GAAP, followed by those prepared in accordance with IFRS, followed by those filed with certain Federal, State, and foreign governments or agencies thereof.

Consistent with sections 56A(b) and 451(b)(3), proposed §1.56A-2(b) generally would provide that the term "AFS" means a CAMT entity's financial statement listed in proposed §1.56A-2(c) that has the highest priority. Proposed §1.56A-2(c) generally would adopt the list of financial statements and their order of priority set forth in section 451(b)(3) and §1.451-3(a)(5).

However, proposed §1.56A-2(c)(3) would expand the list of financial statements to include certain certified financial statements prepared in accordance with accounting standards other than GAAP and IFRS but issued by an accounting standards board charged with developing accounting standards for one or more jurisdictions. Because these statements have been certified, they would take a higher priority than financial statements filed with governments or agencies thereof, which are not subject to a certification requirement. However, these statements

would take a lower priority than financial statements certified as being prepared in accordance with GAAP or IFRS.

Additionally, proposed §1.56A-2(c)(5) and (6) would add two additional categories of financial statements of lower priority: (i) financial statements that are unaudited (or audited but not certified) and that are prepared using accepted accounting standards for an external non-tax purpose; and (ii) the CAMT entity's Federal income tax return or information return. These categories would be added to ensure CAMT entities that do not prepare a financial statement described in any of the other categories can perform the necessary AFSI computations required under sections 56A and 59(k), including for purposes of determining whether a corporation is an applicable corporation under section 59(k) or determining the AFSI of an applicable corporation under section 56A.

As discussed previously, the list of financial statements in proposed §1.56A-2(c) would include certain certified financial statements that are used for a substantial non-tax purpose. Proposed §1.56A-2(h) would provide examples illustrating the presence or absence of a substantial non-tax purpose. Comments are requested on whether additional examples are necessary to illustrate other cases in which a financial statement is used for a substantial non-tax purpose.

A stakeholder requested guidance on what it means for a financial statement to be "certified," as section 451(b)(3) and §1.451-3(a)(5) do not address this issue. Proposed §1.56A-2(d) would provide that a financial statement is certified for purposes of proposed §1.56A-2(c) if it is: (i) certified by an independent financial statement auditor to present fairly the financial position and results of operations of a CAMT entity or financial statement group in conformity with the relevant financial accounting standards (that is, an unqualified or unmodified "clean" opinion); (ii) subject to a qualified or modified opinion by an independent financial statement auditor that the financial statement presents fairly the financial position and results of operations of a CAMT entity or financial statement group in conformity with the relevant financial accounting standards, except for the effects of the matter to which the qualification or modification relates (that is, a qualified or modified "except for" opinion); or (iii) subject to an adverse opinion by an independent financial statement auditor, but only if the auditor discloses the amount of the disagreement with the statement. This definition of the term "certified" generally follows the Public Company Accounting Oversight Board's rules governing an audit opinion of an independent financial statement auditor and the definition of a "certified audited" financial statement in former §1.56-1(c)(1)(ii) (*see* TD 8307, 55 FR 33671, 33679 (August 17, 1990)) (1990 Regulations). *See* AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion;* AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*; SEC Release No. 34-81916 (October 23, 2017).

Consistent with §1.451-3(a)(5)(iv), proposed §1.56A-2(e) and (f) would provide additional rules for prioritizing a restated financial statement over an original financial statement if the restated financial statement is issued prior to the date the CAMT entity files its original Federal income tax return for that taxable year, and for prioritizing annual financial statements over periodic financial statements.

B. *Priority of a consolidated financial statement*

Section 56A(c)(2)(A) provides that, if a taxpayer's financial results are reported on the AFS for a group of entities (that is, a financial statement group), rules similar to the rules in section 451(b)(5) apply. Section 451(b)(5) provides that, in such a situation, the AFS for the financial statement group is treated as the AFS of the taxpayer. The rules in §1.451-3(h) generally provide that the AFS for the group is treated as the AFS of the taxpayer, unless the taxpayer has a separate financial statement that is of equal or higher priority than the AFS for the financial statement group.

Proposed §1.56A-2(g)(1) would provide general rules for determining a CAMT entity's AFS if the financial results of the CAMT entity are included in a consolidated financial statement (that is, a financial statement that consolidates the financial results of more than one CAMT entity to treat such CAMT entities as if they were a single economic unit). This section generally would provide that, if a CAMT entity's financial results are included in one or more consolidated financial statements described in proposed §1.56A-2(c)(1) through (5) (that is, financial statements other than a tax return), the CAMT entity's AFS is the consolidated financial statement with the highest priority within those sections. However, if the CAMT entity's financial results are also reported on one or more separate financial statements that are of equal or higher priority to the highest priority consolidated financial statement (as determined under proposed §1.56A-2(c)), then the CAMT entity's AFS is the separate financial statement with the highest priority under proposed §1.56A-2(c).

Proposed §1.56A-2(g)(2)(i) through (iv) would provide exceptions to the use of a separate financial statement if the CAMT entity is a member of a tax consolidated group.

Proposed §1.56A-2(g)(2)(i) generally would require a CAMT entity that is a member of a tax consolidated group that has only one consolidated financial statement described in proposed §1.56A-2(c)(1) through (5) that contains the financial results of all members of the tax consolidated group to use that consolidated financial statement as the CAMT entity's AFS, even if the CAMT entity's financial results also are reported on a separate financial statement (or a consolidated financial statement that has the financial results of some, but not all, members of the tax consolidated group) that is of equal or higher priority to that consolidated financial statement.

Proposed §1.56A-2(g)(2)(ii) generally would provide that, if there is more than one consolidated financial statement described in proposed §1.56A-2(c)(1) through (5) that contains the financial results of all members of a tax consolidated group, then a CAMT entity that is a member of the tax consolidated group uses the consolidated financial statement with the highest priority, even if the CAMT entity's financial results also are reported on a separate financial statement (or a consolidated financial statement

that has the financial results of some, but not all, members of the tax consolidated group) that is of equal or higher priority to that consolidated financial statement. Proposed §1.56A-2(g)(2)(iii) and (iv) would provide additional exceptions that apply if there are no consolidated financial statements that contain the financial results of all members of a tax consolidated group.

As noted previously, if the AFS of each member of a tax consolidated group is not the same consolidated financial statement after the application of proposed §1.56A-2(g), proposed §1.56A-1(c)(2) would provide rules for combining the different financial statements of the members of the tax consolidated group to form a single consolidated financial statement that is treated as the AFS of the tax consolidated group for purposes of determining FSI and AFSI of the tax consolidated group under the section 56A regulations.

The foregoing rules would be consistent with the treatment of the members of a tax consolidated group as a single corporation for purposes of the CAMT. *See* section 56A(c)(2)(B) and proposed §1.1502-56A(a)(2). In addition, these proposed rules would alleviate the administrative burden of determining the FSI and AFSI of a tax consolidated group by pulling information from financial statements of different members using different accounting standards.

In order to minimize the inconsistent treatment of transactions between FPMG members computing AFSI based on different financial accounting standards, proposed §1.56A-2(g)(2)(v) would provide an additional exception to the use of a separate financial statement for a CAMT entity that is a member of an FPMG. Proposed §1.56A-2(g)(2)(v) would provide that, if the FPMG common parent (as defined in proposed §1.56A-1(b)(25)) prepares a consolidated financial statement (FPMG consolidated AFS) that includes the CAMT entity, the CAMT entity uses the FPMG consolidated AFS as the CAMT entity's AFS, regardless of whether the CAMT entity's financial results also are reported on a separate financial statement that is of equal or higher priority to the FPMG consolidated AFS.

Proposed §1.56A-9, discussed later, would provide rules for attributing items of a disregarded entity or branch to its CAMT entity owner by treating them as a single CAMT entity. For this purpose, proposed §1.56A-2(h) would provide that if the financial results of a disregarded entity or branch are reflected in the CAMT entity owner's AFS, the disregarded entity or branch may not determine its own AFS under the rules of §1.56A-2 as if it were a separate CAMT entity (that is, the CAMT entity owner uses its AFS to determine its FSI and AFSI under the rules in proposed §1.56A-9). Proposed §1.56A-2(h) would further provide that if the financial results of a disregarded entity or branch are not reflected in the CAMT entity owner's AFS, the disregarded entity or branch determines its own AFS under the rules of proposed §1.56A-2, as if it were a CAMT entity (however, *see* proposed §1.56A-9(b)(3) for rules for determining the FSI and AFSI of a CAMT entity that owns a disregarded entity or branch that determines its own AFS).

Proposed §1.56A-2 generally would be consistent with the guidance described in section 4 of Notice 2023-64, as modified and clarified in section 4 of Notice 2024-10.

III. *Proposed §1.56A-3: AFSI Adjustments for AFS Year and Taxable Year Differences*

Pursuant to the authority granted by sections 56A(c)(1), (c)(15), and (e), proposed §1.56A-3 would provide rules under section 56A(c)(1) regarding appropriate adjustments that are made to AFSI if an AFS covers a period other than the taxable year. If a CAMT entity's AFS is prepared on the basis of a financial accounting period that differs from the CAMT entity's taxable year, proposed §1.56A-3(b) would require the CAMT entity to compute FSI and AFSI as if the financial reporting period were the same as the taxable year by conducting an interim closing of the books using the accounting standards the CAMT entity uses to prepare the AFS.

The Treasury Department and the IRS considered the methods in the 1990 Regulations and in §1.451-3(h)(4), among other methods, in determining which adjustments are appropriate under section 56A(c)(1). Those methods included (i) performing an interim closing of the books, (ii) using pro rata amounts for each financial accounting year that includes any part of the taxable year, and (iii) in the case of an accounting year ending at least five months after the end of the taxable year, using the amount reported for the financial accounting year ending within the taxable year. The proposed regulations would provide for adjustments based on an interim closing of the books because this method carries out the purposes of the statute by producing an accurate measurement of AFSI for the taxable year.

Proposed §1.56A-3(b)(2) would provide examples illustrating the application of an interim closing of the books to determine FSI and AFSI when a CAMT entity's AFS is prepared on the basis of a financial accounting period that differs from the taxable year.

IV. *Proposed §1.56A-4: AFSI Adjustments and Basis Determinations with Respect to Foreign Corporations*

A. *Overview*

Section 56A(c)(2)(C) provides that a taxpayer's AFSI with respect to a corporation that is not a member of the taxpayer's tax consolidated group generally only takes into account dividends (reduced to the extent provided by the Secretary in regulations or other guidance) and other amounts that are includible in gross income or deductible as a loss under chapter 1 (other than amounts required to be included under sections 951 and 951A or such other amounts as provided by the Secretary). Section 56A(c)(3)(A) provides that the AFSI of a taxpayer that is a U.S. shareholder of one or more CFCs is adjusted to also take into account the taxpayer's pro rata share of items taken into account in computing the net income or loss set forth on the AFS (as adjusted under rules similar to those that apply in determining AFSI) of each CFC with respect to which the taxpayer is a U.S. shareholder. *See* proposed §1.56A-6 (AFSI adjustments with respect to CFCs).

Section 56A(c)(15) authorizes the Secretary to issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes of section 56A, including: (i) adjustments to prevent the omission or duplication of any item;

and (ii) adjustments to carry out the principles of part II of subchapter C of chapter 1 (relating to corporate liquidations) and part III of subchapter C of chapter 1 (relating to corporate organizations and reorganizations). *See also* section 56A(e).

Pursuant to the authority granted by sections 56A(c)(2)(C), (c)(15), and (e), proposed §1.56A-4 would provide rules concerning foreign corporations. More specifically, proposed §1.56A-4 would provide rules under section 56A(c)(2)(C) for determining the amount of AFSI of a CAMT entity that results solely from the CAMT entity's ownership of stock of a foreign corporation. Additionally, proposed §1.56A-4 would provide (i) rules under section 56A(c)(15)(B) for determining the AFSI and CAMT basis consequences of certain transactions involving foreign corporations (referred to as covered asset transactions); (ii) rules regarding the treatment of elections made under section 338(g) of the Code for acquisitions of stock of foreign corporations; (iii) rules regarding the treatment of purchase accounting and push down accounting with respect to acquisitions of stock of foreign corporations; (iv) rules for adjusting AFSI in certain circumstances when basis in foreign stock received is determined under section 358 of the Code; (v) rules for adjusting modified FSI of a partnership in certain circumstances when the partnership distributes stock of a foreign corporation; and (vi) examples illustrating application of the rules in proposed §1.56A-4.

The interaction of section 56A(c)(2)(C) and (c)(3) raises unique double-counting issues with respect to distributions by CFCs and transfers of stock of CFCs. For example, absent guidance, distributions by CFCs could result in earnings of CFCs being included in the AFSI of a U.S. shareholder of the CFC more than once. Specifically, a duplication of items may result if the U.S. shareholder includes in AFSI, under section 56A(c)(2)(C), the amount of a dividend received from earnings associated with adjusted net income or loss that the U.S. shareholder also includes in AFSI under section 56A(c)(3). A duplication of items may also result if an upper-tier CFC includes in adjusted net income or loss the amount of a dividend received from a lower-tier CFC from earnings associated with adjusted net income or loss that the U.S. shareholder includes in AFSI under section 56A(c)(3) with respect to the lower-tier CFC. Section 56A grants the Secretary broad authority to address this issue. *See* section 56A(c)(2)(C), (c)(15)(A), and (e).

The Treasury Department and the IRS considered various approaches to applying section 56A(c)(2)(C) to items that result solely from a CAMT entity's ownership of stock of a CFC. As indicated previously, the interaction of section 56A(c)(2)(C) and (c)(3) raises unique duplication concerns that are not present in the case of a CAMT entity's ownership of stock of a domestic corporation. In the regular tax context, similar duplication concerns relating to U.S. taxpayers owning the stock of CFCs have given rise to complex rules (*see*, for example, sections 959 and 961). Creating a similar system for CAMT would be a substantial undertaking and an impediment to releasing timely guidance addressing this issue and would also increase taxpayers' compliance burden and the administrative burden on the IRS. To avoid these issues, the proposed regulations would require taxpayers to rely on existing regular tax rules with respect to CFCs within CAMT. Because the regular tax rules apply to both distributions by CFCs and transfers of stock of CFCs, the proposed regulations would require taxpayers to rely on certain regular tax rules for determining both the earnings and profits of foreign corporations and the basis of the stock of foreign corporations. Additionally, relying on the regular tax rules would be consistent with the statutory language of section 56A(c)(2)(C). *See* for example, the statutory language of section 56A(c)(2)(C) (referring to "other amounts which are includible in gross income or deductible as a loss under this chapter").

The Treasury Department and the IRS also are of the view that ownership of stock of all foreign corporations should be subject to the same rules under proposed §1.56A-4 to avoid the need for, and complexity arising from, rules addressing foreign corporations' transition into and out of CFC status. Accordingly, proposed §1.56A-4 would apply to the ownership of stock of any foreign corporation, regardless of whether the foreign corporation is a CFC. Compare the discussion in part XVIII of this Explanation of Provisions of the rules under section 56A(c)(2)(C) regarding investments in domestic corporations that are not members of the CAMT entity's tax consolidated group and the rules under section 56A regarding certain transactions involving domestic corporations.

B. *General rule for ownership of foreign stock*

Proposed §1.56A-4(c)(1) would provide for adjustments to a CAMT entity's AFSI as a result of direct ownership of stock of a foreign corporation. Specifically, consistent with Notice 2024-10, proposed §1.56A-4(c)(1)(i) would require a CAMT entity, in calculating AFSI, to disregard any items of income, expense, gain, and loss resulting from ownership of stock of the foreign corporation, including any such items that result from acquiring or transferring such stock, reflected in the CAMT entity's FSI. Proposed §1.56A-4(c)(1)(ii) would generally require the CAMT entity to include in AFSI any items of income, deduction, gain, and loss for regular tax purposes resulting from ownership of stock of the foreign corporation, including any items that result from acquiring or transferring such stock (for example, transaction costs). Proposed §1.56A-4(e) would provide that if a partnership directly owns stock of a foreign corporation, then in determining the AFSI of a CAMT entity that is a partner in the partnership (or an indirect partner, in the case of tiered partnerships), the partner takes into account the tax items described in proposed §1.56A-4(c)(1)(ii) (described in the preceding sentence) that are allocated to the partner for regular tax purposes. However, proposed §1.56A-4(c)(1)(i) (disregarding certain items reflected in FSI) would apply at the partnership level because the partnership, as the direct owner of the stock of the foreign corporation, may have reflected certain items resulting from the ownership of stock of the foreign corporation in its FSI.

As one illustration of proposed §1.56A-4(c)(1), the AFSI of a CAMT entity that is a domestic corporation would not reflect any inclusion with respect to a dividend received from a foreign corporation if

the CAMT entity is eligible for a dividends-received deduction under section 245A of the Code for the entire amount of the dividend, because the item of FSI with respect to the dividend would be disregarded, and the regular tax income item with respect to the dividend would be offset by an item of deduction resulting from the receipt of the dividend. As another example, the AFSI of a CAMT entity that is a domestic corporation would generally not reflect any inclusion with respect to a distribution of previously taxed earnings and profits (PTEP) (described in section 959 of the Code) by a foreign corporation to the CAMT entity because the item of FSI with respect to the distribution would be disregarded and section 959(a) excludes the regular tax amount of the distribution of PTEP from the CAMT entity's gross income. *See also* proposed §1.56A-6(c)(2) (applying similar rules in the context of dividends received by a CFC from a foreign corporation) and part VI of this Explanation of Provisions (regarding AFSI adjustments with respect to CFCs). Also, under proposed §1.56A-4(c)(1)(ii), the AFSI of a CAMT entity that is a shareholder of a passive foreign investment company (as defined in section 1297 of the Code) would include regular tax items resulting from the ownership of the stock of the passive foreign investment company, including any amounts under sections 1291, 1293, and 1296 of the Code. The Treasury Department and the IRS are considering whether additional rules should be included in the final regulations to address passive foreign investment companies, including rules that would specifically address adjustments to AFSI with respect to the ownership of stock in a section 1291 fund and the indirect ownership of stock in a lower-tier passive foreign investment company. In addition, the Treasury Department and the IRS are considering whether rules specific to passive foreign investment companies would be appropriate in §1.59-4 (CAMT foreign tax credit), including rules similar to the rules in section 1291(g)(1)(C)(ii) in respect of foreign taxes paid by section 1291 funds and rules similar to the rules in section 1293(f) in respect of foreign taxes paid by qualifying electing funds. The Treasury Department and the IRS request comments on this topic.

Under proposed §1.56A-4(c)(1)(ii), no adjustment to AFSI would be made for amounts included in a CAMT entity's gross income under sections 951 and 951A. *See* section 56A(c)(2)(C). Furthermore, because a deduction under section 250 of the Code arises with respect to a foreign corporation only in connection with an income inclusion under section 951A, no adjustment is made to AFSI for amounts deducted under section 250. Additionally, because adjusted net income or loss of a CFC is computed without regard to foreign income taxes (*see* proposed §§1.56A-8(b) and 1.56A-6(c)(1)), no adjustment would be made for the gross-up for deemed-paid foreign tax credits under section 78 of the Code.

The items described in proposed §1.56A-4(c)(1)(ii) are determined under regular tax rules, including subchapter C of chapter 1 (subchapter C), taking into account the CAMT entity's basis in the stock of the foreign corporation for regular tax purposes and the foreign corporation's earnings and profits for regular tax purposes. Accordingly, any AFSI consequences of a distribution in respect of, or transfer of, stock of a foreign corporation would be determined, as applicable, by reference to the earnings and profits of the foreign corporation for regular tax purposes or the basis in such stock for regular tax purposes. *See*, for example, proposed §1.56A-4(d)(5) (CAMT basis in foreign stock is equal to its basis for regular tax purposes). Further, CAMT retained earnings are not relevant in determining AFSI in respect of ownership of stock of foreign corporations. Certain earnings and profits of a foreign corporation for regular tax purposes carry over to a domestic corporation under section 381(c)(2) of the Code for purposes of determining that domestic corporation's CAMT retained earnings. *See* §1.367(b)-3(f)(1) (providing the extent to which earnings and profits of a foreign corporation carryover to a domestic corporation in an inbound nonrecognition transaction); proposed §1.56A-4(h)(8) (*Example 8*); and proposed §1.56A-18(c)(7)(i). CAMT retained earnings of a domestic corporation would not carry over to a foreign corporation under section 381(c)(2) because CAMT retained earnings are not relevant in determining AFSI in respect of ownership of stock of foreign corporations. This is the case even though earnings and profits of a domestic corporation may carry over to a foreign corporation under section 381(c)(2) for purposes of determining the foreign corporation's earnings and profits for regular tax purposes.

While proposed §1.56A-4(c)(1)(ii) would determine the AFSI consequences resulting from ownership of stock of a foreign corporation by reference to the basis in that stock for regular tax purposes and the foreign corporation's earnings and profits for regular tax purposes, the rules in proposed §§1.56A-18 and 1.56A-19 generally would determine the AFSI consequences resulting from ownership of stock of a domestic corporation by reference to the CAMT basis in that stock and the domestic corporation's CAMT retained earnings.

C. *Covered asset transactions*

Pursuant to the authority granted by section 56A(c)(15)(B), proposed §1.56A-4 would incorporate certain rules under subchapter C for determining the AFSI and CAMT basis consequences of certain transactions involving foreign corporations (referred to as covered asset transactions). However, the proposed rules would use the CAMT basis of transferred assets to determine the AFSI consequences of such transfers and that basis may be different than the basis for regular tax purposes, except in the case of foreign stock. Using CAMT basis for assets other than foreign stock is consistent with the general rule in proposed §1.56A-1 and appropriate because the duplication concerns that exist for foreign stock are not present.

Proposed §1.56A-4(b), which would provide definitions that apply for purposes of proposed §1.56A-4, would define the term covered asset transaction. The definition of covered asset transaction uses the concept of a component transaction (within the meaning of proposed §1.56A-18(b)(6)) to distinguish the fact patterns in which the rules of proposed §1.56A-4 (which apply to ownership of foreign stock) apply versus the rules of proposed §§1.56A-18 and 1.56A-19 (which generally apply to ownership of domestic stock). The rules of proposed §§1.56A-18 and 1.56A-19 apply

on a component transaction-by-component transaction basis. Covered asset transactions include two categories of transactions.

The first category of covered asset transactions involves a transfer of an asset to, or by, a foreign corporation. More specifically, this first category includes a component transaction in which one or more assets are: (i) transferred by a foreign corporation in a transfer to which section 311 of the Code applies; (ii) transferred by a foreign corporation in a transfer that is part of a complete liquidation to which sections 332 and 337 of the Code apply; (iii) transferred to a foreign corporation in a transfer to which section 351 or section 361 of the Code applies; (iv) transferred by a foreign corporation in a transfer to which section 361 applies; (v) stock, or stock and securities, of a domestic corporation described in section 355(a)(1)(A) of the Code and transferred by a foreign corporation in a transfer to which section 355 applies; or (vi) securities of a foreign corporation that is a party to a reorganization described in section 368(a)(1) and transferred in a transfer to which section 354 or 356 applies.

The second category of covered asset transactions involves a transfer of foreign stock to or by a domestic corporation. That is, this second category includes a component transaction in which one or more assets, at least one of which is stock of a foreign corporation, are: (i) transferred by a domestic corporation in a transfer to which section 311 applies; (ii) transferred by a domestic corporation in a transfer that is part of a complete liquidation to which sections 332 and 337 apply; (iii) transferred to a domestic corporation in a transfer to which section 351 or section 361applies; (iv) transferred by a domestic corporation in a transfer to which section 361 applies; (v) stock, or stock and securities, of a foreign corporation described in section 355(a)(1)(A) and transferred by a domestic corporation in a transfer to which section 355 applies; or (vi) securities of a domestic corporation that is a party to a reorganization described in section 368(a)(1) and transferred in a transfer to which section 354 or 356 applies, provided the securities are exchanged for stock or securities of a foreign corporation that is a party the reorganization .

Proposed §1.56A-4(c)(2) would provide for adjustments to a CAMT entity's AFSI as a result of a transfer of an asset other than stock of a foreign corporation in a covered asset transaction. Specifically, proposed §1.56A-4(c)(2)(i) would require a CAMT entity, in calculating AFSI, to disregard any items of income, expense, gain, and loss with respect to the transferred asset resulting from the covered asset transaction reflected in the CAMT entity's FSI. Proposed §1.56A-4(c)(2)(ii) would require the CAMT entity to include any items of income, deduction, gain, and loss for regular tax purposes with respect to the transferred asset resulting from the covered asset transaction; however, for this purpose, the amount of each such item would be computed by substituting the CAMT entity's CAMT basis in the transferred asset for the CAMT entity's basis in the transferred asset for regular tax purposes.

Proposed §1.56A-4(d)(1) would provide rules for determining the CAMT basis in an asset that is transferred in a covered asset transaction. The rules for determining CAMT basis would rely on the principles of the Code that apply to these transactions for determining basis for regular tax purposes, but use CAMT basis instead of regular tax basis as applicable. If the asset is transferred in a covered asset transaction described in section 311, the transferee's CAMT basis in the asset would be determined in the manner described in section 301(d) of the Code. If the asset is transferred in a covered asset transaction described in sections 332 and 337, the transferee's CAMT basis in the asset would be determined in the manner described in section 334(b) of the Code, substituting the transferor's CAMT basis in the asset for the transferor's basis in the asset for regular tax purposes. If the asset is transferred in a covered asset transaction described in section 351 or 361, the transferee's CAMT basis in the asset would be determined in the manner described in section 362 of the Code, substituting the transferor's CAMT basis in the asset for the transferor's basis in the asset for regular tax purposes and substituting the amount of gain included in the transferor's AFSI for the amount of gain recognized to the transferor for regular tax purposes. However, if the transferor is not a CAMT entity, the transferee's CAMT basis in the asset would be equal to the transferee's basis in the asset for regular tax purposes. Thus, if an individual transfers an asset to a foreign corporation in a transaction described in section 351, this rule would apply to the extent the individual is not a CAMT entity (that is, an individual that does not operate a trade or business that would not be required to determine AFSI for any purpose under the section 56A regulations).

If the asset transferred is stock or securities of a domestic corporation described in section 355(a)(1)(A) and the asset is transferred by a foreign corporation in a covered asset transaction to which section 355 applies, the transferee's CAMT basis in the transferred stock or securities of the domestic corporation would be equal to the transferee's basis in the stock or securities for regular tax purposes. If the asset transferred is stock or securities of a foreign corporation described in section 355(a)(1)(A) and the asset is transferred by a domestic corporation in a covered asset transaction to which section 355 applies, the transferee's CAMT basis in the stock or securities of the domestic corporation would be determined by applying section 358, substituting the transferee's CAMT basis in the stock or securities of the domestic corporation for the transferee's basis in the stock of the domestic corporation for regular tax purposes. If the asset transferred is securities of a foreign corporation that is a party to a reorganization described in section 368(a)(1) and the asset received in exchange for the securities is not stock of a foreign corporation that is a party to the reorganization, the transferee's CAMT basis in the asset received would be determined by applying section 358, substituting the transferee's CAMT basis in the securities of the foreign corporation for the transferee's basis in such securities for regular tax purposes. If the asset transferred is securities of a domestic corporation that is a party to a reorganization described in section 368(a)(1) and the asset received in exchange for the securities is not stock of a foreign corporation that is a party to the reorganization, the transferee's CAMT basis in the asset received would be determined by applying section 358, substituting the transferee's CAMT basis in the securities

of the domestic corporation for the transferee's basis in such securities for regular tax purposes.

D. *Section 338(g) transactions*

Proposed §1.56A-4(c)(3) would provide adjustments to the AFSI of a foreign corporation the stock of which is purchased in a transaction where the purchaser makes an election under section 338(g) (a section 338(g) transaction), consistent with the general principles underlying the rules in proposed §1.56A-4 to follow regular tax rules for foreign stock and transactions involving foreign corporations. Specifically, proposed §1.56A-4(c)(3) would require such a foreign corporation, when calculating AFSI, to include any net gain or loss that results for regular tax purposes with respect to all assets the foreign corporation is treated as selling by reason of the section 338(g) transaction; however, for this purpose, the amount of gain or loss with respect to each asset that the foreign corporation is deemed to have sold by reason of the section 338(g) transaction is computed by substituting the foreign corporation's CAMT basis in the asset for the foreign corporation's basis in the asset for regular tax purposes. Proposed §1.56A-4(d)(2) would provide a parallel rule that if stock of a foreign corporation is acquired in a section 338(g) transaction, immediately after the section 338(g) transaction, the foreign corporation's CAMT basis in the assets it is deemed to have purchased by reason of the section 388(g) transaction is equal to the foreign corporation's basis in those assets for regular tax purposes. *See* proposed §1.56A-18(g)(2) and (4) (addressing AFSI consequences to a domestic target corporation and CAMT basis in the target corporation's assets in a transaction where there is an election under section 336(e), 338(g), or 338(h)(10) of the Code).

E. *Purchase accounting and push down accounting adjustments*

Proposed §1.56A-1(c)(4)(ii) would provide that, except as otherwise provided, any purchase accounting and push down accounting adjustments, as applicable, are required to be reflected in the CAMT entity's AFS basis, balance sheet accounts, and FSI. Proposed §1.56A-4(c)(4) would provide an exception to this general rule such that any purchase accounting or push down accounting adjustments, as applicable, with respect to an acquisition of the stock of a foreign corporation by a CAMT entity would be disregarded for purposes of determining the CAMT entity's AFSI. Proposed §1.56A-4(d)(4) would provide a parallel rule that any purchase accounting or push down accounting adjustments, as applicable, with respect to an acquisition of the stock of a foreign corporation by a CAMT entity would be disregarded for purposes of determining the CAMT basis in the foreign corporation's assets. *See* proposed §1.56A-18(c)(3) (addressing purchase accounting and push down accounting adjustments where the stock of a domestic corporation is acquired).

F. *AFSI adjustments in certain cases in which basis in foreign stock is determined under section 358*

CAMT basis in stock of a foreign corporation is equal to the basis in the stock for regular tax purposes. *See* proposed §1.56A-4(d)(5). If stock of a foreign corporation is received in a transaction subject to section 358, the recipient CAMT entity's basis in the foreign stock received for regular tax purposes is determined in whole or in part by reference to the basis in other property for regular tax purposes, which may be different than the CAMT basis in such property. For example, if the stock of a foreign corporation is received by reason of an asset transferred to the foreign corporation in a transaction described in section 351(a), the transferor's basis in the stock of the foreign corporation received is determined under section 358 by reference to the transferor's basis in the asset transferred. As another example, if the stock of a foreign corporation is received in a distribution described in section 355, the distributee's basis in the stock of the foreign corporation received is determined under section 358 by reference to the distributee's basis in the stock of the distributing corporation.

Proposed §1.56A-4(f) would provide rules that apply to certain cases in which a CAMT entity receives stock of a foreign corporation in a covered asset transaction and the CAMT entity's basis in the stock of the foreign corporation for regular tax purposes is determined under section 358. These rules compare the CAMT basis in the stock of the foreign corporation (which equals its basis for regular tax purposes) with what the CAMT basis would have been had it been determined under section 358, substituting the CAMT basis for the basis for regular tax purposes in the property by reference to which the basis of the foreign stock for regular tax purposes is determined in whole or in part (such amount, the hypothetical CAMT basis). To the extent a CAMT entity's basis in the stock of the foreign corporation received for regular tax purposes exceeds its hypothetical CAMT basis in that stock (referred to as basis disparity in this part IV of this Explanation of Provisions), the CAMT entity increases its AFSI for the taxable year in which the foreign stock is received if either of two requirements is satisfied.

The first requirement is satisfied if a principal purpose of the covered asset transaction is to avoid treatment of the CAMT entity or another CAMT entity as an applicable corporation or to reduce or otherwise avoid a liability under section 55(a) (principal purpose rule). The second requirement is satisfied if within two years of the date the stock of the foreign corporation is received, the basis in such stock of the foreign corporation is taken into account, in whole or in part, in determining the AFSI of the recipient CAMT entity or another CAMT entity (two-year rule). The principles of the two-year rule apply with respect to any asset whose basis for regular tax purposes is determined in whole or in part by reference to the basis of the foreign stock received. For example, if stock of the foreign corporation received is subsequently transferred in a transaction described in section 351(a) to another foreign corporation in exchange for stock of such other foreign corporation (or if the foreign stock received is exchanged under section 354 of the Code for stock in another foreign corporation), then the two-year rule applies to both the stock of the foreign corporation received in the initial transfer as well as the stock of the other foreign corporation received in the subsequent transfer.

To illustrate the principal purpose rule, consider the following fact pattern.

USP, a domestic corporation, owns all the stock of a controlled foreign corporation (CFC1), which has a functional currency of the U.S. dollar. CFC1 owns Asset A, with a basis for regular tax purposes of $10x, a CAMT basis of $4x, and fair market value of $20x. The intent is for CFC1 to sell Asset A. For CAMT purposes, if CFC1 were to sell Asset A, CFC1 would include $16x in adjusted net income or loss under proposed §1.56A-6 (fair market value of $20x, less CAMT basis of $4x) and USP's pro rata share of CFC1's adjusted net income or loss would take into account the $16x. With a principal purpose of reducing CFC1's adjusted net income or loss and USP's pro rata share, Asset A is contributed to a newly formed foreign corporation (CFC2) in exchange solely for stock of CFC2 in a transaction that qualifies under section 351(a) for regular tax purposes and therefore is a covered asset acquisition (asset transfer). CFC1's CAMT basis in the stock of CFC2 received is equal to $10x (the amount of CFC1's basis in the stock of CFC2 for regular tax purposes), and CFC1's hypothetical CAMT basis in the stock of CFC2 is $4x. In a transaction purported to be separate from the asset transfer for purposes of qualifying the asset transfer under section 351, CFC1 then subsequently sells the stock of CFC2 to a third party in exchange for cash, and the CAMT basis for purposes of determining the amount included in CFC1's adjusted net income or loss is $10x. Under the principal purpose rule, CFC1's adjusted net income or loss is increased by the $6x basis disparity (the excess of the basis in the stock of CFC2 for regular tax purposes and CAMT purposes ($10x) over the hypothetical CAMT basis ($4x)) for the taxable year in which the asset transfer occurs.

The Treasury Department and the IRS considered alternatives to addressing the basis disparity concern. One alternative is to adjust (increase or decrease) the recipient CAMT entity's AFSI in all cases in which there is a basis disparity, including if the basis disparity arises when a CAMT entity's basis in stock of the foreign corporation received for regular tax purposes is less than the hypothetical CAMT basis. However, in this case, if the CAMT entity and the foreign corporation whose stock is received are related, the decrease in AFSI would be allowed only when the recipient CAMT entity and the foreign corporation are no longer related. Another alternative is to implement an account system whereby the basis disparity would be tracked and taken into account as an increase or decrease to AFSI, as applicable, as the basis in the stock of the foreign corporation received is taken into account, for example, upon a taxable sale or a return of basis distribution under section 301. A concern with an account tracking system is that it would introduce complexity, including the need to track the account reflecting stock of each foreign corporation for a potentially significant period and address subsequent transactions that duplicate basis in the foreign stock (transactions in which basis in another asset is determined by reference to the basis in the foreign stock, including section 351 transfers of the foreign stock). The Treasury Department and the IRS welcome comments on the proposed rule and whether alternatives should be further considered.

G. *Adjustments to AFSI when certain foreign stock is distributed by a partnership*

Proposed §1.56A-4(g) would provide rules for distributions of certain stock of a foreign corporation by a partnership to a related CAMT entity. If a partnership distributes stock of a foreign corporation and the distributee partner increases its basis in the stock pursuant to section 732(b) of the Code for regular tax purposes, section 734(b)(2)(B) of the Code generally requires the partnership to reduce the basis of its remaining property for regular tax purposes if either the partnership has an election under section 754 of the Code in effect or the distribution results in a substantial basis reduction as defined in section 734(d). There is no similar mechanism under CAMT, however, for the partnership to reduce its basis in remaining property, other than its basis in any remaining foreign stock to the extent the basis in such stock is reduced for regular tax purposes. As a result, if the distributee partner were to subsequently dispose of the foreign stock, there would be an omission from AFSI in the amount of the basis increase under section 732(b) that did not result in a corresponding basis decrease under section 734(b)(2)(B) to any remaining foreign stock held by the partnership.

The Treasury Department and the IRS are concerned that related parties might abuse the rules relating to the CAMT basis of foreign stock distributed by a partnership to create omissions from AFSI. Accordingly, proposed §1.56A-4(g)(1) would provide that if a partnership distributes stock of a foreign corporation to a partner that is a related CAMT entity, and the basis for regular tax purposes in the foreign stock to the related CAMT entity distributee is increased pursuant to section 732(b) (distributee step-up amount), and the distributee step-up amount is greater than the amount, if any, that the distributing partnership is required to decrease its basis for regular tax purposes in any remaining foreign stock pursuant to section 734(b)(2)(B) (partnership basis decrease amount), the distributing partnership must increase its modified FSI for the taxable year of the distribution by any excess of the distributee step-up amount over the partnership basis decrease amount. For purposes of this rule, a partner would be a related CAMT entity if immediately before the distribution, the partner is related to the distributing partnership or any partner in the distributing partnership within the meaning of sections 267(b) or 707(b)(1) of the Code, without regard to section 267(c)(3).

The proposed rule would be limited to related party partnerships and basis increases in order to address potentially abusive transactions. The Treasury Department and the IRS request comments on proposed §1.56A-4(g), including whether it is appropriate to limit the rule to related party partnerships and whether rules are needed to prevent duplications to AFSI for distributions of foreign stock by a partnership where the distributee partner decreases the basis for regular tax purposes of the distributed foreign stock pursuant to section 732(a)(2) or (b).

V. *Proposed §1.56A-5: AFSI Adjustments for Partner's Distributive Share of Partnership AFSI*

Pursuant to the authority granted by section 56A(c)(2)(D)(i), (c)(15), and (e), proposed §1.56A-5 would provide rules under section 56A(c)(2)(D) regarding a

partner's distributive share of partnership AFSI. Section 56A(c)(2)(D)(i) provides that, except as provided by the Secretary, if the taxpayer is a partner in a partnership, AFSI of the taxpayer with respect to such partnership is adjusted to only take into account the taxpayer's distributive share of AFSI of such partnership. Section 56A(c)(2)(D)(ii) provides that, for the purposes of the CAMT, the AFSI of a partnership is the partnership's net income or loss set forth on the partnership's AFS adjusted under rules similar to the rules of section 56A.

Stakeholders have suggested various approaches to determining a CAMT entity's distributive share of AFSI from a partnership investment (that is, a CAMT entity's interest in a partnership). One suggested approach is a "top-down" method that would start with the FSI amount reported by the CAMT entity on its AFS and adjustments to this amount under section 56A. Under a top-down method, a CAMT entity's distributive share of AFSI from a partnership investment generally would be based on the CAMT entity's method used to account for the investment for AFS purposes.

Another suggested approach is a "bottom-up" method. Under this method, a partnership would calculate its AFSI and allocate each partner a "distributive share" of the partnership's AFSI. Stakeholders have suggested that a partner's "distributive share" of a partnership's AFSI could be based on tax principles (for example, section 704(b) or (c) of the Code) or financial accounting principles (for example, the equity method (as described in proposed §1.56A-1(b)(15))). Other suggested approaches included allowing CAMT entities to use their regular tax income amounts from a partnership investment as their distributive share amount of AFSI from such investment.

A bottom-up approach is consistent with the statute and is more conducive to taking into account section 56A adjustments. A bottom-up approach supports the framework of section 56A(c)(2)(D)(ii), which suggests that a partnership calculates its AFSI prior to determining the partners' distributive shares of such AFSI. Additionally, a bottom-up approach allows for a consistent methodology to be used to calculate a CAMT entity's distributive share of partnership AFSI regardless of the method used by a CAMT entity to account for its partnership investment for AFS purposes. For example, if a CAMT entity accounts for a partnership investment by using the fair value method for AFS purposes (as described in proposed §1.56A-1(b)(17)), a top-down approach would require the CAMT entity to report a mark-to-market amount with respect to that partnership investment for purposes of its FSI, although making applicable adjustments to that amount under section 56A in a precise manner might not be possible. As a result, under a top-down approach, multiple methodologies might be required to calculate the applicable adjustments under section 56A, depending on the CAMT entity's method to account for its partnership investment for AFS purposes. Under a bottom-up approach, all CAMT entities would calculate their distributive share amounts of AFSI from a partnership investment using a consistent methodology, which is referred to in proposed §1.56A-5(c) as the "applicable method."

Additionally, under a bottom-up approach, a CAMT entity's distributive share of AFSI generally should be based on the income it reports for AFS purposes with respect to its partnership investment rather than the amount of its taxable income with respect to the partnership investment. Accordingly, under proposed §1.56A-5, a CAMT entity's distributive share of AFSI from a partnership investment generally would be based on the share of the partnership's FSI that the CAMT entity reports on its AFS with respect to such investment, rather than on the CAMT entity's allocations of partnership items for regular tax purposes. This rule comports with the structure of the CAMT, which generally imposes a tax that is based on book income with certain adjustments. Proposed §1.56A-5 would provide certain exceptions that would be consistent with the statute's adjustments to FSI.

A. *General rule*

Proposed §1.56A-5 would provide rules for the applicable method (that is, a bottom-up approach) to determine a CAMT entity's distributive share of AFSI with respect to its partnership investment. In a tiered partnership structure, each partnership would be a CAMT entity with respect to the partnership in which it is a partner and would be required to compute its distributive share of AFSI with respect to its interest in the lower-tier partnership.

Proposed §1.56A-5(b) generally would provide that, if a CAMT entity is a partner in a partnership, its AFSI with respect to its partnership investment is adjusted as required under the applicable method in proposed §1.56A-5(c) and the rules in proposed §1.56A-20 (concerning AFSI adjustments to apply certain principles of subchapter K of chapter 1 (subchapter K)) to take into account its distributive share of the partnership's AFSI. A CAMT entity must use the applicable method described in proposed §1.56A-5(c) to determine its AFSI adjustment regardless of the CAMT entity's method used to account for its partnership investment for AFS purposes.

B. *Applicable method*

Under the applicable method in proposed §1.56A-5(c), a CAMT entity would compute its distributive share of AFSI with respect to its partnership investment by first disregarding any amount the CAMT entity reflects in its FSI with respect to that investment for the taxable year (for example, under the fair value method or the equity method), except as provided in proposed §1.56A-5(d). *See* proposed §1.56A-5(c)(1). The CAMT entity then would include its "distributive share amount" (as determined under proposed §1.56A-5(e)) for the taxable year in its AFSI with respect to its investment in the partnership. *See* proposed §1.56A-5(c)(2).

C. *Amounts not disregarded*

The statutory directive in section 56A(c)(2)(D) to take into account only the taxpayer's distributive share of a partnership's AFSI does not mean that a CAMT entity may disregard all amounts with respect to a partnership investment that are outside the scope of the "distributive share amount," as computed under proposed §1.56A-5(e), in determining its FSI with respect to that investment. Section 56A(c)(2)(D) and the applicable

method implementing this statutory provision address only a CAMT entity's AFSI amount based on a partnership's AFSI. FSI amounts resulting from transactions such as a transfer, sale or exchange, or deconsolidation of a partnership investment are not covered by section 56A(c)(2)(D). Accordingly, proposed §1.56A-5(d) would clarify the amounts of FSI with respect to the CAMT entity's partnership investment that may not be disregarded in applying the applicable method under proposed §1.56A-5(c). Under proposed §1.56A-5(d), a CAMT entity may not disregard any FSI amounts attributable to a transfer, sale or exchange, contribution, distribution, dilution, deconsolidation, change in ownership, or any other transaction between any partners (including the CAMT entity) and the partnership, or between any partners (including the CAMT entity), that are not derived from, and included in, the partnership's FSI. As a result, such amounts are not excluded from a CAMT entity's AFSI under the applicable method. However, these amounts may be subject to adjustment under proposed §§1.56A-1(d)(4) (concerning redetermination of FSI gains and losses) and 1.56A-20 (concerning AFSI adjustments to apply certain subchapter K principles). In addition, in the case of a CAMT entity and a partnership that are members of the same financial statement group, proposed §1.56A-5(d) would provide that the FSI of the CAMT entity with respect to the partnership investment is determined under proposed §1.56A-1(c)(3)(iii) (concerning elimination journal entries).

D. *Distributive share amount*

The rules for computing the distributive share amount included in a CAMT entity's AFSI with respect to its partnership investment under proposed §1.56A-5(c)(2) are contained in proposed §1.56A-5(e). Proposed §1.56A-5(e)(1) would provide that a CAMT entity's distributive share amount is computed for each taxable year based on the following four steps: (i) the CAMT entity determining its distributive share percentage; (ii) the partnership determining its modified FSI; (iii) the CAMT entity multiplying its distributive share percentage by the modified FSI of the partnership (as reported by the partnership); and (iv) the CAMT entity adjusting the product of the amount determined in (iii) for certain separately stated section 56A adjustments.

Proposed §1.56A-5(e)(2) would provide rules for how a CAMT entity determines its distributive share percentage. As described previously in this part V of the Explanation of Provisions, determining a CAMT entity's distributive share percentage based on the amount of FSI it reports on its AFS with respect to its partnership investment, and not on its economic interest for regular tax purposes, is appropriate because the CAMT is a tax based on income reported by a CAMT entity for AFS purposes.

Accordingly, proposed §1.56A-5(e)(2) would provide that a CAMT entity's distributive share percentage is a fraction, the numerator of which is the FSI amount that is disregarded under the applicable method (but redetermined based on the partnership's taxable year if the taxable year of the partnership and the CAMT entity are different), and the denominator of which depends on the method of accounting the CAMT entity uses for AFS purposes, but in each case, as determined by the CAMT entity for AFS purposes.

In the case of a CAMT entity and a partnership that are members of the same financial statement group, or in the case of a CAMT entity that uses the equity method to account for its partnership investment (including the hypothetical liquidation at book value method under the equity method), the denominator would be 100 percent of the partnership's FSI for the partnership's taxable year. *See* proposed §1.56A-5(e)(2)(i). In the case of a CAMT entity that uses the fair value method to account for its partnership investment, the denominator would be the total change in the fair value of the partnership during the partnership's taxable year as determined by the CAMT entity for inclusion of its share of the total change in its AFS. *See* proposed §1.56A-5(e)(2)(ii). In the case of a CAMT entity that treats its partnership investment as other than equity for AFS purposes (for example, as debt) (a non-AFS partner), the denominator would be 100 percent of the partnership's FSI for the taxable year plus the FSI amount included in the numerator of the distributive share percentage for the taxable year. *See* proposed §1.56A-5(e)(2)(iii). In the case of a CAMT entity that treats itself as owning 100 percent of the equity in the partnership for AFS purposes because the CAMT entity treats all other partners as non-AFS partners, the denominator would be 100 percent of the partnership's FSI for the taxable year plus the sum of any amounts reflected in the partnership's FSI that are treated as paid or accrued to the other partners for the partnership's taxable year. *See* proposed §1.56A-5(e)(2)(iv). In the case of a CAMT entity that uses any other method of accounting to account for its partnership investment, the denominator would be an amount determined under the principles set forth in proposed §1.56A-5(e)(2)(i) and (ii) that is reasonable under the facts and circumstances and reflective of the proportionate amount of the partnership's FSI the CAMT entity is reporting for AFS purposes. *See* proposed §1.56A-5(e)(2)(v).

It is possible for the distributive share percentage to be a negative number. This situation may arise if a partner is using the equity method to account for its partnership investment and the partnership's FSI is positive but the CAMT entity is reporting a negative FSI amount. In such cases, the negative distributive share percentage is multiplied by the partnership's modified FSI. If the distributive share percentage is negative and the partnership's modified FSI is positive, the result for the CAMT entity's share of modified FSI will be a negative amount. Similarly, if the distributive share percentage is negative and the partnership's modified FSI is negative, the result for the CAMT entity's share of modified FSI will be a positive amount. Examples under proposed §1.56A-5 would include illustrations on computing the distributive share percentage. *See* proposed §1.56A-5(k). The Treasury Department and the IRS appreciate that the calculation methodology provided for in proposed §1.56A-5(e)(2) may produce imprecise results under certain circumstances, particularly in the case of a CAMT entity that uses the hypothetical liquidation at book value method under the equity method to account for its partnership investment for AFS purposes, treats itself as a non-AFS partner, or treats itself as owning 100 percent of the equity in the partnership because the

CAMT entity treats all other partners in the partnership as non-AFS partners. The Treasury Department and the IRS request comments on more precise methods that could be used to calculate a CAMT entity's distributive share percentage, including in the circumstances described in the previous sentence. The Treasury Department and the IRS also request comments on whether AFSI with respect to a non-AFS partner's partnership investment should be determined other than by use of a distributive share percentage and the applicable method, including in situations where more than one CAMT entity is a non-AFS partner in the partnership.

The second step in the distributive share amount computation is for the partnership to determine its modified FSI. To facilitate this computation, proposed §1.56A-5(e)(3) would provide that a partnership starts with its FSI for its taxable year (as determined under proposed §1.56A-1(c)) and makes all AFSI adjustments provided for in the section 56A regulations that are applicable to partnerships, with certain enumerated exceptions.

The third step in the distributive share amount computation is for the CAMT entity to multiply its distributive share percentage by the partnership's modified FSI, as reported by the partnership to the CAMT entity. *See* proposed §1.56A-5(e)(1)(iii).

The fourth and final step in the distributive share amount computation is for the CAMT entity to adjust the amount determined in the previous sentence (that is, in the third step) by certain AFSI items that are separately stated to the CAMT entity and not taken into account by the partnership in determining its modified FSI. *See* proposed §1.56A-5(e)(1)(iv) and (e)(4)(ii). Separately stated AFSI items that adjust a CAMT entity's distributive share amount would include certain AFSI items with respect to basis adjustments under section 743(b) and §1.1017-1(g)(2) attributable to section 168 property or qualified wireless spectrum and would be based on the CAMT entity's distributive share of the items for regular tax purposes. *See* proposed §§1.56A-15(d)(2)(ii) and (iv) and 1.56A-16(d)(2)(ii) and (iv).

Separately stated AFSI items that adjust a CAMT entity's distributive share amount would also include certain amounts resulting from a disposition of section 168 property or qualified wireless spectrum by a partnership to which the CAMT entity had a basis adjustment under section 743(b) or §1.1017-1(g)(2) in place, as provided under proposed §§1.56A-15(e)(3)(iii) and (iv) and 1.56A-16(e)(3)(iii) and (iv). *See* proposed §§1.56A-15(e)(3)(iii) and (iv) and 1.56A-16(e)(3)(iii) and (iv).

Lastly, separately stated AFSI items that adjust a CAMT entity's distributive share amount would include the CAMT entity's distributive share of deferred distribution gain or loss described in proposed §1.56A-20(d)(1)(ii), which would be equal to the CAMT entity's allocable share of the items as provided in proposed §1.56A-20(d)(2)(i), taking into account any acceleration event under proposed §1.56A-20(d)(1)(iii) and (d)(2)(ii).

Under proposed §1.56A-5(e)(4)(iii), certain AFSI items would be separately stated by the partnership but would not be taken into account as adjustments to a CAMT entity's distributive share amount. Instead, these AFSI items would be taken into account by a CAMT entity in determining its AFSI. These AFSI items include items described in proposed §1.56A-4(c)(1)(ii) with respect to stock of foreign corporations owned by the partnership, as provided under proposed §1.56A-4(e); items described in proposed §1.56A-6(c)(2)(iii) with respect to stock of foreign corporations owned by the partnership, as provided under proposed §1.56A-6(c)(2)(iv); items described in proposed §1.56A-8(c) with respect to creditable foreign tax expenditures of a partnership, as provided under proposed §1.56A-8(c); and the item described in proposed §1.56A-21(e)(2)(iii) with respect to discharge of indebtedness income reflected in the partnership's FSI, as provided under proposed §1.56A-21(e)(2)(ii). Although proposed §1.56A-5(e)(4)(iii) refers to the items described in §1.56A-6(c)(2)(iii) as "AFSI items," these items represent adjustments to the adjusted net income or loss of a CFC. *See* §1.56A-6(c)(1) (generally providing that for purposes of determining a CFC's adjusted net income or loss, references to AFSI in other sections of the section 56A regulations are treated as references to adjusted net income or loss).

The adjustment to AFSI described in proposed §1.56A-6(b) is not included as a separately stated item because, under proposed §1.56A-6(b)(1) (which incorporates the principles of section 951(a)(2)), a partnership is not treated as owning stock of a CFC for purposes of proposed §1.56A-6(b)(1), and therefore proposed §1.56A-6(b) does not result in an adjustment to modified FSI of a partnership. Rather, in the case of a partnership that owns stock of a CFC, a partner that is a U.S. shareholder with respect to the CFC determines its own pro rata share of the adjusted net income or loss of the CFC and makes an appropriate adjustment to its AFSI directly under proposed §1.56A-6(b)(1). *See* proposed §1.56A-6(e)(3) (*Example 3*).

Proposed §1.56A-5(e)(5) would provide rules coordinating the effect of equity method basis adjustments for AFS purposes with a CAMT entity's adjustments to a partnership's modified FSI under the applicable method. If a CAMT entity includes in its FSI amortization of an equity method basis adjustment with respect to a partnership investment that is attributable to section 168 property or qualified wireless spectrum held by the partnership, and if the CAMT entity has a basis adjustment under section 743(b) with respect to the same property that affects the CAMT entity's distributive share amount, then the CAMT entity adjusts its AFSI to disregard any such FSI amortization. The rule in proposed §1.56A-5(e)(5) is intended to remove the potential for a duplicative reduction to AFSI for an equity method basis adjustment and section 743(b) basis adjustment that relates to the same property.

Proposed §1.56A-5(e)(6)(i) would provide rules for determining a CAMT entity's distributive share amount if the partnership treats as its AFS its Federal income tax return pursuant to proposed §1.56A-2(c)(6). In such case, a CAMT entity's distributive share amount with respect to its partnership investment would be equal to the amount of FSI disregarded under proposed §1.56A-5(c)(1) of the applicable method further adjusted to disregard any items described in proposed §§1.56A-4(b)(1) and 1.56A-8(b) that are reflected in such amount. Additionally, the AFSI items described in proposed §1.56A-5(e)(4)(iii)(A) through (C) would still apply to determine the CAMT entity partner's AFSI, but not the AFSI item described in

proposed §1.56A-5(e)(4)(iii)(D) since the AFSI item in proposed §1.56A-5(e)(4)(iii)(D) is dependent on the partnership's FSI and, pursuant to §1.56A-5(e)(6)(i), the partnership effectively does not have an FSI amount if it treats as its AFS its Federal income tax return. *See* proposed §1.56A-21(e)(2)(iii).

Proposed §1.56A-5(f) would provide that, in the case of a tiered entity structure, if a CAMT entity is a partner in a partnership (UTP) that directly or indirectly owns an investment in a lower-tier partnership (LTP), each partnership, starting with the lowest-tier partnership and continuing in order up the chain of ownership, must use the applicable method to determine the distributive share amounts of each CAMT entity partner in the tiered-partnership chain. Because each UTP determines its own distributive share amount, amounts separately stated under proposed §1.56A-5(e)(4)(ii) to an UTP are included in determining the UTP's modified FSI under the applicable method in proposed §1.56A-5(c). Under proposed §1.56A-5(g), the distributive share amount required to be included in a CAMT entity's AFSI for a taxable year with respect to a partnership investment under proposed §1.56A-5(c)(2) is based on the modified FSI of the partnership for any taxable year of the partnership ending within or with the taxable year of the CAMT entity.

E. *Reporting and filing requirements—partner*

Proposed §1.56A-5(h) would provide rules on the reporting and filing requirements for a CAMT entity that is a partner in a partnership. The Treasury Department and the IRS are aware that, in order to compute its distributive share of a partnership's AFSI, a CAMT entity may require information from the partnership. To facilitate information reporting by partnerships, the proposed regulations would require a partnership to provide the information to the CAMT entity if the CAMT entity cannot determine its distributive share of the partnership's AFSI without the information and the CAMT entity makes a timely request for the information.

Under proposed §1.56A-5(h)(1), if a CAMT entity cannot determine its distributive share of a partnership's AFSI without receiving certain information from the partnership, the CAMT entity would be required to request the information from the partnership by the 30th day after the close of the partnership's taxable year to which the information request relates. The information, and the requests made for the information, would be required to be maintained by the CAMT entity in its books and records. The partnership would be required to continue to provide the information to the CAMT entity for each subsequent taxable year unless the partnership receives written notification from the CAMT entity that the information is not required.

The Treasury Department and the IRS are aware that a CAMT entity might not timely receive the requested information from the partnership. Under proposed §1.56A-5(h)(2)(i), a CAMT entity that does not timely receive the requested information from the partnership would be required to make a good-faith estimate of its distributive share of the partnership's AFSI. Except as provided in proposed § 1.56A-5(h)(2)(iii)(B), once the CAMT entity receives the information from the partnership, the CAMT entity (if not also an applicable corporation) should report the information to its partners, including any UTP (which would then report the information to its partners), until the information is received by an applicable corporation. *See* proposed §1.56A-5(h)(2)(ii) and (iii)(B).

In the case of a partnership subject to the centralized partnership audit regime in subchapter C of chapter 63 of the Code (BBA partnership), if making the required estimate requires the CAMT entity to treat a partnership-related item (PRI) in a manner that is inconsistent with the BBA partnership's treatment of the PRI, the CAMT entity must follow the procedures for filing a notice of inconsistent treatment with respect to the PRI. *See* proposed §1.56A-5(h)(2)(iii)(A). If, as part of providing a CAMT entity with information under proposed §1.56A-5(h)(1), the BBA partnership must change a PRI reported on its partnership return for a taxable year and the due date for filing the return has passed, the BBA partnership must file an administrative adjustment request (AAR) under section 6227 of the Code to adjust the PRI. Pursuant to the centralized partnership audit regime, the adjustment is determined and taken into account under section 6227 and the regulations thereunder. *See* proposed §1.56A-5(h)(2)(iii)(B).

F. *Reporting and filing requirements—partnerships*

Proposed §1.56A-5(i) would provide rules for a partnership that receives a request from a CAMT entity for information to determine the CAMT entity's distributive share amount, including information necessary to determine the denominator for the distributive share percentage as described in proposed §1.56A-5(e)(2), the partnership's modified FSI as described in proposed §1.56A-5(e)(3), and for the CAMT entity to make the AFSI adjustments as described in proposed §1.56A-5(e)(4). The partnership would be required to file the information with the IRS in forthcoming forms, instructions, or other guidance, as described in proposed §1.56A-5(i)(1).

Proposed §1.56A-5(i)(2) would provide special rules for tiered partnership structures. These rules would require an UTP that has a reporting and filing requirement under proposed §1.56A-5(i) to request the information from an LTP, which then must file the requested information with the IRS and furnish it to the UTP as described in proposed §1.56A-5(i)(1). The information would be required to be requested by the UTP by the later of the 30th day after the close of the taxable year to which the information request relates or 14 days after the date the UTP receives an information request from another UTP.

Under proposed §1.56A-5(i)(3), the partnership would be required to provide the requested information by the date prescribed under section 6031(b) of the Code. However, under proposed §1.56A-5(i)(3)(iii) a partnership would not be required to furnish information to a CAMT entity until it has received a notice of request. A partnership would be considered to have received a notice of request when it receives the request either electronically or in the manner agreed to by the parties, or the partnership has an obligation to continue providing information to a CAMT entity due to the CAMT entity's request in a prior taxable year.

Under proposed §1.56A-5(i)(4), the information would be requested electronically or in the manner agreed to by the parties. Under proposed §1.56A-5(i)(5), the partnership would be required to retain in its books and records a copy of the information request and the date it was received. Under proposed §1.56A-5(i)(6), a partnership that fails to furnish the requested information would be subject to penalties under section 6722 of the Code.

The Treasury Department and the IRS request comments on whether exceptions to the reporting requirements should apply for partnerships that meet certain criteria. For example, such criteria may include the fair market value of the partnership's assets or whether the partnership is controlled (either directly or indirectly) by an applicable corporation. If a partnership is exempt from some or all of the reporting requirements outlined in proposed §1.56A-5(i), the Treasury Department and the IRS request comments on how a partner in the partnership would determine its distributive share of AFSI with respect to its partnership investment. The Treasury Department and the IRS also request comments regarding the application of the requirement in proposed §1.56A-5(i)(3) that a partnership provide information requested by a partner by the date prescribed under section 6031(b) of the Code for filing its partnership return when the partnership to which the request is made is a UTP or LTP in a tiered partnership structure.

G. *Limitation on allowance of negative distributive share amount*

Proposed §1.56A-5(j)(1) would provide a rule limiting the amount of a CAMT entity's negative distributive share amount from a partnership investment for a taxable year that can be included in the CAMT entity's AFSI for such taxable year in a manner similar to the rule in section 704(d) that applies for regular tax purposes. This rule would provide that, if a CAMT entity's distributive share amount with respect to a partnership investment for a taxable year, as determined under proposed §1.56A-5(e), is negative, such distributive share amount for the taxable year would include only the negative distributive share amount that does not exceed the CAMT entity's CAMT basis in its partnership investment as of the end of the partnership's taxable year. Ordering rules similar to the rules in §1.704-1(d)(2) apply in computing a CAMT entity's CAMT basis in its partnership investment for purposes of applying the loss limitation rule for negative distributive share amounts. The Treasury Department and the IRS request comments regarding the application of the ordering rule in §1.704-1(d)(2) and whether more specific ordering rules are needed for purposes of applying the loss limitation rule for negative distributive share amounts.

Proposed §1.56A-5(j)(2) would provide that any excess negative distributive amount that is disallowed for a taxable year under proposed §1.56A-5(j)(1) is carried forward and may be used by the CAMT entity in a subsequent taxable year to the extent such negative amount does not exceed a CAMT entity's CAMT basis in its partnership investment in the subsequent taxable year.

Proposed §1.56A-5(j)(3) would provide rules for determining a CAMT entity's CAMT basis in a partnership investment. These rules would be similar to the rules in section 705 of the Code that apply for regular tax purposes.

A CAMT entity's CAMT basis in a partnership investment would start with the basis of the investment for AFS purposes as of the first day of the partnership's first taxable year ending after December 31, 2019 in which the CAMT entity held its interest in the partnership and would reflect certain adjustments for each taxable year of the partnership ending after December 31, 2019 (but not adjustments that would make the CAMT basis less than zero). *See* proposed §1.56A-5(j)(3).

VI. *Proposed §1.56A-6: AFSI Adjustments with Respect to Controlled Foreign Corporations*

A. *General rule for adjusting AFSI under proposed §1.56A-6(b)*

Pursuant to the authority granted by section 56A(c)(5), (c)(15), and (e), proposed §1.56A-6 would provide rules under section 56A(c)(3) regarding an adjustment to the AFSI of a CAMT entity for any taxable year in which the CAMT entity is a U.S. shareholder of one or more CFCs. Under proposed §1.56A-6(b)(1), if a CAMT entity is a U.S. shareholder of a CFC, the CAMT entity's AFSI is generally adjusted for its pro rata share of the CFC's adjusted net income or loss, which generally means the CFC's FSI for the CFC's taxable year, adjusted for all AFSI adjustments provided under the section 56A regulations (except as provided under proposed §1.56A-6(c)(2) through (5), which are described later in this Explanation of Provisions). More specifically, proposed §1.56A-6(b)(1) would provide that, except as provided in proposed §1.56A-6(b)(3) (concerning an aggregate negative adjustment), for any taxable year, a CAMT entity that is a U.S. shareholder of one or more CFCs makes a single adjustment to the CAMT entity's AFSI that is equal to the sum of the CAMT entity's pro rata shares of the adjusted net income or loss of each such CFC, with such aggregate amount reduced as provided in proposed §1.56A-6(b)(2) (reduction for taxes if an applicable corporation does not claim foreign tax credits) and (4) (reduction for utilization of a CFC adjustment carryover, as defined in proposed §1.56A-6(b)(6)). The CAMT entity's pro rata share of the adjusted net income or loss of a CFC is determined for the taxable year of the CFC that ends with or within the taxable year of the CAMT entity and is determined under the principles of section 951(a)(2). These principles include, for example, rules similar to those described in section 951(a)(2)(A) and (B) and the aggregation rules in §1.958-1(d).

A single adjustment under section 56A(c)(3) is consistent with the statutory language. *See* section 56A(c)(3)(B) (which refers to "the adjustment determined under subparagraph (A)" rather than multiple "adjustments") and section 59(l) (which refers to "the adjustment under section 56A(c)(3)" in the singular and provides for the aggregation of an applicable corporation's pro rata share of creditable taxes paid or accrued by each CFC). Accordingly, to calculate the adjustment under section 56A(c)(3) for a U.S. shareholder of several CFCs, the net loss of a CFC may offset net income of another CFC in the same taxable year under proposed §1.56A-6(b). This rule would be consistent with the guidance provided in

section 7.02(2) of Notice 2023-64. If the sum of the pro rata share of the adjusted net income or loss of each CFC of which the CAMT entity is a U.S. shareholder produces a negative amount, this amount is carried to the succeeding taxable year, as described subsequently in more detail.

For purposes of determining inclusions of subpart F income and global intangible low-taxed income under sections 951 and 951A, a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of section 958(a) of the Code and therefore has no inclusions under section 951 or 951A with respect to any stock of a CFC it owns. *See* §§1.951-1(a)(4) (directing taxpayers to §1.958-1(d) for rules regarding the ownership of stock of a foreign corporation through a domestic partnership for purposes of section 951) and 1.958-1(d) (providing generally that for purposes of applying sections 951 and 951A, a domestic partnership is not treated as owning stock of a foreign corporation). Accordingly, because a CAMT entity's pro rata share of the adjusted net income or loss of a CFC is determined under the principles of section 951(a)(2), a domestic partnership would have no pro rata share with respect to the adjusted net income or loss of any stock of a CFC it owns and no adjustment would be made to the partnership's modified FSI under proposed §1.56A-6(b)(1). However, if a partner in the partnership is a U.S. shareholder with respect to the CFC, the partner would determine its own pro rata share of the adjusted net income or loss of the CFC and would make an appropriate adjustment to its AFSI directly under proposed §1.56A-6(b)(1). *See* proposed §1.56A-6(e)(3) (*Example 3*).

B. *Additional mechanics for adjusting AFSI under proposed §1.56A-6(b)*

Solely for purposes of determining AFSI under section 56A (and not under section 59(k)), proposed §1.56A-6(b)(2) would require an applicable corporation that is not claiming foreign tax credits for the taxable year to reduce the amount of the adjustment determined under proposed §1.56A-6(b)(1) by its share of eligible current year taxes of CFCs for the taxable year (calculated under proposed §1.59-4(d)(3) as if the applicable corporation had claimed foreign tax credits for the taxable year). For this purpose, the applicable corporation's share of eligible current year taxes of CFCs is reduced to reflect the suspensions and disallowances described in proposed §1.59-4(b)(1) that apply at the level of the U.S. shareholder for purposes of determining foreign income taxes eligible for the CAMT FTC. Finally, the proposed regulations would not permit a reduction to the amount of the adjustment under proposed §1.56A-6(b)(1) for taxes deemed paid by the applicable corporation on distributions of PTEP under section 960(b) (PTEP taxes).

Proposed §1.56A-6(b)(3) would provide that, if the amount of the adjustment determined under proposed §1.56A-6(b)(1) with respect to a taxable year of a U.S. shareholder would be negative (after taking into account the tax reduction provided under proposed §1.56A-6(b)(2) but before taking the CFC adjustment carryovers under proposed §1.56A-6(b)(4) into account), then there is no adjustment under proposed §1.56A-6(b)(1) for the taxable year. This would-be negative adjustment amount would give rise to a CFC adjustment carryover generated in the taxable year. Proposed §1.56A-6(b)(4) would provide that if the adjustment determined under proposed §1.56A-6(b)(1) with respect to a taxable year of a U.S. shareholder would be positive (after taking into account the tax reduction provided under proposed §1.56A-6(b)(2) but before taking proposed §1.56A-6(b)(4) into account), then the adjustment under proposed §1.56A-6(b)(1) (after taking into account the tax reduction provided under proposed §1.56A-6(b)(2)) is reduced by the aggregate amount of CFC adjustment carryovers to the taxable year, but not below zero. Proposed §1.56A-6(b)(5) would provide rules describing the ordering and use of CFC adjustment carryovers, which parallel similar rules for FSNOL carryovers in proposed §1.56A-23(d).

Proposed §1.56A-6(b)(7) would provide that members of a tax consolidated group are treated as a single entity for purposes of proposed §1.56A-6(b). *See also* proposed §1.1502-56A(h) for rules regarding the use of CFC adjustment carryovers by a tax consolidated group.

C. *Definition of adjusted net income or loss*

Proposed §1.56A-6(c)(1) generally would define the term adjusted net income or loss with respect to any CFC, for any taxable year of the CFC, as the FSI of the CFC, adjusted for all AFSI adjustments provided under the section 56A regulations, except as provided in proposed §1.56A-6(c)(2) through (5). Adjusted net income or loss of a CFC must be expressed in U.S. dollars. Accordingly, items not expressed in U.S. dollars that are taken into account in determining the CFC's adjusted net income or loss must be translated to U.S. dollars. This translation may be required where the reporting currency used for a CFC's AFS is not the U.S. dollar, because in that case the CFC's FSI (the starting point in determining the CFC's adjusted net income or loss) will not be expressed in U.S. dollars. It may also be required where an adjustment made in determining the CFC's adjusted net income or loss references an amount as determined for regular tax purposes, because that regular tax amount may be denominated in the CFC's functional currency for regular tax purposes, which may not be the U.S. dollar (and may also be different from the reporting currency used for the CFC's AFS). In any case in which currency translation is required under proposed §1.56A-6(c)(1), it is undertaken using the weighted average exchange rate, as defined in §1.989(b)-1, for the CFC's taxable year. For purposes of translating a CFC's adjusted net income or loss to U.S. dollars, the rules described in proposed §1.56A-6(c)(1) apply in lieu of the rules described in proposed §1.56A-1(e)(1).

The adjustments in proposed §1.56A-6(c)(2) are intended to address certain potential duplications of items and would be generally consistent with, but expand upon, the guidance provided in Notice 2024-10. *See* part IV.A of this Explanation of Provisions describing a potential duplication of items when an upper-tier CFC owns stock of a lower-tier CFC. Proposed §1.56A-6(c)(2) would provide adjustments to a CFC's adjusted net income or loss relating to the CFC's ownership of stock of a foreign corporation, in lieu of the adjustments described in proposed §1.56A-4(c)(1). Proposed §1.56A-6(c)(2)

(ii) would exclude from a CFC's adjusted net income or loss any items of income, expense, gain, and loss resulting from ownership of stock of a foreign corporation, including from acquiring or transferring such stock, reflected in the CFC's FSI. Proposed §1.56A-6(c)(2)(iii) would include in a CFC's adjusted net income or loss any items of income, deduction, gain, and loss resulting from the CFC's ownership of stock of a foreign corporation, including from acquiring or transferring such stock, for regular tax purposes, except for the amount of any dividend received from another foreign corporation to the extent the dividend is a CAMT excluded dividend. Proposed §1.56A-6(d) would define the term "CAMT excluded dividend" to mean a dividend received by a CFC to the extent the dividend is excluded from (i) the recipient CFC's gross income under section 959(b), or (ii) both (A) the recipient CFC's foreign personal holding company income under section 954(c)(3) or (c)(6) of the Code, and (B) the recipient CFC's gross tested income under §1.951A-2(c)(1)(iv).

Because a CFC's adjusted net income or loss reflects all AFSI adjustments provided under the section 56A regulations, except as provided in proposed §1.56A-6(c)(2) through (5), if a CFC is a partner in any partnership or the owner of any disregarded entity, the items taken into account in computing the CFC's adjusted net income or loss generally include the CFC's distributive share amount of modified FSI from any such partnership (*see* proposed §1.56A-5) and the AFSI of any such disregarded entity (*see* proposed §1.56A-9). This would be consistent with the guidance provided in section 7.02(3) of Notice 2023-64. Proposed §1.56A-6(c)(2)(iv) would further provide that if a partnership directly owns stock of a foreign corporation, then in determining the adjusted net income or loss of a CFC that is a partner in the partnership (or an indirect partner in the case of tiered partnerships), the partner takes into account the items described in proposed §1.56A-6(c)(2)(iii) (including taking into account the exception for CAMT excluded dividends) that are reported to the partner by the partnership for regular tax purposes.

Section 56A(c)(3)(A) provides that the AFSI of a CAMT entity that is a U.S. shareholder of a CFC should be adjusted to take into account a pro rata share of CFC items under rules similar to the rules under section 951(a)(2). Reading section 56A(c)(3) as limited only to the pro rata share of CFC items that would be taken into account in computing AFSI under section 56A(c)(4) and proposed §1.56A-7 (that is, items of income that are effectively connected with the conduct of a trade or business within the United States and deductions connected with such income) would be underinclusive. Thus, proposed §1.56A-6(c)(3) would provide that a CFC's adjusted net income or loss is not limited to amounts taken into account in determining AFSI under proposed §1.56A-7, which would generally limit the AFSI of a foreign corporation to taxable income that is effectively connected with the conduct of a trade or business within the United States.

Moreover, where an amount is subject to CAMT under section 56A(c)(4) and proposed §1.56A-7 because a CFC is itself an applicable corporation, such amount should be excluded from a U.S. shareholder's adjustment under 56A(c)(3) to prevent double counting of the same income of the CFC. Thus, proposed §1.56A-6(c)(3) would provide that, if a CFC is an applicable corporation, the CFC's adjusted net income or loss is reduced by the amount of AFSI of the CFC (with such AFSI determined by taking proposed §1.56A-7 into account). The rule in proposed §1.56A-6(c)(3) would be consistent with the guidance provided in section 7.02(5) of Notice 2023-64.

Proposed §1.56A-6(c)(4) would provide that the AFSI adjustment provided under proposed §1.56A-8(c) does not apply in computing a CFC's adjusted net income or loss. Proposed §1.56A-8(c) generally would provide a reduction in the AFSI of an applicable corporation by the amount of foreign income taxes deducted by the applicable corporation, if the applicable corporation does not choose to claim foreign tax credits for the taxable year.

Proposed §1.56A-6(c)(5) would provide that the AFSI adjustment provided under proposed §1.56A-23(c) (providing a reduction to AFSI for FSNOL carryovers) does not apply in computing a CFC's adjusted net income or loss. Allowing a CFC to make the adjustment for FSNOL carryovers provided by proposed §1.56A-23(c) when determining the CFC's adjusted net income or loss, while also allowing for the use of CFC adjustment carryovers to reduce a U.S. shareholder's adjustment to AFSI under proposed §1.56A-6(b)(1), would lead to an improper double counting of loss carryovers.

VII. *Proposed §1.56A-7: AFSI Adjustments with Respect to Effectively Connected Income*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-7 would provide rules under section 56A(c)(4) for applying the principles of section 882 to determine a foreign corporation's AFSI. As amended by section 10101 of the IRA, section 882(a)(1) provides, in part, that a foreign corporation engaged in a trade or business within the United States during the taxable year is taxable under the CAMT on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

In determining taxable income for purposes of section 882(a)(1), gross income includes only gross income which is effectively connected with the conduct of a trade or business within the United States (ECI). *See* section 882(a)(2). Deductions are generally allowed for these purposes only if and to the extent they are connected with income which is ECI. *See* section 882(c)(1)(A). Accordingly, proposed §1.56A-7(b) would provide that, for purposes of section 56A(c)(4), the AFSI of a foreign corporation is adjusted to include only amounts and items of FSI that would be included in ECI or allowable as a deduction by such corporation for purposes of section 882(c) had such amount or item accrued for regular tax purposes in the taxable year.

Section 7.02(5) of Notice 2023-64 provides guidance under which, for purposes of applying section 56A(c)(4), in the case of a foreign corporation that qualifies for and claims the benefits of the business profits provisions of an applicable income tax treaty, the principles of those provisions would apply in determining the foreign corporation's AFSI. This guidance was intended to clarify that a foreign

corporation entitled to benefits under an income tax treaty may apply the treaty to determine its AFSI. After further consideration, the Treasury Department and the IRS are of the view that it is not necessary to make this clarification in the proposed regulations, because section 894(a) of the Code already provides that the Code is applied with due regard to any income tax treaty obligation of the United States that applies to a taxpayer, and nothing in the IRA changes the normal operation of U.S. income tax treaties in this context.

VIII. *Proposed §1.56A-8: AFSI Adjustments for Certain Federal and Foreign Income Taxes*

Section 56A(c)(5) provides that AFSI is appropriately adjusted to disregard any Federal income taxes or income, war profits, or excess profits taxes (within the meaning of section 901) with respect to a foreign country or possession of the United States which are taken into account in the taxpayer's AFS. Further, the statute provides a grant of authority to the Secretary to provide an exception to this rule for a taxpayer that does not choose to claim foreign tax credits for a taxable year. Finally, section 56A(c)(5) authorizes the Secretary to prescribe such regulations or other guidance as may be necessary or appropriate to provide for the proper treatment of current and deferred taxes for purposes of section 56A(c)(5), including the time at which the taxes are properly taken into account.

Pursuant to the authority granted by section 56A(c)(5), (c)(15), and (e), proposed §1.56A-8(b)(1) would adjust AFSI to disregard any applicable income taxes, as defined in proposed §1.56A-8(b)(2), that are taken into account in a CAMT entity's AFS. The proposed regulations would define applicable income taxes as Federal income taxes and foreign income taxes that are taken into account in a CAMT entity's AFS as current tax expense (or benefit), as deferred tax expense (or benefit), or through increases or decreases to other AFS accounts of the CAMT entity (for example, AFS accounts used to account for FSI from investments in other CAMT entities, AFS accounts used to account for section 168 property, or AFS accounts used to account for other items of income and expense). *See* proposed §1.56A-8(b)(2). Additionally, the proposed regulations would define Federal income taxes to mean any taxes imposed by subtitle A of the Code and to include amounts allowed as credits against taxes imposed by subtitle A, including credit amounts that are generated by a partnership and passed through to a partner. *See* proposed §1.56A-1(b)(18). Proposed §1.56A-1(b)(23) would define foreign income tax to have the meaning provided in §1.901-2.

AFSI is relevant in determining both whether a corporation is an applicable corporation and the amount of an applicable corporation's CAMT liability under section 55(a). For purposes of determining whether a corporation is an applicable corporation, the Treasury Department and the IRS are of the view that AFSI should be determined on a pre-tax basis for all taxpayers, regardless of whether the taxpayer chooses to claim foreign tax credits for the taxable year. This ensures that all taxpayers determine whether a corporation is an applicable corporation using the same metric (pre-tax AFSI) and ensures that the choice of whether to claim foreign tax credits has no effect on the determination of whether a corporation is an applicable corporation.

For purposes of determining the amount of an applicable corporation's CAMT liability under section 55(a), however, the Treasury Department and the IRS are of the view that it is an appropriate exercise of the regulatory authority granted under section 56A(c)(5) to allow a reduction to AFSI (similar to the deduction for regular tax purposes under section 164 of the Code) for foreign income taxes if an applicable corporation does not choose to claim foreign tax credits for the taxable year and thus is not eligible to claim a CAMT FTC under section 59(l).

Accordingly, proposed §1.56A-8(c) would provide that an applicable corporation that does not choose to claim a foreign tax credit for the taxable year would reduce its AFSI by the amount of foreign income taxes which the applicable corporation deducts for regular tax purposes under section 164 (taking into account all other relevant provisions) for the taxable year, including foreign income taxes of a disregarded entity of which the applicable corporation is the owner for regular tax purposes and any creditable foreign tax expenditures (within the meaning of §1.704-1(b)(4)(viii)) allocated to the applicable corporation as a partner or indirect partner in a tiered partnership or other type of pass-through entity. This adjustment is disregarded in applying the average annual AFSI tests described in §1.59-2(c) to determine whether a corporation is an applicable corporation. *See* §1.59-2(c)(1)(ii)(B) and (c)(2)(ii)(B).

An applicable corporation that chooses to claim a foreign tax credit for the taxable year, however, would not reduce its AFSI by the amount of foreign income taxes that the applicable corporation deducts in the taxable year (for example, foreign income taxes paid to specified foreign countries under section 901(j)). *See* proposed §1.56A-8(e)(2) (*Example 2*). The Treasury Department and the IRS are of the view that this approach is consistent with the grant of regulatory authority provided in section 56A(c)(5).

Proposed §1.56A-6(b)(2) provides a rule similar to proposed §1.56A-8(c) that would reduce the pro rata share adjustment provided under proposed §1.56A-6(b)(1) for certain foreign income taxes of CFCs if an applicable corporation does not choose to claim foreign tax credits for the taxable year.

Proposed §1.56A-8(d) would provide that, for purposes of proposed §§1.56A-8(b) and 1.59-4, applicable income taxes are considered taken into account in an AFS of a CAMT entity if any journal entry has been recorded in the books and records used to determine an amount in the AFS of the CAMT entity for any year, or in another AFS that includes the CAMT entity, to reflect such taxes. Applicable income taxes are considered taken into account in an AFS of a CAMT entity even if the taxes do not increase or decrease the CAMT entity's FSI at the time of the journal entry. Further, if applicable income taxes are taken into account in a partnership's AFS, they also are considered taken into account in any AFS of the partnership's partners.

IX. *Proposed §1.56A-9: AFSI Adjustments for Owners of Disregarded Entities or Branches*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed

§1.56A-9 would provide rules under section 56A(c)(6) and (15) for determining the AFSI of a CAMT entity that owns a disregarded entity or branch. Section 56A(c)(6) provides that AFSI is adjusted to take into account any AFSI of a disregarded entity owned by the taxpayer.

Proposed §1.56A-9(b)(1) would provide that, for purposes of the section 56A regulations, a disregarded entity or branch and the CAMT entity that owns the disregarded entity or branch, including through other disregarded entities or branches, (CAMT entity owner) are treated as a single CAMT entity. As a result, the CAMT entity owner would be treated as directly owning the assets of, being directly liable for the liabilities of, and directly earning or incurring any income, expense, gain, loss, or other similar item of the disregarded entity or branch. Further, proposed §1.56A-9(b)(2) would provide that transactions between the disregarded entity or branch and the CAMT entity owner (or between disregarded entities or branches owned by the same CAMT entity) and any balance sheet account or income statement account that reflects the CAMT entity owner's investment in the disregarded entity or branch (or a disregarded entity's investment in another disregarded entity or branch that is ultimately owned by the same CAMT entity owner) would be disregarded. Proposed §1.56A-9(b)(3) would provide that if a disregarded entity or branch is required to determine its own AFS under §1.56A-2(h), the CAMT entity owner of the disregarded entity or branch treats such separate AFS of the disregarded entity or branch as part of the CAMT entity owner's own AFS.

Financial accounting does not have the concept of a disregarded entity. For financial accounting purposes, a single member limited liability corporation, for instance, may have a financial statement (or be a separate member of a financial statement group) and, thus, is treated the same as any other corporation. Section 56A(c)(6) affirms the application of regular tax principles to the treatment of disregarded entities. Accordingly, these proposed rules would apply regular tax principles for the treatment of disregarded entities and branches, rather than treating disregarded entities and branches as independently calculating AFSI and then adding that AFSI to the AFS of the owner.

X. *Proposed §1.56A-10: AFSI Adjustments for Cooperatives*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-10 would provide rules under section 56A(c)(7) regarding the determination of AFSI for a cooperative. Proposed §1.56A-10(b) would provide that, in the case of a cooperative to which section 1381 of the Code applies, AFSI of the cooperative is reduced by the amounts referred to in section 1382(b) of the Code and the regulations under section 1382(b) (relating to patronage dividends and per-unit retain allocations), but only to the extent such amounts were not otherwise taken into account in determining the AFSI of the cooperative.

XI. *Proposed §1.56A-11: AFSI Adjustments for Alaska Native Corporations*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-11 would provide rules under section 56A(c)(8) regarding Alaska Native Corporations. Section 56A(c)(8) provides for two adjustments to the AFSI of Alaska Native Corporations. First, section 56A(c)(8)(A) provides that cost recovery and depletion attributable to certain property that is allowed for regular tax purposes is allowed in calculating AFSI. Section 21(c) of the ANCSA (43 U.S.C. 1620(c)) describes land and interests in land that Alaska Native Corporations receive pursuant to certain provisions of the ANCSA. Such property interests have a basis equal to their fair market value either at the time the corporation receives the property or at the time the corporation first commercially develops the property. Proposed §1.56A-11(c) would provide that the AFSI of an Alaska Native Corporation (i) is reduced for cost recovery and depletion attributable to such property to the extent of the amount recovered for regular tax purposes, and (ii) is adjusted to disregard any cost recovery or depletion attributable to such property that is reflected in the corporation's FSI. In other words, proposed §1.56A-11(c) allows an Alaska Native Corporation to use the basis of such property for regular tax purposes in lieu of the AFS basis of such property for all depletion and cost recovery computations (including gain or loss computations) with respect to such property that apply in determining AFSI.

Second, section 56A(c)(8)(B) provides that deductions for certain amounts payable under the ANCSA are allowed in calculating AFSI only at the time the deductions are allowed for regular tax purposes. Section 7(i) and (j) of the ANCSA (43 U.S.C. 1606(i) and (j)) requires the Regional Corporations (within the meaning of 43 U.S.C. 1606) to divide a portion of their revenues among all Regional Corporations, and to distribute at least a minimum percentage of their revenues to shareholders. Proposed §1.56A-11(d) would provide that the AFSI of an Alaska Native Corporation (i) is reduced by regular tax deductions for payments under section 7(i) and 7(j) of the ANCSA at the time they are deducted for regular tax purposes, and (ii) is adjusted to disregard expenses for specified payments reflected in the corporation's FSI.

XII. *Proposed §1.56A-12: AFSI Adjustments with Respect to Certain Tax Credits*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-12 would provide rules under section 56A(c)(9) and (c)(15) regarding AFSI adjustments for certain credits. Proposed §1.56A-12(b)(1) would provide that AFSI is adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under section 48D(d) or 6417, provided that this amount is not otherwise disregarded under proposed §1.56A-8 (concerning taxes). This provision would permit the exclusion of certain credit amounts from AFSI, which would follow their treatment for regular tax purposes.

For regular tax purposes, an eligible taxpayer that elects to transfer an eligible credit, as those terms are defined in section 6418(f) of the Code, excludes from gross income amounts received from the transfer of the credit. Section 6418(b)(2). Pursuant to the Secretary's authority under section 56A(c)(15), and consis-

tent with the treatment of similar credits for which an election under section 6417 (a companion provision to section 6418) is made, proposed §1.56A-12(b)(2) would provide that AFSI is adjusted to disregard any amount received from the transfer of an eligible credit that is not included in the gross income of the CAMT entity under section 6418(b) or that is treated as tax exempt income under section 6418(c)(1)(A), provided that the amounts are not otherwise disregarded under proposed §1.56A-8. In addition, proposed §1.56A-12(b)(3) would provide that AFSI is adjusted to disregard amounts received pursuant to a direct pay election under section 48D(d)(2) or 6417(c) that is treated as tax exempt income for regular tax purposes, provided that the amounts are not otherwise disregarded under proposed §1.56A-8. The rules in proposed §1.56A-12(b)(1) through (3) would be consistent with section 6 of Notice 2023-7.

Pursuant to the Secretary's authority under section 56A(c)(15), proposed §1.56A-12(c) would provide rules for the treatment of purchasers (transferees) of an eligible credit for purposes of determining their AFSI. For regular tax purposes, under section 6418(a) and §1.6418-2(f)(2), a transferee does not have gross income as a result of utilizing a purchased credit with a value in excess of the amount paid for the purchased credit. Consistent with this regular tax treatment, proposed §1.56A-12(c)(2) would provide that, to the extent FSI of a transferee reflects income from the utilization of a purchased credit, AFSI is adjusted to disregard the income if it is not otherwise disregarded under proposed §1.56A-8.

For regular tax purposes, section 6418(b)(3) provides that the transferee cannot deduct the cash payment it makes to purchase the credit. Consistent with that regular tax treatment, proposed §1.56A-12(c)(1) would provide that, for a transferee taxpayer that is a CAMT entity, AFSI is adjusted to disregard the cash payment the transferee taxpayer made to purchase the credit, if the expense is not otherwise disregarded under proposed §1.56A-8.

Both the direct pay election provisions and the credit transfer provisions of the Code reference the basis reduction and credit recapture provisions in section 50 of the Code. *See* sections 48D(d)(5), 6417(g), and 6418(g)(3), respectively. For regular tax purposes, liability for credit recapture would represent nondeductible tax. To ensure that the CAMT treatment of a credit recapture is not more advantageous than the regular tax treatment, proposed §1.56A-12(d) would provide that, to the extent FSI reflects a decrease for a credit recapture under sections 48D(d)(5), 50(a)(3), 6417(g), or 6418(g)(3) that is not otherwise disregarded under proposed §1.56A-8, AFSI is adjusted to disregard the decrease to FSI.

XIII. *Proposed §1.56A-13: AFSI Adjustments for Covered Benefit Plans*

Pursuant to the authority granted by section 56A(c)(11)(A), (c)(15), and (e), proposed §1.56A-13 would provide rules under section 56A(c)(11) regarding adjustments to AFSI with respect to covered benefit plans. As defined in proposed §1.56A-13(c), the term "covered benefit plan" would include: (i) a qualified defined benefit pension plan that is a defined benefit plan described in section 401(a) with a trust that is exempt from tax under section 501(a), and that is not a multiemployer plan described in section 414(f); (ii) a qualified foreign plan described in section 404A(e); or (iii) another plan if, under the accounting standards that apply to the AFS, the plan is treated as a defined benefit plan that provides post-employment benefits other than pension benefits.

The definition of the third type of covered benefit plan in proposed §1.56A-13(c)(4) would be consistent with a recommendation from stakeholders that a welfare plan providing post-retirement benefits should be treated as a covered benefit plan if it is accounted for on a defined benefit basis. For example, if the accounting standards that apply to the AFS are GAAP, then a plan that provides post-employment benefits other than pension benefits and that is accounted for under the rules of Accounting Standards Codification (ASC) 715-60 would be treated as a covered benefit plan.

A defined benefit pension plan with a trust created or organized in Puerto Rico is a qualified defined benefit pension plan described in proposed §1.56A-13(c)(2)(i) only if an election described in section 1022(i)(2)(A) of the Employee Retirement Income Security Act of 1974, Public Law 93-406, 88 Stat. 829, and §1.401(a)-50(a) has been made with respect to the plan for its trust to be treated as created or organized in the United States for purposes of section 401(a) of the Code. A defined benefit pension plan with a trust created or organized in any other possession specified in section 937(a)(1) of the Code is not a qualified defined benefit pension plan under proposed §1.56A-13(c)(2)(i).

Proposed §1.56A-13(b) would provide that AFSI: (i) is adjusted to disregard any amount of income, cost, expense, gain, or loss that otherwise would be included on a CAMT entity's AFS in connection with any covered benefit plan; (ii) is increased by any amount of income in connection with any covered benefit plan that is included in gross income for the taxable year under any provision of chapter 1; and (iii) is reduced by deductions allowed for the taxable year under any provision of chapter 1 with respect to any covered benefit plan.

XIV. *Proposed §1.56A-14: AFSI Adjustments for Tax-Exempt Entities*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-14 would provide rules under section 56A(c)(12) regarding tax-exempt entities. Section 56A(c)(12) states that, in the case of an organization subject to tax under section 511 (generally, a tax-exempt entity), AFSI must be appropriately adjusted to only take into account any AFSI (i) of an unrelated trade or business (as defined in section 513) of such organization, or (ii) derived from debt-financed property (as defined in section 514) to the extent that income from such property is treated as unrelated business taxable income.

For most organizations described in section 501(c), unrelated business taxable income (UBTI) is defined in section 512(a)(1) of the Code as the gross income derived by any exempt organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by chapter 1 that are directly connected with the carrying on of such trade or business, both

computed with the modifications provided in section 512(b).

The modifications in section 512(b) generally exclude from UBTI income from passive sources, such as dividends, interest, annuities, and certain other items (section 512(b)(1)), royalties (section 512(b)(2)), certain rents (section 512(b)(3)), and certain capital gains (section 512(b)(5)). However, notwithstanding section 512(b)(1), (2), (3), and (5), section 512(b)(4) includes as an item of gross income derived from an unrelated trade or business the amount of income determined under section 514(a)(1) that is derived from debt-financed property, as defined in section 514(b). Section 512(a)(3) provides an alternate definition of UBTI for certain organizations that is computed without regard to the modifications in section 512(b)(1), (2), (3), and (5).

Stakeholders have requested clarification that the modifications in section 512(b) apply for purposes of section 56A(c)(12). One stakeholder stated that section 56A(c)(12)(B), which specifically includes income from debt-financed property, would be unnecessary if section 56A(c)(12)(A) already included such income (as would be the case if section 512(b) did not apply).

For the reason mentioned by the stakeholder, the modifications in section 512(b) should apply for purposes of section 56A(c)(12). Therefore, proposed §1.56A-14(b) would provide that, in the case of an organization subject to tax under section 511, AFSI is adjusted to take into account any AFSI of an unrelated trade or business of such organization, subject to the applicable modifications to UBTI found in section 512(b), including AFSI derived from debt-financed property to the extent that income from such property is treated as UBTI.

XV. *Proposed §1.56A-15: AFSI Adjustments for Section 168 Property*

Pursuant to the authority granted by section 56A(c)(13)(B)(ii), (c)(15), and (e), proposed §1.56A-15 would provide rules under section 56A(c)(13) for determining the AFSI adjustments for property to which section 168 applies (section 168 property). To implement section 56A(c)(13), the proposed regulations would mimic the regular tax treatment of all section 168 property to the extent of the timing and amount of regular tax basis recovery with respect to the section 168 property, regardless of when the section 168 property is placed in service, whether and how the costs with respect to section 168 property are recognized in FSI, and whether gain or loss with respect to section 168 property is recognized in FSI. As a result, proposed §1.56A-15 applies the principle that the application of section 56A(c)(13) should not provide the CAMT entity with a better result with respect to section 168 property for AFSI purposes than for regular tax purposes.

Proposed §1.56A-15(b) would provide definitions that generally follow the definitions in sections 2 and 4 of Notice 2023-7, as modified and clarified by sections 5 and 9.02 of Notice 2023-64. A new defined term, covered book inventoriable depreciation, would be added to explain a simplified method for a CAMT entity to determine depreciation in ending inventory for purposes of determining the tax COGS depreciation and covered book COGS depreciation adjustments, as discussed in part XV.B of this Explanation of Provisions. In addition, new defined terms, tax capitalization method change and tax capitalization method change AFSI adjustment, would be added for changes in methods of accounting for regular tax purposes involving a change from capitalizing and depreciating costs as section 168 property to deducting the costs (or vice versa), as discussed in part XV.B of this Explanation of Provisions. Further, the definition of the term tax depreciation section 481(a) adjustment would be expanded to include an adjustment (or portion thereof) required under section 481(a) for any other change in method of accounting (other than a tax capitalization method change) that impacts the timing of taking into account depreciation of section 168 property in computing taxable income (for example, a change in method of accounting involving a change from deducting depreciation of section 168 property to capitalizing such depreciation under section 263A or another capitalization provision, or vice versa). These additional or expanded definitions for changes in methods of accounting would prevent depreciation of section 168 property from being duplicated in, or omitted from, AFSI.

A. *Section 168 property*

1. *In General*

Proposed §1.56A-15(c)(1) generally would define section 168 property to mean: (i) MACRS property, as defined in §1.168(b)-1(a)(2), that is depreciable under section 168; (ii) computer software that is qualified property, as defined in §1.168(k)-1(b)(1) or 1.168(k)-2(b)(1), and is depreciable under section 168; and (iii) certain other intangible property that is depreciable under section 168, is qualified property as defined in §1.168(k)-2(b)(1), and is described in §1.168(k)-2(b)(2)(i)(E), (F), or (G). Property described in §1.168(k)-2(b)(2)(i)(E), (F), or (G) includes: (i) a qualified film or television production, or a qualified live theatrical production, for which a deduction otherwise would be allowable under section 181 of the Code and which was initially released, broadcast, or staged live, respectively, after September 27, 2017; or (ii) a specified plant for which the taxpayer has properly made an election to apply section 168(k)(5) and that is planted, or grafted to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer's farming business, as defined in section 263A(e)(4) of the Code.

As explained previously, section 168 property includes computer software and certain other intangible property that is "qualified property". The term "qualified property" is defined in §1.168(k)-1(b)(1) or 1.168(k)-2(b)(1) as depreciable property that meets the following four requirements: (i) the depreciable property is of a specified type; (ii) the original use of the depreciable property commences with the taxpayer, or used depreciable property meets the acquisition requirements of section 168(k)(2)(E)(ii); (iii) the depreciable property is placed in service by the taxpayer within a specified time period or is planted or grafted by the taxpayer before a specified date; and (iv) the depreciable property is acquired by the taxpayer after September 27, 2017.

2. *Property Depreciable Under Section 168*

The definition of "Section 168 Property" in section 4.04 of Notice 2023-7 includes only property "depreciated" under section 168. The Treasury Department and the IRS have further considered the interim guidance in Notice 2023-7 in response to stakeholder feedback. Accordingly, the proposed regulations would interpret the adjustment under section 56A(c)(13) to include property "depreciable" under section 168 even if the property is not ultimately depreciated under section 168, but only to the extent of the depreciation allowed under section 167. Accordingly, proposed §1.56A-15(c)(1) would expand the definition of "Section 168 Property" to include property "depreciable" under section 168. As a result, section 168 property would include property that has not yet been placed in service but that would be property "depreciable" under section 168 once placed in service. Additionally, section 168 property would include property eligible for the additional first year depreciation deduction, even if the taxpayer makes the election out under section 168(k)(7). *See* proposed §1.56A-15(c)(5). However, proposed §1.56A-15(c)(2) would clarify that the adjustments under section 56A(c)(13) apply only to the portion of the cost of property depreciable under sections 167 and 168, and not the portion deductible under section 181 or recovered under any other section of the Code.

Proposed §1.56A-15(c)(3) would provide that the adjustments under section 56A(c)(13) do not apply to deductible expenditures (such as deductible repair expenditures) that are made with respect to section 168 property, and proposed §1.56A-15(c)(4) would clarify that property that is not depreciable under section 168 for regular tax purposes does not give rise to adjustments under section 56A(c)(13). These items would not be depreciable under section 168, and therefore are not within the scope of section 56A(c)(13). However, stakeholders have recommended that the AFSI adjustments under section 56A(c)(13) with respect to section 168 property take into account repair expenditures with respect to such property that are deductible for regular tax purposes, but which are capitalized and depreciated for AFS purposes. Stakeholders commented that this approach would simplify the computation of AFSI and would reduce the compliance burden on taxpayers. In addition, stakeholders noted that certain industries (for example, regulated utilities) are subject to industry-specific GAAP or IFRS rules that increase the disparity between the amount of repair expenditures expensed for AFS purposes compared to the deductible repair expenditures for regular tax purposes, and, thus, such industries may have increased amounts of AFSI after application of the adjustments under section 56A(c)(13). The Treasury Department and the IRS continue to study this issue. Comments are requested on whether the AFSI adjustments with respect to section 168 property should take into account or otherwise reflect the repair expenditures with respect to section 168 property that are deducted for regular tax purposes but capitalized and depreciated for AFS purposes.

Proposed §1.56A-15(c)(6) would provide that section 56A(c)(13) applies to property placed in service in any taxable year, including taxable years beginning before January 1, 2023 (that is, the effective date of the CAMT). This rule is based on section 56A(c)(13), which does not limit the depreciation adjustments to property placed in service in certain years or under certain conditions. In contrast, *see* section 56A(d)(3), which limits the net loss set forth on a taxpayer's AFS to taxable years ending after December 31, 2019.

B. *AFSI adjustments for depreciation*

Proposed §1.56A-15(d)(1) would provide the AFSI adjustments for depreciation that are required under section 56A(c)(13). Proposed §1.56A-15(d)(2) would provide special rules for section 168 property held by a partnership, and proposed §1.56A-15(d)(3) would provide special rules for determining the adjustments under proposed §1.56A-15(d)(1) if depreciation is an inventoriable cost for AFS or regular tax purposes. Finally, proposed §1.56A-15(d)(4) would provide adjustment periods for tax capitalization method change AFSI adjustments.

More specifically, under proposed §1.56A-15(d)(1), AFSI of a CAMT entity would be reduced by: (i) tax cost of goods sold (tax COGS) depreciation (that is, tax depreciation capitalized under section 263A to inventory or to the basis of property described in section 1221(a)(1) that is not inventory), but only to the extent of the amount recovered as part of cost of goods sold in computing gross income for the taxable year or as part of the computation of gain or loss from the sale or exchange of non-inventory property described in section 1221(a)(1) of the Code that is included or deducted in computing taxable income for the taxable year; (ii) deductible tax depreciation (that is, depreciation deductions allowed under section 167, or another provision of the Code, with respect to section 168 property), but only to the extent of the amount that is allowed as a deduction in computing taxable income for the taxable year; and (iii) any tax depreciation section 481(a) adjustment (that is, an adjustment for regular tax purposes under section 481(a) of the Code with respect to a change in method of accounting for depreciation for section 168 property or any other change in method of accounting (other than a tax capitalization method change) that impacts the timing of taking into account depreciation with respect to section 168 property in computing taxable income) that is negative, but only to the extent of the amount of such adjustment that is taken into account in computing taxable income for the taxable year.

AFSI of a CAMT entity also would be adjusted to disregard covered book cost of goods sold (book COGS) depreciation, covered book depreciation expense, covered book expense, and any AFS basis recovery with respect to section 168 property that is reflected in FSI following the date such property is disposed of for regular tax purposes. Covered book COGS depreciation includes depreciation expense, other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition of section 168 property occurs for regular tax purposes, or impairment loss reversal that is taken into account as cost of goods sold (or as part of the computation of gain or loss from the sale or exchange of property held for sale) in FSI

with respect to section 168 property. Covered book depreciation expense includes depreciation expense, other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition of section 168 property occurs for regular tax purposes, or impairment loss reversal that is taken into account in FSI with respect to section 168 property and is not included in covered book COGS depreciation. Covered book expense includes an amount other than covered book COGS depreciation and covered book depreciation expense that reduces FSI and is reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of section 168 property for regular tax purposes.

AFSI of a CAMT entity (i) would be increased by any tax depreciation section 481(a) adjustment that is positive, but only to the extent of the amount of such adjustment that is taken into account in computing taxable income for the taxable year, and (ii) would be increased or decreased, as appropriate, by any tax capitalization method change AFSI adjustment. The tax capitalization method change AFSI adjustment is determined as of the beginning of the tax year of change and equals the difference between (i) the cumulative amount of adjustments made to AFSI with respect to the cost(s) subject to the tax capitalization method change, and (ii) the cumulative amount of adjustments to AFSI that would have been made if the new method of accounting had been applied for those taxable years. As provided in the definition in proposed §1.56A-15(b)(11), the tax capitalization method change AFSI adjustments include only amounts with respect to taxable years beginning after December 31, 2019, because generally AFSI adjustments are not made for earlier periods. *See also* proposed §1.56A-1(d)(3). The IRS may publish IRB guidance that provides for other AFSI adjustments under section 56A(c)(13). *See* proposed §1.56A-15(d)(1).

These proposed regulations generally would follow the adjustments described in section 4.03 of Notice 2023-7, as modified by section 9.02(5) and (6) of Notice 2023-64, with certain modifications.

The proposed regulations also would include special rules for section 168 property held by partnerships under proposed §1.56A-15(d)(2). If section 168 property is held by a partnership, the adjustments provided in proposed §1.56A-15(d)(1) (excluding the covered book adjustments in proposed §1.56A-15(d)(1)(iii)) would include amounts resulting from any basis adjustment under section 734(b) attributable to section 168 property that is treated as an increase or decrease to tax depreciation or a tax depreciation section 481(a) adjustment for regular tax purposes. *See* proposed §1.56A-5(e)(3) for the manner in which the adjustments provided for in proposed §1.56A-15(d)(1) are taken into account by a partnership in computing modified FSI.

However, if section 168 property is held by a partnership, the adjustments provided in proposed §1.56A-15(d)(1) would not include amounts resulting from any basis adjustment under section 743(b) of the Code. Additionally, the adjustments provided in proposed §1.56A-15(d)(1) would not include any decreases in tax depreciation or income amounts for regular tax purposes resulting from any basis adjustment under §1.1017-1(g)(2) attributable to section 168 property held by a partnership (as calculated under §1.743-1(j)(4)(ii)). Instead, the adjustments provided in proposed §1.56A-15(d)(2)(ii) and (iv) for amounts resulting from basis adjustments under section 743(b) and §1.1017-1(g)(2) that would have been included in the adjustments provided in §1.56A-15(d)(1) would be separately stated to the partnership's CAMT entity partners for inclusion in their distributive amounts. *See* proposed §1.56A-5(e)(4) for the manner in which the adjustments provided for in proposed §1.56A-15(d)(2)(ii) and (iv) are taken into account by a CAMT entity partner.

Stakeholders also requested an adjustment to reduce AFSI for amounts of depreciation that are capitalized under section 263A during the taxable year, regardless of the period in which the capitalized amount is recovered, similar to the methodology under §1.163(j)-1(b)(1)(iii). This approach is inconsistent with section 56A(c)(13)'s directive to mimic the regular tax treatment of all section 168 property to the extent of the timing and amount of regular tax basis recovery with respect to the section 168 property, and therefore the application of section 56A(c)(13) should not provide the taxpayer with a better result for AFSI than for regular tax purposes. However, the Treasury Department and the IRS continue to study the viability of this and other simplifying safe harbors. In addition, the proposed regulations would include special rules to determine tax COGS depreciation and covered book COGS depreciation adjustments, as well as simplifying methods for FIFO and LIFO method taxpayers to determine depreciation in ending inventory for purposes of computing the tax COGS depreciation and covered COGS depreciation adjustments to AFSI. *See* proposed §1.56A-15(d)(3).

In addition, stakeholders requested guidance on potential adjustments to AFSI to account for a change in method of accounting made for regular tax purposes from deducting a cost as an expense to capitalizing and depreciating that cost under sections 167 and 168, and vice versa (proposed §1.56A-15(b)(10) would define this type of change in method of accounting as a tax capitalization method change). As a result of a tax capitalization method change, the cost at issue would be reclassified to or from section 168 property beginning with the taxable year the tax capitalization method change is effective (depending on the particular tax capitalization method change), and therefore the CAMT entity would be required to begin or cease making adjustments under section 56A(c)(13) beginning in that year of change. Accordingly, proposed §1.56A-15(d)(1)(vi) would require adjustments to AFSI to prevent any omission or duplication that would otherwise result from the CAMT entity being required to begin or cease making adjustments under section 56A(c)(13) as a result of a tax capitalization method change (proposed §1.56A-15(b)(11) would define these adjustments as the "tax capitalization method change AFSI adjustment"). For example, if a CAMT entity changes its method of accounting for regular tax purposes from capitalizing and depreciating a cost under sections 167 and 168 to deducting that cost as a repair under section 162, adjustments under section 56A(c)(13) would no longer be required beginning in the year of change as the cost would no longer constitute section 168 property and a tax capitalization method change AFSI adjustment would be made to adjust

the cumulative amount of AFSI as of the beginning of the year of change to reflect the cumulative amount of adjustments to AFSI that would have been made in prior years under the new method of accounting. Proposed §1.56A-15(d)(4) would provide that, in general, a negative tax capitalization method change AFSI adjustment reduces AFSI in the tax year of change by the full amount of the adjustment, and a positive tax capitalization method change AFSI adjustment increases AFSI ratably over four taxable years beginning with the tax year of change. For purposes of proposed §1.56A-15(d)(4), a short taxable year would be treated as if it were a full 12-month taxable year. If, in any taxable year, a CAMT entity ceases to engage in the trade or business to which the tax capitalization method change AFSI adjustment relates, proposed §1.56A-15(d)(4) would require the CAMT entity to include in its AFSI for such taxable year any portion of the adjustment not included in AFSI for a previous taxable year.

Examples in proposed §1.56A-15(d)(5) would illustrate the adjustments to AFSI that would be required by proposed §1.56A-15(d).

C. *Disposition of section 168 property*

1. *In General*

To prevent duplications or omissions of AFSI, proposed §1.56A-15(e)(1) generally would provide that, if a CAMT entity disposes of section 168 property for regular tax purposes, the CAMT entity must adjust AFSI for the year of the disposition to redetermine the gain or loss taken into account in the CAMT entity's FSI on the disposition by reference to the CAMT basis in the property (in lieu of the AFS basis). For this purpose, the CAMT basis in the property would be determined by adjusting the AFS basis in the property on the disposition date by the amounts described in proposed §1.56A-15(e)(2). Proposed §1.56A-15(e)(1) would clarify that, to the extent the CAMT basis of section 168 property is negative (for example, if regular tax basis exceeds AFS basis), such negative amount is recognized as AFSI gain upon disposition of the section 168 property. Proposed §1.56A-15(e)(7) would provide that, in the case of a disposition for regular tax purposes in an intercompany transaction defined in §1.1502-13(b)(1)(i), the timing of taking into account the AFSI adjustment under proposed §1.56A-15(e)(1) is deferred until the taxable year in which the FSI of the tax consolidated group includes the selling member's FSI gain or loss. The calculation of FSI of a tax consolidated group is further discussed in part XXXI.C of this Explanation of Provisions, and the treatment of tax items relating to intercompany transactions is further discussed in part XXXI.G of this Explanation of Provisions.

Proposed §1.56A-15(e)(2)(i) would provide that the CAMT basis of the section 168 property as of the disposition date is the AFS basis of the section 168 property as of that date: (i) decreased by the full amount of the tax depreciation with respect to such property (regardless of whether any amount of the tax depreciation was capitalized for regular tax purposes and not yet taken into account as a reduction to AFSI through an adjustment described in proposed §1.56A-15(d)(1)(i) or (ii) as tax COGS depreciation or deductible tax depreciation); (ii) increased by the amount of any covered book expense with respect to the property; (iii) increased by the amount of any covered book COGS depreciation and covered book depreciation expense that reduced the AFS basis of such property as of the date of disposition, including covered book COGS depreciation and covered book depreciation expense with respect to AFS basis that are otherwise disregarded for AFSI and CAMT basis purposes (for example, AFS basis increases that are disregarded for AFSI and CAMT basis purposes under proposed §1.56A-18 or 1.56A-19 (concerning corporate transactions)); (iv) decreased by any reductions to the CAMT basis of such property under proposed §1.56A-21(c)(4) and (5) (concerning CAMT attribute reductions for troubled companies); (v) decreased by any amount allowed as a credit against tax imposed by subtitle A with respect to such property, but only to the extent of the amount that reduces the tax basis of such property for regular tax purposes; and (vi) increased or decreased, as appropriate, by the amount of any adjustments to AFS basis that are disregarded for AFSI and CAMT basis purposes under other sections of the section 56A regulations with respect to such property (for example, AFS basis decreases that are disregarded for AFSI and CAMT basis purposes under §1.56A-8 and AFS basis adjustments that are disregarded for AFSI and CAMT basis purposes under §1.56A-18 or 1.56A-19).

These proposed regulations generally would follow the adjustments described in section 4.07 of Notice 2023-7, as modified by section 9.02(5) and (7) of Notice 2023-64, with certain modifications for Federal tax credits that reduce the basis of section 168 property for regular tax purposes. Proposed §1.56A-15(e)(2)(i)(E) would provide for an adjustment to decrease CAMT basis upon disposition by any amount allowed as a Federal tax credit to the extent of the amount that reduces the basis of section 168 property for regular tax purposes. Because Federal tax credits can offset an applicable corporation's CAMT liability under section 55(a), this adjustment would provide parity with the regular tax rules that generally apply a "no excess benefit" principle such that the adjusted basis of property is reduced, in whole or in part, if a Federal tax credit is determined with respect to such property. Accordingly, this adjustment would prevent an applicable corporation from obtaining an excess benefit for CAMT purposes upon disposition through a recovery of additional CAMT basis equal to the amount of the credit. This adjustment is also consistent with the implementation of section 56A(c)(13) in these proposed regulations by mimicking the regular tax treatment of all section 168 property to the extent of the timing and amount of regular tax basis recovery.

Proposed §1.56A-15(e)(2)(ii) and (e)(3) would provide special rules regarding adjustments to the AFS basis of section 168 property. Proposed §1.56A-15(e)(2)(ii)(A) would provide that, for section 168 property placed in service prior to the effective date of CAMT (that is, January 1, 2023), the adjustments in proposed §1.56A-15(e)(2)(i) include amounts attributable to all taxable years beginning before January 1, 2023. This would be consistent with the implementation of section 56A(c)(13) in these proposed regulations by mimicking the regular tax treatment of all section 168 property to the extent of the timing and

amount of regular tax basis recovery such that unrecovered pre-effective date AFS basis is not recovered upon disposition when regular tax basis recovery already occurred. In the case of section 168 property acquired in a transaction that is a covered recognition transaction, as defined in proposed §1.56A-18, with respect to at least one party to the transaction, or in a partnership transaction described in proposed §1.56A-20, proposed §1.56A-15(e)(2)(ii)(B) would provide that the adjustments in proposed §1.56A-15(e)(2)(i) include only amounts attributable to the period following the transaction. The adjustments in proposed §1.56A-15(e)(2)(i) are not required for the period prior to a covered recognition transaction or a partnership transaction described in proposed §1.56A-20 because gain or loss was included in AFSI at the time of the transaction (using CAMT basis in lieu of AFS basis). Accordingly, for a subsequent disposition of section 168 property after a covered recognition transaction or a partnership transaction described in proposed §1.56A-20, the adjustments in proposed §1.56A-15(e)(2)(i) that pre-date the transaction are not needed to determine the CAMT basis and redetermine gain or loss for purposes of adjusting AFSI for the subsequent disposition.

Proposed §1.56A-15(e)(2)(ii)(C), which contains a special rule for coordination with section 56A(c)(5), would provide that the adjustment for tax credits described in proposed §1.56A-15(e)(2)(i)(E) applies regardless of the treatment of the tax credit for AFS purposes. In addition, proposed §1.56A-15(e)(2)(ii)(D) would provide a rule for determining CAMT basis of section 168 property following a change in method of accounting for depreciation or a tax capitalization method change. Under the rule, adjustments under §1.56A-15(e)(2)(i) would be determined as though the CAMT entity used the method of accounting to which it changed under the corresponding method change when making the adjustments under §1.56A-15(d)(1) in all taxable years prior to the taxable year in which the disposition of the section 168 property occurs. This special rule would be needed to prevent income or deductions from being duplicated or omitted because of the accounting method change.

Proposed §1.56A-15(e)(2)(ii)(E) would provide that the adjustments described in proposed §1.56A-15(e)(2)(i)(B) (covered book expense) and (C) (covered book COGS depreciation and covered book depreciation expense) would include only the covered book expense, covered book COGS depreciation, and covered book depreciation expense amounts that were actually disregarded by the CAMT entity under proposed §1.56A-15(d)(1)(iii) in computing its AFSI, modified FSI, or adjusted net income or loss for the relevant taxable years. However, for a taxable year ending on or before December 31, 2019, or for a taxable year in which the CAMT entity satisfies the simplified method under proposed §1.59-2(g) (including a taxable year included in the relevant three-taxable-year period), the CAMT entity is deemed to have disregarded the appropriate amounts under proposed §1.56A-15(d)(1)(iii). This rule prevents a CAMT entity that did not disregard the appropriate amounts in prior years from receiving a double benefit on disposition given that the rules in proposed §1.56A-15(e)(2) otherwise would include these amounts in the CAMT basis of the section 168 property disposed of.

Proposed §1.56A-15(e)(3) would provide special rules for section 168 property disposed of by a partnership. If a partnership disposes of section 168 property, the partnership must adjust its modified FSI (described in proposed §1.56A-5(e)(3)) for the taxable year in which the disposition occurs to redetermine any gain or loss taken into account in the partnership's FSI by reference to the CAMT basis (in lieu of the AFS basis) of the section 168 property. For purposes of this calculation, adjustments to a partnership's AFS basis of section 168 property disposed of by the partnership include any tax depreciation (including any reduction in tax depreciation) relating to a section 734(b) basis adjustment. Accordingly, tax depreciation relating to a section 734(b) basis adjustment would be required in all cases to be recaptured upon a disposition of the section 168 property by a partnership unless a corresponding adjustment was made to the AFS basis of the property as a result of the transaction that gave rise to the section 734(b) basis adjustment.

Adjustments to a partnership's AFS basis of section 168 property disposed of by a partnership do not include any tax depreciation (including any reduction in tax depreciation) or adjustments to the partnership's AFS basis in the section 168 property with respect to a basis adjustment under §1.1017-1(g)(2). However, if a partner in the partnership is subject to the attribute reduction rules under proposed §1.56A-21(c)(4) and (5) for discharge of indebtedness income realized through the partnership, the partner must increase its distributive share amount (under proposed §1.56A-5(e)(4)(ii)(A)) for the taxable year of the disposition of the section 168 property by the amount of any remaining basis adjustment under §1.1017-1(g)(2) with respect to the section 168 property that has not yet been taken into account for regular tax purposes. *See* §1.1017-1(g)(2)(v) and proposed §1.56A-5(e)(4)(ii)(A).

Adjustments to a partnership's AFS basis of section 168 property disposed of by a partnership also do not include any tax depreciation (including any reduction in tax depreciation) or adjustments to the partnership's AFS basis in the section 168 property with respect to a basis adjustment under section 743(b). However, if a partner in the partnership has a section 743(b) adjustment with respect to section 168 property held by the partnership that is disposed of by the partnership for regular tax purposes, the partner must increase its distributive share amount (under proposed §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the section 168 property by an amount equal to the total amount of any tax depreciation or tax depreciation section 481(a) adjustments (including negative amounts) with respect to a section 743(b) basis adjustment that decreased the partner's distributive share amount under proposed §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition. Likewise, the partner must decrease its distributive share amount (under proposed §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the section 168 property by an amount equal to the total amount of any tax depreciation or tax depreciation section 481(a) adjustments with respect to a section 743(b) basis adjustment that increased the partner's distributive share amount under proposed §1.56A-5(e)(1)

(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition. Thus, tax depreciation or tax depreciation section 481(a) adjustments relating to a section 743(b) basis adjustment that adjusted a partner's distributive share amount would be required in all cases to be recaptured by the partner upon a disposition of the section 168 property by the partnership.

Section 56A(a) provides that the term "AFSI" means, for any corporation for any taxable year, the net income or loss of the taxpayer set forth on its AFS for the taxable year, adjusted as provided in section 56A. Section 56A(c)(13) does not expressly include an adjustment to AFSI to apply nonrecognition or gain deferral provisions that apply to certain dispositions of section 168 property for regular tax purposes. However, under the authority granted by section 56A(c)(15), the Secretary may provide for such an adjustment in certain situations (for example, *see* proposed §§1.56A-18 and 1.56A-19, which would provide for an adjustment to AFSI if section 168 property is disposed of in a covered nonrecognition transaction).

Accordingly, proposed §1.56A-15(e)(4) would provide that except as otherwise provided in other sections of the section 56A regulations, the nonrecognition and gain deferral rules of the Code would not apply when a CAMT entity recognizes gain or loss from the disposition of section 168 property in its FSI, regardless of whether or when any gain or loss on the disposition is taken into account for regular tax purposes. These rules would be consistent with sections 9.02 and 9.03 of Notice 2023-64 and with section 56A(c)(13)'s directive to mimic the regular tax treatment of all section 168 property to the extent of the timing and amount of regular tax basis recovery, which does not extend to the timing and amount of disposition proceeds received upon the disposition of section 168 property that are taken into account in determining gain or loss in FSI (unless otherwise provided in other sections of the section 56A regulations).

Proposed §1.56A-15(e)(6) also follows the principle applied in interpreting section 56A(c)(13) by providing a special rule that, if section 168 property is disposed of for regular tax purposes before it is treated as disposed of for AFS purposes, the CAMT entity continues to make AFSI adjustments under proposed §1.56A-15(d)(1)(iii) to disregard any AFS basis recovery that is reflected in FSI following the disposition of the section 168 property for regular tax purposes. Finally, proposed §1.56A-15(e)(5) would provide that the unit of property determination under §1.263(a)-3(e) does not apply for purposes of determining the appropriate asset to ascertain whether section 168 property has been disposed of. Instead, CAMT entities would be required to follow section 168 and the regulations under section 168. *See* §1.168(i)-8(c)(4).

Proposed §1.56A-15(e)(8) would provide examples to illustrate these rules.

XVI. *Proposed §1.56A-16: AFSI Adjustments for Qualified Wireless Spectrum*

Pursuant to the authority granted by section 56A(c)(14)(A)(ii)(II), (c)(15), and (e), proposed §1.56A-16 would provide rules under section 56A(c)(14) regarding qualified wireless spectrum. The principles of interpretation and rules applied would be consistent with the principles and rules for section 168 property discussed in part XV of this Explanation of Provisions, except for certain rules that are not applicable to qualified wireless spectrum (for example, the definition of section 168 property and the rules for tax depreciation that is capitalized under section 263A to inventory or to the basis of property under section 1221(a)(1) that is not inventory). Therefore, section 56A(c)(14) would be interpreted to mimic the regular tax treatment of all qualified wireless spectrum to the extent of the timing and amount of regular tax basis recovery with respect to the qualified wireless spectrum, regardless of when placed in service and regardless of whether gain or loss with respect to qualified wireless spectrum is recognized in FSI.

The definitions, rules for adjusting AFSI for amortization and other amounts with respect to qualified wireless spectrum, and rules upon disposition of qualified wireless spectrum are therefore not discussed. Instead, only rules or definitions within proposed §1.56A-16 that differ or are unique from the section 168 property rules (that is, the definition of qualified wireless spectrum) are discussed in this section. Proposed §1.56A-16(c)(1) would define "qualified wireless spectrum" as wireless spectrum that: (i) is used in the trade or business of a wireless telecommunications carrier; (ii) is an amortizable section 197 intangible under section 197(c)(1) and (d)(1)(D); and (iii) was acquired after December 31, 2007, and before August 16, 2022. This definition would be consistent with the definition in section 10.02(4) of Notice 2023-64.

XVII. *Proposed §1.56A-17: AFSI Adjustments to Prevent Certain Duplications and Omissions*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-17 would provide rules under section 56A(c)(15) to prevent certain duplications and omissions.

A. *Only specified adjustments to AFSI are allowed*

Section 56A(c)(15)(A) authorizes the Secretary to issue regulations or other guidance to provide for adjustments to AFSI that the Secretary determines necessary to carry out the purposes of section 56A, including adjustments to prevent the duplication or omission of any item. Consistent with Notice 2023-64 and proposed §1.56A-1(d)(2), proposed §1.56A-17(b) would provide that, to prevent duplications or omissions of items of income, expense, gain or loss, AFSI is adjusted for those items identified in proposed §1.56A-17(c) through (e) and any other items identified in the section 56A regulations. Accordingly, CAMT entities would not be allowed to self-identify items they believe to be duplications or omissions and make AFSI adjustments for such items. The Treasury Department and the IRS request comments on whether additional adjustments are necessary to prevent duplications or omissions of items under section 56A.

B. *Adjustment for changes in accounting principles*

New accounting standards commonly are implemented retrospectively through an adjustment to the beginning balance of a CAMT entity's retained earnings in the

AFS for the year in which the new standards are implemented, which may result in a duplication of AFSI or an omission from AFSI. For example, a duplication would arise if a new accounting standard were to recognize income or expense in a later year than the prior standard (as that amount would be taken into account in FSI under both the prior standard and the new standard, thus necessitating an offsetting adjustment to retained earnings). Conversely, an omission would arise if the new standard were to recognize income or expense in a prior year whereas the old standard would have recognized such amount in a future year (as that amount would not be taken into account in FSI under either standard, thus necessitating an adjustment to retained earnings to account for the economic effect of that amount in the financial statements).

To prevent these duplications or omissions, and consistent with Notice 2023-64, proposed §1.56A-17(c)(1) generally would require a CAMT entity to adjust its AFSI by the "accounting principle change amount," as described in proposed §1.56A-17(c)(2)(i), if the CAMT entity implements a change in accounting principle in its AFS. Under proposed §1.56A-17(c)(2)(i), the accounting principle change amount would be equal to the net cumulative adjustment to the CAMT entity's beginning retained earnings resulting from the change in accounting principle. The accounting principle change amount would also be subject to further adjustment if any portion of the amount relates to any FSI items to which other AFSI adjustments apply, such as taxes under section 56A(c)(5) and proposed §1.56A-8, and to disregard any portion of the cumulative adjustment attributable to taxable years beginning on or before December 31, 2019.

Proposed §1.56A-17(c)(2)(ii) also provides rules for determining the accounting principle change amount when a CAMT entity is treated as having a change in accounting principle under proposed §1.56A-1(c)(5) because the priority of the CAMT entity's AFS for the taxable year (as determined under proposed §1.56A-2(c)) is different from the priority of the CAMT entity's AFS for the immediately preceding taxable year. In such a case, the accounting principle change amount would be equal to the difference between the CAMT entity's beginning retained earnings reflected on the current AFS as of the beginning of the taxable year and the ending retained earnings reflected on the former AFS as of the end of the immediately preceding taxable year. The accounting principle change amount would also be subject to further adjustment if any portion of the amount relates to any FSI items to which other AFSI adjustments apply, such as taxes under section 56A(c)(5) and proposed §1.56A-8, and to disregard any portion of the cumulative adjustment attributable to taxable years beginning on or before December 31, 2019.

Proposed §1.56-17(c)(3) would provide rules consistent with Notice 2023-64 for spreading accounting principle change amounts across multiple taxable years. Different spread period rules would apply depending on whether a net adjustment to AFSI prevents the duplication or prevents the omission of an amount. Because the same accounting principle change amount could prevent a duplication of an item and prevent the omission of another item, proposed §1.56-17(c)(3) would require a CAMT entity to determine the appropriate spread period rules based on whether the accounting principle change amount prevents a net duplication or a net omission due to the accounting principle change.

Proposed §1.56A-17(c)(3)(i)(A) generally would provide that, if an accounting principle change adjustment prevents a net duplication for AFSI purposes, the adjustment must be taken into account in the CAMT entity's AFSI ratably over four taxable years, beginning with the taxable year the change in accounting principle is implemented in the CAMT entity's AFS. However, stakeholders have observed that duplicated items could be taken into account in FSI over a shorter or longer period of time. Moreover, a distortion could occur if the duplicated items were significant and taken into account in FSI over a different period than the corresponding AFSI adjustment. A spread period other than four years may be appropriate to prevent such distortions but have abuse and administrability concerns associated with allowing excessively long spread periods. Accordingly, proposed §1.56A-17(c)(3)(i)(B) would provide that the spread period is capped at 15 years, which should be sufficient to prevent undue distortions. If a CAMT entity can demonstrate that a net duplication is reasonably anticipated to be taken into account in FSI over a period other than 4 years, proposed §1.56A-17(c)(3)(i)(B) would allow such CAMT entity to take the AFSI adjustment into account ratably over a spread period, not to exceed 15 years, that matches the period that the net duplication is taken into account in the AFS under the new accounting principle (regardless of whether the duplicated amount is taken into account ratably over that period). The Treasury Department and the IRS request comments about whether a spread period greater than 15 years is necessary for an accounting principle change amount that prevents duplication.

In contrast, if an adjustment prevents a net omission for AFSI purposes, proposed §1.56A-17(c)(3)(ii) would require (i) adjustments that result in an increase to AFSI to be taken into account in AFSI ratably over four taxable years, beginning with the taxable year that the change in accounting principle is implemented in the CAMT entity's AFS, and (ii) adjustments that result in a decrease to AFSI to be taken into account in AFSI in full in the taxable year the change in accounting principle is implemented in the CAMT entity's AFS. Unlike items that were duplicated in AFSI, items that would be omitted from AFSI (but for the accounting principle change adjustment) already would have been taken into account in FSI under the new accounting principle. Accordingly, there is no need to defer any portion of the AFSI adjustment to future taxable years in order to match its timing with the related FSI items, as the omitted item would have already been taken into account in FSI in a prior period under the new accounting principle. Nonetheless, the spread period rules for amounts omitted from AFSI would follow the spread period rules used for section 481(a) adjustments for regular tax purposes, consistent with the description immediately preceding.

Proposed §1.56A-17(c)(4) would provide, consistent with Notice 2023-64, that any portion of an accounting principle change amount not included in AFSI for a previous taxable year must be taken into account in AFSI in the taxable year the CAMT entity ceases to engage in the trade or business that is the subject of

the change in accounting principle. The Treasury Department and the IRS request comments on proposed §1.56A-17(c)(4) and whether and to what extent the rules and concepts provided in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, that accelerate the recognition of a section 481(a) adjustment in certain circumstances should apply to accelerate the recognition of an accounting principle change amount (without suggesting that an accounting principle change is inherently also a tax accounting method change).

C. *Adjustment for restatement of a prior year's AFS*

Proposed §1.56A-2(e) would provide rules for the restatement of FSI for a taxable year on a CAMT entity's restated AFS (restatement) issued prior to the date that the CAMT entity files its original Federal income tax return for such taxable year. Proposed §1.56A-17(d) would provide rules for a restated AFS issued on or after the date that the CAMT entity files its original Federal income tax return. Consistent with Notice 2023-64, proposed §1.56A-17(d)(1) generally would require the CAMT entity to adjust its AFSI to account for the restatement (AFSI restatement adjustment). Unlike Notice 2023-64, which required the adjustment to be taken into account in the first taxable year for which the CAMT entity had not filed an original return as of the restatement date, proposed §1.56A-17(d)(1)(i) would require that the adjustment be made for the taxable year during which the restated AFS is issued. This change was made because of a concern that the rule in Notice 2023-64 might not provide CAMT entities with enough time to take into account the restatement if it were issued shortly before the next due date for filing an original return. Providing an adjustment for the taxable year during which the restated AFS is issued is intended to minimize the instances in which a CAMT entity would file an amended return or an administrative adjustment request (AAR) under section 6227 of the Code as a result of a restatement. However, proposed §1.56A-17(d)(2) would require a CAMT entity that has a restatement, and that files an amended return or AAR to adjust taxable income as a result of the restatement, to use the restated AFS to determine AFSI on the amended return or AAR instead of making the AFSI restatement adjustment.

The AFSI restatement adjustment would be equal to the cumulative effect of the restatement on the CAMT entity's FSI for the restatement year, including any restatement of the CAMT entity's beginning retained earnings. The AFSI restatement adjustment would also be subject to further adjustment if any portion of the amount relates to any FSI items to which other AFSI adjustments apply, such as taxes under section 56A(c)(5) and proposed §1.56A-8, and to disregard any portion of the cumulative adjustment attributable to taxable years beginning on or before December 31, 2019. A spread period for the adjustment, as in the case of an adjustment for a change in accounting principle, was not considered appropriate in the case of restatements, which are corrections in the application of such principles.

Proposed §1.56A-17(d)(3) would provide that a CAMT entity is treated as if it restated its AFS for the preceding taxable year, and subject to the AFSI restatement adjustment rules discussed previously, if (i) a CAMT entity adjusts the beginning balance of retained earnings on its AFS for the current taxable year to be different from the ending balance of retained earnings on its AFS for the preceding taxable year without restating the AFS (for example, as the result of a prior period adjustment), (ii) the difference is attributable to items that otherwise would be reflected in the CAMT entity's FSI under the relevant accounting standards used to prepare the CAMT entity's AFS, and (iii) the CAMT entity is not otherwise subject to §1.56A-17(c), (d)(1) or (2).

D. *Adjustment for amounts disclosed in an auditor's opinion*

Auditors' opinions that are described in proposed §1.56A-2(d)(2) (a qualified or modified "except for" opinion) or (d)(3) (an adverse opinion in which the auditor discloses the amount of the disagreement) identify situations in which a CAMT entity's accounting treatment of an item diverges from the relevant accounting standard. Consistent with Notice 2023-64, proposed §1.56A-17(e) would require AFSI to be adjusted to take into account amounts disclosed in such a qualified or adverse auditor's opinion if those amounts would have increased the CAMT entity's FSI had the amounts been reported in the CAMT entity's AFS. However, no AFS adjustment would be required if the disclosed amount were already included in FSI for a prior year. If FSI for a subsequent year includes amounts included in AFSI due to an adjustment under proposed §1.56A-17(e), AFSI for the subsequent year is adjusted to prevent any duplication of income. These proposed rules would follow the rules for such adjustments in the 1990 Regulations.

E. *No adjustment for timing differences*

Stakeholders requested an adjustment to prevent perceived distortions caused by timing differences, particularly in situations in which items are included in FSI before the effective date of the CAMT but included in taxable income thereafter, or vice versa. These timing differences do not create a duplication or omission of AFSI within the meaning of section 56A(c)(15) of the Code and are precisely the types of financial accounting and taxable income differences that the CAMT was intended to capture. Although proposed §1.56A-17(b) prevents such adjustments, for the avoidance of doubt and consistent with Notice 2023-64, proposed §1.56A-17(f) would not permit any adjustment to account for differences between the period an item is taken into account in FSI and the period it is taken into account for regular tax purposes. This proposed regulation would adopt the approach taken in the 1990 Regulations, which was upheld in *CSX Corp. v. United States*, 124 F.3d 643 (4th Cir. 1997).

XVIII. *Proposed §§1.56A-18 and 1.56A-19: AFSI, CAMT Basis, and CAMT Retained Earnings Resulting from Certain Corporate Transactions Involving Domestic Corporations*

Pursuant to authority granted by section 56A(c)(2)(C), (c)(15), and (e), proposed §1.56A-18 would provide rules regarding investments in domestic corporations that are not members of the CAMT entity's tax consolidated group. Pursuant

to authority granted by sections 56A(c)(15) and 56A(e), proposed §§1.56A-18 and 1.56A-19 also would provide rules under section 56A regarding transactions involving domestic corporations. The rules in proposed §§1.56A-18 and 1.56A-19 would not apply to investments in stock in foreign corporations and transactions involving foreign corporations described in proposed §1.56A-4.

A. *Overview*

1. *Equity Investments in Domestic Corporations that are not Members of the Shareholder's Tax Consolidated Group*

Section 56A(c)(2)(C) provides, in part, that a taxpayer's AFSI with respect to a corporation that is not a member of the taxpayer's tax consolidated group only takes into account dividends received from that corporation (reduced to the extent provided by the Secretary) and other amounts that are includible in gross income or deductible as a loss under chapter 1 (other than amounts provided by the Secretary) with respect to that corporation.

The financial accounting consequences of an investment in a domestic corporation differ considerably from the Federal income tax consequences of such an investment. Under the Code, a shareholder generally has income or deductions upon the occurrence of a realization event with respect to the shareholder's stock (typically, a distribution from the corporation or an exchange of the stock). The Code specifies the shareholder's tax consequences when such an event occurs, including capital gain or loss, dividend income, a dividends received deduction, or some other result.

In contrast, financial statement income often includes gain or loss with respect to stock even if there has been no realization event for Federal income tax purposes. For example, financial statement income may include unrealized appreciation or depreciation in stock prices, a proportionate share of the corporation's income or loss, or loss from impairment.

2. *Subchapter C Transactions*

Section 56A(c)(15) authorizes the Secretary to issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes of section 56A, including adjustments to carry out the principles of part II of subchapter C (relating to corporate liquidations) and part III of subchapter C (relating to corporate organizations and reorganizations) of chapter 1. *See* section 56A(c)(15)(B).

For Federal income tax purposes, a taxpayer generally recognizes gain or loss on the exchange of property if the property received differs in material kind or extent from the property exchanged. The purpose of the corporate liquidation, organization, and reorganization provisions in parts II and III of subchapter C is to provide nonrecognition treatment for certain specifically described distributions or exchanges incident to certain readjustments of corporate structures made in one of the particular ways specified in the Code that are required by business exigencies and that effect only a readjustment of a continuing interest in property in modified corporate form. *See*, for example, §1.368-1(b).

Parties to nonrecognition transactions under subchapter C generally take the acquired assets with a carryover basis (that is, the assets' basis in the hands of the party from whom the assets were acquired) and take the qualifying property (that is, property that is permitted to be received under section 354 or 355 without the recognition of gain or loss) received in the transaction with an exchanged basis (that is, the basis in the property exchanged for qualifying property). If the assets being transferred include stock of another corporation, the basis in the assets of that other corporation generally is not affected by the transaction.

Business combinations and dispositions are treated differently under financial accounting principles than under Federal income tax principles. Under financial accounting principles, acquisitions of entities or lines of business generally are recorded on the AFS at fair value, with the acquiring corporation (acquiror) valuing the assets and liabilities of the acquired entity or line of business at their fair value as of the acquisition date (that is, purchase accounting). *See*, for example, ASC 805-20-25-1. Additionally, an acquired CAMT entity may elect to adjust the carrying value of its assets and liabilities and the assets and liabilities of any lower-tier entities to fair value as of the date the entity is acquired (that is, push-down accounting). *See*, for example, ASC 805-20-25-4. In contrast, Federal income tax principles generally preclude adjustments to the basis in the assets of acquired corporations, whether or not gain or loss was recognized in the transaction.

Additionally, although entities generally have separate books and records for financial accounting purposes, financial consolidation generally eliminates the effects of multiple tiers of ownership and disregards the ownership of stock of lower-tier entities as such. Instead, financial consolidation looks through separate legal entities in order to present the financial results as if all of the items of income, expense, gain, and loss of the members of the financial consolidation were the items of a single corporation. In contrast, domestic corporations that are not members of a tax consolidated group generally are treated as separate entities for Federal income tax purposes.

Certain non-pro rata distributions also result in financial accounting gain or loss (*see* ASC 845-10-30-12), regardless of whether such transactions would be eligible for nonrecognition treatment under subchapter C.

B. *Section 3 of Notice 2023-7*

Section 3 of Notice 2023-7 provides guidance under section 56A(c)(15) by describing adjustments to carry out the principles underlying the corporate liquidation, organization, and reorganization provisions of subchapter C. Section 2.01(3)(a) of Notice 2023-7 provides that the financial accounting treatment of corporate transactions controls the determination of AFSI resulting from a transaction unless the treatment is modified as described in Notice 2023-7. For example, under Notice 2023-7, the treatment of a disposition of property that results in gain or loss for Federal income tax purposes (that is, a covered recognition transaction) would be governed by financial accounting principles. As a result, the acquired entities or lines of business generally would be recorded on the AFS at fair value.

However, section 3.03 of Notice 2023-7 further provides, in part, that if a transaction results in no gain or loss for Federal income tax purposes to the party to a transaction under sections 332, 337, 351, 354, 355, 357, 361, 368, or 1032 of the Code (that is, a covered nonrecognition transaction), (i) the party does not take into account the financial accounting gain or loss resulting from the transaction to compute its AFSI, and (ii) to the extent the party does not take into account AFSI resulting from the transaction under Notice 2023-7, any increase or decrease in the financial accounting basis of the assets transferred to the party in the transaction is not taken into account to compute that party's AFSI. In determining whether a transaction is a covered nonrecognition transaction, section 3.02(5)(b) of Notice 2023-7 provides that each component transaction of a larger transaction is evaluated separately.

C. *Proposed regulations*

1. *In General*

Section 56A(a) generally requires AFSI to be determined based on the taxpayer's AFS unless an adjustment provided in section 56A applies. Accordingly, except as otherwise provided in the section 56A regulations, the section 56A regulations generally implement the CAMT by following financial accounting principles. For example, *see* proposed §1.56A-1(d)(1) (generally providing that Federal income tax treatment is not relevant for determining a CAMT entity's AFSI except as otherwise provided in the section 56A regulations).

a. *Section 56A(c)(2)(C) and investments in domestic corporations*

Section 56A(c)(2)(C) constitutes an exception to the general rule in section 56A(a) concerning the determination of AFSI by a CAMT entity with respect to a corporation that is not included on a tax consolidated return with the CAMT entity. In the context of a CAMT entity that is a shareholder in a domestic corporation, section 56A(c)(2)(C) is implemented by providing that, if a CAMT entity's role in a transaction is purely as a shareholder of a domestic corporation (and not as a party to the transaction), regular tax rules govern the CAMT entity's determination of its AFSI, using CAMT inputs (such as CAMT earnings and CAMT basis) where applicable. In other words, in the context of a CAMT entity that is a shareholder in a domestic corporation, section 56A(c)(2)(C) should apply with respect to situations in which the CAMT entity holds stock in the domestic corporation. Such situations include, for example, dividend distributions (*see* section 301), redemptions (*see* sections 302 and 303 of the Code), stock distributions (*see* section 305 of the Code), or certain distributions and exchanges as part of a corporate reorganization (*see* sections 354 through 356 of the Code)). In contrast, taking into account the structure of the statute and the grant of regulatory authority in section 56A(c)(15)(B), section 56A(c)(2)(C) generally should not apply if the CAMT entity is a party to a transaction involving the stock of the domestic corporation (such as a section 351 exchange, a disposition or acquisition of stock, or a transfer of property by a distributing corporation to a controlled corporation in a transaction to which sections 355 and 368(a)(1)(D) apply). Proposed §1.56A-18(c) would provide guidance regarding investments in domestic corporations that are not members of the CAMT entity's tax consolidated group.

In the case of a domestic corporation that is not included in a CAMT entity's tax consolidated group, section 56A(c)(2)(C) is implemented to mean that it applies solely to transactions with respect to holding the corporation's stock (and not to transactions to which the CAMT entity is a party), for several reasons. First, this approach would give effect to the statutory exception in section 56A(c)(2)(C) with due regard for the broad statutory requirement in section 56A(a) that a corporate CAMT entity's AFSI must be determined starting with financial accounting net income or loss. Second, construing section 56A(c)(2)(C) so broadly as to result in the general application of regular tax rules to all transactions involving corporations that are not members of the same tax consolidated group is inconsistent with Congress's grant of authority to the Secretary in section 56A(c)(15)(B) to incorporate the principles of parts II and III of subchapter C.

While this approach is an appropriate implementation of section 56A(c)(2)(C) in the context of investments in domestic corporations, additional considerations are present in the case of investments in foreign corporations that call for a different application of section 56A(c)(2)(C) in that context (for instance, the interaction of section 56A(c)(2)(C) and (c)(3), which raises unique double-counting issues with respect to distributions by CFCs and transfers of stock of CFCs). *See* the discussion of the application of section 56A(c)(2)(C) with respect to investments in foreign corporations in part IV.A of this Explanation of Provisions.

b. *Section 56A(c)(15)(B) and certain transactions involving domestic corporations*

Proposed §§1.56A-18 and 1.56A-19 would clarify and expand the guidance in Notice 2023-7 concerning covered recognition transactions and covered nonrecognition transactions (collectively, covered transactions). Under proposed §§1.56A-18 and 1.56A-19, a CAMT entity would use financial accounting rules to determine its AFSI resulting from a corporate transaction unless the entity qualifies for an exception under proposed §1.56A-18 or 1.56A-19. *See* proposed §1.56A-18(c)(2)(ii)(A). This rule reflects, and would be consistent with, the general rule in section 56A(a). The rules for covered transactions described in this part XVIII of the Explanation of Provisions do not apply to determine the CAMT consequences of either a corporate transaction involving domestic corporations that are members of the same tax consolidated group while those corporations remain members of the group or a corporate transaction involving a foreign corporation described in proposed §1.56A-4. For ease of discussion, the remainder of this part XVIII of the Explanation of Provisions does not repeat these exclusions when discussing the rules for covered transactions.

More specifically, under proposed §§1.56A-18 and 1.56A-19, the CAMT consequences of corporate transactions would be determined under financial accounting principles (using CAMT inputs, such as CAMT retained earnings) unless the CAMT entity qualifies solely

for nonrecognition treatment under the relevant Code section. In other words, if a transaction results in the recognition of any amount of gain or loss for regular tax purposes with regard to that CAMT entity (the so-called "cliff effect"), the CAMT entity would apply the relevant financial accounting principles (and not the applicable section of the Code) to the covered recognition transaction. *See* the definition of a "covered recognition transaction" in proposed §1.56A-18(b)(10).

In contrast, if the CAMT entity qualifies solely for nonrecognition treatment with respect to a transaction, the CAMT entity would determine its AFSI from the transaction by applying regular tax rules with CAMT inputs. Accordingly, the transaction would result in a deferral of AFSI to the CAMT entity, but a stepped-up basis in the assets transferred in the transaction would be prohibited to ensure that such AFSI could be recognized in the future. *See* the definition of a "covered nonrecognition transaction" in proposed §1.56A-18(b)(9).

The proposed approach to covered transactions is based upon the following principles. First, the grant of authority in section 56A(c)(15)(B) to provide for such adjustments as the Secretary determines necessary to carry out the principles of parts II and III of subchapter C is an exception to the general rule requiring a CAMT entity's AFSI to be computed based on financial accounting principles. However, section 56A(c)(15)(B) does not refer to, or consequently require, the wholesale importation of Federal income tax rules from, or tax items computed under, parts II and III of subchapter C. In contrast, *see* section 56A(c)(13)(A), which expressly requires AFSI to be reduced by depreciation deductions allowed under section 167 with respect to section 168 property to the extent of the amount allowed as deductions in computing taxable income for the taxable year. In the case of covered transactions, the Treasury Department and the IRS are of the view that wholly replacing financial accounting principles with the subchapter C rules is not "necessary to carry out the purposes of" section 56A. *See* section 56A(c)(15).

Second, the proposed approach reflects the long-standing principle of parts II and III of subchapter C that a taxpayer should not recognize gain or loss on its investment unless it "cashes out" its investment. *See* section 202 of the Revenue Act of 1918 (1918); *see also* the discussion in part XVIII.A.2 of this Explanation of Provisions. Accordingly, the proposed approach distinguishes between transactions in which the CAMT entity has wholly retained its investment (that is, covered nonrecognition transactions) and transactions in which the CAMT entity has not (that is, covered recognition transactions).

The Treasury Department and the IRS considered several alternatives to the proposed "cliff effect" approach with respect to covered transactions. Under one alternative, the regular tax rules of parts II and III of subchapter C would be incorporated wholesale, using CAMT inputs (such as CAMT basis) in lieu of regular tax inputs. However, as noted previously, section 56A(c)(15)(B) does not compel the wholesale importation of the regular tax rules of parts II and III of subchapter C with respect to covered transactions. Additionally, this alternative approach would not adequately implement section 56A(a), which generally requires the use of financial accounting net income or loss.

Under another alternative, financial accounting principles would be incorporated in proportion to the amount of "boot" (that is, money or property received in a corporate transaction other than stock and securities permitted to be received without the recognition of gain or loss under the applicable Code section(s)) in a transaction that otherwise qualifies for nonrecognition treatment to the CAMT entity. However, such a "proportionate" approach would be inappropriate because many aspects of the financial accounting treatment of corporate transactions are not easily proportioned. For example, under GAAP, a corporate transaction may be recharacterized to reverse the identity of the acquiror and the target corporation, or the direction of a spin-off may be reversed such that the parent corporation is the one whose stock is treated as distributed for GAAP purposes. These types of characterizations are binary in effect (that is, they are either applied or not applied).

Proposed §1.56A-18(b) and (c) would provide definitions and operating rules, respectively, for purposes of proposed §§1.56A-18 and 1.56A-19. Proposed §§1.56-18(d) through (h) and 1.56A-19 would provide rules to determine the CAMT consequences of various types of covered transactions.

2. *Equity Ownership in Domestic Corporations that are Not Members of the Shareholder's Tax Consolidated Group*

a. *In general*

As discussed in part XVIII.C.1.a of this Explanation of Provisions, section 56A(c)(2)(C) conforms the treatment of investments in the stock of domestic corporations for purposes of section 56A to Federal income tax principles during the period in which the shareholder holds the stock. Accordingly, proposed §1.56A-18(c)(2) would provide that, in computing AFSI, CAMT entities disregard any FSI resulting from equity ownership of domestic corporations that are not members of the CAMT entity's tax consolidated group, except with respect to amounts that result from a transaction described in proposed §1.56A-18 or 1.56A-19. For example, a shareholder CAMT entity would disregard FSI that otherwise would result from applying the equity method or the fair value method to the CAMT entity's investment in stock of the subsidiary domestic corporation. Instead, CAMT entities would be required to follow Federal income tax principles to determine AFSI resulting from equity ownership of subsidiary domestic corporations.

Proposed §1.56A-18(c)(2) also would provide that a CAMT entity disregards any adjustments to carrying values or retained earnings on the CAMT entity's AFS, and instead adjusts CAMT basis in the stock and adjusts CAMT retained earnings as provided in proposed §1.56A-18 or 1.56A-19. In other words, CAMT entities would adjust the CAMT basis in stock when required by the applicable provision of the Code, and CAMT entities would adjust the CAMT retained earnings based on AFSI. *Compare* part IV of this Explanation of Provisions, describing AFSI adjustments and basis determinations with respect to foreign corporations.

b. *Alternative approach considered*

The Treasury Department and the IRS considered an alternative approach under which Federal income tax principles would determine *whether* there is an inclusion in AFSI for purposes of section 56A(c)(2)(C) (as in proposed §§1.56A-18 and 1.56A-19), but financial accounting principles would determine the amount of the inclusion (that is, unadjusted financial accounting carrying values would be used in AFSI computations). However, because of the significant differences in timing and amount of inclusions for Federal income tax and financial accounting purposes, such an approach would risk the omission or duplication of items of income, deduction, gain, and loss.

The Treasury Department and the IRS request comments on whether additional guidance is needed under proposed §§1.56A-18 and 1.56A-19 for shareholders in corporations that appear on the same consolidated AFS as the shareholder but that do not file a consolidated Federal income tax return with the shareholder.

3. *Purchase Accounting and Push-Down Accounting*

The proposed regulations would provide that purchase accounting and push-down accounting adjustments are disregarded in computing any aspect of AFSI resulting from covered transactions that are stock acquisitions, including for purposes of determining the acquiror corporation's CAMT basis and CAMT earnings. *See* proposed §1.56A-18(c)(3). In other words, the proposed regulations would treat stock in lower-tier corporations as an asset, and covered nonrecognition transactions generally would not affect the inside basis of a lower-tier corporation's assets. *See* proposed §1.56A-18(c)(1) and (c)(4)(ii). Respecting tiers of stock ownership and eliminating purchase accounting and push-down accounting (and thereby preserving two-levels of tax—one at the corporate level, and another at the shareholder level) is consistent with the principles of parts II and III of subchapter C.

4. *CAMT Basis in Domestic Stock*

Proposed §1.56A-18(c)(6) would provide that a CAMT entity's CAMT basis in domestic corporate stock is equal to the CAMT entity's adjusted basis in the stock for regular tax purposes as of the first day of the CAMT entity's first taxable year beginning after December 31, 2019, adjusted as required by proposed §1.56A-18 or 1.56A-19, rather than the carrying value of the stock on the CAMT entity's AFS on that day. Because the carrying value of the stock reflects adjustments under financial accounting principles that do not require a realization event, adopting the carrying value as the CAMT basis may lead to the duplication or omission of income with respect to domestic corporate stock. Additionally, the Treasury Department and the IRS understand that the carrying value of stock is not always maintained for financial accounting purposes because it is not relevant for the preparation of the AFS (for example, if the shareholder and the corporation appear on the same consolidated AFS).

5. *Covered Transactions*

a. *Overview*

As discussed in part XVIII.C.1 of this Explanation of Provisions, the proposed regulations would provide that financial accounting treatment governs the computation of a domestic corporation's AFSI with respect to a covered transaction, but that the AFSI computation is modified if the covered transaction qualifies as a covered nonrecognition transaction. This proposed approach would be consistent with Notice 2023-7. Additionally, in certain cases, the proposed regulations would provide modified rules for computing AFSI from covered recognition transactions.

Under Notice 2023-7, the determination of whether a transaction qualifies as a covered nonrecognition transaction is made on a party-by-party and transaction-by-transaction basis. To clarify the treatment of the various parties to covered transactions, proposed §§1.56A-18(d) through (h) and 1.56A-19 would significantly expand the covered transaction guidance described in Notice 2023-7 to provide separate rules for the following types of covered transactions: (i) non-liquidating distributions; (ii) distributions for which an election under section 336(e) is made; (iii) corporate liquidations; (iv) taxable sales of stock and assets; (v) stock reorganizations; (vi) asset reorganizations; (vii) divisive transactions to which section 355 applies; (viii) single-corporation reorganizations; and (ix) corporate formations to which section 351 applies. The proposed rules for certain of these covered transactions are described in the remainder of this part XVIII.C.5 of the Explanation of Provisions.

The proposed regulations generally would require a CAMT entity that is a party to a covered nonrecognition transaction: (i) to disregard any gain or loss reflected in FSI resulting from the transaction; (ii) to determine AFSI resulting from the transaction by applying the relevant Code section (that is, no AFSI is recognized); (iii) to determine the basis consequences of the transaction by applying the relevant Code section (using CAMT basis in lieu of AFS basis); and (iv) to adjust CAMT earnings (in lieu of AFS retained earnings) by applying section 312 (and, if applicable, section 381(c)(2)). In other words, for covered nonrecognition transactions, proposed §§1.56A-18 and 1.56A-19 would provide that financial accounting gain or loss with respect to such transactions is not taken into account in computing AFSI, and that the parties to the transaction take a carryover or exchange basis (rather than a fair value basis) in the assets or stock received.

In contrast, the proposed rules generally would require a CAMT entity that is a party to a covered recognition transaction: (i) to determine its AFSI by recomputing any gain or loss reflected in its FSI using the CAMT basis of any property transferred in the transaction (in lieu of AFS basis); (ii) to determine the CAMT basis in any property received in the transaction to be its AFS basis; and (iii) to adjust CAMT earnings (in lieu of AFS earnings) by the amount of AFSI resulting from the transaction. In other words, financial accounting principles generally would apply to covered recognition transactions, using CAMT inputs in lieu of financial accounting inputs.

For CAMT entities that are shareholders, the same general rules would apply to both covered nonrecognition transactions and covered recognition transactions. The proposed regulations would require such

a CAMT entity: (i) to determine its AFSI by disregarding any gain or loss reflected in its FSI and applying the relevant Code section, using the distribution amount and CAMT basis, if relevant; (ii) to determine the characterization of the transaction by applying the relevant Code section based on CAMT earnings (in lieu of earnings and profits); (iii) to determine CAMT basis in stock or other property received by applying the relevant Code section, using CAMT basis; and (iv) to adjust CAMT earnings (in lieu of AFS retained earnings) by applying section 312 based on AFSI.

b. *Non-liquidating distributions*

Proposed §1.56A-18(d) reflects the application of the general approach described in part XVIII.C.5.a of this Explanation of Provisions to non-liquidating distributions by a CAMT entity, including the treatment of CAMT entity shareholders that receive such distributions. Under proposed §1.56A-18(d), the distributing corporation in a transaction that is a covered nonrecognition transaction with respect to the distributing corporation generally would be required (i) to disregard any FSI resulting from the non-liquidating distribution, (ii) to compute AFSI by applying the relevant Code section (section 311(a)) (that is, no AFSI would be recognized), and (iii) to adjust CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution by applying the relevant Code section (section 312). In contrast, if the distribution is a covered recognition transaction with respect to the distributing corporation, the distributing corporation would be required (i) to determine its AFSI by recomputing any gain or loss reflected in its FSI using the CAMT basis in the distributed property, and (ii) to adjust CAMT earnings (in lieu of AFS earnings) by the amount of AFSI resulting from the transaction.

Regardless of whether the non-liquidating distribution is a covered nonrecognition transaction or a covered recognition transaction, CAMT entities that are shareholders of the distributing corporation would be required (i) to disregard any FSI resulting from the non-liquidating distribution, (ii) to compute AFSI by applying the relevant Code section, using CAMT basis and CAMT earnings, and (iii) to adjust CAMT earnings resulting from the distribution by applying the relevant Code section (section 312). However, for administrability and to limit the burden on smaller entities, the proposed regulations would provide that the character of any distribution is determined based on regular tax earnings and profits of the distributing corporation or the target corporation unless the shareholder receiving the distribution owns more than 25 percent by vote or value of the distributing corporation or the target corporation and the distributing corporation or the target corporation itself would not qualify for the safe harbor for determining applicable corporation status in proposed §1.59-2(g). *See* proposed §1.56A-18(c)(2)(iii).

c. *Taxable stock and asset sales*

Proposed §1.56A-18(g) would address the treatment of taxable sales of domestic stock. Proposed §1.56A-18(g)(1)(i) generally would require a target corporation shareholder in a taxable stock sale (that is, a covered recognition transaction), including a transaction to which section 304 applies, (i) to determine gain or loss resulting from the sale for AFSI purposes by using CAMT basis in lieu of AFS basis, (ii) to determine its CAMT basis in the property received in the transaction to be equal to the shareholder's AFS basis in that property (that is, the financial accounting treatment is unmodified), and (iii) to determine its CAMT current earnings based on its AFSI. Proposed §1.56A-18(g)(3) would provide analogous rules for the acquiror corporation.

However, proposed §1.56A-18(g)(1)(ii) would provide that, if an election is made for a disposition or purchase of domestic stock under sections 336(e) or 338, respectively, then the transfer of stock is disregarded, and the target corporation shareholder adjusts its CAMT current earnings to reflect the deemed liquidation of the target corporation. Proposed §1.56A-18(g)(2) and (4) would further provide that, if an election is made for a sale or purchase, as applicable, of stock of a domestic target corporation under section 336(e), 338(g), or 338(h)(10), the target corporation's AFSI is computed under regular tax rules, using the CAMT basis in its assets, and the new target corporation's CAMT basis in the property deemed to be received from the target corporation equals the new target corporation's regular tax basis in that property as a result of that election.

Proposed §1.56A-18(h) would address the treatment of taxable asset sales by a domestic corporation. Under these proposed rules, each of the acquiror corporation and the target corporation would (i) determine its AFSI resulting from the transaction by redetermining any gain or loss reflected in its FSI by reference to its CAMT basis (in lieu of AFS basis) in the transferred property, (ii) determine its CAMT basis in the property received to be equal to its AFS basis in that property, and (iii) adjust (to the extent applicable) its CAMT current earnings (in lieu of AFS retained earnings) based on its AFSI.

d. *Acquisitive reorganizations*

In the case of covered nonrecognition transactions described in section 368(a)(1)(B) (B reorganizations), proposed §1.56A-19(b)(1) would require the target corporation shareholder or security holder: (i) to determine its AFSI by disregarding any resulting gain or loss reflected in its FSI and applying the relevant Code section (section 354) to the transfer (that is, no AFSI would be recognized by the target corporation shareholder or security holder); (ii) to determine its CAMT basis in the stock received from the acquiror corporation by applying the relevant Code section (section 358), using CAMT basis (in lieu of AFS basis); and (iii) to adjust its CAMT earnings (in lieu of AFS retained earnings) resulting from the transaction by applying section 312. Proposed §1.56A-19(b)(3) would provide analogous rules for the acquiror corporation in a B reorganization.

If a stock acquisition fails to qualify as a B reorganization, the rules applicable to taxable stock sales or section 351(b) transactions would apply, as appropriate. *See* proposed §1.56A-19(b)(2) and (4); *see also* parts XVIII.C.5.c and f, respectively, of this Explanation of Provisions. Proposed §1.56A-19(b)(5) and (6) also would provide rules regarding the acquiror corporation parent in covered nonrecogni-

tion transactions and covered recognition transactions, respectively.

In the case of acquisitive reorganizations other than B reorganizations, proposed §1.56A-19(c) would expand upon the approach described in Notice 2023-7. In a transaction that is a covered nonrecognition transaction with respect to the target corporation, proposed §1.56A-19(c)(1) would require the target corporation: (i) to disregard any FSI resulting from the exchange of target corporation property for acquiror stock; (ii) to apply section 361(a) and (b) to the transfer (that is, the transaction would not result in AFSI to the target corporation); (iii) to determine the CAMT basis of the property received by applying section 358, using CAMT basis in lieu of AFS basis; and (iv) to adjust its CAMT earnings (in lieu of AFS retained earnings) resulting from the transaction by applying section 312. *See* proposed §1.56A-19(c)(1)(i).

An additional rule would apply if the target corporation purges all "boot" received in the transaction (that is, if the target corporation distributes or transfers all non-qualifying property) and qualifies solely for nonrecognition treatment under section 361(c). *See* proposed §1.56A-19(c)(1)(ii). Under this proposed rule, the target corporation would disregard any FSI resulting from gain or loss with respect to the boot and determine its AFSI by applying section 361(c) (that is, no AFSI would be recognized by the target corporation). In other words, the aforementioned "cliff effect" (that is, the application of financial accounting principles rather than regular tax rules) would be inapplicable if the target corporation distributes all of the boot received to its shareholders in a manner that qualifies the target corporation solely for nonrecognition treatment under the regular tax rules.

Conversely, if the target corporation recognizes any gain or loss on the distribution or transfer of the boot to its shareholders or security holders, then the transaction would be a covered recognition transaction, and the target corporation would determine any gain or loss resulting from the distribution or transfer in its AFSI by reference to its CAMT basis (in lieu of AFS basis) in the distributed or transferred property. *See* proposed §1.56A-19(c)(2).

Proposed §1.56A-19(c)(3)(i) would provide that, in an acquisitive reorganization that is a covered nonrecognition transaction with respect to the domestic acquiror corporation, the acquiror corporation disregards any FSI resulting from the exchange of acquiror corporation stock or other property for target corporation assets, and instead applies section 1032(a) in determining AFSI (that is, the transaction would not result in AFSI to the acquiror corporation). Proposed §1.56A-19(c)(3)(ii) would provide that the acquiror corporation takes a carryover basis in the assets acquired (*see* section 362(b)) using CAMT basis in lieu of AFS basis. Proposed §1.56A-19(c)(3)(iii) and (iv) would further provide that the acquiror corporation adjusts CAMT retained earnings (in lieu of AFS retained earnings) resulting from the transaction by applying sections 312 and 381(c)(2), and succeeds to the target corporation's attributes under CAMT by applying section 381.

In contrast, if an acquisitive reorganization is a covered recognition transaction with respect to the acquiror corporation, the transaction would be treated in the same manner as a taxable asset sale. *See* proposed §1.56A-18(h). Similarly, if an acquisitive reorganization is a covered recognition transaction with respect to a target corporation shareholder or security holder, the transaction would be treated in the same manner as a taxable stock sale or a section 351(b) transaction, as appropriate. *See* parts XVIII.C.5.c and f, respectively, of this Explanation of Provisions. Proposed §1.56A-19(c)(5) and (6) also would provide rules regarding the acquiror corporation parent in covered nonrecognition transactions and covered recognition transactions, respectively.

e. *Divisive transactions*

In the case of divisive transactions, proposed §1.56A-19(d) would retain the general approach described in Notice 2023-7, with certain clarifications and other revisions. Proposed §1.56A-19(d)(1) generally would provide that, in a divisive transaction that is solely a covered nonrecognition transaction with respect to the distributing corporation, the distributing corporation disregards any FSI resulting from (i) the transfer of assets and liabilities to the controlled corporation, (ii) the receipt of any controlled corporation securities or other consideration in the transaction, and (iii) the distribution of controlled corporation stock to the distributing corporation's shareholders in the transaction. The distributing corporation would compute its AFSI with respect to the transaction by applying sections 355 and 361 (that is, the transaction would not result in AFSI to the distributing corporation), would determine its basis in any property received from the controlled corporation by applying section 358 (using CAMT basis in lieu of AFS basis), and would adjust CAMT retained earnings (in lieu of AFS retained earnings) by applying section 312.

Proposed §1.56A-19(d)(1)(ii) would further provide that, if all qualified property (within the meaning of section 355(c)(2)(B) or section 361(c)(2)(B), as appropriate) is distributed in a transaction that qualifies the distributing corporation solely for nonrecognition treatment under section 361(c), then the distributing corporation computes AFSI by disregarding any FSI relating to the distribution of the qualified property. In other words, the aforementioned "cliff effect" would be inapplicable if the distributing corporation distributes all of the boot received to its shareholders and security holders in a manner that qualifies the distributing corporation solely for nonrecognition treatment under the regular tax rules.

However, proposed §1.56A-19(d)(2) would provide that, if a section 355 transaction causes the distributing corporation to recognize gain or loss, then the section 355 transaction is a covered recognition transaction to the distributing corporation, which would be required to determine its gain or loss resulting from the transaction by using CAMT basis in lieu of AFS basis. Similarly, if the distributing corporation recognizes any gain or loss on the distribution or transfer of property under section 361(c), then the distribution or transfer would be a covered recognition transaction, and the distributing corporation would determine any gain or loss resulting from the distribution or transfer in its AFSI by reference to its CAMT basis (in lieu of AFS basis) in the distributed or transferred property.

As reflected in the foregoing paragraph, a distributing corporation that transfers property to a controlled corporation in a section 355 transaction is treated as a party to the transaction. Therefore, the rule for shareholders in proposed §1.56A-18(c)(2)—under which Federal income tax principles rather than financial accounting principles would apply—is inapplicable. However, as mentioned previously, the applicable Code provision(s) would govern the transaction so long as the distributing corporation "purges" all of the boot received in the transaction to its shareholders and securities (that is, if the transaction qualifies as a covered nonrecognition transaction to the distributing corporation).

Under proposed §1.56A-19(d)(3), the treatment of the distributing corporation's shareholders or security holders generally would follow the regular tax treatment, except that basis consequences would be determined using CAMT basis in lieu of AFS basis, and CAMT retained earnings would be adjusted using AFSI.

Proposed §1.56A-19(d)(4) would provide that, if a controlled corporation transfers solely its stock to the distributing corporation in a transaction that qualifies as a covered nonrecognition transaction with respect to the controlled corporation, the controlled corporation does not include in AFSI any FSI with respect to the transfer. Instead, the controlled corporation would apply section 1032(a) to the transfer (that is, no AFSI would be recognized by the controlled corporation), would determine the basis of any property received from the distributing corporation using CAMT basis (in lieu of AFS basis), and would adjust CAMT earnings by applying section 312. In contrast, if a controlled corporation transfers money or other property (in addition to stock) to a distributing corporation as part of a section 355 transaction, proposed §1.56A-19(d)(5)(i)(A) would treat the transfer as a covered recognition transaction to the controlled corporation, unless the distributing corporation purges all boot received in the transfer and qualifies solely for nonrecognition treatment under section 361(b). *See* proposed §1.56A-19(d)(5).

Proposed §1.56A-18(e) would clarify the AFSI computation for a distributing corporation and a target corporation if a distributing corporation makes an election under section 336(e), as described in §1.336-2(b)(1).

f. *Corporate formations*

Proposed §1.56A-19(g) would address the treatment of covered transactions to which section 351 applies. For purposes of proposed §1.56A-19(g), a section 351 transferor is treated as a party to the section 351 exchange. Therefore, the rule for shareholders in proposed §1.56A-18(c)(2)—under which Federal income tax principles rather than financial accounting principles would apply—is inapplicable. Additionally, unlike the target corporation in an acquisitive reorganization or the distributing corporation in a section 355 transaction, the section 351 transferor cannot preclude the recognition of gain or loss (and, thus, the aforementioned "cliff effect") by distributing any non-stock consideration to its shareholders as part of the transaction, because such an outcome is not permitted under the regular tax rules. *Cf.* section 361.

Proposed §1.56A-19(g)(1) would clarify that a section 351 exchange can be a covered nonrecognition transaction with respect to the section 351 transferee and certain section 351 transferors and also be a covered recognition transaction with respect to the section 351 transferee and other section 351 transferors. Treatment of the component transactions of the section 351 exchange as a covered nonrecognition transaction or a covered recognition transaction would be tested separately with respect to each party to the section 351 exchange. Each component transaction of the section 351 exchange in which the section 351 transferee transfers solely stock (including nonqualified preferred stock described in section 351(g)(2)(NQPS)) to a section 351 transferor would be a covered nonrecognition transaction with respect to the section 351 transferee. Each component transaction of the section 351 exchange in which the section 351 transferee transfers money or other property in addition to its stock to a section 351 transferor would be a covered recognition transaction with respect to the section 351 transferee. A component transaction of a section 351 transferor that is a party to the section 351 exchange would be a covered nonrecognition transaction with respect to the section 351 transferor if section 351(a) would apply to the section 351 transferor and would be a covered recognition transaction with respect to the section 351 transferor if section 351(b) would apply to the section 351 transferor, including by reason of section 351(g).

Proposed §1.56A-19(g)(2) and (4) would provide the CAMT consequences of A component transactions of a section 351 exchange that are covered nonrecognition transactions with respect to section 351 transferors and section 351 transferees, respectively. Proposed §1.56A-19(g)(2) would provide that, if a section 351 exchange is a covered nonrecognition transaction with respect to the section 351 transferor, then the section 351 transferor disregards any FSI resulting from the exchange, computes its AFSI by applying section 351 to the exchange (that is, the transaction would not result in AFSI to the section 351 transferor), and determines its CAMT basis in the stock received by applying section 358, using CAMT basis in lieu of AFS basis. Similarly, if a component transaction of a section 351 exchange is a covered nonrecognition transaction with respect to the section 351 transferee, then proposed §1.56A-19(g)(4) would provide that the section 351 transferee would disregard any FSI resulting from the exchange, would compute its AFSI by applying section 1032(a) to the exchange (that is, the transaction would not result in AFSI to the section 351 transferee), and generally would determine CAMT basis in the property received by applying section 362(a)(1), using CAMT basis in lieu of AFS basis and CAMT recognized gain (relevant only if the exchange involves NQPS, which is "stock" for purposes of section 1032 but is treated as "other property" for purposes of section 351(b)), subject to the special CAMT basis rule in proposed §1.56A-19(g)(4)(iii).

The special CAMT basis rule in proposed §1.56A-19(g)(4)(iii) is an application of the authority granted in section 56A(c)(15)(A) to adjust CAMT basis to prevent the duplication or omission of CAMT items through the receipt of a relatively small amount of NQPS by a CAMT-irrelevant section 351 transferor to increase the section 351 transferor's CAMT basis in the transferred property that could result

under proposed §1.56A-19(g)(4)(ii). Under proposed §1.56A-19(g)(4)(iii), a section 351 transferee would determine its CAMT basis in the property received from a section 351 transferor by redetermining the amount of any CAMT gain recognized by the section 351 transferor to include only the amount, if any, by which the fair market value of the portion of the property transferred by the section 351 transferor in exchange for NQPS exceeds the section 351 transferor's CAMT basis in that portion of the transferred property. This special CAMT basis rule would apply if (i) the section 351 transferor is not an applicable corporation and its AFSI otherwise is not required to be taken into account by any applicable corporation for the taxable year in which qualification of the component transaction as a covered recognition transaction with respect to the section 351 transferor otherwise would be determined under the section 56A regulations, (ii) the section 351 transferee solely transfers its stock to that section 351 transferor, and (iii) the fair market value of the NQPS is 10 percent or less of the aggregate fair market value of the stock (including the NQPS) transferred by the section 351 transferee to the section 351 transferor in the section 351 exchange.

However, if a section 351 transferor receives money or other property from the section 351 transferee in a section 351 exchange, then the section 351 exchange would be a covered recognition transaction with respect to both the section 351 transferor under proposed §1.56A-19(g)(3) and the section 351 transferee under proposed §1.56A-19(g)(5) (unless no money is received and the "other property" is solely NQPS, in which case the exchange would be a covered recognition transaction with respect to the section 351 transferor under proposed §1.56A-19(g)(3) but a covered nonrecognition transaction with respect to the section 351 transferee under proposed §1.56A-19(g)(4)). Proposed §1.56A-19(g)(3) would provide that the section 351 transferor (i) determines its gain or loss on the exchange for AFSI purposes by using CAMT basis in lieu of AFS basis, (ii) determines its CAMT basis in the property received as equal to its AFS basis in the property transferred, and (iii) adjusts its CAMT retained earnings based on its AFSI. Proposed §1.56A-19(g)(5) would provide analogous rules for the section 351 transferee, subject to the special CAMT basis rule in proposed §1.56A-19(g)(5)(iii).

The special CAMT basis rule in proposed §1.56A-19(g)(5)(iii) is an application of the authority granted in section 56A(c)(15)(A) to adjust CAMT basis to prevent the duplication or omission of CAMT items through the transfer of a relatively small amount of money or other property by a section 351 transferee to increase the section 351 transferee's CAMT basis in the transferred property that could result under proposed §1.56A-19(g)(5)(ii). Under proposed §1.56A-19(g)(5)(iii), a section 351 transferee would determine its CAMT basis in the property received from a section 351 transferor by redetermining the section 351 transferee's AFS basis in that property to not exceed the sum of the amount of the section 351 transferor's CAMT basis in the transferred property immediately before the section 351 exchange and the amount, if any, by which the fair market value of the portion of the property other than stock of the section 351 transferee that the section 351 transferee transfers to the section 351 transferor exceeds the section 351 transferee's CAMT basis in that portion of the transferred property. This special CAMT basis rule would apply if (i) the section 351 transferor is not an applicable corporation and its AFSI otherwise is not required to be taken into account by any applicable corporation for the taxable year in which qualification of the component transaction as a covered recognition transaction with respect to the section 351 transferee otherwise would be determined under the section 56A regulations, (ii) the section 351 transferee transfers its stock and money or other property to that section 351 transferor, and (iii) the amount of money and fair market value of other property is 10 percent or less of the sum of the money and the aggregate fair market value of the stock and other property transferred by the section 351 transferee to the section 351 transferor in the section 351 exchange.

g. *Complete liquidations*

Proposed §1.56A-18(f) would address the treatment of complete liquidations under section 331 or section 332 of the Code and other corporate dissolutions. In the case of a complete liquidation that is a covered nonrecognition transaction with respect to the liquidating corporation, proposed §1.56A-18(f)(1) would provide that the liquidating corporation disregards any gain or loss in its FSI resulting from the liquidation and instead applies section 337(a) to the liquidating distributions (that is, the transaction would not result in AFSI to the liquidating corporation). In the case of a complete liquidation that is a covered recognition transaction with respect to the liquidating corporation, proposed §1.56A-18(f)(2) would provide that the liquidating corporation determines any gain or loss from the liquidation or dissolution for AFSI purposes by using CAMT basis in lieu of AFS basis.

Proposed §1.56A-18(f)(4) would provide that a liquidation recipient receiving a distribution in a covered nonrecognition transaction (i) disregards any gain or loss resulting from the distribution in its FSI, (ii) applies section 332 to the liquidating distributions received (that is, the transaction would not result in AFSI to the liquidation recipient), (iii) determines the CAMT basis of any property received from the liquidating corporation under section 334(b) using CAMT basis in lieu of AFS basis, (iv) adjusts CAMT retained earnings by applying sections 381(c)(2) and 312 of the Code, and (v) succeeds to the liquidating corporation's attributes under CAMT by applying section 381. Proposed §1.56A-18(f)(5) would provide that a liquidation recipient in a covered recognition transaction determines any gain or loss resulting from the distribution for AFSI purposes using its CAMT basis in lieu of AFS basis.

Proposed §1.56A-18(f)(3) would clarify that a single liquidation or other corporate dissolution can be a covered nonrecognition transaction with respect to the liquidating corporation and one liquidation recipient and also be a covered recognition transaction with respect to the liquidating corporation and other liquidation recipients.

XIX. *Proposed §1.56A-20: AFSI Adjustments to Apply Certain Subchapter K Principles*

Pursuant to the authority granted by section 56A(c)(2)(D)(i), (c)(15), and

(e), proposed §1.56A-20 would provide rules under section 56A(c)(15)(B), which authorizes the Secretary to issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes section 56A, including adjustments to carry out the principles of part II of subchapter K.

The guidance concerning Covered Nonrecognition Transactions and Covered Recognition Transactions described in section 3 of Notice 2023-7 apply to certain partnership transactions. For contributions of property by a partner to a partnership to which nonrecognition treatment under section 721 of the Code applies in whole, section 3 of Notice 2023-7 provides that any FSI resulting for AFS purposes to a partnership or a contributing partner is not taken into account in the partnership's or the partner's AFSI (partnership contribution rule). For distributions of property by a partnership to a partner to which nonrecognition treatment under section 731 of the Code applies in whole, section 3 of Notice 2023-7 provides that any FSI resulting for AFS purposes to a partnership or a partner to a transaction is not taken into account in the partnership's or the partner's AFSI (partnership distribution rule; together with the partnership contribution rule, the partnership covered nonrecognition rules).

A. *Scope of rules and general operating rule*

Proposed §1.56A-20(a)(2) would provide that the rules in proposed §1.56A-20 apply to contributions to or distributions from a partnership, but not with respect to stock of a foreign corporation except in the limited circumstance of the effect on the CAMT basis of a partnership investment for a distribution of foreign stock that is distributed in the same transaction as other property. Proposed §1.56A-20(b) would provide a general operating rule for transactions between a CAMT entity and a partnership in which it holds an investment. This general operating rule would require each of the CAMT entity, any other partners in that partnership, and the partnership itself to include in its AFSI any income, expense, gain, or loss reflected in its FSI as a result of the transaction, except as otherwise provided in proposed §1.56A-20 (which would apply after the application of §1.56A-1(c) and (d)).

B. *Contributions of property*

According to stakeholders, one possible approach to the partnership contribution rule would be to import certain rules into the CAMT that apply to partnership contributions for regular tax purposes, such as section 704(c) or the so-called "mixing bowl" rules under sections 704(c)(1)(B) and 737 of the Code, to prevent the shifting of built-in gains or losses inherent in contributed property from contributing partners subject to the CAMT to partners that are not subject to the CAMT. Some stakeholders proposed incorporating section 704(c) principles in their entirety, while other stakeholders proposed alternative methods of preventing the shifting of gains or losses between partners without incorporating the complexity of section 704(c) into the CAMT.

One alternative proposed by stakeholders as a means of avoiding much of the complexity associated with incorporating the existing section 704(c) methodologies, including the ceiling rule described in §1.704-3(b)(1), into the CAMT, is a deferred sale approach based on former proposed §1.704-3(d) (*see* 57 FR 61353 (December 24, 1992)). Under this approach, a contribution of property that results in a gain or loss in the contributing partner's FSI would be deferred by the contributing partner and included in its AFSI over time. This approach would differ from the treatment of partnership Covered Nonrecognition Transactions under Notice 2023-7. However, according to stakeholders, this approach would be more consistent with financial accounting principles and would reduce the administrative and compliance burdens on partnerships and the IRS by having all gains or losses resulting from a contribution of property to which section 721(a) applies accounted for by the contributing partner rather than by the partnership.

Rules are needed to prevent the shifting of built-in gain or loss away from the contributing partner. However, the Treasury Department and the IRS believe that importing section 704(c) as well as sections 704(c)(1)(B) and 737 in their entirety into the CAMT would create significant complexity and administrative burden for taxpayers, partnerships, and the IRS.

Pursuant to the authority granted by section 56A(c)(15) and (e), as an alternative to importing these subchapter K rules in their entirety into the CAMT, the proposed regulations would adopt a deferred sale method. More specifically, proposed §1.56A-20(c)(1) generally would provide that, if property (other than stock in a foreign corporation) is contributed by a CAMT entity (contributor) to a partnership in a transaction to which section 721(a) applies (subject to special rules in proposed §1.56A-20(e) and (f) for determining section 721(a) treatment), any gain or loss reflected in the contributor's FSI from the property transfer is included in the contributor's AFSI in accordance with the deferred sale approach set forth in proposed §1.56A-20(c)(2). The deferred sale approach would not apply to disregard any other FSI amount resulting to the contributor or the partnership from the transaction (for example, FSI gain or loss resulting from a deconsolidation or a dilution) for purposes of determining AFSI. *See* proposed §1.56A-20(c)(1).

Under proposed §1.56A-20(c)(2)(i), a contributor would be required to include the amount of gain or loss reflected in its FSI (deferred sale gain or loss) resulting from the contribution of the property to a partnership in a transaction described in proposed §1.56A-20(c)(1) (deferred sale property) in its AFSI ratably, on a monthly basis, over the applicable recovery period beginning on the first day of the month that the deferred sale property is contributed to the partnership, unless the special rule in proposed §1.56A-20(c)(2)(i)(E) would apply to the timing of the inclusion. If the contribution is treated as a sale for AFS purposes, the gain or loss resulting from the transaction would be redetermined by reference to the contributor's CAMT basis in the deferred sale property at the time of the contribution rather than the contributor's AFS basis in the deferred sale property. *See* proposed §1.56A-20(c)(2)(i)(A). For example, if the FSI resulting from the contribution is calculated for AFS purposes by subtracting the AFS basis of the deferred sale property from its fair market value, the result would be

redetermined by reference to the CAMT basis of the deferred sale property rather than the contributed property's AFS basis.

The applicable recovery period for the deferred sale property would depend on the type of deferred sale property contributed to a partnership. For deferred sale property that is section 168 property or qualified wireless spectrum and placed in service by the contributor in a taxable year prior to the taxable year in which the property becomes deferred sale property, the applicable recovery period would be the full recovery period that was assigned to the property by the contributor in the taxable year such property was placed in service for purposes of depreciating or amortizing the property for regular tax purposes. *See* proposed §1.56A-20(c)(2)(i)(B). For deferred sale property that is section 168 property or qualified wireless spectrum and that is either placed in service and contributed to the partnership in the same taxable year it is placed in service, or is contributed and placed in service by the partnership in the same taxable year as the contribution, the applicable recovery period would be the recovery period used by the partnership to depreciate or amortize the deferred sale property for regular tax purposes. *See* proposed §1.56A-20(c)(2)(i)(C).

For deferred sale property subject to depreciation or amortization for AFS purposes that is not section 168 property or qualified wireless spectrum in the hands of the contributor or the partnership, the applicable recovery period would be the recovery period used by the partnership to depreciate or amortize the deferred sale property for AFS purposes. *See* proposed §1.56A-20(c)(2)(i)(D). For deferred sale property that is section 168 property or qualified wireless spectrum but is not subject to depreciation because it has not been placed in service before it is contributed to the partnership, but is placed in service by the partnership in the immediately subsequent taxable year and thus is subject to depreciation in that year, the applicable recovery period would be the recovery period for regular tax purposes used by the partnership in the immediately subsequent taxable year, and the inclusion of the deferred sale gain or loss by the contributor would begin in the first month of that subsequent taxable year. *See* proposed §1.56A-20(c)(2)(i)(E). For property that is not described in proposed §1.56A-20(c)(2)(i)(B) through (E), the applicable recovery period would be 15 years. *See* proposed §1.56A-20(c)(2)(i)(F).

Under proposed §1.56A-20(c)(2)(ii), a contributor would accelerate a portion of its deferred sale gain or loss into its AFSI upon the occurrence of certain events. If a contributor's distributive share percentage in the partnership decreases by more than one-third following its contribution of the deferred sale property (whether by sale or exchange, liquidation of all or a part of the contributor's interest in the partnership, dilution, deconsolidation, or otherwise), the contributor would include in its AFSI for the taxable year in which the decrease occurs an amount of the remaining deferred sale gain proportionate to the percentage change in the contributor's distributive share percentage. Any remaining deferred sale gain would continue to be included in the contributor's AFSI ratably on a monthly basis over the remaining applicable recovery period of the deferred sale property. *See* proposed §1.56A-20(c)(2)(ii)(D). Under proposed §1.56A-20(c)(2)(ii), a contributor's deferred sale loss would not be accelerated into its AFSI upon a decrease in its distributive share percentage unless the decrease is the result of the contributor disposing of its entire investment in the partnership. In contrast, if the partnership sells, distributes, or otherwise disposes of the deferred sale property (including by distribution to the contributor or the partnership's contribution of the deferred sale property to another CAMT entity in a recognition or nonrecognition transaction), the contributor would accelerate all of the remaining deferred sale gain or loss into its AFSI for the taxable year of the disposition. *See* proposed §1.56A-20(c)(2)(iii).

If the contributor defers gain upon a contribution to which section 721(c) applies in accordance with the gain deferral method described in §1.721(c)-3, and if the deferred sale approach under proposed §1.56A-20(c)(2) applies, then additional acceleration rules would apply. Under proposed §1.56A-20(c)(2)(iv), if an acceleration event described in §1.721(c)-4(b) occurs, the contributor must include in its AFSI for the contributor's taxable year of the event the amount of any deferred sale gain with respect to the deferred sale property that has not yet been included in the contributor's AFSI as of the date of the acceleration event. If a partial acceleration event described in §1.721(c)-5(d) occurs, then the contributor would include in its AFSI in the taxable year of the event an amount of deferred sale gain that bears the same ratio to the total amount of any deferred sale gain that has yet to be included in the contributor's AFSI immediately before the event, that the taxable gain required to be recognized under §1.721(c)-5(d)(2) or (3) bears to the total amount of remaining built-in gain (as defined in §1.721(c)-1(b)(13)) with respect to section 721(c) property, as computed for regular tax purposes. The amount (if any) of deferred sale gain with respect to deferred sale property remaining after application of proposed §1.56A-20(c)(2)(iv) would continue to be included in the contributor's AFSI ratably on a monthly basis over the remaining applicable recovery period of the deferred sale property.

If a contribution of property to a partnership would result in section 721(a) not applying (and, thus, would result in the recognition of gain or loss for regular tax purposes (for example, under section 721(b) or (c)), then the CAMT entity would include in its AFSI in the taxable year of contribution all FSI resulting from the contribution. However, if the CAMT entity defers gain upon a contribution to which section 721(c) applies in accordance with the gain deferral method described in §1.721(c)-3, then the deferred sale approach in proposed §1.56A-20(c)(2) would apply.

If the contributor is a partnership for Federal tax purposes, the deferred sale gain or loss included in the AFSI of the contributor partnership (that is, the UTP) for a taxable year in accordance with the deferred sale approach would be included in the distributive share amounts of the partners of the contributor partnership (whether or not they were partners at the time of contribution) in proportion to their distributive share percentages for that taxable year, as determined under proposed §1.56A-5(e)(2). *See* proposed §1.56A-20(c)(2)(v).

Proposed §1.56A-20(c)(3) would provide basis rules for contributions of

property. Proposed §1.56A-20(c)(3)(i) would provide that the partnership's initial CAMT basis in contributed property would be the partnership's initial AFS basis in the contributed property at the time of contribution, regardless of whether section 721(a) applies, in whole or in part, to the contribution.

Proposed §1.56A-20(c)(3)(ii) would provide that the contributor's initial CAMT basis in its partnership investment upon a contribution of property to the partnership to which section 721(a) applies is the contributor's AFS basis in the acquired partnership investment, decreased by any deferred sale gain or increased by any deferred sale loss that is required to be included in the contributor's AFSI in accordance with the deferred sale approach. The contributor's initial CAMT basis in the acquired partnership investment would be subsequently increased or decreased: (i) on the last day of each taxable year during the applicable recovery period by an amount equal to the deferred sale gain or loss, respectively, required to be included in AFSI in such year in accordance with the deferred sales approach (without duplication of any increases or decreases to CAMT basis described in the following clause (ii)); or (ii) immediately prior to an event causing all or a portion of the deferred sale gain or loss to be accelerated into AFSI in accordance with proposed §1.56A-20(c)(2)(ii) by an amount equal to the sum of (A) the deferred sale gain or loss that accrued during the taxable year prior to the acceleration event, and (B) the amount required to be included in AFSI under proposed §1.56A-20(c)(2)(ii).

C. *Distributions of property*

A stakeholder recommended that section 731 generally should apply upon a distribution of property to prevent the recognition of gain or loss by the partnership or partners for purposes of the CAMT if gain or loss would not be recognized for regular tax purposes. Likewise, if a partner would have a stepped-up basis in distributed assets for AFS purposes, stakeholders recommended the inclusion of CAMT rules similar to the carryover basis rules of section 732 to prevent the omission of gains. Stakeholders also suggested that it may be appropriate to import other rules from subchapter K into the CAMT, such as basis adjustments under section 734(b) or the mixing bowl rules under sections 704(c)(1)(B) and 737 (as previously discussed), to prevent the omission of gains or losses or to prevent the shifting of built-in gains or losses among partners. However, given the complexity of importing basis adjustment or mixing bowl rules into the CAMT, the stakeholder also proposed either turning off section 731 entirely for purposes of the CAMT or adopting a deferred sales method at the partnership level.

If section 731(a) and (b) were imported into the CAMT in their entirety, then other rules that apply to partnership distributions for regular tax purposes also would need to be imported into the CAMT to prevent the omission of certain gains or losses or the shifting of built-in gains or losses. However, the Treasury Department and the IRS believe that importing sections 731, 732, 734, 704(c)(1)(B), and 737 into the CAMT in their entirety would create significant complexity and an administrative burden.

Accordingly, pursuant to the authority granted by section 56A(c)(15) and (e), these proposed regulations would adopt a deferred distribution gain or loss approach (similar to the rules for contributions of property in proposed §1.56A-20(c)(2)) to the gain or loss recognized by the partnership on a distribution of property to which section 731(b) applies. The proposed regulations would not alter the AFS results to a partner using the principles of section 731(a) because importing section 731(a) into the CAMT also would require importing the carryover basis rules under section 732(a)(2) and (b) and, thus, the basis adjustment rules under section 734(b). As such, the timing or amount of any FSI resulting to a CAMT entity partner from a distribution of partnership property would not be affected by these rules, except to the extent of the CAMT entity's distributive share amount of any deferred distribution gain or loss resulting from the distribution.

Proposed §1.56A-20(d)(1)(i) generally would provide that, except as provided in proposed §1.56A-20(f), if a partnership distributes property to a partner in a transaction to which section 731(b) applies, any gain or loss reflected in the partnership's FSI resulting from the distribution of property is disregarded for purposes of determining the partnership's modified FSI (as defined in proposed §1.56A-5(e)(3)). Instead, any such gain or loss would be included by the partners in their distributive share amounts (as defined in proposed §1.56A-5(e)) in accordance with the deferred distribution gain or loss approach in proposed §1.56A-20(d)(1)(ii) and (iii) and (d)(2). The deferred distribution gain or loss approach would not apply to disregard any other FSI amount resulting from the transaction (for example, FSI gain or loss to a partner resulting from a deconsolidation or dilution) for purposes of determining AFSI. *See* proposed §1.56A-20(d)(1)(i).

Under proposed §1.56A-20(d)(1)(ii), the amount of gain or loss reflected in the partnership's FSI (deferred distribution gain or loss) resulting from the distribution of property (deferred distribution property) (i) would be allocated among the partners in proportion to their distributive share percentages for the taxable year in which the distribution occurs (as determined under proposed §1.56A-20(d)(2)(i)) (a partner's allocable share of deferred distribution gain or loss), and (ii) would be included by each partner in their respective distributive share amounts ratably, on a monthly basis, over the applicable recovery period for the deferred distribution property beginning on the first day of the month in which the distribution occurs unless the special rule in proposed §1.56A-20(d)(1)(ii)(E) would apply to the timing of the inclusion.

If the distribution is treated as a sale for AFS purposes, the partnership would redetermine the amount of deferred distribution gain or loss by reference to the partnership's CAMT basis in the deferred distribution property at the time of the distribution rather than its AFS basis in the deferred distribution property. *See* proposed §1.56A-20(d)(1)(ii)(A). For example, if the FSI resulting from the distribution is calculated for AFS purposes by subtracting the AFS basis of the deferred distribution property from its fair market value, the AFS basis would be replaced with the CAMT basis of the deferred distribution property.

The applicable recovery period for the deferred distribution property would depend on the type of property. For deferred distribution property that is sec-

tion 168 property or qualified wireless spectrum and that was placed in service by the partnership in a taxable year prior to the taxable year in which the property becomes deferred distribution property, the applicable recovery period would be the full recovery period that was assigned to the property by the partnership in the taxable year such property was placed in service for purposes of depreciating or amortizing the property for regular tax purposes. *See* proposed §1.56A-20(d)(1)(ii)(B). For deferred distribution property that is section 168 property or qualified wireless spectrum and that is either placed in service by a partnership and distributed by the partnership to a partner in the same taxable year it is placed in service, or is distributed by the partnership to a partner and placed in service by the partner in the same taxable year as the distribution, the applicable recovery period would be the recovery period used by the partner to depreciate or amortize the property for regular tax purposes. *See* proposed §1.56A-20(d)(1)(ii)(C).

For deferred distribution property subject to depreciation or amortization for AFS purposes that is not section 168 property or qualified wireless spectrum, the applicable recovery period would be the recovery period for newly placed in service property that was used by the partnership to depreciate or amortize the deferred distribution property for AFS purposes. *See* proposed §1.56A-20(d)(1)(ii)(D). For deferred distribution property that is section 168 property or qualified wireless spectrum that is not placed in service in the same taxable year it is distributed to the partner but is placed in service by the partner in the immediately subsequent taxable year, the applicable recovery period would be the recovery period for regular tax purposes that is used by the partner for the deferred distribution property in the immediately subsequent taxable year. *See* proposed §1.56A-20(d)(1)(ii)(E). For deferred distribution property that is not described in proposed §1.56A-20(d)(1)(ii)(B) through (E), the applicable recovery period would be 15 years. *See* proposed §1.56A-20(d)(1)(ii)(F).

Under proposed §1.56A-20(d)(1)(iii), a partner would accelerate the remaining amount of its allocable share of deferred distribution gain or loss into its AFSI upon the occurrence of certain events. If a partnership (i) terminates under section 708(b)(1) of the Code as a result of a dissolution or liquidation, (ii) sells or exchanges all or substantially all of its assets, or (iii) merges or consolidates with one or more partnerships and is not the resulting partnership for regular tax purposes (as determined under §1.708-1(c)), then for the taxable year in which the acceleration event occurs, each partner must include in its distributive share amount the amount of the partner's allocable share (if any) of deferred distribution gain or loss that has yet to be included in its distributive share amount as of the date immediately before the acceleration event. Similarly, if a partner disposes of its entire investment in the partnership, including through a liquidating distribution by the partnership, the partner must include in its distributive share amount for the partner's taxable year in which the disposition occurs the amount of the partner's allocable share (if any) of deferred distribution gain or loss that has yet to be included in the partner's distributive share amount as of the disposition date. *See* proposed §1.56A-20(d)(2)(ii). The Treasury Department and IRS request comments on the events in the proposed regulations that require an acceleration of a partner's remaining deferred distribution gain or loss and whether additional rules are needed to determine whether a partnership has sold or exchanged substantially all of its assets.

If a distribution of property or money from a partnership to a partner results in any gain, loss, or other amount being reflected in the partner's FSI, that amount would be redetermined using the relevant CAMT basis, if applicable, and included in the partner's AFSI in the year of the distribution. If the relevant CAMT basis is the partner's CAMT basis in its partnership investment, proposed §1.56A-20(d)(2)(iii) would provide that (A) money distributed in the same transaction as property is treated as reducing CAMT basis, if applicable, prior to any distribution of property, (B) stock in a foreign corporation distributed in the same transaction is treated as reducing CAMT basis prior to any distribution of property other than stock in a foreign corporation, and (C) principles similar to §1.731-1(a)(1)(ii) apply for purposes of calculating the effect of the distribution on the CAMT entity's AFSI.

If any partner of the distributing partnership is a partnership for Federal tax purposes, then proposed §1.56A-20(d)(2)(iv) would provide that the deferred distribution gain or loss included in the partner's distributive share amount under proposed §1.56A-20(d)(2)(i) is included in its partners' respective distributive share amounts (whether or not the partners were partners in the partnership at the time of the distribution) in proportion to their distributive share percentages for the taxable year, as determined under proposed §1.56A-5(e)(2).

Proposed §1.56A-20(d)(3) would provide basis rules for distributions of property. Proposed §1.56A-20(d)(3)(i) would provide that a partner's initial CAMT basis of property distributed by a partnership is the partner's initial basis of the property for AFS purposes, determined immediately after the distribution. Proposed §1.56A-20(d)(3)(ii) would provide that the CAMT basis of a partner's investment in a partnership following the partnership's distribution of property is increased or decreased (i) at the end of each taxable year during the applicable recovery period, by the amount required to be included in the partner's distributive share amount in each taxable year in accordance with proposed §1.56A-20(d)(1)(ii), and (ii) immediately prior to an acceleration event described in proposed §1.56A-20(d)(1)(iii) or (d)(2)(ii), by the amount of deferred distribution gain or loss not previously included in the partner's distributive share amount.

D. *Treatment of liabilities*

One stakeholder suggested that, as part of importing sections 721 and 731 into the CAMT, section 752 of the Code should be fully imported into the CAMT to better align the treatment of contributions to and distributions from a partnership under the CAMT with their treatment for regular tax purposes, to prevent resulting distortions, and to reduce the potential for tax avoidance. Another stakeholder suggested an alternative approach that would not import any aspect of section 752 into the CAMT, on the grounds that the alternative approach would provide administrative

simplicity and be consistent with how liabilities are treated for financial accounting purposes.

Importing section 752 into the CAMT would create significant administrative complexity and generally would be inconsistent with how partner and partnership liabilities are treated for AFS purposes. Accordingly, proposed §1.56A-20(e)(1) generally would provide that the treatment of partner and partnership liabilities for purposes of determining a partner's or partnership's AFSI is based on the treatment of such liabilities for AFS purposes and not how such liabilities are treated under section 752.

With regard to the treatment of liabilities upon a contribution or distribution of property to or from a partnership, proposed §1.56A-20(e)(2) would provide that section 752 is inapplicable in determining the amount of gain or loss to be included in the AFSI of the partner or partnership. Accordingly, any rules relating to liabilities for regular tax purposes, such as those under §§1.707-5 and 1.707-6, would not apply for purposes of the CAMT. For example, if section 707 or section 752 of the Code would provide that gain or loss is not recognized for regular tax purposes upon a contribution of encumbered property, that rule would be disregarded in determining whether section 721(a) or 731(b) applies to a transaction for purposes of the CAMT.

E. *Proportionate deferred sale approach for partial nonrecognition transactions under sections 721(a) and 731(b)*

As previously described, the partnership Covered Nonrecognition Transaction guidance described in Notice 2023-7 applies only if no gain or loss is recognized on the transaction for regular tax purposes. Stakeholders recommended that these rules also apply to partnership contributions and distributions that are afforded partial nonrecognition treatment for regular tax purposes, and that AFSI generally should result from the transaction in proportion to the amount of gain or loss that is recognized for regular tax purposes.

As discussed in parts XIX.B and C of this Explanation of Provisions, proposed §1.56A-20(c) and (d) would adopt a deferred sale approach and a deferred distribution gain or loss approach that provides for the deferral of AFSI resulting from a contribution of property to, or a distribution of property from, a partnership. These proposed rules would differ from the partnership Covered Nonrecognition Transaction guidance described in Notice 2023-7 by providing for the deferral of gain or loss. However, because the deferred sale approach and the deferred distribution gain or loss approach would require FSI resulting from a partnership contribution or distribution to be included in AFSI over a definite period of time, and because a "cliff effect" rule for partnership contributions and distributions could result in selective recognition of losses for purposes of the CAMT, it is appropriate to apply the deferred sale approach to a partial nonrecognition transaction to the extent section 721(a) or 731(b) applies to the transaction (after applying the special rules in proposed §1.56A-20(e)).

Accordingly, proposed §1.56A-20(f) would provide that, if a transfer of property by a partner to a partnership, or by a partnership to a partner, is not a nonrecognition transaction for regular tax purposes, in whole or in part, under section 721(a) or section 731(b), respectively (or would not be a nonrecognition transaction under these Code sections for regular tax purposes considering the application of proposed §1.56A-20(e)), then the partner or partnership, as applicable, must include an amount in its AFSI for the taxable year of the transfer. The amount to be included is an amount (if any) of the FSI reflected on the partner's or partnership's AFS resulting from the transaction that (i) bears the same ratio to the total amount of gain or loss reflected in the partner's or partnership's FSI resulting from the transaction, as (ii) the taxable gain or loss that would be recognized on the transfer without the application of section 752 and the exceptions in §§1.707-5 and 1.707-6 bears to the taxable gain or loss realized on the transfer for regular tax purposes. Any FSI resulting from the transaction must be calculated using the CAMT basis of the property and not the AFS basis of the property. Any resulting FSI that is not included in AFSI in the taxable year of the transfer under the rule described in proposed §1.56A-20(f) would be subject to the deferred sale approach or the deferred distribution gain or loss approach.

F. *Maintenance of books and records and reporting requirements*

Proposed §1.56A-20(g) would provide rules relating to the maintenance of books and records and reporting requirements for a partnership and each CAMT entity that is a partner in the partnership. The Treasury Department and the IRS are aware that, for a CAMT entity partner to determine the timing of inclusion in its AFSI of any deferred sale gain or loss resulting from its contribution of deferred sale property, the CAMT entity partner will require information from the partnership. Similarly, a partnership may require information from a partner receiving a distribution of deferred distribution property to determine the timing of inclusion of deferred distribution gain or loss in the CAMT entities' distributive share amounts. To facilitate compliance with the rules of proposed §§1.56A-20 and 1.56A-5, the proposed regulations would require partnerships and CAMT entity partners in such partnership to maintain certain information in their respective books and records and to report that information as appropriate.

Proposed §1.56A-20(g)(1) would require a partnership and each CAMT entity that is a partner in the partnership to include in its respective books and records all information necessary for the partnership and each CAMT entity to comply with the rules of proposed §§1.56A-20 and 1.56A-5. As applicable for partnerships and CAMT entities to comply with their respective requirements under these proposed regulations, the information to be maintained in their separate books and records includes, without limitation, (i) the recovery periods used to depreciate deferred sale property and deferred distribution property for regular tax purposes; (ii) the properties contributed to the partnership that had a built-in gain or loss at the time of contribution and the amount of the built-in gain or loss with respect to each property for AFSI purposes; (iii) the CAMT basis of any property contributed to or distributed from the partnership; and (iv) the amount of deferred distribution gain or loss to be allocated among, and

included in the distributive share amounts of, the partners of the partnership.

Proposed §1.56A-20(g)(2)(i) would provide that partnerships must report to a CAMT entity the information required for the CAMT entity to comply with the rules of proposed §§1.56A-20 and 1.56A-5. The information to be reported to CAMT entities that are partners in a partnership to facilitate compliance with these sections includes, without limitation, (A) the recovery periods used to depreciate deferred sale property, (B) the date on which the partnership sold, distributed, or otherwise disposed of deferred sale property; (C) the date on which an acceleration or partial acceleration event described in §1.721(c)-4(b) or §1.721(c)-5(d), respectively, occurred; and (D) the amount of deferred distribution gain or loss resulting from a distribution of property that is included in the CAMT entity partner's distributive share amount under proposed §1.56A-20(d).

A partnership may report information to a CAMT entity partner in any reasonable manner sufficient for a CAMT entity to comply with the rules of proposed §1.56A-20. However, if any information relates to the determination of a CAMT entity's distributive share amount with respect to its investment in the partnership, the proposed regulations would require the partnership to report the information consistently with the rules of proposed §1.56A-5(h). *See* proposed §1.56A-20(g)(2)(ii).

XX. *Proposed §1.56A-21: AFSI Adjustments for Troubled Companies*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-21 would provide rules under section 56A regarding financially troubled companies.

A. *Overview*

The U.S. Bankruptcy Code (11 U.S.C. 101-1532) governs bankruptcies in the United States. The Bankruptcy Code and related authorities give debtors relief from debts they cannot repay to allow them to reorder their affairs and enjoy a "fresh start." For example, bankruptcy gives otherwise viable business enterprises a chance to continue intact, thereby preserving jobs for employees and the availability of products and services for customers, and enhancing market competition and stability.

The Internal Revenue Code plays an important role in implementing the foregoing objective. Section 61(a)(11) of the Code provides that, except as otherwise provided in subtitle A, gross income includes income from the discharge of indebtedness in the year of the discharge. However, section 108(a)(1) of the Code provides that gross income does not include any amount that otherwise would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer, if the discharge occurs under circumstances specified in section 108(a)(1)(A) through (E), including in a title 11 case and if the taxpayer is insolvent. *See* section 108(a)(1)(A) and (B), respectively.

Section 108(b) requires taxpayers that exclude income under section 108(a) to reduce certain specified tax attributes, including net operating losses (NOLs) and the minimum tax credit under section 53(b) of the Code. Section 108(b)(1) provides that the amount of income excluded under section 108(a) (excluded COD income, also referred to as discharge of indebtedness income) is applied to reduce the tax attributes of the taxpayer as provided in section 108(b)(2). Thus, section 108 effectively defers rather than excludes tax on excluded COD income.

Section 108(b)(2) generally provides that the following tax attributes are reduced in the following order: (i) any NOL; (ii) amounts used to determine the general business credit under section 38 of the Code; (iii) the minimum tax credit available under section 53(b); (iv) any net capital losses and any capital loss carryover under section 1212 of the Code; (v) the basis of the property of the taxpayer (*see* section 1017 of the Code for provisions for making this reduction); (vi) any passive activity loss or credit carryover of the taxpayer under section 469(b) of the Code; and (vii) any carryover to or from the taxable year of the discharge for purposes of determining the amount of the foreign tax credit allowable under section 27.

Any amount of excluded COD income that remains after attribute reduction under section 108(b) (so-called "black hole COD") is not includible in income. *See* H.R. Rep. 96-833 at 11 (1980); S. Rep. No. 96-1035 at 12 (1980).

As under section 61(a)(11) of the Code, financial accounting principles generally require debtors to recognize gain on debt discharges. If debts are extinguished, GAAP requires gain to be recognized on the difference between the price at which the debt is satisfied and the carrying value of the debt. *See* ASC 470-50-40-2. Outside of bankruptcy, troubled companies recognize gain for financial accounting purposes upon the satisfaction of debt to the extent that the carrying value of the debt exceeds the fair value of the assets transferred to the creditor in satisfaction of the debt. *See* ASC 470-60-35-1. If a company enters bankruptcy, the carrying value of pre-petition debt is adjusted to the probable amount of the allowed claims for the debt, and gain is recognized in cases in which the former is higher than the latter. *See* ASC 852-10-45-6 and 852-10-45-9. (There is no corresponding income inclusion under section 61 to be excluded under section 108 because no realization event has occurred.) When liabilities subsequently are settled in accordance with the plan of reorganization approved by the bankruptcy court, the difference between the fair value of the consideration a creditor receives and the allowed claim of the debt is recognized in the income statement. *See* ASC 405-20-40-1.

Both the Code and financial accounting principles also address a corporation's emergence from bankruptcy. Section 368(a)(1)(G) provides nonrecognition treatment for the transfer by a corporation of its assets to another corporation in a title 11 or similar case, so long as certain requirements are satisfied. Taxpayers also may emerge from bankruptcy in a taxable transaction, with favorable rules that permit the use of tax attributes to offset gain prior to the attribute reduction required by section 108(b). *See* §1.108-7(b).

Under GAAP, "fresh-start reporting" requires eligible companies to adjust the carrying values of assets and liabilities immediately before the emergence from bankruptcy. *See* ASC 852-10-45-21. Assets are marked to their fair value, with gain or loss reported in the amount

of the change. *See id*. The settlement of liabilities for an amount different than that previously recorded on the company's books and records results in gain or loss. Any retained earnings on the books of a company in bankruptcy are also eliminated upon its emergence. *See id*. Fresh-start reporting places the emerging company, which is treated as the successor to the bankrupt company under financial accounting principles, on a similar footing to that of a new company that acquired the bankrupt company's assets.

B. *CAMT and troubled companies*

Section 56A does not specifically address the treatment of troubled companies for purposes of the CAMT. However, absent adjustments to AFSI for income from debt discharges and fresh-start reporting, troubled companies would have additional tax liabilities under the CAMT that could impede the companies from achieving solvency or emerging from bankruptcy. Avoiding this unnecessary harm also would protect the interests of the government in its tax collection efforts. Authority for such adjustments is provided in section 56A(c)(15) and (e).

C. *Notice 2023-7 and troubled companies*

Sections 3.06 and 3.07 of Notice 2023-7 provide guidance for the exclusion of discharge of indebtedness income and gain resulting from fresh-start reporting, respectively. Under section 3.06(1) of Notice 2023-7, financial accounting gain equal to the amount of discharge of indebtedness income excluded under section 108(a) is not taken into account for purposes of calculating the AFSI of a financial statement group for the year in which the discharge of indebtedness occurs. Under section 3.06(2) of Notice 2023-7, financial statement groups with excluded income under section 3.06(1) reduce CAMT attributes to the extent of the reduction of regular tax attributes under section 108(b) using the principles and ordering rules of sections 108(b) and 1017. Section 3.07 of Notice 2023-7 provides that financial accounting gain or loss resulting from a financial statement group's emergence from bankruptcy, and resulting changes to the financial accounting basis of property, are not taken into account for purposes of calculating the financial statement group's AFSI.

D. *Proposed regulations*

Proposed §1.56A-21 would provide rules for determining AFSI with respect to events relating to the bankruptcy or insolvency of a CAMT entity. Proposed §1.56A-21 also would provide rules for determining AFSI with respect to the receipt of Federal financial assistance (within the meaning of section 597(c) of the Code and §1.597-1(b)).

1. *Proposed Rules for Bankruptcy Exclusion*

Consistent with section 3.06 of Notice 2023-7, proposed §1.56A-21(c)(1)(i) would exclude from AFSI income from the discharge of indebtedness for CAMT entities in a title 11 case. This exclusion is intended to cover all FSI otherwise includible in AFSI that arises from an extinguishment or modification of a debt instrument during bankruptcy of the CAMT entity, regardless of the timing of the reporting of the item under financial accounting principles. The language of the proposed rule is similar to that of the bankruptcy exclusion in section 108(a)(1)(A), with modifications reflecting differences in the timing of the recognition of income for tax and financial accounting purposes.

2. *Proposed Rules for Insolvency Exclusion*

Consistent with section 3.06 of Notice 2023-7 and section 108(a)(1)(B), proposed §1.56A-21(c)(2)(i) would exclude from AFSI income from the discharge of indebtedness for insolvent CAMT entities (including foreign corporations), but only to the extent of their insolvency. However, stakeholders have indicated that the amount of insolvency ordinarily is not measured as part of the financial reporting process. Therefore, proposed §1.56A-21(b)(6) would provide that the amount by which a CAMT entity is insolvent is determined under section 108(d)(3).

3. *Disregarded Entities and Partnerships*

Special rules would address the application of the bankruptcy and insolvency exclusions to disregarded entities and partnerships. Disregarded entities would be eligible for these exclusions only if their regarded owner is eligible. *See* proposed §1.56A-21(c)(3) and (d)(5). For partnerships, eligibility for these exclusions would be determined at the partner level. *See* proposed §1.56A-21(e).

4. *Attribute Reduction*

Consistent with section 3.06 of Notice 2023-7, proposed §1.56A-21(c) would require CAMT entities that exclude income from a discharge of indebtedness under proposed §1.56A-21(c)(1)(i) or (c)(2)(i) to reduce CAMT-specific assets in the order listed in proposed §1.56A-21(c)(4)(iii). Under proposed §1.56A-21(c)(4)(iii), the tax attributes subject to reduction (but not below zero) would be: (i) the CAMT basis of covered property, but only to the extent the basis of the covered property is reduced by the CAMT entity under section 108 for regular tax purposes; (ii) FSNOLs; (iii) CFC adjustment carryovers; (iv) the CAMT basis of property (other than covered property) that is depreciated or amortized for AFS purposes; (v) the CAMT basis of property (other than covered property) that is not depreciated or amortized for AFS purposes; (vi) CAMT foreign tax credits; and (vii) any remaining CAMT basis of covered property. For purposes of proposed §1.56A-21, the term "covered property" would mean section 168 property, qualified wireless spectrum, and property whose regular tax basis is determined under section 21(c) of the ANCSA. *See* proposed §1.56A-21(b)(2).

The attributes listed in clauses (i) through (v) and (vii) of the prior paragraph would be reduced by one dollar for each dollar excluded under proposed §1.56A-21(c)(1)(i) and (c)(2)(i), subject to specified limitations for basis reductions. CAMT FTCs would be reduced under a conversion formula that takes into account the differing economic values of deductions and credits. *See* proposed §1.56A-21(c)(5).

The proposed order and amount of the reduction of CAMT attributes gen-

erally would parallel the order and amount of tax attribute reductions in section 108(b). However, reductions to the CAMT basis of covered property would be prioritized over reductions to other CAMT attributes to the extent the basis of such property has been reduced under section 108(b)(1) (proposed prioritization rule). Under section 56A(c)(8), (13), and (14), depreciation deductions claimed for regular tax purposes with respect to property whose basis is determined under section 21(c) of the ANCSA, section 168 property, and qualified wireless spectrum, respectively, are carried over into the CAMT. The proposed prioritization rule would align reductions to the CAMT basis of these three categories of property with the section 108(b)(1) reductions to the same property for regular tax purposes. This proposed rule is intended to minimize regular tax and CAMT basis mismatches in these categories that would make the CAMT harder to administer and enforce.

The proposed prioritization rule also would address a stakeholder's concern that, absent such a rule, taxpayers that have a reduction in depreciable basis in section 168 property under section 108(b)(1) would incur a double detriment if they also were required to reduce attributes other than the CAMT basis of the same property. This double detriment would result because AFSI is computed with regular tax depreciation taken on section 168 property. *See* section 56A(c)(13) and proposed §1.56A-15. Reducing depreciable basis for regular tax purposes has the effect of not only increasing future regular taxable income, but also increasing future AFSI (because basis eligible for depreciation is no longer available). Therefore, if CAMT entities were required to reduce CAMT attributes other than depreciable basis after regular tax depreciable basis already has been reduced, their future AFSI would rise $2 for every $1 of excluded COD income: (i) the first $1 increase in future AFSI would result from the loss of the depreciation deduction against AFSI that the CAMT entity otherwise would have received; and (ii) the second $1 increase in future AFSI would result from the loss of an attribute other than CAMT depreciable basis.

To prevent this double detriment, the proposed prioritization rule would tie reductions in CAMT depreciable basis to the same reductions for regular tax purposes, just as depreciation and amortization deductions for purposes of the CAMT are aligned with regular tax depreciation and amortization deductions under section 56A(c)(13) and (14), respectively. Only when all other attributes have been reduced to zero would the basis of section 168 property (and other covered property) be reduced more than the basis of that property is reduced under section 108(b)(1).

Under section 3.06(2) of Notice 2023-7, the amount of the CAMT attribute reduction is limited to the amount of tax attributes reduced under section 108(b). Stakeholders recommended eliminating this limitation because CAMT attributes are separate from, and arise out of, a different measure of income than the regular tax, and the attribute reduction limitation in Notice 2023-7 does not take this difference into account. Under these proposed regulations, the CAMT attribute reduction would be limited to the amount of CAMT attributes subject to reduction rather than to the amount of tax attributes reduced under section 108(b). *See* proposed §1.56A-21(c)(4)(ii)(B).

5. *Timing of Attribute Reduction*

Proposed §1.56A-21(c)(4)(iv)(A) would specify that attribute reductions for FSNOLs, CFC net loss carryforwards, and CAMT FTCs are made after the determination of CAMT liability in the taxable year of a discharge. This provision is similar to §1.108-7(b), which provides an ordering rule for attribute use and reduction under section 108(b). Similarly, proposed §1.56A-21(c)(4)(iv)(B) would specify that CAMT basis reductions are made immediately before the close of the taxable year of the discharge of indebtedness of the CAMT entity solely with regard to assets of the CAMT entity under that section that the CAMT entity will hold at the beginning of the immediately subsequent taxable year. Proposed §1.56A-21(c)(4)(iv)(C) would provide that a CAMT entity must make CAMT basis reductions in the same manner as basis reductions for regular tax purposes.

6. *Exclusion of Income from Fresh-Start Reporting*

Proposed §1.56A-21(d) would provide rules for the computation of AFSI for CAMT entities emerging from bankruptcy. Under proposed §1.56A-21(d)(2)(i), gain or loss reflected in FSI resulting from a CAMT entity's emergence from bankruptcy would be disregarded, with corresponding adjustments to CAMT basis and CAMT earnings to eliminate financial accounting changes from the excluded gain or loss. This proposed rule would be consistent with section 3.07 of Notice 2023-7, with additional clarifications as to the scope of its application.

For example, stakeholders expressed uncertainty as to whether section 3.06 of Notice 2023-7 (concerning discharge of indebtedness income) or, rather, section 3.07 of Notice 2023-7 (concerning emergence from bankruptcy) applies to debt discharges that occur upon a debtor's emergence from bankruptcy. Stakeholders also expressed uncertainty over whether section 3.06 of Notice 2023-7 is intended to cover all transactions in bankruptcy, including sales of assets prior to the emergence from bankruptcy and covered nonrecognition transactions prior to, or concurrent with, the emergence from bankruptcy. Some of these transactions may not give rise to income under fresh-start reporting even though they occur in bankruptcy and otherwise may increase a debtor's FSI.

To clarify that the discharge of indebtedness provisions take priority in cases involving the emergence from bankruptcy, proposed §1.56A-21(d)(2)(ii) would provide that, in such cases, a CAMT entity would rely on proposed §1.56A-21(c) to determine the CAMT consequences of a discharge of indebtedness. Proposed §1.56A-21(d)(2)(iii) and (d)(3) would provide that, in the case of an emergence from bankruptcy in a covered transaction, the rules of §§1.56A-18 and 1.56A-19 would apply to determine the CAMT consequences of the emergence transaction.

7. *Investments in Partnerships*

Proposed §1.56A-21(e) provides rules for determining the AFSI of a CAMT entity that is a partner in a partnership

that realizes discharge of indebtedness income. Proposed §1.56A-21(e)(2)(i) provides that any discharge of indebtedness income reflected in a partnership's FSI is disregarded for determining the partnership's AFSI. Instead, any exclusion from AFSI for a partnership's discharge of indebtedness income, and any resulting CAMT attribute reductions, are applied at the partner level in the manner as the rules in section 108(a) and section 108(b) are applied at the partner level for regular tax purposes. For purposes of applying the attribute reduction rules, proposed §1.56A-21(e)(2)(ii)(B) provides that a CAMT entity treats its partnership investment as covered property to the extent the basis of covered property held by the partnership is reduced by the partnership for regular tax purposes under §1.1017-1(g)(2). Additionally, if a CAMT entity that is a partner in a partnership treats its partnership investment as covered property, the basis adjustment rules under §1.1017-1(g)(2) with respect to covered property held by the partnership apply for purposes of determining the CAMT entity's distributive share amount under proposed §1.56A-5. Proposed §1.56A-21(e)(2)(iii) provides that discharge of indebtedness income reflected in a partnership's FSI is separately stated to the partners in accordance with their distributive share percentages for the taxable year in which the income is realized for AFS purposes. For purposes of determining whether a CAMT entity that is a partner in a partnership is insolvent, proposed §1.56A-21(e)(3) provides that the CAMT entity includes its share of partnership's liabilities under section 752 of the Code in the same manner as its share of partnership liabilities would be included for regular tax purposes.

8. *Exclusion of Financial Accounting Gain from Federal Financial Assistance*

Stakeholders have expressed concern over the inclusion in AFSI of financial accounting gain attributable to amounts that constitute "Federal financial assistance" (FFA), as defined in proposed §1.56A-21(b)(4), for regular tax purposes. FFA may arise in the context of an acquisition of a troubled financial institution. Financial accounting principles may require gain attributable to these amounts to be reported as gain on a CAMT entity's AFS and included in FSI when the relevant transaction is entered into (for example, as a result of bargain purchase gain). In contrast, for regular tax purposes, the recognition of gross income attributable to FFA may be deferred over multiple taxable years under section 597 and the regulations under section 597.

Stakeholders stated that this mismatch in timing of recognition of amounts attributable to FFA for AFSI purposes and regular tax purposes may cause or increase CAMT tax liability solely because of a CAMT entity's participation in transactions involving troubled financial institutions that the provision of FFA is otherwise intended to encourage. To address this mismatch in timing, proposed §1.56A-21(f) would provide adjustments to AFSI so as not to include any financial accounting gain attributable to FFA any earlier than when the gain is included in gross income for purposes of section 597 and the regulations under section 597.

XXI. *Proposed §1.56A-22: AFSI Adjustments for Certain Insurance Companies and Other Specified Industries*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-22 would provide rules under section 56A regarding insurance companies and other specified industries.

A. *AFSI adjustments for covered variable contracts*

Some insurance companies issue insurance contracts (including variable contracts, as defined in section 817(d) of the Code) for which the insurance company's obligations to the contract holders (and the company's corresponding reserves) reflect (in whole or in part) the change in value of a designated pool of investment assets supporting the contracts. These contracts generally are accounted for on the insurance company's financial statements by including in its FSI both (i) the change in the unrealized gain or loss in the supporting assets, and (ii) the offsetting change in liability resulting from the related change in the company's obligation to the contract holders. *See* section 2.02 of Notice 2023-20.

In the absence of a special rule for insurance companies issuing this type of contract, AFSI would be determined by disregarding (i) the change in unrealized gain or loss on certain stock under section 56A(c)(2)(C) and proposed §§1.56A-4, 1.56A-18, and 1.56A-19, and (ii) the change in unrealized gain or loss on certain partnership interests (in whole or in part) under section 56A(c)(2)(D) and proposed §§1.56A-5 and 1.56A-20, even though the offsetting change in liabilities would be taken into account. This outcome would result in a mismatch that could significantly overstate or understate AFSI for these insurance companies relative to both taxable income and economic income.

Section 3 of Notice 2023-20 provides interim guidance that addresses this mismatch. Under section 3 of Notice 2023-20, for purposes of determining an insurance company's AFSI, the change in the obligation to holders of "Covered Variable Contracts", as defined in section 2.05(2) of Notice 2023-20, is disregarded to the extent the related gains or losses on assets supporting the contracts are both (i) taken into account in determining FSI, and (ii) excluded from AFSI under section 56A(c)(2)(C) or (c)(2)(D)(i).

A stakeholder suggested that "turning off" section 56A(c)(2)(C) and (c)(2)(D)(i) could achieve the same result as under Notice 2023-20 and would be simpler to administer, because no adjustments to an insurance company's AFSI would be needed to eliminate the mismatch. In contrast, the approach described in Notice 2023-20 requires two adjustments: first, section 56A(c)(2)(C) or (c)(2)(D)(i) is applied to exclude from AFSI certain gains and losses in the assets supporting the contracts; and second, section 3.02 of Notice 2023-20 is applied to exclude from AFSI the offsetting change in the obligations to the contract holders.

To address the foregoing mismatch in a manner that is simple to administer, proposed §1.56A-22(c)(1) generally would provide that proposed §§1.56A-4, 1.56A-5, and 1.56A-18 through 1.56A-20 (and, thus, any statutory AFSI adjustments implemented by these provisions)

would not apply to exclude from an insurance company's AFSI any gains or losses on assets supporting covered variable contracts, as defined in proposed §1.56A-22(b)(5), to the extent that (i) the gains and losses result in a change in the amount of the obligations to the contract holders, and (ii) this change is included in the insurance company's FSI.

A stakeholder also suggested that the definition of Covered Variable Contracts in Notice 2023-20 be broadened. Accordingly, proposed §1.56A-22(b)(5) would define this term more generally rather than by including in the definition only specific types of identified contracts.

B. *AFSI adjustments for covered reinsurance agreements*

In certain types of reinsurance arrangements (namely, funds withheld reinsurance and modified coinsurance agreements), the ceding company retains the investment assets that support the obligations to the holders of the underlying insurance contracts. Under these agreements, the reinsurance operates like conventional reinsurance, but from a legal title and financial accounting perspective, the ceding company retains these investment assets as security for the reinsurer's obligations under the reinsurance agreement (and for modified coinsurance, the ceding company also retains the reserves). *See* Credit for Reinsurance Model Law (MO-785), NAIC Model Laws, Regulations, Guidelines, & Other Resources, section 3 (2019); NAIC, *Accounting Practice & Procedures Manual*, SSAP 61R, Life, Deposit-Type and Accident and Health Reinsurance (2023). The ceding company records a liability to the reinsurer to reflect the assets it has retained.

Under GAAP and IFRS, the change in unrealized gains and losses on certain of these retained assets generally is accounted for in the ceding company's OCI, and the change in a related and offsetting payable to the reinsurer is accounted for in the ceding company's FSI. *See* section 2.03 of Notice 2023-20. The definition of FSI in proposed §1.56A-1(b)(20) would exclude OCI from AFSI. Accordingly, without a special rule, the change in the payable would be included in the determination of AFSI, but the offsetting change in the unrealized gain or loss in the retained assets generally would not be included.

Section 4 of Notice 2023-20 provides interim guidance that addresses this mismatch. Section 4 of Notice 2023-20 also provides related guidance to the reinsurer, guidance in the case of a retrocession, and guidance if the insurance company elects to account for parts of the reinsurance arrangement at fair value.

The rules in proposed §1.56A-22(d) generally would be consistent with section 4 of Notice 2023-20. Proposed §1.56A-22(d)(1) generally would provide that (i) the ceding company in a "covered reinsurance agreement", as defined in proposed §1.56A-22(b)(4), excludes from AFSI any changes in the amount of the payable to the reinsurer that correspond to the unrealized gains and losses in the withheld assets to the extent the unrealized gains and losses are not included in AFSI, and (ii) the reinsurer in a covered reinsurance agreement excludes from AFSI any changes in the amount of the receivable from the ceding company that correspond to the unrealized gains and losses in the assets withheld by the ceding company.

However, the rule in proposed §1.56A-22(d)(3), related to accounting for the reinsurance arrangement at fair value, would "turn off" the general rule in proposed §1.56A-22(d)(1) if the insurance company either (i) makes an election for AFS purposes to account for the covered reinsurance agreement at fair value in its FSI, or (ii) otherwise accounts for both the payable (for the ceding company) or the receivable (for the reinsurer) and the covered reinsurance agreement at fair value in its FSI. Accordingly, proposed §1.56A-22(d)(3) would apply only if the covered reinsurance agreement is accounted for at fair value in FSI. Comments are requested on whether the rule in proposed §1.56A-22(d)(3) appropriately describes the circumstances (under GAAP, IFRS, and other generally accepted accounting standards) in which the general rule in proposed §1.56A-22(d)(1) should not apply.

C. *Use of fresh start basis*

Various Acts of Congress fully subjected to Federal taxation certain entities that previously had been exempt from Federal taxation (in whole or in part). *See* section 2.04 of Notice 2023-20. These Acts provided special rules for determining the adjusted basis of an asset held by any of these entities on the day it became fully subject to Federal taxation. These rules generally provided that, for certain purposes, the adjusted basis of any asset held by the entity on the day it became fully subject to Federal taxation is equal to the fair market value of the asset on that day, providing a "fresh start" for these entities.

Consistent with section 5 of Notice 2023-20, proposed §1.56A-22(e) would provide that, for purposes of determining AFSI, the adjusted basis of any asset held by the entity since the date it became fully taxable is determined in accordance with the particular Act that fully subjected the entity to Federal taxation.

XXII. *Proposed §1.56A-23: AFSI Adjustments for Financial Statement Net Operating Losses and Other Attributes*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-23 would provide rules under section 56A(d) for determining the AFSI adjustment for financial statement net operating loss (FSNOL) carryovers, built-in losses, and other attributes.

A. *General FSNOL rules*

Section 56A(d)(1) provides that AFSI is reduced by an amount equal to the lesser of (i) the aggregate amount of FSNOL carryovers to the taxable year, or (ii) 80 percent of AFSI computed without regard to the FSNOL adjustment. Section 56A(d)(2) provides that an FSNOL for any taxable year is a financial statement net operating loss carryover to each taxable year following the taxable year of the loss. The portion of the FSNOL carried to subsequent taxable years is the amount of the FSNOL remaining after subtracting the adjustments under section 56A(d)(1) for previous years. Section 56A(d)(3) defines an "FSNOL" as the amount of the net loss set forth on a corporation's applicable financial statement as adjusted by section 56A(c), and without regard to the FSNOL deduction, for taxable years ending after December 31, 2019.

Proposed §1.56A-23(c) would provide that, if the AFSI of a corporation for a taxable year is positive (determined after application of the section 56A regulations), the corporation's AFSI is reduced by an amount equal to the lesser of (i) the aggregate amount of FSNOL carryovers to the taxable year, or (ii) 80 percent of the AFSI of the corporation (determined after application of the section 56A regulations and without regard to proposed §1.56A-23). Proposed §1.56A-23(d)(1) would provide that an FSNOL for any taxable year is carried forward to each taxable year following the taxable year of the loss, and that any remaining FSNOL is carried forward to the subsequent taxable year. An example in proposed §1.56A-23(d)(2) would clarify that the rules in proposed §1.56A-23(d) apply even if the corporation was not an applicable corporation in a prior taxable year. The statute generally requires AFSI adjustments related to pre-effective date years that affect post-effective date years to be made. This is consistent with the rules described in proposed §1.56A-1(d)(3), which provides that the AFSI adjustments described in the section 56A regulations are made for taxable years ending after December 31, 2019. Proposed §1.56A-23(c) and (d) would be consistent with the rules described in section 12 of Notice 2023-64.

The section 56A(d) rules regarding the use of FSNOLs generally match the rules regarding the use of NOLs applicable to most corporations for regular tax purposes under section 172 in that both FSNOLs and NOLs generally (i) may be carried forward for an indefinite number of years but may not be carried back and (ii) may be used to reduce only 80 percent of AFSI (as described in section 56A(d)(1)) or taxable income (as described in section 172(a)(2)), respectively. However, section 172 provides exceptions to the general rule for nonlife insurance companies that are not in section 56A(d). In particular, section 172 provides that a nonlife insurance company's NOLs may be carried back for two years and carried forward 20 years and also that the NOLs are not subject to the 80 percent limit described in section 172(a)(2). *See* section 172(b)(1)(C) and (f). Stakeholders have observed that this disparity could create a substantial mismatch between AFSI and regular taxable income for nonlife insurance companies that does not exist for other corporations. The Treasury Department and the IRS request comments on how substantial this mismatch may be and the severity of the economic effects of such mismatch, whether rules should be provided to address this potential mismatch, and how the rules might operate.

B. *Limitation on FSNOLs and built-in losses acquired in successor transactions*

The existence of FSNOLs and built-in losses may incentivize acquisitions for Federal income tax reasons in a manner inconsistent with the purposes of section 56A. Accordingly, proposed §1.56A-23(e) and (f) would limit the use of FSNOLs and built-in losses, respectively, to which an applicable corporation succeeds (i) in a reorganization or liquidation described in section 381(a), or (ii) after a stock acquisition (including a stock acquisition in which the target corporation becomes a member of a tax consolidated group) (collectively, successor transactions, as defined in proposed §1.56A-23(e)(3)). The proposed limitation is intended to replicate the target corporation's ability to use the CAMT attributes prior to the transaction.

Proposed §1.56A-23(e) would limit the use of FSNOLs after a successor transaction. Under proposed §1.56A-23(e)(2), a successor corporation or successor group could use the FSNOLs of an acquired business to offset the successor's AFSI only if the acquired business is separately tracked in the successor's books and records, and only to the extent of the AFSI generated by the separately tracked business after the successor transaction (separately tracked income). Proposed §1.56A-23(e)(2)(ii) would provide rules for determining separately tracked income for purposes of proposed §1.56A-23(e), proposed §1.56A-23(e)(3)(iii) would provide rules regarding the separation of an acquired business from the associated acquired FSNOLs, and proposed §1.56A-23(e)(3)(iv) would provide rules regarding the integration of an acquired business with the successor's business.

Proposed §1.56A-23(f) would provide rules regarding the use of built-in losses after a successor transaction. Under proposed §1.56A-23(f), built-in losses that are recognized after a successor transaction would be treated as if they were acquired FSNOLs for purposes of proposed §1.56A-23(e). This rule is intended to ensure that acquired built-in losses are treated similarly to acquired FSNOLs. For this purpose, "built-in losses" would be defined by reference to certain specified provisions in section 382 of the Code. *See* proposed §1.56A-23(f)(2).

The foregoing limitations are modeled after the separate return limitation year rules in §§1.1502-15 and 1.1502-21(c). Stakeholders also had recommended applying section 382 to limit the use of FSNOLs and other CAMT attributes after an acquisition. However, the Treasury Department and the IRS are not proposing to apply the limitation in section 382 to FSNOLs or other CAMT attributes due to complexities that would arise from importing the section 382 limitation into the CAMT system. Additionally, applying section 382 and the regulations under section 382 to the use of FSNOLs and other CAMT attributes is not necessary to carry out the purposes of section 56A for two reasons: (i) the SRLY-like limitation in proposed §1.56A-23(e) would operate to deter acquisitions undertaken to acquire FSNOLs and other CAMT attributes, and (ii) the administrative burden of applying section 382 and the regulations under section 382 to FSNOLs and other CAMT attributes would outweigh the benefits of applying the section 382 limitation to FSNOLs.

XXIII. *Proposed §1.56A-24: AFSI Adjustments for Hedging Transactions and Hedged Items*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-24 would provide rules under section 56A regarding hedging transactions and hedged items.

A. *Overview*

Depending on the relevant accounting standards, certain categories of assets and liabilities (for example, derivatives) may be required to be periodically measured and reflected in the AFS at fair value. Stakeholders expressed concern regarding

the inclusion in a CAMT entity's AFSI of these periodic measurements of fair value, referred to by certain stakeholders as book or financial statement "mark-to-market" adjustments.

More specifically, some stakeholders expressed concern about situations in which an asset or a liability is periodically measured at fair value and reflected in FSI in a CAMT entity's AFS, but a related asset or liability is not. For example, in the case of a hedging transaction and the related item, the hedging transaction may be required to be periodically measured at fair value, but the related item may not. As a result, in situations involving hedging transactions, CAMT entities may have AFS mismatches between the hedging transaction and the related item, despite the hedging transaction and the related item offsetting each other economically. This mismatch may give rise to distortions in the determination of AFSI that should be alleviated with an adjustment to FSI to avoid the non-economic results that would arise absent an adjustment. The Joint Committee on Taxation has stated that Congress intended for mismatches involving certain hedging transactions to be addressed in the regulations.[2]

These situations also may cause volatility in the determination of a CAMT entity's AFSI due to unrealized gain and loss on a hedging transaction or the related item in cases in which there may not be corresponding economic volatility for the hedging transaction and the related item. For example, a CAMT entity may manage risk with respect to price fluctuations of commodities for future customer delivery obligations by entering into hedging transactions with similar terms as those customer delivery obligations. The delivery obligations may not be periodically measured at fair value, but the hedging transaction generally would be required to be periodically measured at fair value. As a result, a CAMT entity could have volatility in the determination of AFSI attributable to fluctuations in commodities prices even if those fluctuations are hedged as an economic matter. Stakeholders have expressed concern that absent an adjustment for these hedging transactions used to manage business risks, there may be unintended cashflow constraints due to the inclusion of unrealized gain or loss in FSI in the context of hedging transactions in which there generally are not meaningful economic gains or losses.

Some stakeholders also expressed concern about the AFSI treatment of a hedging transaction entered into to manage the foreign currency exposure of a net investment in a foreign operation. In particular, stakeholders expressed concern that changes in the fair value of these hedges are included in equity accounts, such as retained earnings or OCI, and as a result not included in FSI. However, these hedges may be marked to market for regular tax purposes, resulting in a divergence between FSI and regular taxable income due to the manner in which changes in values with respect to these particular hedging transactions are required to be reported under applicable financial accounting principles.

B. *Proposed regulations*

To address the mismatches and distortions described in part XXIII.A of this Explanation of Provisions, proposed §1.56A-24 would provide certain adjustments to AFSI (determined without regard to proposed §§1.56A-23 and 1.56A-24, but after giving effect to all other sections of the section 56A regulations) for an AFSI hedge or the related item. Under proposed §1.56A-24(b)(1), an "AFSI hedge*"* generally would include hedging transactions for regular tax purposes (for example, those defined in §1.1221-2(b), whether or not the character of gain or loss from the transaction is determined under §1.1221-2) as well as hedging transactions for financial accounting purposes. However, an AFSI hedge would not include a hedging transaction entered into by an insurance company to hedge obligations to holders of life insurance or annuity contracts that take into account the value of one or more specified assets or indices (for example, contracts that have guaranteed minimum benefits or crediting rates), because the amount of the liabilities that corresponds to the hedging transaction is also included in the insurance company's FSI. *See* proposed §1.56A-24(b)(1)(ii)(A). Under proposed §1.56A-24(b)(4), the term "hedged item" would mean an asset or a liability that is reflected in a CAMT entity's AFS for which there is a risk of interest rate or price changes, currency fluctuations, or other risk that is eligible to be managed by an AFSI hedge and that is managed by one or more AFSI hedges.

Proposed §1.56A-24(b)(3) would provide that the term *"*fair value measurement adjustment*"* means a change in the value of an asset or a liability due to required periodic determinations at least annually of the increases or decreases in fair value of that asset or liability included in a CAMT entity's FSI, regardless of whether the determinations are required due to the type of asset or liability or an election by the CAMT entity. A fair value measurement adjustment would not include an impairment loss or impairment loss reversal within the meaning of proposed §1.56A-1(b)(29) and (30), respectively. Under the definition of the term fair value measurement adjustment, changes in the value of an asset or liability not included in a CAMT entity's FSI, such as those generally resulting from a cash flow hedge (as defined in Accounting Standards Codification paragraph 815-30-20 or IFRS 9 Chapter 6.5.11), do not constitute fair value measurement adjustments.

Under proposed §1.56A-24(c)(2), a fair value measurement adjustment for an AFSI hedge or a hedged item for a taxable year would be disregarded by a CAMT entity for purposes of determining the CAMT entity's AFSI if the CAMT entity (i) has a fair value measurement adjustment with respect to an AFSI hedge but not the hedged item or (ii) has a fair value measurement adjustment with respect to a hedged item but not the AFSI hedge. However, in either situation, the fair value measurement adjustment would not be disregarded if either the AFSI hedge or hedged item is marked to market for regular tax purposes. In these cases, the book and regular tax treatment of the AFSI

[2] *See* Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 117th Congress (JCS–1–23), December 2023, at page 171 ("For example, under new section 56A(c)(15) and (e), the Secretary is intended to exercise authority to provide that gains and losses with respect to derivative contracts used to manage business risks are to be included in AFSI when such gains and losses are recognized for regular Federal income tax purposes.").

hedge or hedged item are likely to correspond (for example, the hedged item may be marked-to-market for both book and regular tax purposes), so that no adjustment to AFSI is needed.

The adjustments to AFSI in proposed §1.56A-24(c)(2) would delay the inclusion in AFSI of unrealized gain or loss attributable to fair value measurement adjustments for an AFSI hedge or a hedged item until the earlier of when the gain or loss on the corresponding hedged item or AFSI hedge (as applicable) is recognized for FSI purposes, or an "AFSI subsequent adjustment date" (as defined in proposed §1.56A-24(b)(2)) otherwise occurs. These adjustments to AFSI are intended to address certain financial accounting mismatches between an AFSI hedge and a hedged item by coordinating the timing of recognition between AFSI hedges and hedged items in a manner similar to other rules involving economically integrated transactions, such as §1.446-4.

The rules in proposed §1.56A-24(c)(2) are intended to avoid the inclusion of unrealized gain or loss in AFSI that is offset economically by a hedged item or AFSI hedge (as applicable) but for which there are timing differences for recognition for financial accounting purposes. By doing so, these proposed rules also are intended to avoid situations in which a CAMT entity would have volatility in the determination of AFSI (and, potentially, in the determination of whether the CAMT entity is subject to the CAMT) because only one of an AFSI hedge or a hedged item is subject to fair value measurement adjustments included in net income, and there is no corresponding difference for regular tax purposes. In the commodities hedging example described in part XXIII.A of this Explanation of Provisions, if the requirements of proposed §1.56A-24(c)(2) were satisfied, the hedging transaction would be an AFSI hedge for which fair value measurement adjustments would be disregarded until an AFSI subsequent adjustment date occurs, resulting in similar timing for the inclusion of gain or loss in AFSI between the AFSI hedge and the hedged item.

Proposed §1.56A-24(d) would apply in situations in which a CAMT entity marks to market a "net investment hedge," as defined in proposed §1.56A-24(b)(5), for regular tax purposes. Under proposed §1.56A-24(d), the CAMT entity would include the amount of mark-to-market gain or loss for regular tax purposes in AFSI. This proposed rule is intended to result in greater conformity between the timing of the net investment hedge for financial accounting purposes and for regular tax purposes by including the unrealized gain or loss for the net investment hedge in AFSI.

Proposed §1.56A-24(e)(1) would provide operative rules for the inclusion of certain taxable amounts in AFSI for fair value measurement adjustments disregarded from a CAMT entity's AFSI under proposed §1.56A-24(c)(2). Under proposed §1.56A-24(e)(1), if the fair value measurement adjustment includes items corresponding to items of income, gain, deduction, or loss for regular tax purposes, such as the accrual of original issue discount on a bond, those items would be taken into account for AFSI purposes.

Proposed §1.56A-24(e)(2) would provide for subsequent adjustments for an AFSI hedge or a hedged item (as applicable) in the taxable year in which there is an AFSI subsequent adjustment date. In general, proposed §1.56A-24(e)(2) would provide for the inclusion in AFSI of the cumulative fair value measurement adjustments previously disregarded in determining AFSI under proposed §1.56A-24(c)(2) and for certain adjustments to CAMT basis. Proposed §1.56A-24(e)(3) would provide for subsequent adjustments for a net investment hedge in the taxable year in which a net investment hedge matures or is sold, disposed of, or otherwise terminated, or the asset or liability that was a net investment hedge subject to §1.56A-24(d) otherwise ceases to constitute a net investment hedge.

These proposed rules address the situations described by stakeholders in which one component of a transaction is periodically measured at fair value and reflected in FSI in a CAMT entity's AFS, but a related asset or liability is not, without a corresponding mismatch in treatment for regular tax purposes. The Treasury Department and the IRS invite comments on whether there are other similar situations potentially giving rise to a substantial mismatch for which a similar adjustment to AFSI may be appropriate.

XXIV. *Proposed §1.56A-25: AFSI Adjustments for Mortgage Servicing Income*

Pursuant to the authority granted by section 56A(e), proposed §1.56A-25 would provide rules under section 56A(c)(10)(A) regarding mortgage servicing income. CAMT entities that hold contracts to service mortgage assets (mortgage servicing contracts) may have servicing assets or servicing liabilities related to those mortgage servicing contracts. For mortgage servicing contracts that are servicing assets, the relevant accounting standards (for example, ASC 860-50-35) generally require a CAMT entity to determine FSI by taking into account either changes in fair value of the mortgage servicing contracts or the amortization of the value of those contracts.

In general, for regular tax purposes, the treatment of certain sales of mortgages originated by a taxpayer and the income from related mortgage servicing contracts is determined under Rev. Rul. 91-46, 1991-2 C.B. 358 (for example, if the contract entitles the taxpayer to receive amounts that exceed reasonable compensation for the services to be performed, the income attributable to this excess is taken into account under the timing rules for stripped coupons in section 1286 of the Code). In addition, if the taxpayer is a dealer in securities under section 475 of the Code, the mark-to-market method of accounting generally applies to any securities, including any excess mortgage servicing rights treated as stripped coupons. As a result, the timing for the inclusion of items related to mortgage servicing contracts for financial accounting purposes may be different than the timing for the inclusion of items related to mortgage servicing contracts for regular tax purposes.

Consistent with section 56A(c)(10)(A), proposed §1.56A-25 would provide that AFSI is adjusted so as not to include any item of income in connection with a mortgage servicing contract any earlier than the period in which such income is included in gross income under chapter 1. This proposed rule implements the statutory provision, which results in consistent treatment of items of income in connection with a mortgage servicing contract of

a taxpayer for purposes of the CAMT and for regular tax purposes.

Section 56A(c)(10)(B) authorizes the Secretary to provide regulations to prevent the avoidance of taxes imposed by chapter 1 of subtitle A of the Code for amounts not representing reasonable compensation (as determined by the Secretary) with respect to a mortgage servicing contract. While this NPRM does not include proposed regulations under section 56A(c)(10)(B), the Treasury Department and the IRS continue to study the issue and invite comments concerning whether regulations should be issued pursuant to this specific grant of regulatory authority.

XXV. *Proposed §1.56A-26: AFSI Adjustments for Certain Related-Party Transactions and CAMT Avoidance Transactions*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-26 would provide rules regarding certain related-party transactions and CAMT avoidance transactions. The Treasury Department and the IRS are concerned that taxpayers may enter into transactions with related parties or enter into other transactions or arrangements in order to avoid the application of CAMT or to improperly reduce CAMT liability. Proposed §1.56A-26(b) would defer AFSI losses resulting from transactions between related parties. Proposed §1.56A-26(c) would provide an anti-abuse rule for arrangements undertaken with a principal purpose of avoiding CAMT, including avoiding treatment as an applicable corporation or reducing or otherwise avoiding a liability under section 55(a). Proposed §1.56A-26(c) permits the Commissioner to disregard or recharacterize such arrangements to the extent necessary to carry out the purposes of CAMT. An arrangement includes, for example, the filing of a financial statement with the SEC or with an agency of a foreign government that is equivalent to the SEC, where such filing is not required and is made for the purpose of affecting which financial accounting standard is considered the applicable financial accounting standard under the FPMG rules in proposed §1.59-3.

Proposed §1.56A-26(d) would require income, expense, gain, or loss arising from transactions between commonly controlled CAMT entities to be clearly reflected for purposes of the CAMT, consistent with the principles of section 482 of the Code. More specifically, proposed §1.56A-26(d) would require any item of income, expense, gain, or loss reflected in the FSI of a CAMT entity with respect to a controlled transaction or controlled transfer (as defined in §1.482-1(i)(8)) between two or more CAMT entities to be adjusted to reflect the principles of section 482 and the regulations under section 482, regardless of whether section 482 otherwise is considered to apply. This proposed rule would clarify that the principles of section 482 apply to determine the effect of controlled transactions and controlled transfers on AFSI. No inference is intended regarding how section 482 applies to affect any amount required for the calculation of AFSI without regard to this proposed rule.

XXVI. *Proposed §1.56A-27: AFSI Adjustments for Foreign Governments*

Pursuant to the authority granted by section 56A(c)(15) and (e), proposed §1.56A-27 would provide rules under section 56A regarding AFSI adjustments for income of foreign governments. These proposed rules would provide for an adjustment to AFSI of a foreign government for any amount that, if it were properly treated as gross income for regular tax purposes, would be excluded from gross income and exempt from taxation under subtitle A pursuant to section 892 of the Code.

Under proposed §1.56A-1(d)(2), except as provided in the section 56A regulations, a CAMT entity may not make any adjustments to its FSI in determining its AFSI. The Treasury Department and the IRS are of the view that any amount of FSI, if it were properly treated as gross income for regular tax purposes and would qualify for the exemption under section 892 for that person, should be excluded from that person's FSI when determining its AFSI only for purposes of determining CAMT liability. Therefore, proposed §1.56A-27(b) would provide for an adjustment to AFSI for income of foreign governments that qualifies for treatment under section 892.

The adjustment in proposed §1.56A-27 would apply only for purposes of determining CAMT liability, and not for purposes of determining whether a corporation is an applicable corporation under section 59(k). *See*, for example, proposed §1.59-2(c)(1)(ii)(B).

XXVII. *Proposed §1.59-2: General Rules for Determining Applicable Corporation Status*

Pursuant to the authority granted by section 59(k)(1)(C) and (k)(3), proposed §1.59-2 would provide rules under section 59(k) for determining whether a corporation is an applicable corporation for purposes of sections 55 through 59. Proposed §1.59-2(b) would provide definitions that apply for purposes of section 59, including the definition of an "applicable corporation." For purposes of the special rules provided in proposed §1.59-2(f) (*see* discussion in part XXVII.C of this Explanation of Provisions), proposed §1.59-2(b) would provide definitions for "relevant relationship criteria," "test group," and "test group parent." Proposed §1.59-2(b)(4) would define "relevant relationship criteria" to mean the relationship criteria set forth in the rules for the average annual AFSI tests under proposed §1.59-2(c)(1)(ii)(A), (c)(2)(ii)(A), or (c)(2)(iii)(A), as applicable. *See* discussion of the average annual AFSI tests in part XXVII.A of this Explanation of Provisions. Proposed §1.59-2(b)(5) would provide that the term "test group" means, with respect to a corporation, the corporation and all persons that are treated as related to such corporation under the relevant relationship criteria. Proposed §1.59-2(b)(6) would provide that the term "test group parent" means the relevant person(s) as described in proposed §1.59-2(b)(6)(i) through (vii). Terms used in proposed §§1.59-2 through 1.59-4 that are not defined in those sections have the meanings provided in proposed §1.56A-1(b).

A. *Average annual AFSI test*

1. *Corporation is Not a Member of an FPMG*

Proposed §1.59-2(c)(1) describes the average annual AFSI test applied to a cor-

poration that is not a member of an FPMG to determine whether such a corporation is an applicable corporation. Such a corporation meets the average annual AFSI test for a taxable year if its average annual AFSI for the 3-taxable-year period ending with such taxable year exceeds $1,000,000,000. For this purpose, the AFSI of the corporation and the AFSI of all persons treated as a single employer with the corporation under section 52(a) or (b) would be treated as the AFSI of the corporation. *See* proposed §1.59-2(c)(1)(ii)(A). Moreover, if a person treated as a single employer with a corporation has a taxable year that differs from the taxable year of the corporation, then the corporation's AFSI would include such person's AFSI for the taxable year of such person that ends with or within the taxable year of the corporation. *See* proposed §1.59-2(c)(1)(ii)(A).

Consistent with section 59(k)(1), the AFSI of a corporation described in proposed §1.59-2(c)(1)(i) and the AFSI of any person treated as a single employer with the corporation under section 52(a) or (b) would be determined without regard to certain specified AFSI adjustments. *See* proposed §1.59-2(c)(1)(ii)(B). Certain of the specified adjustments would be disregarded according to the terms of the statute. These are the adjustment for FSNOLs in proposed §1.56A-23, the adjustment for distributive share of partnership AFSI in proposed §1.56A-5, and the adjustment for covered benefit plans in proposed §1.56A-13. *See* section 59(k)(1)(B)(i) and (k)(1)(D)(i). In addition, the adjustments in proposed §§1.56A-6(b)(2) and 1.56A-8(c), which would decrease AFSI for foreign income taxes when the foreign tax credit is not claimed for regular tax purposes, would be disregarded so that, for testing purposes, there is equal treatment of those choosing to claim, and those not choosing to claim, the foreign tax credit. The adjustment to apply certain subchapter K principles provided in proposed §1.56A-20 would be disregarded to permit testing without the burden of determining that adjustment. Finally, the adjustment with respect to certain income of foreign governments provided in proposed §1.56A-27 would be disregarded because it would be inappropriate to disregard the income for testing purposes.

To avoid the duplication of AFSI, if a partnership is treated as a single employer with a corporation under section 52(a) or (b), then the AFSI of any partner in the partnership that is either that corporation or treated as a single employer with that corporation would be determined without regard to any amounts reflected in the partner's FSI that is derived from, and included in, the FSI of the partnership. *See* proposed §1.59-2(c)(1)(ii)(C).

To provide for the application of the rules relating to discharge of indebtedness income with respect to partnership investments, if a partnership is treated as a single employer with a corporation under section 52(a) or (b), then the exclusions from AFSI for discharge of indebtedness income in proposed §1.56A-21(c) apply to the partnership's AFSI, but are based on a determination of whether the relevant partner meets any of the exclusions provided in proposed §1.56A-21(c)(1) and (2), including the application of any resulting CAMT attribute reductions provided in proposed §1.56A-21(c)(4) and (5). *See* proposed §1.59-2(c)(1)(ii)(D).

2. *Corporation Is a Member of an FPMG*

Proposed §1.59-2(c)(2) describes the average annual AFSI test applied to a corporation that is a member of an FPMG for purposes of determining whether such corporation (FPMG corporation) is an applicable corporation. The FPMG corporation is subject to the two-prong average annual AFSI test described in proposed §1.59-2(c)(2) if it is a member of an FPMG at the beginning or end of its taxable year. *See* proposed §1.59-2(b)(3). Under the first prong, the average annual AFSI of the FPMG corporation for the 3-taxable-year period ending with such taxable year must exceed $1,000,000,000. *See* proposed §1.59-2(c)(2)(i)(A). For this purpose, the combined AFSI of the FPMG corporation and all relevant aggregation entities (as defined in proposed §1.59-2(b)(4)) is treated as the AFSI of the FPMG corporation. The relevant aggregation entities for an FPMG corporation are all members of the FPMG, other than the FPMG corporation itself, and any other person that is treated as a single employer with the FPMG corporation under section 52(a) or (b). If a relevant aggregation entity has a taxable year that differs from the taxable year of the FPMG corporation, then the FPMG corporation's AFSI includes such relevant aggregation entity's AFSI for the taxable year that ends with or within the taxable year of the FPMG corporation. If such relevant aggregation entity does not have a taxable year for regular tax purposes, its AFS reporting year is treated as its taxable year. *See* proposed §1.59-2(c)(2)(ii)(A).

Certain specified AFSI adjustments would be disregarded in applying the first prong of this test. In addition to those AFSI adjustments disregarded when applying the average annual AFSI test to corporations that are not members of an FPMG, the adjustments for income of CFCs and income effectively connected with a U.S. trade or business (*see* §§1.56A-6 and 1.56A-7, respectively) also would be disregarded, pursuant to section 59(k)(2)(A). *See* proposed §1.59-2(c)(2)(ii)(B).

For purposes of applying the $1,000,000,000 average AFSI threshold test in proposed §1.59-2(c)(2)(i)(A), an FPMG corporation that is a foreign corporation and any relevant aggregation entity that is not a United States person (as defined in section 7701(a)(30)) would not make any AFSI adjustment described in the section 56A regulations that is dependent on the treatment of an item for regular tax purposes, such as for depreciation (*see* section 56A(c)(13) and proposed §1.56A-15), if the FPMG corporation or relevant aggregation entity, as applicable, does not take such item into account for regular tax purposes. *See* proposed §1.59-2(c)(2)(ii)(C). If an AFSI adjustment provides for disregarding an FSI item and replacing it with an amount taken into account for regular tax purposes, neither would be taken into account, with the result that the FSI amount is included in AFSI. To illustrate, assume the following facts: A foreign corporation (FP) directly owns all the stock of another foreign corporation (FC) and the stock of a domestic corporation (DC); FP and FC are not CFCs and do not have U.S. shareholders that own (within the meaning of section 958(a)) stock of FP or FC; FP and FC are not engaged in a U.S. trade or business; and FP is the FPMG common parent of an FPMG, the members of which are FP, FC, and DC. Under this rule, with respect to FP's ownership of the stock of

FC, the AFSI of FP is determined without regard to the adjustments described in proposed §1.56A-4 (concerning AFSI adjustments with respect to stock of a foreign corporation). However, this rule does not preclude any adjustments described in proposed §1.56A-26.

This rule is intended to lessen the burden of determining AFSI when there is no regular tax treatment of an item while ensuring that the item is taken into account. Absent such a rule, it would be necessary to determine the regular tax treatment of an item solely for CAMT purposes. This would present an added compliance burden while not achieving the purpose of conforming the CAMT treatment of an item to the regular tax treatment of an item, since there is no regular tax treatment of such item. Moreover, specifically in the context of the AFSI adjustments with respect to stock of a foreign corporation in proposed §1.56A-4, the double counting concerns that support applying regular tax rules are not necessarily present in the case of a foreign corporation that does not take the item into account for regular tax purposes (such as a foreign corporation that is not a CFC that has U.S. shareholders that own (within the meaning of section 958(a)) stock of the foreign corporation). The Treasury Department and the IRS invite comment on the rule.

To avoid the duplication of AFSI, if a partnership is a relevant aggregation entity with respect to an FPMG corporation, then the AFSI of any partner in the partnership that is either the FPMG corporation or a relevant aggregation entity would be determined without regard to any amount reflected in the partner's FSI that is derived from, and included in, the FSI of the partnership. *See* proposed §1.59-2(c)(2)(ii)(D).

To provide for the application of the rules relating to discharge of indebtedness income with respect to partnership investments, if a partnership is a relevant aggregation entity with respect to an FPMG corporation, then the exclusions from AFSI for discharge of indebtedness income in proposed §1.56A-21(c) apply to the partnership's AFSI, but are based on a determination of whether the relevant partner meets any of the exclusions provided in proposed §1.56A-21(c)(1) and (2), including the application of any resulting CAMT attribute reductions provided in proposed §1.56A-21(c)(4) and (5). *See* proposed §1.59-2(c)(2)(ii)(E).

The proposed regulations provide a rule to avoid the duplication of AFSI in certain cases in which AFSI of a shareholder of a foreign corporation and AFSI of the foreign corporation would both be taken into account under the aggregation rules. *See* proposed §1.59-2(c)(2)(ii)(F). Specifically, for purposes of the $1,000,000,000 average AFSI threshold test in proposed §1.59-2(c)(2)(i)(A), the AFSI of a shareholder of a foreign corporation that is the FPMG corporation or a relevant aggregation entity with respect to the FPMG corporation (corporate aggregation entity) would be determined without regard to any item reflected in the FSI of the shareholder that is attributable to FSI of the FPMG corporation or corporate aggregation entity and that, under proposed §1.59-2(c)(2)(ii)(C) (concerning items that are not taken into account for regular tax purposes), is not disregarded, if either of two conditions is satisfied. First, the shareholder is the FPMG corporation and is a foreign corporation. Second, the shareholder is a relevant aggregation entity with respect to the FPMG corporation and is not a United States person (as defined in section 7701(a)(30) of the Code). Thus, proposed §1.59-2(c)(2)(ii)(F) would apply only to the extent that, absent application of this rule, items would be included in the AFSI of multiple persons for purposes of applying the $1,000,000,000 average AFSI threshold test in proposed §1.59-2(c)(2)(i)(A) to the FPMG corporation. To illustrate, assume the following facts: A foreign corporation (FP) directly owns all the stock of another foreign corporation (FC) and the stock of a domestic corporation (DC); FP and FC are not CFCs that have U.S. shareholders that own (within the meaning of section 958(a)) stock of FP or FC; FP and FC are not engaged in a U.S. trade or business; FP is the FPMG common parent of an FPMG, the members of which are FP, FC and DC; FC has $100x of FSI and AFSI; and for financial accounting purposes, FP accounts for its interest in FC under the equity method. Under proposed §1.59-2(c)(2)(i)(C) (concerning items of certain foreign persons not taken into account for regular tax purposes), FP's AFSI is determined without regard to the adjustments described in proposed §1.56A-4 (rules for foreign stock). Absent the application of this rule, FC's $100x of FSI would be included in FC's AFSI and FP's FSI under the equity method of accounting and therefore FP's AFSI for purposes of the $1,000,000,000 average AFSI threshold test in proposed §1.59-2(c)(2)(i)(A). Under proposed §1.59-2(c)(2)(ii)(F), the AFSI of FP is determined without regard to the $100x of FSI of FC that is included in the FSI of FP in order to prevent double counting of the $100x.

The Treasury Department and the IRS are studying whether additional guidance is needed to carry out the purposes of proposed §1.59-2(c)(2)(ii)(F), including guidance on determining when an item is attributable to FSI. The Treasury Department and the IRS welcome comments on this matter.

Under the second prong, the average annual AFSI of an FPMG corporation for the 3-taxable-year period ending with the taxable year must be $100,000,000 or more. *See* proposed §1.59-2(c)(2)(i)(B). For this purpose, rules similar to those applicable to a corporation that is not a member of an FPMG with respect to aggregating AFSI, disregarding certain specified AFSI adjustments, avoiding the duplication of partnership income, and accounting for adjustments applicable to discharge of indebtedness income with respect to partnership investments, would apply. *See* proposed §1.59-2(c)(2)(iii).

3. *Corporation in Existence for Less Than Three Taxable Years and Short Taxable Years*

Proposed §1.59-2(d) would implement the special rules in section 59(k)(1)(E) for applying the average annual AFSI test. If a corporation has been in existence for less than three taxable years, the average annual AFSI tests would be applied on the basis of the period during which the corporation, or any predecessor, was in existence. *See* proposed §1.59-2(d)(1) and (3). Under proposed §1.59-2(d)(2)(i), the AFSI for any taxable year of less than 12 months would be annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months in the short period.

A stakeholder recommended that extraordinary items in a short taxable year be disregarded in annualizing income for a short period. Proposed §1.59-2(d)(2)(ii) would provide that, in annualizing the income for a short period, items described as extraordinary items in §1.6655-2(f)(3)(ii)(A) are disregarded, but the items are included in AFSI for the annualized 12-month period after the AFSI for the short period has been annualized.

B. *Single employer*

Proposed §1.59-2(e) would provide rules under section 59(k)(1)(D) for determining whether a corporation and another person are treated as a single employer under section 52(a) or (b). Under these proposed rules, solely for purposes of determining whether a corporation is an applicable corporation, all AFSI of persons treated as a single employer with the corporation under section 52(a) or (b) would be treated as AFSI of that corporation.

In accordance with section 52(a), proposed §1.59-2(e)(1) generally would provide that corporations that are members of a controlled group of corporations are treated as a single employer. Section 52(a) and proposed §1.59-2(e)(1) would define a "controlled group of corporations" by reference to section 1563(a), except that "more than 50 percent" is substituted for "at least 80 percent" each place it appears in section 1563(a)(1). Section 1563(a)(1), (2), and (3) provide that a controlled group of corporations may be a parent-subsidiary controlled group, a brother-sister controlled group, or a combined group of corporations. Proposed §1.59-2(e)(1)(iii) would provide the definition of brother-sister controlled group in accordance with section 1563(f)(5). A controlled group of corporations is determined by taking into account the ownership interests described in section 1563(d)(1) and (2), as applicable.

In accordance with section 52(b), proposed §1.59-2(e)(2) generally would provide that trades or businesses that are under common control are members of a controlled group and are treated as a single employer. Section 52(b), which applies to partnerships, trusts, estates, corporations, and sole proprietorships, provides that the regulations under section 52(b) are to be based on principles similar to the principles that apply under section 52(a). Section 52(b) and §1.52-1 provide rules similar to the rules under section 52(a), but with certain modifications to account for different types of ownership interests. The constructive ownership rules under section 1563(d) that apply for purposes of section 52(a) also apply for purposes of section 52(b).

Section 1018(s)(3)(A) of the Technical and Miscellaneous Revenue Act of 1988 amended section 1563(d)(1)(B) to expand the constructive ownership rules of section 1563(e) that apply for purposes of section 1563(d)(1) to include section 1563(e)(2) relating to attribution from partnerships and section 1563(e)(3) relating to attribution from estates or trusts.

A controlled group of corporations under section 52(a), which cross-references section 1563, is determined based on all of the applicable constructive ownership rules of section 1563(e), including section 1563(e)(2) and (e)(3). By contrast, a group of trades or businesses under common control under section 52(b) is determined based on the constructive ownership rules in §1.52-1(b) and (c). The constructive ownership rules in §1.52-1(c)(1) were proposed to be revised to conform with the statutory amendment to section 1563(d)(1)(B) by a proposed regulation published in *the* ***Federal Register*** (88 FR 84770) on December 6, 2023. Specifically, that proposed regulation would revise §1.52-1(c)(1) to include a reference to the constructive ownership rules in §1.414(c)-4(b)(2), as revised by the same proposed regulation, that attribute ownership of stock directly or indirectly owned by or for a partnership, and a reference to the constructive ownership rules in §1.414(c)-4(b)(3) that attribute ownership of stock directly or indirectly owned by or for an estate or trust.

These proposed regulations would apply the constructive ownership rules under section 52(b) that are set forth in §1.52-1(c)(1) as revised by the proposed regulation published in the ***Federal Register*** at 88 FR 84770, and all references to §1.52-1(c) should be understood to include those changes. Proposed §1.59-2(e)(3) would provide that, in determining whether persons are treated as a single employer under section 52(a) or (b), section 1563(b) and §1.1563-1(b) (relating to component members of a controlled group of corporations) are not taken into account. Therefore, a foreign corporation subject to income tax under section 881 of the Code may be a member of a controlled group of corporations or a group of trades or businesses that are under common control and treated as a single employer under section 59(k)(1)(D) for purposes of proposed §1.59-2(c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(2)(iii)(A).

Proposed §1.59-2(e)(4) would provide that, although an S corporation, a RIC, or a REIT is excluded from the definition of an "applicable corporation," the S corporation, RIC, or REIT is not excluded from being treated as a single employer under section 52(a) or (b) for purposes of proposed §1.59-2(c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(2)(iii)(A).

C. *Aggregation group*

The Treasury Department and the IRS considered two approaches for applying the relevant aggregation rules necessary to determine a corporation's AFSI for purposes of the average annual AFSI test. The first approach would require the corporation to determine its test group as of the beginning of the taxable year for which the corporation is determining applicable corporation status and compute the AFSI of such test group for the relevant three-taxable-year period. Under this approach, the corporation would include in its AFSI for the three-taxable-year period the AFSI of the persons that were members of such test group regardless of whether the corporation was related to those persons under the relevant relationship criteria during the three-taxable-year-period. The second approach would require the corporation to include in its AFSI for the three-taxable-year period only the AFSI of persons it was related to under the relevant relationship criteria during the three-taxable-year period (and for the period in which they were related). The Treasury Department and the IRS are of the view that the second approach better implements the language of the statute, as it would decrease the instances in which a person's AFSI is duplicated in more than one corporation's AFSI for the same three-taxable-year test-

ing period. This approach is also consistent with rules provided by the Treasury Department and the IRS to determine the applicability of other sections of the Code, where such applicability is determined based on the size of the taxpayer.

Accordingly, proposed §1.59-2(f)(1) would provide special rules for applying the average annual AFSI test if a corporation's test group changes. These rules generally would require that a corporation include in its AFSI for a taxable year the AFSI of all persons treated as related to the corporation under the relevant relationship criteria at any point during the taxable year. If a person is treated as related to the corporation under the relevant relationship criteria for only a portion of the taxable year, the corporation includes in its AFSI for that taxable year the AFSI of the person for only the portion of the taxable year in which the relevant relationship criteria is satisfied. Similar to the rules in proposed §1.56A-3 for CAMT entities with a financial accounting period that differs from the CAMT entity's taxable year, the related person determines AFSI for the portion of the corporation's taxable year by performing an interim closing of its books. For example, if a corporation has the calendar year as its taxable year and a person becomes related to the corporation on April 1 and unrelated on November 1 of the taxable year, the person would perform an interim closing of its books at the end of the day on March 31 and October 31, and the corporation would include the AFSI of that person on the person's books (after taking the interim closing of the books into account) from April 1 through October 31 for that year.

However, proposed §1.59-2(f)(2) would provide additional rules if a corporation experiences a change in ownership during a taxable year. Proposed §1.59-2(f)(2)(i) would provide that a corporation (that is not a test group parent) experiences a change in ownership during a taxable year if the corporation is no longer related under the relevant relationship criteria at the end of the taxable year to a test group parent it was related to as of the first day of the taxable year. If a corporation is treated as related to multiple test group parents under the relevant relationship criteria as of the first day of the taxable year, then the determination of whether the corporation experiences a change in ownership is made separately with respect to each test group parent. Therefore, such a corporation could experience a change in ownership during the taxable year with respect to one test group parent but not another. If a corporation experiences a change in ownership during a taxable year that results in the corporation and a person no longer being treated as related under the relevant relationship criteria, proposed §1.59-2(f)(2)(i) would provide that the corporation does not include that person's AFSI in the corporation's AFSI for any period prior to the change in ownership to determine whether the corporation meets the average annual AFSI test described in proposed §1.59-2(c) for the taxable year in which the change in ownership occurs or for any subsequent taxable year so long as the corporation and the person remain unrelated. In addition, if a corporation experiences a change in ownership during a taxable year that results in the corporation joining a tax consolidated group that is an applicable corporation for the taxable year that includes the corporation's first taxable year in which it is a member of the tax consolidated group, then the corporation is treated as an applicable corporation beginning with the first taxable year in which it is a member of the tax consolidated group. For the taxable years in which the corporation is a member of the tax consolidated group, the corporation's AFSI is included in the tax consolidated group's AFSI under §1.1502-56A.

Stakeholders noted that the approach provided in section 3 of Notice 2023-7 would result in the AFSI of target and acquirer being double counted in determining the applicable corporation status of relevant corporations following the change in ownership. The Treasury Department and IRS are of the view that section 59(k)(1)(C)(i)(I) (providing that the term "applicable corporation" does not include any corporation if the corporation has a change in ownership) contemplates that a corporation that experiences a change in ownership should be afforded a "fresh start" following the change in ownership, including in determining the applicable corporation status of the corporation following the change in ownership (regardless of whether the corporation was an applicable corporation at the time of the change in ownership). Accordingly, a corporation that experiences a change in ownership sheds the AFSI history of any persons to which it is no longer related due to the change in ownership in determining its applicable corporation status following the change in ownership.

D. *Simplified method*

Section 59(k)(3)(A) authorizes the Secretary to issue regulations or other guidance providing a simplified method for determining whether a corporation is an applicable corporation subject to the CAMT. Under that authority, proposed §1.59-2(g) would provide a simplified safe harbor method for determining applicable corporation status. Except as discussed in this part XXVII.D of this Explanation of Provisions, the proposed regulations regarding the simplified method would be consistent with section 5 of Notice 2023-7.

Proposed §1.59-2(g)(2) would provide that, under the simplified method, the average annual AFSI tests are applied with specified modifications. Under these modifications, the dollar thresholds in proposed §1.59-2(c)(1)(i) and (c)(2)(i)(A) would be reduced from $1 billion to $500 million, and the dollar threshold in proposed §1.59-2(c)(2)(i)(B) would be reduced from $100 million to $50 million.

Some stakeholders suggested that these reduced dollar thresholds, which would be consistent with the thresholds under the simplified method in section 5 of Notice 2023-7, should be raised. Other stakeholders suggested that these thresholds could be lowered further if necessary to extend the applicability of the safe harbor method. The thresholds used in Notice 2023-7 are based on an analysis prepared by the Treasury Department to reduce the risk that entities that meet the simplified method thresholds would have been applicable corporations subject to CAMT liability under the statutory tests. Accordingly, the thresholds used in Notice 2023-7 and that would be provided under proposed §1.59-2(g)(2) are not intended to permit a corporation that would be an applicable corporation under the statutory tests to avoid that status by using the simplified method. The proposed regulations would retain these reduced thresholds but

allow for further modifications in IRB guidance.

Proposed §1.59-2(g)(2)(iii)(B) would further provide that, in determining AFSI under the simplified method, the only AFSI adjustments are those in proposed §1.56A-8(b) (concerning taxes) and, solely for purposes of proposed §1.59-2(c)(2)(i)(B) (the $100 million second prong of the FPMG test), in proposed §1.56A-7 (concerning effectively connected income). In determining the AFSI of a person whose financial results are reflected on a consolidated AFS, those members of a test group whose financial results are reflected on the consolidated AFS would be treated as a single CAMT entity for purposes of §1.56A-1(c)(3) and (4) (regarding FSI of a CAMT entity whose financial results are reflected on a consolidated AFS). Thus, consolidation entries would be taken into account and would not be disregarded, except for consolidation entries that eliminate transactions between persons whose AFSI is not aggregated for purposes of the average annual AFSI tests (that is, persons that are neither treated as a single employer under section 52(a) or (b) nor members of an FPMG). *See* proposed §1.59-2(g)(2)(iii)(A). Section 5.03(2)(c)(ii) of Notice 2023-7 did not extend single CAMT entity treatment to members of an FPMG. The proposed simplified method also would permit a corporation that has a financial reporting year (AFS year) that differs from its taxable year to determine its AFSI by using its AFS year. *See* proposed §1.59-2(g)(2)(iv).

Under section 5.03(1) of Notice 2023-7, the simplified method applies only for the first taxable year beginning after December 31, 2022. Stakeholders recommended that the simplified method be extended to subsequent taxable years. The simplified method should be extended to apply for any taxable year for which applicable corporation status is relevant. *See* proposed §1.59-2(g)(1).

E. *Termination of applicable corporation status*

Proposed §1.59-2(h) would provide rules regarding the termination of applicable corporation status under section 59(k)(1)(C). Under proposed §1.59-2(h)(1)(i), a corporation's status as an applicable corporation would terminate following certain ownership changes described in proposed §1.59-2(f)(2)(i) (generally, an ownership change in which the corporation and its test group parent(s) no longer satisfy the relationship criteria under section 52(a) or (b) or section 59(k)(2)(A), as applicable). However, proposed §1.59-2(h)(3)(ii) would provide that if a corporation whose status as an applicable corporation terminates for the taxable year due to a change in ownership that results in the corporation joining a tax consolidated group that is an applicable corporation for the tax consolidated group's taxable year that includes such taxable year, then the corporation is also treated as an applicable corporation for such taxable year and subsequent taxable years, as applicable.

Under proposed §1.59-2(h)(1)(ii), a corporation's status as an applicable corporation also would terminate if the corporation did not meet the average annual AFSI test for five consecutive taxable years. As the determination of a corporation's status as an applicable corporation for a taxable year is based on average annual AFSI for a prior three-taxable-year period, a corporation with AFSI for a taxable year that is unusually high or inconsistent with historical levels or a corporation that is experiencing a consistent downward trend in AFSI for each taxable year would continue to remain an applicable corporation until such time that its average annual AFSI for the three taxable years either no longer includes an anomaly year or fully captures the downward trend AFSI. Accordingly, five taxable years is an appropriate period for determining whether the corporation's status should terminate under proposed §1.59-2(h).

Finally, proposed §1.59-2(h)(3)(i) would provide that, except for a corporation that joins a tax consolidated group that is already an applicable corporation, a corporation whose status as an applicable corporation is terminated under proposed §1.59-2(h)(1) continues to apply the rules in proposed §1.59-2 to determine whether it is an applicable corporation for the taxable year in which the status termination occurs (that is, the corporation may become an applicable corporation for the same taxable year in which its status terminates or for any taxable year thereafter).

F. *Substantiation and reporting requirements*

Proposed §1.59-2(i) would require a corporation (other than an S corporation, a RIC, or a REIT) to maintain books and records sufficient to demonstrate whether the corporation is an applicable corporation for any taxable year, including the identification of all persons treated as a single employer with the corporation under section 52(a) or (b) and whether the corporation is a member of an FPMG under §1.59-3. Proposed §1.59-2(j) would require a corporation (other than an S corporation, a RIC, or a REIT) to provide information to demonstrate whether the corporation is an applicable corporation in the form and manner as Form 4626 and other applicable forms (or any successor forms) or instructions prescribe.

XXVIII. *Proposed §1.59-3: Rules for Foreign-parented Multinational Groups*

Pursuant to the authority granted by section 59(k)(2)(B), (k)(2)(D), and (k)(3), proposed §1.59-3 would provide rules under section 59(k) for determining whether a corporation is a member of an FPMG. As discussed in part XXVII of this Explanation of Provisions, the average annual AFSI tests that apply in determining whether a corporation is an applicable corporation depend on whether the corporation is a member of an FPMG.

A. *FPMG*

Proposed §1.59-3(c) would define an FPMG with respect to any taxable year of a corporation as two or more entities, one of which is the corporation, if: (1) at least one of the entities is a domestic corporation and at least one of the entities is a foreign corporation; (2) the entities are included in the same applicable financial statement for that taxable year; and (3) one of the entities is an FPMG common parent.

Under the proposed regulations, an FPMG common parent would be an ultimate parent that is a foreign corporation. *See* proposed §1.59-3(b)(9). An ultimate parent is an entity that has a controlling interest in at least one other entity and in which no entity has a controlling inter-

est. *See* proposed §1.59-3(b)(12). A controlling interest is generally based on the entity's applicable financial accounting standard. Both terms are described subsequently.

In general, a foreign corporation includes, in addition to a foreign corporation for regular tax purposes, a deemed foreign corporation. *See* proposed §1.59-3(b)(7). A deemed foreign corporation is an ultimate parent that is not a corporation and that directly or indirectly owns, other than through a domestic corporation (excluding a deemed domestic corporation), (1) a foreign trade or business as defined in §1.989(a)-1(c), or (2) an equity interest in a foreign corporation in which the ultimate parent has a controlling interest (including through a domestic corporation). *See* proposed §1.59-3(e). For example, if the ultimate parent is a partnership (PRS) that owns two assets, all the stock of a domestic corporation (DC) and 15 percent of the stock of a foreign corporation (FC), with the other 85 percent of the stock of FC owned by DC, and PRS has a controlling interest in FC, then PRS would be a deemed foreign corporation. However, if DC owned all the stock of FC, then PRS would not be a deemed foreign corporation. This rule reflects that, in some cases, the U.S. tax classification of the ultimate parent may have minimal or no U.S. tax relevance aside from CAMT and, without this rule, the FPMG rules could effectively be elective.

In general, a domestic corporation includes, in addition to a domestic corporation for regular tax purposes, a deemed domestic corporation. *See* proposed §1.59-3(b)(5). For purposes of the FPMG determination under proposed §1.59-3, a U.S. trade or business for purposes of section 882 of a foreign corporation (excluding a deemed foreign corporation) is treated as if it were a domestic corporation separate from, and wholly owned by, the foreign corporation. *See* proposed §1.59-3(d). This allows the first prong of the FPMG definition (requiring at least one domestic corporation and at least one foreign corporation) to be met in the case of a single foreign corporation that is engaged in a U.S. trade or business. *See* proposed §1.59-3(j)(1) (*Example 1*). A U.S. trade or business is treated as a separate deemed domestic corporation only for purposes of the FPMG determination.

The foreign corporation may be engaged, or treated as engaged, in a U.S. trade or business as a result of activities of one or more disregarded entities or pass-through entities in which the foreign corporation has a direct or indirect interest. For example, if a foreign corporation owns a disregarded entity and that disregarded entity owns an interest in a partnership that is engaged in a U.S. trade or business, the foreign corporation's U.S. trade or business resulting from its indirect ownership of the partnership interest will be treated as a separate domestic corporation that is wholly owned by the foreign corporation.

For purposes of the FPMG determination under proposed §1.59-3, an entity is any CAMT entity and any deemed domestic corporation. Any disregarded entity or branch that is owned by a CAMT entity, including through ownership of one or more disregarded entities or branches, is treated as part of that CAMT entity, except to the extent the disregarded entity or branch is a deemed domestic corporation. *See* proposed §1.59-3(b)(6). For example, if a foreign corporation owns a disregarded entity that owns a second disregarded entity, both disregarded entities would be treated as part of the foreign corporation. If, instead, the foreign corporation owned a branch that was engaged in a U.S. trade or business for purposes of section 882, the U.S. trade or business would be treated as a separate domestic corporation that is wholly owned by the foreign corporation. As a result, even if there is only one legal entity, there may be two entities for purposes of proposed §1.59-3, and that legal entity alone may qualify as an FPMG.

B. *Controlling interest*

Whether an entity has a controlling interest is determined under proposed §1.59-3(f). Under proposed §1.59-3(f)(1) an entity (upper-tier entity) would have a controlling interest in another entity (lower-tier entity) if, under the applicable financial accounting standard (as described in part XXVIII.C of this Explanation of Provisions), the upper-tier entity's consolidated financial statement is required to reflect the assets, liabilities, equity, income, and expenses of the lower-tier entity. An upper-tier entity may have a controlling interest in a lower-tier entity without having a direct interest in that entity. Whether the upper-tier entity has a controlling interest under proposed §1.59-3(f)(1) is based on the rules of the applicable financial accounting standard and therefore is not dependent on what is reflected in the entities' financial statements. For example, the analysis is not impacted by whether a consolidated financial statement is prepared and, if it is prepared, whether an entity's financial results are reflected in the consolidated financial statement. As a result, if a consolidated financial statement is not prepared, an upper-tier entity may nonetheless have a controlling interest in a lower-tier entity under the applicable financial accounting standard, or if a consolidated financial statement is prepared but erroneously excluded an entity, the upper-tier entity would still have a controlling interest in that erroneously excluded entity.

In addition, under proposed §1.59-3(f)(2), there are three circumstances in which an upper-tier entity has a controlling interest in another entity even if there would not be a controlling interest under the applicable financial accounting standard. First, the upper-tier entity has a controlling interest in any deemed domestic corporation that the upper-tier entity, or any foreign corporation in which the upper-tier entity has a controlling interest, is treated as owning under proposed §1.59-3(d). For example, if the upper-tier entity is engaged in a U.S. trade or business and therefore is deemed to own a deemed domestic corporation under proposed §1.59-3(d), the upper-tier entity would be treated as having a controlling interest in that deemed domestic corporation even if for accounting purposes there would be only one entity and therefore no consolidated financial statement. Similarly, if the upper-tier entity has a controlling interest in a foreign corporation that is engaged in a U.S. trade or business and therefore is deemed to own a deemed domestic corporation under proposed §1.59-3(d), then the upper-tier entity is treated as having a controlling interest in that deemed domestic corporation even if that deemed domestic corporation does not exist under the appli-

cable financial accounting standards. *See* proposed §1.59-3(f)(2)(i).

Second, if an entity is owned, directly or indirectly, by a member of an FPMG without regard to this controlling interest rule and both entities are in the same section 52 group, then the member of the FPMG (and therefore the FPMG common parent) would have a controlling interest in the entity. A section 52 group, with respect to a person, means that person and the persons whose AFSI is required to be aggregated with the AFSI of that person under proposed §1.59-2(c)(1)(ii)(A). *See* proposed §1.59-3(b)(11). If a member of the FPMG has a controlling interest in an entity under this rule, any other member of the FPMG that has a controlling interest in that member (whether pursuant to this rule or another one) would also have a controlling interest in the entity that the member has a controlling interest in under this rule. The rule applies iteratively up the chain of entities with controlling interests, ending with the FPMG common parent. *See* proposed §1.59-3(f)(3). This rule applies only to controlling interests under proposed §1.59-3(f)(2)(ii) because the other controlling interest rules in proposed §1.59-3(f)(2) apply accounting principles to determine controlling interests, which include direct and indirect controlling interests. For example, if a foreign corporation has a controlling interest in only one entity, which is a domestic subsidiary, under its applicable financial accounting standard and no entity has a controlling interest in the foreign corporation, so the foreign corporation would be the FPMG common parent, then if either the foreign corporation or domestic subsidiary also owns an interest in another entity and that entity is part of either the foreign corporation's or domestic subsidiary's section 52 group, the foreign corporation or domestic subsidiary has a controlling interest in such other entity under this rule (and therefore, either way, the foreign corporation has a controlling interest in such entity). *See* proposed §1.59-3(f)(2)(ii) and (f)(3).

Third, the upper-tier entity has a controlling interest in any entity in which it would have a controlling interest but for the fact that the entity is (or would be) excluded from the upper-tier entity's consolidated financial statement: (1) based on size or materiality; (2) because the entity is held for sale; (3) because the entity or business is being wound down, liquidating, or otherwise ceasing operations or being terminated or disposed of; or (4) because the entity is permitted but not required to be excluded under the applicable financial accounting standard from a consolidated financial statement of the upper-tier entity. For example, if a foreign corporation wholly owned a domestic corporation that was held for sale, even if the foreign corporation is not treated as having a controlling interest in the domestic corporation under the applicable financial accounting standard because the stock of the domestic corporation is held for sale, the foreign corporation would be treated as having a controlling interest in the domestic corporation.

The Treasury Department and the IRS are considering structures that may result in divergence between the financial accounting rules and economics (for example, where taxpayers own a significant economic interest in an entity but are not treated as having a controlling interest), as well as how to address structures that are linked, including multi-parented groups, companies with stapled stock, and dual listed companies, as those structures may present additional questions regarding which entity is the ultimate parent for purposes of determining whether there is an FPMG and who are the members of the FPMG under proposed §1.59-3. Future guidance may include these structures for determining the FPMG and its members, including by treating more than one entity as an FPMG common parent of the FPMG.

C. *Applicable financial accounting standard*

Under the general rule in proposed §1.59-3(f)(1), the determination of whether an upper-tier entity has a controlling interest in a lower-tier entity would depend on the applicable financial accounting standard. The applicable financial accounting standard for this purpose would be GAAP unless an exception applies. *See* proposed §1.59-3(g)(1). Proposed §1.59-3(g)(2) would identify the exceptions, which can only apply in cases in which there is not a GAAP consolidated financial statement prepared that includes the ultimate parent (determined by treating GAAP as the applicable financial accounting standard). *See* the last sentence of proposed §1.59-3(g)(2)(i).

The goal of these exceptions is, for cases in which a group prepares a consolidated financial statement that is of the ultimate parent and that is filed with the SEC or a foreign equivalent, to apply the controlling interest test based on the financial accounting standard used in preparing that consolidated financial statement. The Treasury Department and the IRS are of the view that this would appropriately reduce compliance burden because the controlling interest determination required under proposed §1.59-3(f) would generally already have been made for purposes of preparing the consolidated financial statement and would increase reliability due to review by an external auditor and regulator.

For special cases, such as consolidated financial statements of the ultimate parent that are prepared under multiple financial accounting standards, there would be a prioritization of GAAP over IFRS and IFRS over other financial accounting standards. This order of priority is set forth in proposed §1.59-3(g)(2)(i) through (iii). If there are no consolidated financial statements of the ultimate parent, if consolidated financial statements are prepared for only a sub-group that does not include the ultimate parent, or if there are multiple consolidated financial statements at the same priority but for different ultimate parents, GAAP would be the default financial accounting standard for purposes of applying the controlling interest test for FPMG determination purposes. *See* proposed §1.59-3(g)(1).

Under the first exception, IFRS is the applicable financial accounting standard if the assets, liabilities, equity, income, and expenses of the corporation being tested for applicable corporation status (tested corporation) are reflected in the consolidated financial statement described in §1.56A-2(c)(2)(i) of its ultimate parent (determined by treating IFRS as the applicable financial accounting standard). *See* proposed §1.59-3(g)(2)(ii). A consolidated financial statement is described in proposed §1.56A-2(c)(2)(i) if it is prepared in accordance with IFRS and filed

with the SEC or with an agency of a foreign government that is equivalent to the SEC. For example, if the assets, liabilities, equity, income, and expenses of the tested corporation are reflected only in consolidated financial statements described in proposed §1.56A-2(c)(1) (GAAP) and (c)(2)(i) (IFRS) but the GAAP consolidated financial statement is not that of its ultimate parent, whereas the IFRS consolidated financial statement is that of its ultimate parent, then IFRS would be the applicable financial accounting standard. If, instead, the IFRS consolidated financial statement is not that of its ultimate parent, then the first exception would not apply and, because the second exception is not relevant under these facts, GAAP would be the applicable financial accounting standard.

Under the second exception, a financial accounting standard other than GAAP or IFRS would be the applicable financial accounting standard if the assets, liabilities, equity, income, and expenses of the tested corporation are reflected in a consolidated financial statement described in §1.56A-2(c)(3)(i) prepared using the financial accounting standard and the consolidated financial statement is that of the ultimate parent (as determined under that financial accounting standard). *See* proposed §1.59-3(g)(2)(iii)(A). A consolidated financial statement is described in §1.56A-2(c)(3)(i) if it is prepared in accordance with another generally accepted accounting standard and filed with the SEC or with an agency of a foreign government that is equivalent to the SEC. If these conditions are met for more than one consolidated financial statement prepared under different financial accounting standards (other than GAAP or IFRS), then the exception applies only if the ultimate parent is the same under each financial accounting standard (otherwise, GAAP would be the applicable financial accounting standard). *See* proposed §1.59-3(g)(2)(iii)(B).

In such cases, if the accounting standard used to prepare one of those consolidated financial statements was the applicable financial accounting standard in the prior taxable year, that accounting standard would be the applicable financial accounting standard. *See* proposed §1.59-3(g)(2)(iii)(B)(*1*). If none of the consolidated financial statements were prepared using the applicable financial accounting standard from the prior taxable year, the tested corporation would choose one of the accounting standards used to prepare those consolidated financial statements to be the applicable financial accounting standard, provided that the tested corporation specifies that choice on a statement attached to the Form 4626, *Alternative Minimum Tax-Corporations* (or any successor form), of the tested corporation or as otherwise directed in the instructions to the form for the first applicable tax year. If the tested corporation does not choose an accounting standard, chooses one that is not permitted, or fails to specify its choice as required, the Commissioner would have discretion to either treat GAAP as the applicable financial accounting standard (consistent with the default rule) or to treat the accounting standard used to prepare one of those consolidated financial statements as the applicable financial accounting standard. *See* proposed §1.59-3(g)(2)(iii)(B)(*2*).

The exceptions apply in descending order and only if there is not a GAAP consolidated financial statement prepared that is that of the ultimate parent, as determined by treating GAAP as the applicable financial accounting standard. Therefore, if an exception under an earlier paragraph of proposed §1.59-3(g)(2) applies, the later exceptions do not. *See* proposed §1.59-3(g)(2)(i). For example, if proposed §1.59-3(g)(2)(ii) applies (regarding IFRS), then proposed §1.59-3(g)(2)(iii) (regarding financial accounting standards other than GAAP or IFRS) does not apply.

For purposes of the applicable financial accounting standard determination, the assets, liabilities, equity, income, and expenses of the tested corporation are treated as reflected in a consolidated financial statement if either they are reflected in the consolidated financial statement, or they would have been but for the tested corporation being excluded for a reason mentioned in the controlling interest test in proposed §1.59-3(f)(2)(iii)(A) through (D). For example, if the assets, liabilities, equity, income, and expenses of the tested corporation would have been reflected in the consolidated financial statement but for the fact the stock of the tested corporation is held for sale, the assets, liabilities, equity, income, and expenses of the tested corporation would be treated as reflected in the consolidated financial statement. *See* proposed §1.59-3(g)(3).

The tested corporation is required to specify the financial accounting standard that is its applicable financial accounting standard on a statement attached to the Form 4626 (or any successor form) of the tested corporation or as otherwise directed in the instructions to the form each taxable year the applicable financial accounting standard is relevant in determining whether the tested corporation is a member of an FPMG. *See* proposed §1.59-3(g)(4).

D. *Included in the same applicable financial statement for that taxable year and FPMG members*

Under proposed §1.59-3(h), the FPMG common parent and all entities in which the FPMG common parent has a controlling interest at any time during the taxable year would be included in the same applicable financial statement for that taxable year for purposes of proposed §1.59-3. The relevant taxable year is dependent on who is applying the provision and would generally be the taxable year of the corporation determining if it is an applicable corporation. For purposes of determining which entities are included in the same applicable financial statement for that taxable year, it is not relevant whether a consolidated financial statement of the FPMG common parent is prepared or whether an entity is included in a consolidated financial statement of the FPMG common parent or would be if one was prepared. For example, if the FPMG common parent is treated as having a controlling interest in an entity under proposed §1.59-3(f)(2) during the taxable year, that entity will be treated as included in the same applicable financial statement for that taxable year. The entities treated as included in the same applicable financial statement for that taxable year may differ from the entities included in the applicable financial statement(s) determined under proposed §1.56A-2.

Each entity included in the same applicable financial statement for that taxable year under proposed §1.59-3(h) as the FPMG common parent is a member of

that FPMG (including the FPMG common parent). *See* proposed §1.59-3(i). As with the determination of who is included in the same applicable financial statement for that taxable year, the members of the FPMG are not dependent on whether there is a consolidated financial statement or whether the entity is included on one. For example, if CP is the FPMG common parent and CP has a controlling interest in A, B, and C during the taxable year and no consolidated financial statement is prepared, then all those entities (A, B, C, and CP) would be included in the same applicable financial statement for that taxable year for purposes of this test and would be members of the FPMG that has CP as its FPMG common parent.

XXIX. *Proposed §1.59-4: Rules for Determining the CAMT FTC*

A. *Overview*

Under section 59(l), if an applicable corporation chooses to claim a foreign tax credit for any taxable year, the applicable corporation is allowed a CAMT foreign tax credit (CAMT FTC) for the taxable year. Section 59(l)(1) provides that the amount of the CAMT FTC for the applicable corporation for the taxable year equals the sum of:

(i) The lesser of (A) the aggregate of the applicable corporation's pro rata share (as determined under section 56A(c)(3)) of the amount of income, war profits, and excess profits taxes (within the meaning of section 901) imposed by any foreign country or possession of the United States that are taken into account in the AFS of each CFC with respect to which the applicable corporation is a U.S. shareholder, and paid or accrued (for Federal income tax purposes) by each such CFC, or (B) the product of the amount of the adjustment under section 56A(c)(3) and the percentage specified in section 55(b)(2)(A)(i) (currently, 15 percent); and

(ii) In the case of an applicable corporation that is a domestic corporation, the amount of foreign income taxes imposed by any foreign country or possession of the United States to the extent such taxes are taken into account in the applicable corporation's AFS and paid or accrued (for Federal income tax purposes) by the applicable corporation.

Section 59(l)(2) further provides that, if an applicable corporation's pro rata shares of foreign income taxes of the CFCs in which it is a U.S. shareholder exceeds 15 percent of the adjustment under section 56A(c)(3) (such excess, unused CFC taxes), then the unused CFC taxes are carried forward to any of the first five succeeding taxable years to the extent not absorbed in a prior taxable year. Finally, section 59(l)(3) authorizes the Secretary to issue regulations or other guidance as is necessary to carry out the purposes of section 59(l).

Pursuant to the authority granted by section 59(l)(3), proposed §1.59-4 would provide rules under section 59(l) for determining the amount of the CAMT FTC that may be claimed in a taxable year.

B. *Eligible taxes*

Generally, under proposed §1.59-4, a CAMT FTC would be available only with respect to an "eligible tax." Under proposed §1.59-4(b)(1), an "eligible tax" would include a foreign income tax other than a foreign income tax for which a credit is disallowed or suspended for regular tax purposes under sections 245A(d) and (e)(3), 901(e) and (f), 901(i) through (m), 907, 908, 909, 965(g), 999, and 6038(c) of the Code.

The Treasury Department and the IRS are of the view that the policies underlying these disallowances and suspensions for regular tax purposes apply equally in the context of the CAMT FTC. For instance, the Treasury Department and the IRS are of the view that CAMT FTCs should not be available with respect to taxes paid or accrued to specified foreign countries under section 901(j) based on the same foreign policy grounds that justify the disallowance for regular tax purposes. Accordingly, the Treasury Department and the IRS are exercising the authority under section 59(l)(3) to incorporate the specified disallowances and suspensions into CAMT to carry out the purposes of section 59(l). Incorporating the same amount of disallowances or suspensions for regular tax purposes, instead of creating a separate, parallel set of CAMT FTC rules, is intended to reduce taxpayers' compliance burden and the IRS's administrative burden.

C. *Amount of CAMT FTC*

Proposed §1.59-4(c) would provide rules for determining the amount of the CAMT FTC an applicable corporation can claim if it chooses to claim the foreign tax credit under section 901. Generally, for an applicable corporation that is a domestic corporation, the amount of the CAMT FTC for the taxable year would equal the sum of: (i) the lesser of (A) the aggregate of the applicable corporation's pro rata share of taxes of CFCs, as determined under proposed §1.59-4(d), or (B) the product of the amount of the adjustment under proposed §1.56-6(b)(1) and the percentage specified in section 55(b)(2)(A)(i) (currently, 15 percent), and (ii) the amount of eligible taxes paid by the applicable corporation during the taxable year, to the extent the taxes have been taken into account, within the meaning of proposed §1.56A-8(d), on the applicable corporation's AFS.

Proposed §1.59-4(d) would provide rules for determining an applicable corporation's pro rata share of the taxes of a CFC in which the applicable corporation is a U.S. shareholder for a taxable year. Generally, under proposed §1.59-4(d), an applicable corporation's pro rata share of the taxes of a CFC in which the applicable corporation is a U.S. shareholder for the taxable year is the sum of two amounts: (i) the applicable corporation's pro rata share of taxes under section 960(b) of the Code, and (ii) the applicable corporation's pro rata share of eligible current year taxes, as defined in §1.960-1(b)(5), of the CFC, in each case reduced to reflect the suspensions and disallowances described in the definition of "eligible tax" that apply at the level of the U.S. shareholder.

Specifically, under proposed §1.59-4(d)(2), an applicable corporation may claim a CAMT FTC for the amount of foreign income taxes deemed paid by the applicable corporation under §1.960-3(b) for its taxable year, to the extent the taxes have been taken into account, within the

meaning of §1.56A-8(d), on the AFS of the applicable corporation or any CFC with respect to which the applicable corporation is a U.S. shareholder. Under proposed §1.59-4(d)(3), an applicable corporation may claim a CAMT FTC for its pro rata share of eligible current year taxes, as defined in §1.960-1(b)(5), for a taxable year. The applicable corporation's pro rata share of eligible current year taxes comprises: (i) the amount of eligible current year taxes that are deemed paid by the applicable corporation under §1.960-2(b) for regular tax purposes (relating to foreign income taxes properly attributable to subpart F income) for the taxable year; (ii) the aggregate of the applicable corporation's proportionate share of eligible current year taxes of the CFC for each tested income group within each section 904 category of the CFC, as determined under §1.960-2(c)(5) for regular tax purposes for the taxable year; (iii) in the case of a subpart F income group or tested income group within a section 904 category of the CFC for which the denominator of the applicable corporation's proportionate share fraction (as described in §1.960-2(b)(3)(i) and (c)(5), respectively) is zero or less than zero (which may occur because the CFC has a loss in such income group or, in the case of a subpart F income group, because the denominator of the fraction is reduced under §1.960-2(b) in respect of the current year E&P limitation or a chain deficit under section 952(c)(1)(A) or (C), respectively), the aggregate amount of eligible current year taxes of the CFC for each such subpart F income group and tested income group within a section 904 category of the CFC multiplied by the pro rata share percentage, as defined in proposed §1.59-4(b)(3), for the taxable year of the CFC that ends with or within the taxable year of the applicable corporation; and (iv) the aggregate amount of eligible current year taxes of the CFC for each residual income group of the CFC multiplied by the pro rata share percentage, as defined in proposed §1.59-4(b)(3), for the taxable year of the CFC that ends with or within the taxable year of the applicable corporation. Finally, the applicable corporation can claim a CAMT FTC for its pro rata share of taxes of its CFC only to the extent the taxes have been taken into account, within the meaning of proposed §1.56A-8(d), on the AFS of the CFC or the applicable corporation. As reflected in proposed §1.59-4(d)(2), the Treasury Department and the IRS are of the view that providing a CAMT FTC for PTEP taxes deemed paid by the applicable corporation would be consistent with the purposes of section 59(l). Furthermore, as reflected in proposed §1.59-4(d)(3), the Treasury Department and the IRS are of the view that a CAMT FTC generally should be provided with respect to taxes imposed on the earnings of a CFC regardless of the character of those earnings for regular tax purposes, because all the earnings of the CFC are taken into account for CAMT purposes under section 56A(c)(3). For instance, the proposed regulations would allow a CAMT FTC with respect to taxes imposed on the residual earnings of a CFC because such earnings of the CFC are included in AFSI of the U.S. shareholder of the CFC through the application of section 56A(c)(3). *But see* proposed §1.59-4(b)(1) (incorporating certain FTC disallowances that apply for regular tax purposes, such as section 245A(d)). The Treasury Department and the IRS request comments on additional rules that may be appropriate in determining an applicable corporation's pro rata share of eligible current year taxes where the applicable corporation takes into account a qualified deficit of a CFC under section 951(c)(1)(B) impacting the determination of eligible current year taxes that are deemed paid by the applicable corporation under §1.960-2(b) for regular tax purposes.

Additionally, incorporating certain regular tax rules for determining an applicable corporation's pro rata share of PTEP taxes and eligible current year taxes of CFCs, instead of creating a separate set of CAMT FTC rules, is intended to reduce taxpayers' compliance burden and the administrative burden on the IRS. Notably, the proposed regulations do not apply the limitations under section 960(d) with respect to taxes imposed on tested income of the CFC because the underlying character of the CFC earnings generally are not relevant for CAMT purposes. Additionally, proposed §1.59-4(d)(3)(iii) provides rules for determining the applicable corporation's pro rata share of taxes in the case of a subpart F income group or tested income group with a loss, and in certain cases where the current year E&P limitation or the chain deficit rule applies, as in these cases taxes of a CFC may not be credited under the regular tax rules. Similarly, proposed §1.59-4(d)(3)(iv) provides rules for determining the applicable corporation's pro rata share of taxes imposed on the residual income of the CFC because the regular tax rules do not provide mechanics for doing so. *See also* proposed §1.59-4(b)(3) (defining pro rata share percentage for such purpose). Finally, as reflected in proposed §1.59-4, the CAMT FTC is not subject to the section 904 limitation.

D. *Carryover of unused CFC taxes*

Proposed §1.59-4(b)(3) would define "unused CFC taxes" as the excess (if any) of (i) the aggregate of the applicable corporation's pro rata shares of taxes of CFCs, as determined under proposed §1.59-4(d), over (ii) the product of the amount of the adjustment under proposed §1.56A-6(b)(1) and the percentage specified in section 55(b)(2)(A)(i) (currently, 15 percent). If an applicable corporation chooses to claim the foreign tax credit under section 901 for regular tax purposes for a taxable year, any unused CFC taxes for the taxable year are carried to each of the five succeeding taxable years, in chronological order, to the extent not absorbed as taxes deemed paid in a prior taxable year. *See* proposed §1.59-4(e)(1). Under proposed §1.59-4(e)(1), the amount of taxes deemed paid under proposed §1.59-4(e)(2) in a carryover taxable year is absorbed regardless of whether the taxpayer chooses to claim a foreign tax credit under section 901 of the Code for regular tax purposes for the carryover taxable year. Proposed §1.59-4(e)(2) would provide rules determining the amount of the unused CFC taxes that are deemed paid in the carryover taxable year, and proposed §1.59-4(e)(3) would provide an ordering rule requiring the unused CFC taxes from the fifth preceding taxable year to be absorbed first, followed sequentially by the unused CFC taxes from the fourth, third, second, and first preceding taxable year.

E. *Timing of the CAMT FTC*

As reflected in proposed §1.59-4, a foreign income tax may be claimed as a CAMT FTC in the taxable year in which the tax is paid, within the meaning of §1.901-2(g)(5), to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), in the AFS of the CFC or the applicable corporation, as applicable. In many instances, the timing of the CAMT FTC will align with the timing of the foreign tax credit for regular tax purposes. However, under proposed §1.59-4(f), foreign income taxes paid or accrued as a result of a foreign tax redetermination, as defined in §1.905-3(a), would be eligible to be claimed as a CAMT FTC only if the domestic corporation is an applicable corporation in the taxable year to which the foreign tax redetermination relates (relation-back year). A CAMT FTC with respect to such foreign income taxes may be claimed only in the relation-back year, even if the taxes are reflected in a journal entry of an AFS within a taxable year that is later than the relation-back year. *See* proposed §1.59-4(f).

F. *Treatment of partnership taxes*

Under proposed §1.59-4(g), for purposes of proposed §1.59-4(c)(2), the amount of eligible taxes paid or accrued for the taxable year by an applicable corporation that is a direct or indirect partner in a partnership includes the amount of creditable foreign tax expenditures, within the meaning of §1.704-1(b)(4)(viii), allocated to the applicable corporation for regular tax purposes, reduced by the suspensions and disallowances described in the definition of "eligible tax" that apply at the level of the partner. *See* proposed §1.59-4(g). *See also* proposed §1.59-4(d), which would address fact patterns where a CFC is a direct or indirect partner in a partnership.

G. *Tax consolidated groups*

Proposed §1.59-4(h) would provide that members of a tax consolidated group are treated as a single U.S. shareholder for purposes of applying the CAMT FTC provisions in proposed §1.59-4. For rules regarding the use of consolidated unused CFC taxes, *see* proposed §1.1502-56A(i).

XXX. Proposed §§ 1.1502–2, 1.1502–3, 1.1502–53, and 1.1502–55: Computation of Tax Liability of a Tax Consolidated Group and Computation of Minimum Tax Credits of Consolidated Groups

Proposed §1.1502-2(a)(10) would add the alternative minimum tax imposed by section 55(a) to the list of taxes that are added together to determine the tax liability of a tax consolidated group for a consolidated return year.

Section 1.1502-3(d)(4) is proposed to be removed and reserved because it relates to the former corporate alternative minimum tax.

Pursuant to the authority granted by sections 53, 56A(e), and 1502, proposed §1.1502-53 would provide rules under section 53 regarding the determination of a tax consolidated group's consolidated minimum tax credit. Proposed §1.1502-53(b) would define the consolidated minimum credit and set out the application of the limitation in section 53(c) to consolidated groups, based on consolidated regular tax liability and consolidated tentative minimum tax.

Under proposed §1.1502-53(c), a tax consolidated group's use of a member's minimum tax credits arising in separate return years (as defined in §1.1502-1(e)) is limited to the member's contribution to the consolidated section 53(c) limitation. Proposed §1.1502-53(c)(2) would specify how to calculate each member's contribution to the consolidated section 53(c) limitation. In general, a member's contribution to the consolidated section 53(c) limitation is determined by subtracting the member's share of consolidated tentative minimum tax from the member's share of consolidated net regular tax liability. A member's share of the consolidated tentative minimum tax would be determined by multiplying the consolidated tentative minimum tax by a fraction, the numerator of which is the member's positive separate AFSI, and the denominator of which is the tax consolidated group's AFSI. For years in which the group has CAMT liability, the member's contribution to the section 53(c) limitation would be reduced by the member's share of the group's CAMT liability under proposed §1.1502-56A(j). *See* part XXXI.K of this Explanation of Provisions. The rule would also specify which years are included in the computation and how to coordinate these calculations with SRLY subgroup principles and section 383.

Proposed §1.1502-53(d) would provide that, if any consolidated MTC that is attributable to a member may be carried to a separate return year of the member, the amount attributable to the member is apportioned to the member and carried to the separate return year, and the apportioned MTC may not be carried over to an equivalent, or later, consolidated return year of the tax consolidated group. The amount attributable to the member would be determined in the same manner as under proposed §1.1502-56A(j) (concerning consolidated CAMT liability). *See* part XXXI.K of this Explanation of Provisions.

The proposed method for allocating the consolidated MTC would be consistent with the approach suggested by certain stakeholders, who recommended allocating the consolidated MTC under the mechanisms of §1.1502-21(b)(2) (with certain modifications, such as substituting "AFSI" for "taxable income") in the interest of administrability. The proposed method would differ from, and would be simpler than, the allocation method in proposed regulations under section 55 that were published on December 30, 1992 (*see* 57 FR 62251-01) and that were never finalized due in part to concerns about their complexity and administrability.

Section 1.1502-55 is proposed to be removed and reserved because it relates to the former corporate alternative minimum tax.

XXXI. *Proposed §1.1502-56A: Application of CAMT to Consolidated Groups*

Pursuant to the authority granted by section 56A(c)(2)(B), (c)(15), and (e), and section 1502, proposed §1.1502-56A would provide rules under section 56A regarding the application of the CAMT to tax consolidated groups.

A. *Overview*

Section 56A(c)(2)(B) provides a general rule that, if the taxpayer is part of a

tax consolidated group for any taxable year, AFSI for that group for that taxable year must take into account items on the group's AFS that are properly allocable to members of that group. However, section 56A(c)(2)(B) authorizes the Secretary to prescribe by regulation exceptions to that general rule.

Proposed §1.1502-56A would provide rules regarding the computation of the AFSI and CAMT liability of a tax consolidated group. The proposed rules would implement the single-entity computations inherent in section 56A(c)(2)(B) and would provide guidance for applying the AFSI computational rules in proposed §1.56A-1(c) and (d) to tax consolidated groups.

Additionally, proposed §1.1502-56A would provide rules regarding (i) the use of FSNOL, CFC adjustment, and unused CFC tax carryovers (including the limitations that apply for purposes of computing the AFSI of a tax consolidated group after a corporation joins the group), (ii) the computation of CAMT basis in member stock, (iii) tax items relating to intercompany transactions (as defined in §1.1502-13(b)(1)(i)), and (iv) the allocation of CAMT liability, the consolidated minimum tax credit (consolidated MTC), and AFSI among members of a tax consolidated group.

B. *Single-entity treatment*

Consistent with section 3.05 of Notice 2023-7, proposed §1.1502-56A(a)(2) would provide that members of a tax consolidated group are treated as a single CAMT entity during their period of consolidation for purposes of determining AFSI and CAMT liability, except as otherwise provided in proposed §1.1502-56A (for example, *see* the discussion in part XXXI.E of this Explanation of Provisions).

C. *Calculation of FSI of a tax consolidated group*

Consistent with section 6.03(1) of Notice 2023-64, proposed §1.1502-56A(c)(1) would provide that, if the consolidated AFS for a taxable year includes the income, expense, gain, and loss solely of members of a tax consolidated group, the group's FSI for the year equals the FSI on the group's consolidated AFS for the year, as determined under proposed §§1.56A-1(c) and 1.56A-2(g)(2). Consistent with section 6.03(2) of Notice 2023-64, proposed §1.1502-56A(c)(2) would provide that, if a tax consolidated group's consolidated AFS includes the income, expense, gain, or loss of one or more CAMT entities that are not members of the group, the group's FSI for the taxable year is determined from the consolidated AFS by treating all members of the group as a single CAMT entity.

Thus, for example, a tax consolidated group's FSI would be determined by taking into account each AFS consolidation entry regarding (i) a transaction between members and (ii) one member's investment in another member. However, these consolidating entries would be taken into account only as long as the relevant members continue to be members of the same tax consolidated group at the end of the taxable year and if any relevant property continues to be held by the tax consolidated group at the end of the taxable year. The group's FSI also would be determined by disregarding each AFS consolidation entry regarding (i) a transaction between a member and a non-member, (ii) a member's investment in a non-member, and (iii) a non-member's investment in a member. *See* proposed §1.1502-56A(c)(2) and (3).

D. *Treatment of captive partnerships*

Consistent with section 6.03(2) of Notice 2023-64, proposed §1.1502-56A(c)(4) would clarify that treating a tax consolidated group as a taxpayer for purposes of proposed §1.1502-56A does not change the Federal tax classification of an entity classified as a partnership that is owned only by members of the group.

E. *Gain or loss on dispositions of member stock*

Although proposed §1.1502-56A generally would treat members of a tax consolidated group as a single CAMT entity for purposes of determining AFSI and CAMT liability, proposed §1.1502-56A(d)(1) would provide that the group's AFSI includes gain or loss from one member's sale or exchange of stock of another member. For this purpose, gain or loss would be computed relative to the CAMT basis of the stock (as determined under proposed §1.1502-56A(d)(3)). *See* proposed §1.1502-56A(d)(2).

F. *Basis of member stock*

As discussed in part XVIII.C.4 of this Explanation of Provisions, the CAMT basis of stock generally equals the regular tax basis as of the beginning of the first taxable year beginning after December 31, 2019, adjusted as required by proposed §§1.56A-18 and/or 1.56A-19. Any stock of members of a tax consolidated group held as of the beginning of the first taxable year beginning after December 31, 2019, would be subject to this rule.

However, the group's initial CAMT basis in any member stock acquired after that date would equal the CAMT basis of the stock in the hands of a shareholder member immediately after the acquisition (again adjusted as required by proposed §§1.56A-18 and/or 1.56A-19). *See* proposed §1.1502-56A(d)(3)(i).

Adjustments would be made to the AFS basis of member stock on the consolidated AFS for the period during which the member is a member of the group, including adjustments to reflect all other adjustments to FSI under section 56A(c) and the section 56A regulations. *See* proposed §1.1502-56A(d)(3)(ii). These adjustments are necessary because section 56A(c)(2)(B) and proposed §1.1502-56A(a)(2) effectively impose a single level of CAMT on the earnings and operations of a tax consolidated group. To ensure that the same economic income or loss is not duplicated in computing the AFSI of a tax consolidated group, the CAMT basis of subsidiary member stock would be adjusted to reflect the member's income or loss items for purposes of the CAMT.

Therefore, consistent with proposed §1.1502-56A(c), financial accounting adjustments to the AFS basis of subsidiary member stock (as modified under section 56A and the section 56A regulations) would be respected for purposes of determining inclusions for CAMT purposes with regard to that stock. For example, the CAMT operating income or loss

of a member of a tax consolidated group would be reflected for purposes of the CAMT in the CAMT basis of the member stock in the hands of its shareholder member. However, the AFS basis of the stock would include negative adjustments for deductions or losses of a subsidiary member only to the extent those items are absorbed by a member of the group under section 56A and the section 56A regulations. These proposed rules are in general conformity with the stock basis adjustment rules applicable for regular tax purposes. *See* §1.1502-32.

G. *Tax items relating to intercompany transactions*

For purposes of computing AFSI, several provisions in section 56A(c) and the section 56A regulations disregard items that appear on a CAMT entity's AFS and replace them with regular tax items. *See* section 56A(c)(13) and proposed §1.56A-15 (concerning certain depreciation deductions) and section 56A(c)(14) and proposed §1.56A-16 (concerning certain amortization deductions).

Proposed §1.1502-56A(e) would address the application of the foregoing provisions to tax items relating to intercompany transactions. These proposed rules are intended to clarify that intercompany transactions do not affect the tax items taken into account in determining a tax consolidated group's AFSI. *Cf.* §1.1502-13(a)(1) (providing that the purpose of §1.1502-13 is to provide rules to clearly reflect the taxable income (and tax liability) of a tax consolidated group as a whole by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income (or consolidated tax liability)).

The regular tax items substituted into AFSI under section 56A(c)(13) and (14) and proposed §§1.56A-15 and 1.56A-16 could be construed to include a member's increased depreciation or amortization deductions as a result of an intercompany transaction. For example, if one member of a tax consolidated group sells section 168 property to another member at a gain, the asset may give rise to higher depreciation deductions in the hands of the buying member (which has a higher basis in the asset) than in the hands of the selling member. *Cf.* §1.1502-13(c)(7)(ii)(D) (*Example 4*).

This outcome is inappropriate because it is inconsistent with the general treatment of a tax consolidated group as a single entity for purposes of computing AFSI. *See* proposed §1.1502-56A(a)(2). Instead, section 56A(c)(13) and proposed §1.56A-15, and section 56A(c)(14) and proposed §1.56A-16, would substitute only the single-entity amount of tax depreciation or tax amortization, respectively. Accordingly, proposed §1.1502-56A(e)(2) would clarify that, with regard to any regular tax item that is substituted into AFSI, increases or decreases in the amount of the regular tax items resulting from an intercompany transaction are disregarded. Proposed §1.1502-56A(e)(3) would restore these increases or decreases when consolidating entries related to the transaction cease to be taken into account (for example, if one of the parties to the intercompany transaction leaves the tax consolidated group; *see* part XXXI.C of this Explanation of Provisions). While this proposal is intended to serve purposes similar to those of §1.1502-13, the Treasury Department and the IRS did not believe it necessary to incorporate all of the complexities of §1.1502-13, and so proposed §1.1502-56A(e) reflects a simplified approach.

H. *Use of FSNOL carryovers*

Stakeholders recommended that the proposed regulations allocate FSNOLs to members of a tax consolidated group under the mechanisms of §1.1502-21(b)(2) (concerning the carryover and carryback of consolidated net operating losses (CNOLs), including rules regarding the allocation of CNOLs to corporations that cease to be members of a tax consolidated group), with certain modifications (such as substituting "AFSI" for "taxable income").

The Treasury Department and the IRS tentatively have determined that consolidated FSNOLs (that is, the portion of an FSNOL that is attributable to a tax consolidated group) should be treated in a manner similar to CNOLs. Accordingly, under proposed §1.1502-56A(f), the use of consolidated FSNOL carryovers to offset the AFSI of a tax consolidated group would be determined under rules that are based upon, and that are intended to operate in a manner consistent with, the rules in §1.1502-21(b).

Proposed §1.1502-56A(f)(1) generally would provide that the amount of consolidated FSNOL carryovers of a tax consolidated group that can be used to offset the AFSI of the group for any consolidated return year is the aggregate of the group's consolidated FSNOL carryovers to that year. Proposed §1.1502-56A(f)(2) would provide that consolidated FSNOL carryovers include both (i) any consolidated FSNOL of the consolidated group, and (ii) any FSNOLs of the members of the group arising in the respective separate return years of those members (to the extent available for use under proposed §§1.56A-23 and 1.1502-56A). Proposed §1.1502-56A(f)(3) would provide rules regarding the application of the 80-percent limitation in section 56A(d)(1). Proposed §1.1502-56A(f)(4) and (5) would provide detailed rules regarding the carryover of consolidated FSNOLs, including rules regarding situations in which one or more tax consolidated group members deconsolidate from the group.

Stakeholders also recommended that a tax consolidated group's absorption of the FSNOLs of a new member should be subject to the limitations under §1.1502-21(c) (which provides rules limiting the use of NOLs arising in a separate return limitation year (SRLY)) and section 382 of the Code and the regulations under section 382, with modifications to align with the provisions of the CAMT.

The Treasury Department and the IRS are of the view that a limitation akin to the SRLY limitations in §§1.1502-21(c) and 1.1502-15(c) (which imposes a SRLY limitation on built-in losses) should apply to a tax consolidated group's absorption of FSNOLs. Accordingly, proposed §1.56A-23(e), as described in part XXII of this Explanation of Provisions, would limit the use of FSNOLs acquired from outside the tax consolidated group.

However, as noted previously, the Treasury Department and the IRS do not propose to apply section 382 and the regulations under section 382 to limit the use of FSNOL carryovers. Although the Treasury Department and the IRS are concerned that taxpayers might have incen-

tive to acquire a business that has generated FSNOLs even if there is no business reason for the acquisition, applying section 382 and the regulations under section 382 to the use of FSNOL carryovers is not necessary to carry out the purposes of section 56A for two reasons: (i) the SRLY-like limitation in proposed §1.56A-23(e) would operate to deter such transactions in many situations, and (ii) the administrative burdens of applying section 382 and the section 382 regulations to FSNOLs would outweigh the benefits of applying this limitation to FSNOLs.

I. *Use of CFC adjustment carryovers*

Consolidated CFC adjustment carryovers (that is, the portion of a CFC adjustment carryover that is attributable to a tax consolidated group) should generally be treated in a manner similar to FSNOL carryovers. Accordingly, under proposed §1.1502-56A(h), the use of consolidated CFC adjustment carryovers to reduce the tax consolidated group's adjustment to AFSI under §1.56A-6(b)(1) would be determined under rules that are based upon the rules in proposed §1.1502-56A(f), with certain differences to reflect the differences in the rules for CFC adjustment carryovers as compared with the rules for FSNOL carryovers. For example, the 80-percent limitation in section 56A(d)(1) does not apply to CFC adjustment carryovers and is therefore not included in §1.1502-56A(h).

Proposed §1.1502-56A(h)(1) generally would provide that the amount of consolidated CFC adjustment carryovers of a tax consolidated group that can be used to reduce the group's adjustment to AFSI under proposed §1.56A-6(b)(1) is the aggregate of the group's consolidated CFC adjustment carryovers to that year. Proposed §1.1502-56A(h)(2) generally would provide that consolidated CFC adjustment carryovers include both (i) any consolidated CFC adjustment carryovers of the tax consolidated group, and (ii) any CFC adjustment carryovers of the members of the group arising in the respective separate return years of those members (to the extent available for use under proposed §§1.56A-6 and 1.1502-56A).

The Treasury Department and the IRS are of the view that a limitation akin to the SRLY limitations in §1.1502-21(c) should also apply to a tax consolidated group's absorption of CFC adjustment carryovers. Because CFC adjustment carryovers can only be used to reduce a group's adjustment to AFSI under proposed §1.56A-6(b)(1), SRLY limitations akin to §1.1502-21(c) may be sufficient and the more expansive limitations in proposed §1.56A-23(e), applicable to FSNOLs, may not be required. Accordingly, proposed §1.1502-56A(h)(3) would generally provide that, in any consolidated return year, the aggregate amount of CFC adjustment carryovers from all separate return years of a member of a tax consolidated group that can be used to reduce the group's adjustment to AFSI under proposed §1.56A-6(b)(1) cannot exceed the adjustment to AFSI under proposed §1.56A-6(b)(1) generated by the member. However, the Treasury Department and the IRS are considering whether CFC adjustment carryovers generated in a separate return year should be subject to more expansive limitations similar to the limitations in proposed §1.56A-23(e), which currently are proposed to apply to FSNOLs and certain built-in items. The Treasury Department and the IRS welcome comments on this matter.

Proposed §1.1502-56A(h)(4) would provide ordering rules for the use of CFC adjustment carryovers, generally following the rules that apply to FSNOL carryovers under proposed §1.1502-56A(f)(4). Proposed §1.1502-56A(h)(5) would provide rules regarding the carryover of CFC adjustment carryovers to separate return years, which apply when a member deconsolidates from a tax consolidated group. Consistent with the general approach of incorporating rules that apply to FSNOL carryovers, proposed §1.1502-56A(h)(5) directs taxpayers to apply the principles of proposed §1.1502-56A(f)(5).

J. *Use of consolidated unused CFC taxes*

Proposed §1.1502-56A(i)(1) generally would provide that the amount of consolidated unused CFC taxes of a tax consolidated group that can be used to determine the consolidated tentative minimum tax of the group for any consolidated return year is the aggregate of the group's unused CFC taxes in that year. Proposed §1.1502-56A(i)(2) would provide that consolidated unused CFC taxes include both (i) any unused CFC taxes of the consolidated group to the extent available for use under the carryover rules in proposed §1.59-4(e), and (ii) any unused CFC taxes of the members of the group arising in the respective separate return years of those members to the extent available for use under the carryover rules in proposed §1.59-4(e). Proposed §1.1502-56A(i)(3) would provide rules limiting the use of unused CFC taxes from separate return years of a member. Proposed §1.1502-56A(i)(4) would provide rules regarding the amount of unused CFC taxes that can be used in a consolidated return year. Proposed §1.1502-56A(i)(5) would provide rules regarding situations in which one or more members deconsolidate from the group.

The Treasury Department and the IRS are of the view that a limitation akin to the SRLY limitations in §1.1502-21(c) should apply to a tax consolidated group's absorption of unused CFC taxes. Accordingly, proposed §1.1502-56A(i)(3) would limit, in any consolidated return year, the use of unused CFC taxes from all separate return years of a member of a tax consolidated group to an amount equal to (1) the product of (a) the AFSI adjustment with respect to CFCs described in proposed §1.56A-6(b)(1) generated by the member and (b) 15 percent (the percentage specified in section 55(b)(2)(A)(i) for the consolidated year); less (2) the amount of the member's share of taxes of CFCs for which it is a U.S. shareholder, as determined under proposed §1.59-4(d) for the consolidated return year.

K. *CAMT liability*

Proposed §1.1502-56A(j) would provide rules for allocating CAMT liability among members of a tax consolidated group. Proposed §1.1502-56A(j)(1) would provide that liability for the tax imposed on a tax consolidated group under section 55(b)(2) for a consolidated return year is apportioned among members based on the percentage of AFSI attributable to each member for the year. Under proposed §1.1502-56A(j)(2), the percentage of AFSI for the consolidated return year attributable to a member equals the

separate positive AFSI of the member (determined by computing the AFSI by reference to only the member's items of income, gain, expense, and loss) for the consolidated return year, divided by the sum of the AFSI for that year of all members having positive AFSI for that year. This allocation rule is based upon, and is intended to operate in a manner consistent with, the allocation rules in §1.1502-21(b)(2). *See* part XXX of this Explanation of Provisions for a similar allocation rule for the consolidated minimum tax credit.

L. *Allocation of AFSI on deconsolidation*

The allocation of AFSI that would occur under proposed §1.59-2 if a corporation's test group changes is intended to ensure that any future group of which the CAMT entity is a member accurately reflects the income-generating history of the members of the group following the acquisition. The accurate reflection of this history is no less important in cases in which the CAMT entity departing the test group is a member of a tax consolidated group.

Proposed §1.1502-56A(k)(1) would provide that, on leaving a tax consolidated group, a member is allocated its AFSI for purposes of applying the average annual AFSI test under proposed §1.59-2(c) as if the member had been a separate taxpayer during the relevant years. The AFSI allocated to the departing member would not be subtracted from the AFSI of the tax consolidated group of which the corporation ceased to be a member. *See* proposed §§1.1502-56A(k)(2) and 1.59-2.

XXXII. *CAMT Entities Subject to Tonnage Tax*

The Treasury Department and the IRS are considering rules that would provide AFSI adjustments for a corporation that elects under section 1354(a) of the Code (electing corporation), or an electing group as defined in section 1355(a)(2) of the Code that includes an electing corporation, to be subject to the provisions of sections 1352 through 1359 of the Code (tonnage tax regime). The tonnage tax is imposed in lieu of the Federal corporate income tax that would otherwise be imposed under section 11 of the Code on the income of an electing corporation (or electing group) from qualifying shipping activities. *See* H.R. No. 108-548 Part 1 (2004) at 177.

Under section 1352, an electing corporation's qualifying shipping activities are subject to tax on a notional amount of shipping income, which is determined under section 1353(b) based on the net tonnage of qualifying vessels that the electing corporation operates in foreign trade during the taxable year. Section 1357(a) provides that the gross income of an electing corporation does not include its income from qualifying shipping activities. Section 1357(b) provides that gross income of a corporation (other than an electing corporation) that is a member of an electing group also does not include its income from qualifying shipping activities conducted by such member. Section 1355(a)(2) defines the term "electing group" to mean a controlled group that would be treated as a single employer under section 52(a) or (b) of the Code (without regard to section 52(a)(1) or (2)) and one or more members of which is an electing corporation. Under section 1357(c), items of loss, deduction, or credit of any taxpayer from activities giving rise to income excluded under section 1357 are disallowed, subject to limited exceptions for certain depreciation and interest.

The tonnage tax regime was enacted to bolster the U.S. shipping industry by eliminating a competitive disadvantage faced by operators of United States-flag vessels that otherwise would be subject to higher taxes than their foreign-based competition. H.R. No. 108-548 Part 1 (2004) at 177. By incentivizing United States-flag shipping, the tonnage tax regime also supports the national security goals of the Maritime Security Program (MSP), which maintains a fleet of active, militarily-useful, privately-owned vessels to meet national defense and other security requirements and maintains a United States presence in international commercial shipping. *See* section 651 of the Merchant Marine Act, 1936, as modified by section 2 of Public Law 104-239, 110 Stat. 3118, 3118-3119 (October 8, 1996), commonly known as the Maritime Security Act of 1996.

The Treasury Department and the IRS received feedback from stakeholders noting that, unlike former section 56(g) of the Code, section 56A does not provide an AFSI adjustment for an electing corporation and requesting that an AFSI adjustment be provided, in part, to exclude income subject to the tonnage tax regime from AFSI (and therefore from the CAMT). Stakeholders noted that there is tension with applying the CAMT to income subject to the tonnage tax regime given that the regime's purpose is to encourage the use of United States-flag vessels in international shipping. These stakeholders also noted that maintaining United States-flag and United States-crewed merchant vessels for the MSP is important to United States national security, both in peacetime and during times of war. The stakeholders therefore suggested that subjecting such income to the CAMT could undermine the United States national security purpose of the tonnage tax regime.

The Treasury Department and the IRS are considering rules that would provide AFSI adjustments with respect to electing corporations and electing groups within the scope of the tonnage tax regime, including adjustments relating to income from qualifying shipping activities and other adjustments that may be necessary to prevent the imposition of duplicative alternative tax regimes that limit the benefit of certain deductions, NOLs, and credits. The Treasury Department and the IRS request comments on whether to provide such rules addressing the interaction of the CAMT and the tonnage tax, including comments on how best to provide AFSI adjustments to meet the United States national security policy goals of the tonnage tax regime and the MSP while appropriately imposing the CAMT with respect to other AFSI of such entities.

XXXIII. *Transition Rules and AFSI-Only Change Procedures*

A. *Transition rules to implement final regulations*

Pursuant to the authority granted by section 56A(c)(15), the Treasury Department and the IRS are considering transition rules to address AFSI and CAMT attribute adjustments necessary to implement the rules in final regulations if a CAMT entity accounted for and reported

the AFSI adjustment or CAMT attribute in a manner inconsistent with the final regulations in prior taxable years. The Treasury Department and the IRS are considering three different transition approaches that may apply under the final regulations. The transition approach applied may vary based on the particular AFSI adjustment or CAMT attribute; thus, different transition approaches may be applied in specified circumstances under the transition rules in the final regulations. The transition rules would apply to the CAMT entity's first taxable year for which a particular final rule is applicable (transition year).

1. *Transition Year Adjustment Approach*

Under one potential transition approach, a CAMT entity would be required to redetermine as of the beginning of the transition year the cumulative amount of AFSI, and redetermine any relevant CAMT attribute, as if the entity had first applied the rules in the final regulations in its first taxable year beginning after December 31, 2019. The difference between the redetermined cumulative AFSI amount and the aggregate AFSI amounts reported in years prior to the transition year would result in an adjustment to AFSI (transition year adjustment). In conjunction with the transition year adjustment, any CAMT attribute previously determined using the prior treatment would be adjusted to equal the redetermined CAMT attribute as of the beginning of the transition year.

The transition year adjustment would be an adjustment to the CAMT entity's AFSI for the transition year. However, the Treasury Department and the IRS are also considering whether to allow CAMT entities to spread the transition year adjustment across multiple taxable years for AFSI purposes in specified circumstances. The Treasury Department and IRS are considering a rule that would allow a transition year adjustment that involves a change in the timing of when an AFSI adjustment amount is included in AFSI to be spread over periods similar to those for section 481(a) adjustments, while transition year adjustments that do not involve timing differences would be spread ratably over four taxable years, beginning with the transition year. The Treasury Department and the IRS request comments as to whether the transition year rules should address which AFSI adjustments represent an AFSI timing difference and how such determination should be made. The Treasury Department and the IRS also request comments as to whether there are circumstances where a transition year adjustment should be entirely taken into account, with no spread period, in the transition year.

The Treasury Department and the IRS are considering the scope of the final rules that should be subject to a transition year adjustment. For example, such rules may include, but would not be limited to, items similar to those included within the scope of AFSI-only changes (*see* discussion in part XXXIII.C of this Explanation of Provisions; for example, AFSI adjustments and determination of CAMT basis of section 168 property under proposed §1.56A-15)), the determination of CAMT retained earnings, and the computation and carryforward of a FSNOL under proposed §1.56A-23. The Treasury Department and the IRS request comments on the scope of AFSI adjustments, and related CAMT attributes, that should be subject to the transition year adjustment to prevent the duplication or omission of the CAMT entity's AFSI. In addition, to the extent transition rules are provided allowing transition year adjustments to be spread, the Treasury Department and IRS request comments as to whether the applicable spread period should be determined separately for each AFSI adjustment or if certain AFSI adjustments (for example, all adjustments to AFSI for section 168 property under proposed §1.56A-15) should be combined into a net transition year adjustment for purposes of determining the applicable spread period.

As noted previously, while the transition year adjustment would be determined by recomputing prior year AFSI and CAMT attributes to reflect the final rules, the transition year adjustment is an adjustment to the CAMT entity's AFSI for the transition year (subject to proposed spread periods). Accordingly, with respect to a CAMT entity with a partnership investment, the partnership would not need to file an amended partnership return or file a request for an administrative adjustment under section 6227, as applicable, to revise the amount of any partnership-related item relevant in determining the application of section 56A that was reported to the CAMT entity partner in prior taxable years. Instead, the transition rules would provide that the partnership should report additional information to the CAMT entity partner for the first taxable year in which a final rule is appliable to the extent necessary for the CAMT entity partner to determine its transition year adjustment for such partnership-related item. The Treasury Department and the IRS request comments on the application of this transition approach to a CAMT entity that is a partner in a partnership to which this approach would apply.

2. *Cut-off Basis Transition Approach*

Under a second potential transition approach, the transition to the final regulations for certain AFSI adjustments and CAMT attributes would be implemented on a cut-off basis similar to the approach provided in section 2.07 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419. Accordingly, under a cut-off basis transition approach, there would be no transition year adjustment to AFSI for the transition year. In addition, under a cut-off basis transition approach, CAMT attributes (such as the CAMT basis of an asset) would not be redetermined as of the beginning of the transition year as if the CAMT entity had first applied the rules in the final regulations in its first taxable year beginning after December 31, 2019. The Treasury Department and the IRS are considering applying the cut-off basis transition approach to AFSI adjustments and CAMT attributes where the CAMT entity no longer holds property and has already accounted for the disposition of such property in AFSI in a taxable year not subject to the final regulations (even if accounted for in a manner not consistent with the final regulations), for example, certain transactions subject to proposed §1.56A-18, 1.56A-19, or 1.56A-20. In such situations, the Treasury Department and the IRS request comments as to whether special rules are needed for the transferor or transferee to prevent the duplication or omission of the transferor's or transferee's AFSI related to the transaction. The Treasury Department and the IRS also request comments on the scope of AFSI adjustments and

CAMT attributes that should be subject to a cut-off basis transition approach and the application of such transition approach to a CAMT entity that is a partner in a partnership to which this transition approach would apply.

3. *Fresh Start Transition Approach*

Finally, under a third potential transition approach, the transition to the final regulations for certain rules would be implemented using a "fresh start" transition approach with the relevant CAMT attribute redetermined as of the beginning of the transition year as if the entity had first applied the rules in the final regulations in its first taxable year beginning after December 31, 2019. Accordingly, under a "fresh start" transition approach, there would be no transition year adjustment to AFSI as of the beginning of the transition year. For instances where the CAMT basis of an asset may be subject to a "fresh start" transition approach, the Treasury Department and the IRS request comments as to whether the CAMT basis should be based on amounts other than the amounts that should have been reflected in AFSI in prior years under the final rules, such as the actual amounts reflected in AFSI in prior years. For example, if AFSI in prior years reflected excess amortization because the CAMT basis of an amortizable asset exceeded what the CAMT basis would have been had the final regulations applied (for example, due to push down accounting which is disregarded under proposed §§1.56A-4(c)(4) and 1.56A-18(c)(3)), comments are requested as to whether the redetermined CAMT basis should reflect a reduction for the actual amortization reflected in AFSI in prior years or if the redetermined CAMT basis should instead reflect a reduction for the amortization that would have been reflected in AFSI under the final rules.

The Treasury Department and the IRS are considering the scope of the final rules that should be subject to a "fresh start" transition approach. For example, such items may include, but are not limited to, determination of CAMT basis of assets of a foreign corporation under proposed §1.56A-4, CFC adjustment carryovers with respect to controlled foreign corporations under proposed §1.56A-6, determination of CAMT basis of assets of a domestic corporation under proposed §§1.56A-18 and 1.56A-19, and any unused CFC taxes under proposed §1.59-4. The Treasury Department and the IRS request comments on the scope of CAMT attributes that should be subject to a "fresh start" transition approach as well as the application of such an approach to a CAMT entity that is a partner in a partnership to which this transition approach would apply.

The Treasury Department and the IRS welcome comments on these three transition approaches, as well as other approaches for handling changes in the treatment of an item to comply with the final regulations.

B. *Transition rules for taxable years prior to the final regulations*

The Treasury Department and the IRS are aware that a CAMT entity may have a duplication or omission of AFSI or a CAMT attribute if the CAMT entity accounted for and reported the AFSI adjustment or CAMT attribute in a taxable year in a manner inconsistent with the manner used to determine such item in a prior taxable year. To avoid creating undue administrative burden for CAMT entities, and to facilitate a less burdensome interim period before the final regulations are applicable, the Treasury Department and the IRS are of the view that transition rules, including transition adjustments to AFSI, are not appropriate to account for any potential duplication or omission of AFSI or a CAMT attribute for taxable years prior to the transition year. Accordingly, CAMT entities may not make any AFSI adjustments as a result of a redetermination of the cumulative amount of AFSI or redetermine any CAMT attribute as of the beginning of, or during, any taxable year prior to the first taxable year in which a final rule is applicable. *See* proposed §1.56A-1(d)(2) (except as otherwise provided in the section 56A regulations, a CAMT entity may not make any adjustments to its FSI in determining its AFSI). Any difference between a redetermined AFSI amount and the AFSI amount previously determined using the CAMT entity's prior treatment does not result in an adjustment to AFSI for any taxable year prior to the transition year. Similarly, any difference between a redetermined CAMT attribute and the CAMT attribute previously determined using the prior treatment does not result in an adjustment to the CAMT attribute for any taxable year prior to the transition year.

C. *Consent procedures for making AFSI-only changes*

For taxable years beginning after the transition year (*see* discussion in part XXXIII.A of this Explanation of Provisions), the Treasury Department and the IRS are aware that a CAMT entity may need to make corrections to the treatment of an AFSI adjustment due to incorrect application of the final rules. Accordingly, the Treasury Department and the IRS are also considering rules and procedures to address a change in the treatment of an item for AFSI purposes under the final regulations that involves either determining the proper time for taking the item into account or determining the proper amount of the item to prevent duplications or omissions of amounts in AFSI (AFSI-only change). For this purpose, an AFSI-only change would include a change to begin making an AFSI adjustment, a change to properly determine the amount of an AFSI adjustment, or a change to take the AFSI adjustment into account in the appropriate taxable year (AFSI-only items). For this purpose, AFSI adjustments that may be subject to the AFSI-only change procedures may include, but are not limited to, AFSI adjustments to a partner's distributive share of partnership AFSI under proposed §1.56A-5, AFSI adjustments with respect to section 168 property under proposed 1.56A-15, and AFSI adjustments with respect to qualified wireless spectrum under proposed §1.56A-16. An AFSI-only change would not include a change in method of accounting being made for regular tax purposes or an accounting principle change for an item in FSI subject to proposed §1.56A-17(c). Similarly, an AFSI-only change would generally not include items for which an AFSI adjustment is already provided in the final regulations (for example, AFSI adjustments associated with tax capitalization method changes described in proposed

§1.56A-15(b)(10) or 1.56A-16(b)(7), as well as AFSI restatement adjustments and other AFSI adjustments to prevent duplications or omissions of income described in proposed §1.56A-17(d) and (e)).

In order for a CAMT entity to make an AFSI-only change, the Treasury Department and the IRS are considering rules that would require a CAMT entity to follow consent procedures similar to those that apply for changes in method of accounting for regular tax purposes under sections 446 and 481. Similar to a change in method of accounting for regular tax purposes, a CAMT entity would not be permitted to make an AFSI-only change on an amended return or by filing an administrative adjustment request under section 6227. The AFSI-only change procedures would instead require that a CAMT entity request advance consent from the IRS before changing the item under consent procedures similar to those required under section 446(e) and Rev. Proc. 2015-13 (or successor) on a form similar to Form 3115. However, similar to Rev. Proc. 2015-13, automatic consent may be provided for certain changes. If automatic consent is provided for an AFSI-only change, the manner of obtaining automatic consent may involve reduced filing requirements or certain streamlined procedures. In addition, the consent procedures for AFSI-only changes may also include the computation of a cumulative adjustment to AFSI resulting from the AFSI-only change, which the CAMT entity would include in AFSI over a prescribed number of taxable years beginning with the year of change. Finally, such consent procedures would provide audit protection to taxpayers that voluntarily request to make an AFSI-only change in certain circumstances. Applying procedures to AFSI-only changes that are similar to the change in method of accounting principles under section 446(e) may encourage voluntary compliance when a CAMT entity is inadvertently accounting for an AFSI-only item in an impermissible manner because the CAMT entity would be afforded audit protection and favorable spread periods.

Alternatively, the Treasury Department and the IRS are considering providing taxpayers with automatic consent for all AFSI-only changes, along with reduced filing requirements, that may only require that a statement or abbreviated form be attached to the CAMT entity's tax return for the year in which the AFSI-only change is made. While this alternative may streamline the process for a CAMT entity to correct its AFSI if it is accounting for an AFSI-only item in an impermissible manner, the Treasury Department and IRS are considering whether to provide the CAMT entity with audit protection under this type of procedure and whether more restrictive spread periods should apply.

The Treasury Department and the IRS are evaluating whether consent procedures similar to those required for changes in method of accounting under section 446(e) and Rev. Proc. 2015-13 should apply to an AFSI-only change and request comments on this issue, as well as other approaches for implementing AFSI-only changes. The Treasury Department and the IRS request comments on the scope of AFSI-only items that should be subject to the consent procedures. The Treasury Department and the IRS also request comments on the criteria to be applied by a CAMT entity to determine whether it has established a consistent treatment for an AFSI-only item and, thus, is eligible for an AFSI-only change (for example, whether a CAMT entity needs to treat an AFSI-only item in an impermissible manner for a single taxable year, or multiple taxable years, before it may apply the procedures for making an AFSI-only change). The Treasury Department and the IRS also request comments on the consent procedure terms and conditions that should apply for making an AFSI-only change, including audit protection and the spread period of the corresponding adjustments to AFSI to implement the AFSI-only change.

Proposed Applicability Dates and Reliance on the Proposed Regulations

The provisions of the following sections are proposed to apply to taxable years ending after September 13, 2024: proposed §§1.56A-1 through 1.56A-4, 1.56A-6 through 1.56A-11, 1.56A-13, 1.56A-14, 1.56A-17, 1.56A-26, 1.56A-27, and 1.59-2 through 1.59-4 (together, with proposed §1.56A-5(l)(2)(ii) and (iii), the specified regulations). The provisions of the following sections are proposed to apply to taxable years ending after [date of publication of final regulations in the ***Federal Register***]: proposed §§1.56A-5 (other than 1.56A-5(l)(2)(ii) and (iii)), 1.56A-12, 1.56A-15, 1.56A-16, and 1.56A-18 through 1.56A-25. The provisions of proposed §1.56A-5(l)(2)(ii) and (iii) are proposed to apply to taxable years ending after September 13, 2024 and on or before [date of publication of final regulations in the ***Federal Register***] in order to coordinate with certain provisions of the specified regulations. In accordance with section 1503 of the Code, the provisions of the following sections are proposed to apply to consolidated return years for which the date of the income tax return (without extensions) is after [date of publication of final regulations in the ***Federal Register***]: proposed §§1.1502-2, 1.1502-53, and 1.1502-56A.

The Treasury Department and the IRS request comments regarding whether a different applicability date should apply for purposes of applying any specific provision of the proposed regulations and will consider such comments along with all other comments received in response to this notice of proposed rulemaking.

Taxpayers may rely on the specified regulations for any taxable year ending on or before September 13, 2024, provided the taxpayer, and each member of its test group determined under proposed §1.59-2 for that taxable year, consistently follow all of the specified regulations in their entirety in that taxable year and each subsequent taxable year (taking into account any changes to its test group determined under proposed §1.59-2 for each subsequent taxable year) until the first taxable year in which the final regulations are applicable. In the case of rules described in proposed §§1.56A-4 and 1.56A-6 that apply to transfers (as defined in proposed §1.56A-4(b)(3)), taxpayers may rely on such rules for a transfer occurring on or before September 13, 2024, provided the taxpayer, and each member of its test group determined under proposed §1.59-2 for the taxable year of the taxpayer that includes the date of the transfer, consistently follow all of the rules in proposed §§1.56A-4 and 1.56A-6 for all such transfers occurring on or before September 13, 2024, and if any such transfers occur in taxable years ending on or before Septem-

ber 13, 2024, must rely on the specified regulations for such taxable years.

Taxpayers may rely on one or more other sections of the proposed regulations for any taxable year ending on or before [date of publication of final regulations in the ***Federal Register***], provided that, for each section on which the taxpayer relies, the taxpayer, and each member of its test group determined under proposed §1.59-2 for that taxable year, consistently follow that section in its entirety and also follow all of the specified regulations in their entirety in that taxable year and each subsequent taxable year (taking into account any changes to its test group determined under proposed §1.59-2) until the first taxable year in which the final regulations are applicable. Notwithstanding the prior sentence, a taxpayer may not rely on proposed §§1.56A-18, 1.56A-19, and 1.56A-21 in any taxable year unless the taxpayer and each member of its test group determined under proposed §1.59-2 for that taxable year relies on each such section in its entirety. In addition, a taxpayer may not rely on proposed §§1.56A-5 (excluding 1.56A-5(l)(2)(ii) and (iii)) and 1.56A-20 in any taxable year unless the taxpayer and each member of its test group determined under proposed §1.59-2 for that taxable year relies on each such section in its entirety.

Special Analyses

I. *Regulatory Planning and Review*

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) generally requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

This proposed regulation contains reporting, third-party disclosure, and recordkeeping requirements that are required to identify applicable corporations and determine their liability for the CAMT. These collections of information would generally be used by the IRS for tax compliance purposes and by taxpayers to facilitate proper reporting and recordkeeping. The likely respondents to these collections are businesses.

This proposed regulation requires corporations to report their determinations regarding whether they are applicable corporations and, if so, report their CAMT liability by using Form 4626 and the applicable form in the Form 1120 series. These requirements and associated forms are already approved by OMB under 1545-0123. To the extent there is a change in burden as a result of this proposed regulation, the change in burden will be reflected in updated burden estimates for the referenced forms.

This proposed regulation requires partnerships that receive a request for information to provide the information to partners that are subject to the CAMT (or partners directly or indirectly owned by an applicable corporation) and to report the information to the IRS on Schedules K and K-1 of Form 1065. For taxable year 2023, a partnership that receives a request for information after the preparation of its Schedules K and K-1 may provide the information to the partner on a separate statement. This proposed regulation contains recordkeeping requirements associated with the foregoing reporting obligations. These requirements and associated forms are already approved by OMB under 1545-0123. To the extent there is a change in burden as a result of this proposed regulation, the change in burden will be reflected in updated burden estimates for the referenced forms.

This proposed regulation requires a corporation to maintain records sufficient to substantiate its determination regarding whether it is an applicable corporation, including the identification of all persons treated as a single employer with the corporation under section 52(a) or (b) and whether the corporation is a member of an FPMG under proposed §1.59-3. This proposed regulation requires a corporation that is an applicable corporation to maintain records sufficient to substantiate its determination of liability for the CAMT. This proposed regulation also requires a corporation or other entity whose financial results are reflected in a consolidated financial statement to maintain books and records sufficient to demonstrate how the entity's financial statement income reconciles to the income reported on the consolidated financial statement. The recordkeeping requirements within this proposed regulation are considered general tax records under §1.6001-1(e). For PRA purposes, general tax records are already approved by OMB under 1545-0123 for business filers. To the extent there is a change in burden as a result of this proposed regulation, the change in burden will be reflected in updated burden estimates for Form 4626 and the applicable form in the Form 1120 series.

III. *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and that are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis (IRFA) of the proposed rule. The Treasury Department and the IRS have not determined whether the proposed rule, when finalized, would likely have a significant economic impact on a substantial number of small entities. This determination requires further study. However, because there is a possibility of economic impact on a substantial number of small entities, an IFRA is provided in these proposed regulations. The Treasury Department and the IRS invite comments on both the number of entities affected and the economic impact on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel of the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

A. Need For and Objectives of the Rule

The proposed regulations would provide guidance for the application of the CAMT, which is based on the AFSI of certain corporations for taxable years beginning after December 31, 2022. The proposed regulations would provide necessary definitions and rules that relate to the determination of AFSI, whether a corporation is an applicable corporation subject to the tax, and various statutory adjustments to AFSI, including rules regarding the application of the CAMT in the tax consolidated group, partnership, and international contexts. The Treasury Department and the IRS intend and expect that this guidance will allow corporations to determine whether they are subject to the tax and their total liability under the tax.

B. Affected Small Entities

The RFA directs agencies to provide a description of, and if feasible, an estimate of, the number of small entities that may be affected by the proposed rules, if adopted. The Small Business Administration's Office of Advocacy estimates in its 2023 Frequently Asked Questions that 99.9 percent of American businesses meet its definition of a small business. While the CAMT applies only to certain corporations averaging over $1 billion of annual AFSI, referred to as applicable corporations, certain provisions in these proposed regulations apply irrespective of the size of the business, as defined by the Small Business Administration. As is described more fully in the preamble to this proposed regulation and in this IRFA, these proposed regulations may affect a variety of different businesses across several different industries.

These proposed regulations contain reporting, third-party disclosure, and recordkeeping requirements that are required to identify applicable corporations and to determine their liability for the CAMT. In determining whether a corporation is an applicable corporation, it may be necessary to aggregate its AFSI with the AFSI of other entities. Further, in determining the CAMT liability of an applicable corporation, it may be necessary to include in AFSI the applicable corporation's income from its investments in partnerships. In most cases, the AFSI of entities whose AFSI is aggregated with that of a corporation will be based on consolidated financial statements prepared by very large corporations that will bear this burden so that it should not be considered a burden imposed on small entities. However, under the proposed regulations, in order to determine the CAMT liability of an applicable corporation, partnerships would be compelled to provide information to their applicable corporation partners (and, in the case of structures with tiers of partnerships, to partners that are directly or indirectly owned by the applicable corporation) regarding the partner's distributive share of the partnership's AFSI, and to keep associated records. We estimate that approximately 25,000 of the partnerships that would be affected by this burden are small entities.

The Treasury Department and the IRS expect to receive more information on the impact on small businesses through comments on these proposed regulations.

C. Impact of the Rules

The proposed regulations will impose recordkeeping and reporting requirements for partnerships directly or indirectly owned by applicable corporations. These proposed regulations require partnerships that receive a request for information to provide the information to partners that are subject to the CAMT (or to partners that are directly or indirectly owned by an applicable corporation) and to report the information to the IRS on Schedules K and K-1 of Form 1065. For taxable year 2023, a partnership that receives a request for information after the preparation of its Schedules K and K-1 may provide the information to the partner on a separate statement. The proposed regulations impose recordkeeping requirements associated with the foregoing reporting obligations.

D. Alternatives Considered

The Treasury Department and the IRS considered alternatives to the proposed regulations. As described in the Explanation of Provisions of this preamble, the Treasury Department and the IRS considered alternative approaches for computing an applicable corporation's distributive share of a partnership's AFSI. Under these approaches, an applicable corporation would generally have required a more limited amount of information from a partnership for the purpose of computing its distributive share of a partnership's AFSI. One alternative approach considered was a "top-down" approach in which an applicable corporation would use the FSI reported on its AFS with respect to a partnership and adjust that amount by taking into account adjustments required under section 56A. The information necessary for an applicable corporation to compute these adjustments would need to be provided by the partnership. As this approach would still require the partnership to provide information to the partner, it did not substantially lessen the impact of the rules adopted in the proposed regulations.

Another set of approaches considered was to use tax information otherwise required to be maintained for tax purposes. That is, a partner's distributive share of a partnership's AFSI would be an applicable corporation's distributive share of a partnership's book income computed in accordance with the section 704(b) rules, or an applicable corporation's distributive share of partnership taxable income as reported on Schedule K-1.

Yet another alternative considered was the addition of a safe harbor to the proposed approach that would allow applicable corporations to use their financial statement income without making adjustments for partnership investments under section 56A(c)(2)(D)(i). This safe harbor would be in lieu of having the partnership report the partner's distributive share of AFSI to the partners.

These alternative approaches were not adopted in the proposed regulations because the Treasury Department and the IRS are of the view that they are not consistent with the statutory language or its purpose of taxing an applicable corporation's book income, as adjusted under

section 56A. In many cases, an applicable corporation would not be able to reasonably take into account the adjustments required under section 56A to compute AFSI, or the applicable corporation would have to rely heavily or exclusively on regular tax amounts, or both.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The proposed rule would not duplicate, overlap, or conflict with any relevant Federal rules. As discussed previously, the proposed regulations would provide rules for the application of the CAMT. The Treasury Department and the IRS invite input from interested members of the public about identifying and avoided overlapping, duplicative, or conflicting requirements.

IV. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million (updated annually for inflation). This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

V. *Executive Order 13132: Federalism*

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has Federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have Federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

VI. *Executive Order 13175: Consultation and Coordination With Indian Tribal Governments*

Executive Order 13175 (Consultation and Coordination With Indian Tribal Governments) prohibits an agency from publishing any rule that has Tribal implications if the rule either imposes substantial, direct compliance costs on Indian Tribal governments and is not required by statute, or preempts Tribal law, unless the agency meets the consultation and funding requirements of section 5 of the Executive order. These proposed regulations do not have a substantial direct effect on one or more Federally recognized Indian Tribes and do not impose substantial direct compliance costs on Indian Tribal governments within the meaning of the Executive order.

However, the Treasury Department and the IRS held consultation with Alaska Native Corporations on December 2, 2022, to address questions under the IRA, including the application of the CAMT to Alaska Native Corporations, which informed the development of these proposed regulations. The Treasury Department and the IRS also intend to conduct consultation with Alaska Native Corporations on these proposed regulations.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments regarding the notice of proposed rulemaking that are submitted timely to the IRS, as prescribed in this preamble under the **ADDRESSES** section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be made available at https://www.regulations.gov. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.

A public hearing has been scheduled for January 16, 2025 beginning at 10 am EST, in the Auditorium at the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. Participants may alternatively attend the public hearing by telephone.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic by December 12, 2024. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing. If no outline of the topics to be discussed at the hearing is received by December 12, 2024, the public hearing will be cancelled. If the public hearing is cancelled, a notice of cancellation of the public hearing will be published in the ***Federal Register***.

Individuals who want to testify in person at the public hearing must send an email to publichearings@irs.gov to have your name added to the building access list. The subject line of the email must contain the regulation number REG-112129-23 and the language TESTIFY in Person. For example, the subject line may say: Request to TESTIFY in Person at Hearing for REG-112129-23.

Individuals who want to testify by telephone at the public hearing must send an email to publichearings@irs.gov to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG- 112129-23 and the language TESTIFY Telephonically. For example, the subject line may say: Request to TESTIFY Telephonically at Hearing for REG-112129-23.

Individuals who want to attend the public hearing in person without testifying must also send an email to publichearings@irs.gov to have your name added to the building access list. The subject line of the email must contain the regulation number REG-112129-23 and the language ATTEND In Person. For example, the subject line may say: Request to ATTEND Hearing in Person for REG-112129-23. Requests to attend the public hearing must

be received by 5 p.m. EST on January 14, 2025.

Individuals who want to attend the public hearing by telephone without testifying must also send an email to *publichearings@irs.gov* to receive the telephone number and access code for the hearing. The subject line of the email must contain the regulation number REG-112129-23 and the language ATTEND Hearing Telephonically. For example, the subject line may say: Request to ATTEND Hearing Telephonically for REG-112129-23. Requests to attend the public hearing must be received by 5 p.m. EST on January 14, 2025.

Hearings will be made accessible to people with disabilities. To request special assistance during a hearing please contact the Publications and Regulations Branch of the Office of Associate Chief Counsel (Procedure and Administration) by sending an email to publichearings@irs.gov (preferred) or by telephone at (202) 317-6901 (not a toll-free number) by at least January 13, 2025.

Drafting Information

The principal authors of these regulations are Madeline Padner, Frank Dunham III, John Aramburu, James Yu, and C. Dylan Durham of the Office of Associate Chief Counsel (Income Tax and Accounting); Jeremy Aron-Dine, William W. Burhop, and John Lovelace of the Office of Associate Chief Counsel (Corporate); Diane Bloom, Seth Groman, and Chris Dellana of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes); Yosef Koppel, Elizabeth Zanet, and Brian Barrett of the Office of Associate Chief Counsel (Passthroughs and Special Industries); Daren J. Gottlieb, Dylan J. Steiner, Ryan Connery, John J. Lee, Michelle L. Ng, Joel Deuth, and Karen Walny of the Office of Associate Chief Counsel (International); Ian Follansbee and Vanessa Mekpong of the Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order for §§1.56A-1 through 1.56A-27, 1.59-2 through 1.59-4, 1.1502-53, and 1.1502-56A to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.56A-1 also issued under 26 U.S.C. 56A(c)(2)(B), 56A(c)(15), and 56A(e).

Section 1.56A-2 also issued under 26 U.S.C. 56A(b), 56A(c)(15), and 56A(e).

Section 1.56A-3 also issued under 26 U.S.C. 56A(c)(1), 56A(c)(15), and 56A(e).

Section 1.56A-4 also issued under 26 U.S.C. 56A(c)(2)(C), 56A(c)(15), and 56A(e).

Section 1.56A-5 also issued under 26 U.S.C. 56A(c)(2)(D)(i), 56A(c)(15), and 56A(e).

Section 1.56A-6 also issued under 26 U.S.C. 56A(c)(5), 56A(c)(15), and 56A(e).

Section 1.56A-7 also issued under 26 U.S.C. 56A(c)(15) and 56A(e).

Section 1.56A-8 also issued under 26 U.S.C. 56A(c)(5), 56A(c)(15), and 56A(e).

Sections 1.56A-9 through 1.56A-12 also issued under 26 U.S.C. 56A(c)(15) and 56A(e).

Section 1.56A-13 also issued under 26 U.S.C. 56A(c)(11)(A), 56A(c)(15), and 56A(e).

Section 1.56A-14 also issued under 26 U.S.C. 56A(c)(15) and 56A(e).

Section 1.56A-15 also issued under 26 U.S.C. 56A(c)(13)(B)(ii), 56A(c)(15), and 56A(e).

Section 1.56A-16 also issued under 26 U.S.C. 56A(c)(14)(A)(ii)(II), 56A(c)(15), and 56A(e).

Section 1.56A-17 also issued under 26 U.S.C. 56A(c)(15), and 56A(e).

Sections 1.56A-18 and 1.56A-19 also issued under 26 U.S.C. 56A(c)(2)(C), 56A(c)(15), and 56A(e).

Section 1.56A-20 also issued under 26 U.S.C. 56A(c)(2)(D)(i), 56A(c)(15), and 56A(e).

Sections 1.56A-21 through 1.56A-24 also issued under 26 U.S.C. 56A(c)(15) and 56A(e).

Section 1.56A-25 also issued under 26 U.S.C. 56A(e).

Sections 1.56A-26 and 1.56A-27 also issued under 26 U.S.C. 56A(c)(15) and 56A(e).

* * * * *

Section 1.59-2 also issued under 26 U.S.C. 59(k)(1)(C) and (k)(3).

Section 1.59-3 also issued under 26 U.S.C. 59(k)(2)(B) and (D) and 59(k)(3).

Section 1.59-4 also issued under 26 U.S.C. 59(l)(3).

* * * * *

Sections 1.1502-53 and 1.1502-56A also issued under 26 U.S.C. 53, 56A(c)(2)(B), 56A(c)(15), 56A(e), and 1502.

* * * * *

Par. 2. Remove the undesignated center heading "Tax Surcharge" immediately following §1.51-1.

§1.53-1 [Removed and Reserved]

Par. 3. Remove and reserve §1.53-1.

Par. 4. Add an undesignated center heading to read "Alternative Minimum Tax" above reserved §1.53-1.

§§1.53-2 and 1.53-3 [Removed]

Par. 5. Remove §§1.53-2 and 1.53-3.

§1.56-0 [Removed]

Par. 6. Remove §1.56-0.

Par. 7. Remove the undesignated center heading "Regulations Applicable to Taxable Years Beginning in 1969 and Ending in 1970" immediately before §1.56(g)-0.

Par. 8. Remove the undesignated center heading "Tax Preference Regulations" immediately following §1.56(g)-1.

Par. 9. Sections 1.56A-0 through 1.56A-27 are added to read as follows:

* * * * *

Sec.

1.56A-0 Table of contents.
1.56A-1 Definitions and general rules for determining adjusted financial statement income.

1.56A-2 Definition of applicable financial statement (AFS) and AFS priority rules.
1.56A-3 AFSI adjustments for AFS year and taxable year differences.
1.56A-4 AFSI adjustments and basis determinations with respect to foreign corporations.
1.56A-5 AFSI adjustments to partner's distributive share of partnership AFSI.
1.56A-6 AFSI adjustments with respect to controlled foreign corporations.
1.56A-7 AFSI adjustments with respect to effectively connected income
1.56A-8 AFSI adjustments for certain Federal and foreign income taxes.
1.56A-9 AFSI adjustments for owners of disregarded entities or branches.
1.56A-10 AFSI adjustments for cooperatives.
1.56A-11 AFSI adjustments for Alaska Native Corporations.
1.56A-12 AFSI adjustments with respect to certain tax credits.
1.56A-13 AFSI adjustments for covered benefit plans.
1.56A-14 AFSI adjustments for tax-exempt entities.
1.56A-15 AFSI adjustments for section 168 property.
1.56A-16 AFSI adjustments for qualified wireless spectrum property.
1.56A-17 AFSI adjustments to prevent certain duplications or omissions.
1.56A-18 AFSI, CAMT basis, and CAMT retained earnings resulting from certain corporate transactions.
1.56A-19 AFSI, CAMT basis and CAMT retained earnings resulting from certain corporate reorganizations and organizations.
1.56A-20 AFSI adjustments to apply certain subchapter K principles.
1.56A-21 AFSI adjustments for troubled companies.
1.56A-22 AFSI adjustments for certain insurance companies and other specified industries.
1.56A-23 AFSI adjustments for financial statement net operating losses and other attributes.
1.56A-24 AFSI adjustments for hedging transactions and hedged items.
1.56A-25 AFSI adjustments for mortgage servicing income.
1.56A-26 AFSI adjustments for certain related party transactions and CAMT avoidance transactions.
1.56A-27 AFSI adjustments for foreign governments.

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§1.56A-0 Table of contents.

This section lists the table of contents for §§1.56A-1 through 1.56A-27.

§1.56A-1 Definitions and general rules for determining adjusted financial statement income.

(a) Overview.
(1) In general.
(2) Scope of the section 56A regulations.
(b) Definitions.
(1) Adjusted financial statement income.
(2) Adjusted net income or loss.
(3) AFS basis.
(4) AFS consolidation entries.
(5) Applicable corporation.
(6) Applicable financial statement.
(7) CAMT basis.
(8) CAMT entity.
(9) CAMT foreign tax credit.
(10) CFC adjustment carryover.
(11) Change in accounting principle.
(12) Consolidated financial statement.
(13) Controlled foreign corporation.
(14) Disregarded entity.
(15) Equity method.
(16) Equity method base adjustment.
(17) Fair value method.
(18) Federal income taxes.
(19) Financial statement group.
(20) Financial statement income.
(21) Financial statement net operating loss.
(22) For regular tax purposes.
(23) Foreign income tax.
(24) FPMG.
(25) FPMG common parent.
(26) FSNOL carryover.
(27) GAAP.
(28) IFRS.
(29) Impairment loss.
(30) Impairment loss reversal.
(31) IRB guidance.
(32) Modified FSI.
(33) Partnership and tiered partnership.
(34) Pass-through entity.
(35) Purchase accounting.
(36) Push down accounting.
(37) Qualified wireless spectrum.
(38) Restated AFS.
(39) Section 56A regulations.
(40) Section 168 property.
(41) Separate financial statement.
(42) Statutory references.
(i) Chapter 1.
(ii) Code.
(iii) Subchapter K.
(iv) Subtitle A.
(43) Tax consolidated group.
(44) United States shareholder.
(c) General rules for determining FSI.
(1) Federal income tax treatment not relevant for FSI.
(2) Tax consolidated groups; CAMT entities that own disregarded entities.
(i) Tax consolidated groups.
(ii) CAMT entities that own a disregarded entity or branch.
(3) Determining FSI from a consolidated AFS.
(i) In general.
(ii) No netting losses against income within the consolidated AFS.
(iii) Elimination journal entries.
(iv) Consolidation entries other than elimination entries.
(v) Reconciliation requirement.
(4) Determining AFS basis and balance sheet account amounts if the CAMT entity's AFS is a consolidated financial statement.
(i) In general.
(ii) Purchase accounting and push down accounting.
(5) Coordination rule.
(6) Examples.
(i) Example 1: FSI of component members of a financial statement group.
(ii) Example 2: Consolidation entries if an item is converted from one financial accounting standard to another.
(d) General rules for determining AFSI.
(1) Federal income tax treatment not relevant for AFSI except as otherwise provided in guidance.
(2) Limitation on AFSI adjustments.
(3) AFSI adjustments for taxable years beginning before January 1, 2023.
(i) In general.
(ii) Exception for AFSI adjustments that arise from transactions or events that occur in taxable years ending on or before December 31, 2019.

(4) Redetermination of FSI gains and losses.

(5) Tax consolidated groups.

(6) CAMT entities that own disregarded entities.

(e) Rules for translating AFSI to U.S. dollars.

(f) Entity classification and treatment.

(1) Entity classification.

(2) Treatment of an entity as domestic or foreign.

(g) Substantiation requirement.

(1) In general.

(2) Other CAMT entity recordkeeping requirements.

(3) Applicable corporation determination record keeping requirements.

(h) Reporting requirement.

(1) Applicable corporations.

(2) Applicable corporation determination reporting requirements.

(3) Other reporting required for CAMT entities.

(i) Special rules for reporting distributive shares of AFSI and application of subchapter K.

(ii) Other reporting requirements.

(i) Applicability date.

§1.56A-2 Definition of applicable financial statement (AFS) and AFS priority rules.

(a) Overview.

(b) Definition of applicable financial statement.

(c) General financial statement priority.

(1) GAAP statements.

(2) IFRS statements.

(3) Financial statements prepared in accordance with other generally accepted accounting standards.

(4) Other government and regulatory statements.

(5) Unaudited external statements.

(6) Return.

(d) Certified financial statement.

(e) Restatements.

(f) Annual and periodic financial statements.

(g) AFS priority rules for consolidated financial statements.

(1) In general.

(2) Exceptions to use of separate AFS.

(i) Tax consolidated group member has only one consolidated financial statement that contains the financial results of all members of the tax consolidated group.

(ii) Tax consolidated group member has more than one consolidated financial statement that contains the financial results of all members of the tax consolidated group.

(iii) Tax consolidated group member has only one consolidated financial statement that contains its financial results and the financial results of some, but not all, members of the tax consolidated group.

(iv) Tax consolidated group member has more than one consolidated financial statement that contains its financial results and the financial results of some, but not all, members of the tax consolidated group.

(v) Members of an FPMG.

(h) Disregarded entities or branches.

(i) Examples.

(1) Example 1: No substantial non-tax purpose.

(2) Example 2: Substantial non-tax purpose.

(j) Applicability date.

§1.56A-3 AFSI adjustments for AFS years and taxable year differences.

(a) Overview.

(b) AFSI adjustment for mismatched years.

(1) In general.

(2) Examples.

(i) Example 1: Calendar-year taxpayer with fiscal annual financial accounting period.

(ii) Example 2: Fiscal-year taxpayer with calendar-year financial accounting period.

(c) Applicability date.

§1.56A-4 AFSI adjustments and basis determinations with respect to foreign corporations.

(a) Overview.

(b) Definitions.

(1) Covered asset transaction.

(2) Section 338(g) transaction.

(3) Transfer.

(c) Adjustments to AFSI.

(1) Adjustments with respect to stock of a foreign corporation.

(2) Adjustments with respect to covered asset transactions.

(3) Adjustments with respect to section 338(g) transactions.

(4) Adjustments with respect to purchase accounting and push down accounting.

(d) Certain rules for determining CAMT basis.

(1) Covered asset transactions.

(2) Section 338(g) transaction.

(3) Transfers of stock of a foreign corporation involving a partnership.

(4) Purchase accounting and push down accounting.

(5) Stock of a foreign corporation.

(e) Stock in a foreign corporation owned by a partnership.

(f) AFSI adjustments when basis in foreign stock is determined under section 358.

(1) In general.

(i) Principal purpose rule.

(ii) Two-year rule.

(2) Hypothetical CAMT basis.

(g) AFSI adjustments when certain foreign stock is distributed by a partnership.

(1) In general.

(2) Related CAMT entity.

(h) Examples.

(1) Example 1: Dividend received from a foreign corporation.

(2) Example 2: Stock of a foreign corporation owned by a partnership.

(3) Example 3: Sale of stock of a foreign corporation.

(4) Example 4: Foreign corporation reported on equity method.

(5) Example 5: Section 351 transfer.

(6) Example 6: Section 351 transfer with boot.

(7) Example 7: Transfer subject to section 367(a).

(8) Example 8: Inbound liquidation subject to section 367(b).

(i) Applicability date.

(1) In general.

(2) Rule for transfers.

§1.56A-5 AFSI adjustments to partner's distributive share of partnership AFSI.

(a) Overview.

(b) In general.

(c) Applicable method.

(d) FSI amounts with respect to a partnership investment that are not disregarded under paragraph (c)(1) of this section.

(e) Distributive share amount.

(1) In general.

(2) Computing the distributive share percentage.

(3) Computing the modified FSI of the partnership.

(4) AFSI items that are separately stated.

(i) In general.

(ii) Adjustments to a partner's distributive share amount.

(iii) Adjustments to a partner's AFSI.

(5) Effect of equity method basis adjustments to a CAMT entity's FSI.

(6) Computing a partner's distributive share amount when the partnership's AFS is its Federal income tax return.

(i) In general.

(ii) Separately stated AFSI items.

(f) Computation in the case of tiered partnerships.

(g) Taxable year.

(h) Reporting and filing requirements for a CAMT entity that is a partner in a partnership.

(1) In general.

(2) Failure to obtain information.

(i) In general.

(ii) Required estimate.

(iii) Partnerships subject to subchapter C of chapter 63 of the Code.

(i) Reporting and filing requirements for partnerships in which a CAMT entity is a partner.

(1) Requirement to file information with the IRS and to furnish information to a CAMT entity.

(2) Special rules for tiered structures.

(i) Requirement to request information.

(ii) Requirement to furnish and file information.

(iii) Timing of requesting information.

(3) Timing of furnishing information.

(i) In general.

(ii) Late requests.

(iii) Partnership not required to furnish information to a CAMT entity until it has notice of a request.

(4) Manner of furnishing information.

(5) Recordkeeping requirement.

(6) Penalties.

(j) Limitation on allowance of negative distributive share amount.

(1) In general.

(2) Carryover of suspended negative distributive share amount.

(3) CAMT basis in a partnership investment.

(k) Examples.

(1) Example 1: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method.

(2) Example 2: Adjustment of AFSI with respect to a partnership investment accounted for using the hypothetical liquidation at book value under the equity method.

(3) Example 3: Adjustment of AFSI with respect to a partnership investment accounted for using the hypothetical liquidation at book value under the equity method and involving a loss on the investment.

(4) Example 4: Determining distributive share percentage for AFS non-partner.

(5) Example 5: Determining distributive share percentage for entity that treats itself as owning 100 percent of the equity in the partnership for AFS purposes because the CAMT entity treats all other partners in the partnership as AFS non-partners.

(6) Example 6: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method in a tiered partnership structure.

(7) Example 7: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method with a basis adjustment under section 743(b) related to section 168 property.

(8) Example 8: Adjustment of AFSI with respect to a partnership investment accounted for using the fair value method.

(9) Example 9: Computation of CAMT basis in partnership investment.

(10) Example 10: Limitation of negative distributive share amount in excess of CAMT basis.

(l) Applicability dates.

(1) In general.

(2) Exceptions

(i) Paragraph (d).

(ii) Coordination with certain other provisions during prior years.

(iii) Applicability dates for rules described in paragraph (l)(2)(ii).

§1.56A-6 AFSI adjustments with respect to controlled foreign corporations.

(a) Overview.

(b) Section 56A(c)(3) adjustment to AFSI.

(1) Aggregate adjustment.

(2) Tax reduction.

(3) Aggregate negative adjustment.

(4) Reduction for utilization of a CFC adjustment carryover.

(5) CFC adjustment carryover mechanics.

(6) Definition of CFC adjustment carryover.

(7) Tax consolidated groups.

(c) Computing the adjusted net income or loss of a controlled foreign corporation.

(1) In general.

(2) Adjustments relating to ownership of stock of a foreign corporation

(i) In general

(ii) Amounts relating to ownership of stock of a foreign corporation reflected in controlled foreign corporation's FSI.

(iii) Amounts relating to ownership of stock of a foreign corporation included for regular tax purposes.

(iv) Stock of a foreign corporation owned by a partnership.

(3) Controlled foreign corporations engaged in a U.S. trade or business.

(4) Foreign income tax expense.

(5) FSNOL carryovers.

(d) Definition of a CAMT excluded dividend.

(e) Examples.

(1) Example 1: Dividend received by a controlled foreign corporation from another foreign controlled corporation.

(2) Example 2: Sale of stock of lower-tier controlled foreign corporation.

(3) Example 3: Controlled foreign corporation held through a partnership.

(f) Applicability date.

(1) In general.

(2) Multiple United States shareholders with different taxable years.

(3) Transactions involving foreign stock.

§1.56A-7 AFSI adjustments with respect to effectively connected income.

(a) Overview.

(b) Adjusted financial statement income of foreign corporations.

(c) Applicability date.

§1.56A-8 AFSI adjustments for certain Federal and foreign income taxes.

(a) Overview.

(b) AFSI adjustments for applicable income taxes.

(1) In general.

(2) Definition of applicable income taxes.

(c) Applicable corporations that choose not to credit foreign income taxes.

(d) Requirements for an applicable income tax to be considered taken into account in an AFS.

(e) Examples.

(1) Example 1.

(2) Example 2.

(3) Example 3.

(f) Applicability date.

§1.56A-9 AFSI adjustments for owners of disregarded entities or branches.

(a) Overview.

(b) Rules for determining the FSI and AFSI of a CAMT entity that owns a disregarded entity or branch.

(1) In general.

(2) Transactions disregarded.

(3) Certain disregarded entities or branches subject to the rules in §1.56A-2(h).

(c) Applicability date.

§1.56A-10 AFSI adjustments for cooperatives.

(a) Overview.

(b) AFSI adjustments for cooperatives.

(c) Applicability date.

§1.56A-11 AFSI adjustments for Alaska Native Corporations.

(a) Overview.

(b) Definitions.

(1) Alaska Native Corporation.

(2) ANCSA property.

(3) Specified payments.

(c) Cost recovery and depletion.

(d) Deduction for specified payments.

(e) Applicability date.

§1.56A-12 AFSI adjustments with respect to certain tax credits.

(a) Overview.

(b) Proceeds from certain credits excluded from AFSI.

(c) Treatment of transferee taxpayer.

(d) Recapture disregarded as expense in determining AFSI.

(e) Applicability date.

§1.56A-13 AFSI adjustments for covered benefit plans.

(a) Overview.

(b) Adjustments to AFSI for covered benefit plans.

(c) Covered benefit plan.

(1) General definition.

(2) Qualified defined benefit pension plan.

(3) Qualified foreign plan.

(4) Other defined benefit plan.

(d) Applicability date.

§1.56A-14 AFSI adjustments for tax-exempt entities.

(a) Overview.

(b) AFSI adjustments for tax-exempt entities.

(c) Applicability date.

§1.56A-15 AFSI adjustments for section 168 property.

(a) Overview.

(b) Definitions.

(1) Covered book inventoriable depreciation.

(2) Covered book COGS depreciation.

(3) Covered book depreciation expense.

(4) Covered book expense.

(5) Deductible tax depreciation.

(6) Section 168 property.

(7) Tax COGS depreciation.

(8) Tax depreciation.

(9) Tax depreciation section 481(a) adjustment.

(10) Tax capitalization method change.

(11) Tax capitalization method change AFSI adjustment.

(c) Property to which section 168 applies.

(1) In general.

(2) Property to which section 168 applies includes only the portion of property for which a depreciation deduction is allowable under section 167.

(3) Deductible expenditures are not property to which section 168 applies.

(4) Property to which section 168 applies does not include property that is not depreciable under section 168 for regular tax purposes.

(5) Effect of election out of additional first year depreciation.

(6) Property placed in service in taxable years beginning before the CAMT effective date.

(d) AFSI adjustments for depreciation and other amounts with respect to section 168 property.

(1) In general.

(2) Special rules for section 168 property held by a partnership.

(i) In general.

(ii) Basis adjustment under section 743(b) of the Code.

(iii) Basis adjustment under section 734(b) of the Code.

(iv) Basis adjustment under §1.1017-1(g)(2).

(3) Special rules for determining tax COGS depreciation and covered book COGS depreciation adjustments.

(i) In general.

(ii) Simplifying methods.

(4) Adjustment period for tax capitalization method change AFSI adjustments.

(5) Examples.

(i) Example 1: Tax COGS depreciation and covered book COGS depreciation adjustments under FIFO method.

(ii) Example 2: Tax COGS depreciation and covered book COGS depreciation adjustments under LIFO method.

(iii) Example 3: Tax COGS depreciation and covered book COGS depreciation adjustments under LIFO method.

(iv) Example 4: Net positive tax depreciation section 481(a) adjustment.

(v) Example 5: Change in method of accounting to treat the replacement of a portion of section 168 property as a deductible repair.

(vi) Example 6: Change in method of accounting to capitalize costs to section 168 property as required under section 263A.

(vii) Example 7: Deductible tax depreciation under section 174.

(viii) Example 8: Section 168 property treated as leased property for AFS purposes.

(ix) Example 9: Basis adjustment under section 743(b) to section 168 property.

(x) Example 10: Basis adjustment under section 734(b) to section 168 property.

(e) AFSI adjustments upon disposition of section 168 property.

(1) In general.

(2) Adjustments to the AFS basis of section 168 property.

(i) In general.

(ii) Special rules regarding adjustments to the AFS basis of section 168 property.

(A) Property placed in service prior to the effective date of CAMT.

(B) Property acquired in certain transactions to which section 168(i)(7) applies.

(C) Coordination with section 56A(c)(5).

(D) Determination of CAMT basis of section 168 property following a change in method of accounting for depreciation or a tax capitalization method change.

(E) Adjustments to the AFS basis of section 168 property include only the covered book amounts actually disregarded in determining AFSI.

(3) Special rules for section 168 property disposed of by a partnership.

(4) Treatment of amounts recognized in FSI upon the disposition of section 168 property.

(5) Determining the appropriate asset.

(6) Subsequent AFS dispositions.

(7) Intercompany transactions.

(8) Examples.

(i) Example 1: Disposition of section 168 property.

(ii) Example 2: Property acquired in a covered nonrecognition transaction.

(iii) Example 3: Property acquired in a covered recognition transaction.

(iv) Example 4: Property for which a tax credit was claimed.

(v) Example 5: Disposition of property that was subject to a tax capitalization method change and is not section 168 property at time of disposition.

(vi) Example 6: Disposition of property that was subject to a tax capitalization method change and is section 168 property at time of disposition.

(vii) Example 7: Installment sale under section 453.

(viii) Example 8: Like-kind exchange under section 1031.

(ix) Example 9: Replacement property received in a like-kind exchange.

(x) Example 10: Section 168 property disposed of by a partnership.

(xi) Example 11: Section 168 property disposed of by a partnership with a section 743(b) basis adjustment in place.

(f) Applicability date.

§1.56A-16 AFSI adjustments for qualified wireless spectrum property.

(a) Overview.

(b) Definitions.

(1) Covered book amortization expense.

(2) Covered book wireless spectrum expense.

(3) Deductible tax amortization.

(4) Qualified wireless spectrum.

(5) Tax amortization.

(6) Tax amortization section 481(a) adjustment.

(7) Tax capitalization method change for qualified wireless spectrum.

(8) Tax capitalization method change AFSI adjustment for qualified wireless spectrum.

(c) Qualified wireless spectrum.

(1) In general.

(2) Qualified wireless spectrum does not include wireless spectrum that is not depreciable under section 197 for regular tax purposes.

(d) AFSI adjustments for amortization and other amounts with respect to qualified wireless spectrum.

(1) In general.

(2) Special rules for qualified wireless spectrum held by a partnership.

(i) In general.

(ii) Basis adjustment under section 743(b) of the Code.

(iii) Basis adjustment under section 734(b) of the Code.

(iv) Basis adjustment under §1.1017-1(g)(2).

(3) Adjustment period for tax capitalization method change AFSI adjustments for qualified wireless spectrum.

(e) AFSI adjustments upon disposition of qualified wireless spectrum.

(1) In general.

(2) Adjustments to the AFS basis of qualified wireless spectrum.

(i) In general.

(ii) Special rules regarding adjustments to the AFS basis of qualified wireless spectrum.

(A) Qualified wireless spectrum placed in service prior to the effective date of CAMT.

(B) Qualified wireless spectrum acquired in certain transactions to which section 197(f)(2) applies.

(C) Determination of CAMT basis of qualified wireless spectrum following a change in method of accounting for amortization or a tax capitalization method change for qualified wireless spectrum.

(D) Adjustments to the AFS basis of qualified wireless spectrum include only the covered book amounts actually disregarded in determining AFSI.

(3) Special rule for qualified wireless spectrum disposed of by a partnership.

(4) Treatment of amounts recognized in FSI upon the disposition of qualified wireless spectrum.

(5) Subsequent AFS dispositions.

(6) Intercompany transactions.

(7) Example.

(f) Applicability date.

§1.56A-17 AFSI adjustments to prevent certain duplications or omissions.

(a) Overview.

(b) In general.

(c) Change in accounting principle.

(1) In general.

(2) Accounting principle change amount.

(i) In general.

(ii) Change in AFS under paragraph (c)(5) of this section.

(3) Adjustment spread period rule.

(i) Duplications.

(ii) Omissions.

(iii) Short periods.

(4) Acceleration of accounting principle change amount.

(5) Use of different priority AFSs in consecutive taxable years.

(6) Examples.

(i) Example 1: Adjustment spread period: duplicated income spread over 2 years.

(ii) Example 2: Adjustment spread period: duplicated income spread over 10 years.

(iii) Example 3: Adjustment spread period: duplications expected over twenty-year period.

(d) Restatement of a prior year's AFS.
(1) In general.
(i) Adjustments to AFSI.
(ii) Further adjustments to AFSI.
(2) Exception for amended return.
(3) Reconciliation of retained earnings in AFS.
(4) Example.
(e) Adjustment for amounts disclosed in an auditor's opinion.
(1) In general.
(2) Further adjustments to AFSI.
(f) No adjustment for timing differences.
(g) Applicability date.

§1.56A-18 AFSI, CAMT basis, and CAMT retained earnings resulting from certain corporate transactions.

(a) Overview.
(1) Scope.
(2) Exceptions.
(3) Cross-references.
(i) Corporate reorganizations and organizations.
(ii) Transactions within a tax consolidated group.
(iii) Deferral of loss from disposition between certain members of a CAMT-related group.
(iv) Certain arrangements disregarded or recharacterized.
(v) Clear reflection of income requirement.
(vi) AFSI and CAMT attribute rules regarding troubled corporations.
(vii) Financial statement net operating losses.
(viii) Minimum tax credits.
(ix) AFSI history.
(x) Certain stock owned by insurance companies.
(b) Definitions.
(1) Acquiror corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(2) B reorganization.
(3) CAMT current earnings.
(4) CAMT earnings.
(5) CAMT retained earnings.
(i) In general.
(ii) Timing of determination.
(6) Component transaction.
(7) Controlled corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(8) Corporate dissolution.
(9) Covered nonrecognition transaction.
(10) Covered recognition transaction.
(11) Covered transaction.
(12) Distributing corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(13) Distributing corporation shareholder or security holder.
(14) Distribution recipient.
(15) E reorganization.
(16) F reorganization.
(17) Liquidating corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(18) Liquidation recipient.
(19) Party.
(20) Property.
(21) Qualified property.
(22) Recapitalization corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(23) Recapitalizing corporation shareholder or security holder.
(24) Resulting corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(25) Section 351 exchange.
(26) Section 351 transferee.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(27) Section 351 transferor.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(28) Section 355 transaction.
(29) Target corporation.
(i) Covered nonrecognition transaction.
(ii) Covered recognition transaction.
(30) Target corporation shareholder or security holder.
(31) Transferor corporation.
(32) Transferor corporation shareholder or security holder.
(c) Operating rules for this section and §1.56A-19.
(1) Treatment of stock.
(2) FSI resulting from stock investments.
(i) In general.
(ii) Exceptions.
(iii) Characterization of FSI resulting from stock investments.
(3) Purchase accounting and push down accounting for stock acquisitions.
(4) Purchase accounting and push down accounting for asset acquisitions.
(5) Determination of CAMT consequences of component transactions.
(i) Generally separate treatment.
(ii) Effect of other component transactions.
(6) CAMT stock basis transition rule.
(7) CAMT retained earnings following certain cross border transactions.
(i) Inbound liquidations and reorganizations.
(ii) Section 355 distributions.
(8) Examples.
(i) Example 1: Treatment of stock.
(ii) Example 2: FSI resulting from stock investments marked to market.
(iii) Example 3: FSI resulting from stock investments due to equity method annual inclusions.
(iv) Example 4: Remeasurement gain.
(v) Example 5: Purchase accounting and push down accounting.
(vi) Example 6: Identification of component transactions.
(vii) Example 7: Effect of component transaction on other component transactions.
(viii) Example 8: CAMT stock basis transition rule.
(ix) Example 9: CAMT retained earnings.
(d) CAMT consequences of certain non-liquidating stock and property distributions.
(1) Distributing corporation in covered nonrecognition transaction.
(2) Distributing corporation in covered recognition transaction.
(3) Section 355(c) distributions in covered recognition transactions.
(4) Distribution recipient.
(5) Examples.
(i) Example 1: Stock distribution.
(ii) Example 2: Property distribution.
(iii) Example 3: Redemption.
(iv) Example 4: Dividends received deduction.
(v) Example 5: Extraordinary dividend.
(e) Section 336(e) elections.
(1) Distributing corporation with regard to dispositions described in section 355(d)(2) or (e)(2).
(2) Target corporation with regard to dispositions described in section 355(d)(2) or (e)(2).
(3) Distributing corporation shareholder or security holder with regard to dispositions described in section 355(d)(2) or (e)(2).

(4) Distributing corporation with regard to distributions not described in section 355(d)(2) or (e)(2) for which a section 336(e) election is made.

(5) Target corporation with regard to distributions not described in section 355(d)(2) or (e)(2).

(6) New target corporation with regard to distributions not described in section 355(d)(2) or (e)(2).

(7) Example.

(f) CAMT consequences of certain liquidating distributions.

(1) Liquidating corporation in covered nonrecognition transaction.

(2) Liquidating corporation in covered recognition transaction.

(3) Component transactions of a liquidation consisting of covered recognition and covered nonrecognition transactions.

(4) Consequences to liquidation recipient in covered nonrecognition transaction.

(5) Consequences to liquidation recipient in covered recognition transaction.

(6) Examples.

(i) Example 1: Nonrecognition subsidiary liquidation.

(ii) Example 2: Component transactions.

(g) CAMT consequences of stock sales.

(1) Target corporation shareholder.

(i) In general.

(ii) Stock sales for which a section 336(e) or 338(h)(10) election is made.

(2) Target corporation.

(i) In general.

(ii) Stock sales for which a section 336(e), 338(g), or 338(h)(10) election is made.

(3) Acquiror corporation.

(4) New target corporation.

(5) Section 304 transactions.

(6) Examples.

(i) Example 1: Acquisition of stock of a target corporation.

(ii) Example 2: Covered recognition transaction stock sale: section 338(h)(10) election.

(iii) Example 3: Covered recognition transaction stock sale: section 336(e) election.

(h) CAMT consequences of asset sales.

(1) Target corporation.

(2) Acquiror corporation.

(3) Example.

(i) Applicability date.

§1.56A-19 AFSI, CAMT basis and CAMT retained earnings resulting from certain corporate reorganizations and organizations.

(a) Overview.

(b) CAMT consequences of B reorganizations.

(1) Target corporation shareholder or security holder in covered nonrecognition transaction.

(2) Target corporation shareholder or security holder in covered recognition transaction.

(3) Acquiror corporation in covered nonrecognition transaction.

(4) Acquiror corporation in covered recognition transaction.

(i) Failure to qualify as B reorganization.

(ii) Failure to qualify under §1.1032-2(b).

(5) Acquiror corporation parent in covered nonrecognition transaction.

(6) Acquiror corporation parent in covered recognition transaction.

(i) Use of old and cold parent stock with qualifying B reorganization.

(ii) Use of parent stock with transaction that does not qualify as a B reorganization.

(7) Examples.

(i) Example 1: Covered nonrecognition transaction.

(ii) Example 2: Covered recognition transaction.

(c) CAMT consequences of certain acquisitive reorganizations.

(1) Target corporation in a covered nonrecognition transaction.

(i) Reorganization exchanges.

(ii) Section 361(c) distributions.

(2) Target corporation in covered recognition transaction.

(3) Acquiror corporation qualification for covered nonrecognition transaction.

(4) Acquiror corporation in covered recognition transaction.

(i) Failure to qualify as an asset reorganization.

(ii) Failure to qualify under §1.1032-2(b).

(5) Acquiror corporation parent in covered nonrecognition transaction.

(6) Acquiror corporation parent in covered recognition transaction.

(i) Use of old and cold parent stock with qualifying acquisitive reorganization.

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(8) Examples.

(i) Example 1: Covered nonrecognition transaction.

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(d) CAMT consequences of section 355 transactions.

(1) Distributing corporation in covered nonrecognition transactions.

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(ii) Section 361(c) distributions and transfers.

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(5) Controlled corporation in covered recognition transaction.

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(1) Recapitalizing corporation in covered nonrecognition transaction.

(2) Component transactions consisting of covered nonrecognition transaction and corporate distributions.

(3) Recapitalizing corporation shareholder or security holder.

(4) Examples.

(i) Example 1: Covered nonrecognition transaction.

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(f) CAMT consequences of F reorganizations.

(1) Transferor corporation in covered nonrecognition transaction.

(2) Component transactions consisting of covered nonrecognition transaction and corporate distributions.

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(5) Examples.

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(ii) Section 351 transferee's CAMT basis in property.

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(v) Tiered partnerships.

(3) Basis rules.

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(ii) Basis of partnership investment for contributed property.

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(5) Indebtedness.

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(7) Title 11 case.

(c) Discharge of indebtedness income.

(1) AFSI in title 11 cases.

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(b) Definition of financial statement net operating loss.
(c) AFSI adjustments for the utilization of an FSNOL.
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(2) Successor transaction.
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§1.56A-24 AFSI adjustments for hedging transactions and hedged items.

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(1) Scope.
(2) Treatment of fair value measurement adjustment for certain AFSI hedges or hedged items.
(3) Application to prior taxable years.
(d) Net investment hedge adjustments.
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(f) Examples.
(1) Example 1: Fair value measurement adjustment for an AFSI hedge.
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(3) Example 3: Fair value measurement adjustment for AFSI hedge and hedged item.
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(g) Applicability date.

§1.56A-25 AFSI adjustments for mortgage servicing income.

(a) Overview.
(b) In general.
(c) Applicability date.

§1.56A-26 AFSI adjustments for certain related party transactions and CAMT avoidance transactions.

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(1) In general.
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§1.56A-27 AFSI adjustments for foreign governments.

(a) Overview.
(b) In general.
(c) Applicability date.

§1.56A-1 Definitions and general rules for determining adjusted financial statement income.

(a) *Overview*—(1) *In general*. This section provides general definitions that apply for purposes of the regulations provided in this section and §§1.56A-2 through 1.56A-27, 1.59-2 through 1.59-4, 1.1502-53, and 1.1502-56A and provides general rules under section 56A of the Code for determining financial statement income (FSI) and adjusted financial statement income (AFSI), which are relevant for determining whether, and to what extent, a corporation is subject to the corporate alternative minimum tax (CAMT) under section 55(a) of the Code. Paragraph (b) of this section provides general definitions that apply for purposes of this section and §§1.56A-2 through 1.56A-27 and 1.1502-56A (collectively, the section 56A regulations), as well as §§1.59-2 through 1.59-4 and 1.1502-53. Paragraph (c) of this section provides general rules for determining an entity's FSI, including for situations in which the financial results of an entity are consolidated with the financial results of one or more other entities in a consolidated financial statement. Paragraph (d) of this section provides general rules for determining an entity's AFSI. Paragraph (e) of this section provides rules for translating AFSI that is denominated in a currency other than the U.S. dollar. Paragraph (f) of this section provides rules for determining the classification of an entity for purposes of the section 56A regulations. Paragraph (g) of this section provides general substantiation requirements. Paragraph (h) of this section provides general reporting requirements. Paragraph (i) of this section provides the applicability date of this section.

(2) *Scope of the section 56A regulations*. The section 56A regulations apply to determine a CAMT entity's AFSI, modified FSI, or adjusted net income or loss, as applicable, for purposes of sections 55 through 59 of the Code. The section 56A regulations apply to any CAMT entity whose AFSI, modified FSI, or adjusted net income or loss, as applicable, is relevant for determining—

(i) Whether the CAMT entity or any other CAMT entity is an applicable corporation under section 59(k); or

(ii) The tentative minimum tax under section 55(b)(2)(A) of the CAMT entity or any other CAMT entity.

(b) *Definitions*. For purposes of the section 56A regulations:

(1) *Adjusted financial statement income*. The term *adjusted financial statement income* (AFSI) means:

(i) With respect to a corporate alternative minimum tax (CAMT) entity whose applicable financial statement (AFS) for the taxable year is not described in §1.56A-2(c)(6), the CAMT entity's FSI for the taxable year, adjusted as provided in the section 56A regulations. The IRS may publish IRB guidance that permits CAMT entities to make other AFSI adjustments.

(ii) With respect to a CAMT entity whose AFS for the taxable year is described in §1.56A-2(c)(6)—

(A) For a CAMT entity that is a controlled foreign corporation, the amount described in paragraph (b)(20)(ii) of this section for the taxable year, adjusted as provided in the section 56A regulations;

(B) For a CAMT entity that is a partnership, the partnership's items of income, gain, loss, and deduction that are reflected on the partnership's return of partnership income for the taxable year and taken into account in determining the taxable income of each partner (without adjustment); and

(C) For a CAMT entity other than a controlled foreign corporation or a partnership, the CAMT entity's taxable income for the taxable year (without adjustment).

(2) *Adjusted net income or loss*. The term *adjusted net income or loss* means, with respect to a controlled foreign corpo-

ration for a taxable year, the amount provided in §1.56A-6(c).

(3) *AFS basis*. The term *AFS basis* means the carrying value of an item for AFS purposes. *See* paragraph (c)(4) of this section for rules that apply to determine a CAMT entity's AFS basis in an item if the CAMT entity's AFS is a consolidated financial statement.

(4) *AFS consolidation entries*. The term *AFS consolidation entries* means the financial accounting journal entries that are made in preparing a consolidated financial statement for a financial statement group in order to present the financial results of that financial statement group as though all members of the financial statement group were a single economic entity, including journal entries—

(i) To eliminate the effect of transactions and investments between members of the financial statement group;

(ii) To report amounts that are not recorded in the separate books and records of one or more members of the financial statement group; and

(iii) To correct or otherwise adjust amounts that are reported in the separate books and records of one or more members of the financial statement group.

(5) *Applicable corporation.* The term *applicable corporation* has the meaning provided in §1.59-2(b)(1).

(6) *Applicable financial statement*. The term *applicable financial statement* (AFS) has the meaning provided in §1.56A-2(b).

(7) *CAMT basis*. The term *CAMT basis* means the basis of an item for purposes of determining AFSI. Except as otherwise provided in the section 56A regulations (for example, §§1.56A-4(d)(5), 1.56A-15(e) and 1.56A-16(e)), the CAMT basis of an item is the AFS basis of the item, adjusted as provided in the section 56A regulations. *See* paragraph (d)(3) of this section for rules for determining the AFS basis of an item that arose in a taxable year beginning before January 1, 2023.

(8) *CAMT entity*. The term *CAMT entity* means any entity identified in section 7701 of the Code and the regulations under section 7701 other than a disregarded entity.

(9) *CAMT foreign tax credit*. The term *CAMT foreign tax credit* means the credit allowed to an applicable corporation under section 59(l), as computed under §1.59-4(c).

(10) *CFC adjustment carryover.* The term *CFC adjustment carryover* has the meaning provided in §1.56A-6(b)(6).

(11) *Change in accounting principle*. The term *change in accounting principle* means a change from using one accepted accounting principle or practice to another accepted accounting principle or practice for AFS purposes if there are two or more accepted accounting principles or practices that apply or if the original accepted accounting principle or practice is no longer accepted. A change in the method of applying an accepted accounting principle or practice for AFS purposes also is considered a change in accounting principle. *See*, for example, FASB Accounting Standards Codification (ASC) 250-10-20.

(12) *Consolidated financial statement*. The term *consolidated financial statement* means a financial statement that presents the assets, liabilities, equity, income, and expenses of more than one CAMT entity as those of a single economic entity.

(13) *Controlled foreign corporation*. The term *controlled foreign corporation* has the meaning provided under section 957 of the Code or, if applicable, section 953(c)(1)(B) of the Code.

(14) *Disregarded entity*. The term *disregarded entity* means an entity that is disregarded as separate from its owner under §301.7701-3 of this chapter, a qualified subchapter S subsidiary within the meaning of section 1361(b)(3)(B) of the Code, and a qualified real estate investment trust subsidiary within the meaning of section 856(i)(2) of the Code.

(15) *Equity method*. The term *equity method* means the practice, under financial accounting principles, of a CAMT entity (investor) initially recording its investment in the equity of another CAMT entity (investee) as an asset in the investor's AFS, generally, at cost and then adjusting the AFS basis of such asset by the investor's share of the earnings or losses of the investee for periods following the date of investment. *See*, for example, ASC 323. The equity method includes the hypothetical liquidation at book value (HLBV) method under which the investor uses a balance sheet approach to calculate the investor's share of investee earnings or losses based on the change in the investor's claim on the net assets of the investee.

(16) *Equity method basis adjustment*. The term *equity method basis adjustment* means the practice, under financial accounting principles, of a CAMT entity (investor) adjusting its AFS basis in an investment in the equity of another CAMT entity (investee) accounted for under the equity method to reflect amortization of the difference (or a portion of the difference) between the investor's proportionate share of the fair value of the investee's net assets and the investor's proportionate share of the carrying value of the investees net assets as of the date investor acquired the investment. *See*, for example, ASC 323-10-35-13.

(17) *Fair value method*. The term *fair value method* means the practice, under financial accounting principles, of a CAMT entity (investor) recording its investment in the equity of another CAMT entity (investee) as an asset in the investor's AFS and adjusting the AFS basis of such asset as of each reporting date by reference to the investment's fair value (or by reference to the original cost of the investment, reduced for any impairment, if the fair value is not readily determinable). *See*, for example, ASC 321-10.

(18) *Federal income taxes*. The term *Federal income taxes* means taxes imposed by subtitle A of the Code (subtitle A). Federal income taxes include amounts allowed as credits against taxes imposed by subtitle A, including credit amounts that are generated by a partnership and passed through to a partner.

(19) *Financial statement group*. The term *financial statement group* means a group of CAMT entities whose financial results are consolidated and reported on the same consolidated financial statement.

(20) *Financial statement income*. The term *financial statement income* (FSI) means:

(i) With respect to a CAMT entity other than a CAMT entity described in paragraph (b)(20)(ii) of this section for a taxable year, the net income or loss of the CAMT entity set forth on the income statement (sometimes referred to as the statement of earnings, the statement of operations, or the statement of profit and loss) included in the CAMT entity's AFS for the taxable year. FSI includes all the

CAMT entity's items of income, expense, gain, and loss reflected in the net income or loss set forth on the income statement for the taxable year, including nonrecurring items and net income or loss from discontinued operations. FSI does not include amounts reflected elsewhere in the CAMT entity's AFS, including in equity accounts such as retained earnings and other comprehensive income (OCI). *See* paragraph (c) of this section for rules that apply to determine FSI of a CAMT entity.

(ii) With respect to a CAMT entity that is a controlled foreign corporation and whose AFS is the tax return under §1.56A-2(c)(6), the amount determined under §1.964-1(a)(1) for a taxable year without adjustment for §1.964-1(a)(1)(iii).

(21) *Financial statement net operating loss*. The term *financial statement net operating loss* (FSNOL) has the meaning provided in §1.56A-23(b).

(22) *For regular tax purposes*. The term *for regular tax purposes* means for purposes of computing a CAMT entity's regular tax liability, as defined under section 26(b) of the Code, or, if the CAMT entity is a pass-through entity or a controlled foreign corporation, the regular tax liability of a direct or indirect owner of the CAMT entity, as applicable.

(23) *Foreign income tax*. The term *foreign income tax* has the meaning provided in §1.901-2.

(24) *FPMG*. The term *FPMG* (foreign-parented multinational group) has the meaning provided in §1.59-3(c).

(25) *FPMG common parent*. The term *FPMG common parent* has the meaning provided in §1.59-3(b)(9).

(26) *FSNOL carryover*. The term *FSNOL carryover* has the meaning provided in §1.56A-23(d).

(27) *GAAP*. The term *GAAP* means United States Generally Accepted Accounting Principles, which are a common set of accounting rules, standards, and procedures that are generally issued by the Financial Accounting Standards Board (FASB) and, where applicable, the United States Securities and Exchange Commission (SEC).

(28) *IFRS*. The term *IFRS* means International Financial Reporting Standards, which are a common set of accounting rules, standards, and procedures that are generally issued by the International Accounting Standards Board.

(29) *Impairment loss*. The term *impairment loss* means a loss reflected in a CAMT entity's FSI from the impairment write-down of the AFS basis of an asset (or a group of assets) to fair value while the asset (or group of assets) is still held by the CAMT entity. An impairment write-down occurs if an asset (or a group of assets) is tested for impairment and the asset (or group of assets) has an AFS basis that exceeds the fair value of the asset (or group of assets). The frequency with which an asset (or a group of assets) is tested for impairment is not relevant in determining whether an impairment loss has occurred.

(30) *Impairment loss reversal*. The term *impairment loss reversal* means the reversal of a prior-year impairment loss that is reflected in the current-year computation of FSI.

(31) *IRB guidance*. The term *IRB guidance* means guidance published in the Internal Revenue Bulletin (*see* §601.601(d) of this chapter) after [DATE OF PUBLICATION OF THE FINAL RULE IN THE ***FEDERAL REGISTER***].

(32) *Modified FSI*. The term *modified FSI* means, with respect to a partnership for a taxable year, the amount provided in §1.56A-5(e)(3).

(33) *Partnership and tiered partnership*. The term *partnership* has the meaning provided under sections 761(a) and 7701(a)(2) of the Code and the regulations under sections 761 and 7701. The term *tiered partnership* means a structure in which a partnership (upper-tier partnership) owns an interest in another partnership (lower-tier partnership).

(34) *Pass-through entity*. The term *pass-through entity* means a partnership, an S corporation as defined in section 1361(a)(1) of the Code, or any other CAMT entity other than a C corporation, as defined in section 1361(a)(2) of the Code, to the extent that the income or deductions of the entity are included in the income of one or more direct or indirect owners or beneficiaries of the entity for regular tax purposes.

(35) *Purchase accounting*. The term *purchase accounting* means the practice, under financial accounting principles, of a CAMT entity recording acquisitions of other CAMT entities or lines of business on its AFS at fair value, with the acquiring CAMT entity valuing the assets and liabilities of the acquired CAMT entity or line of business at their fair value as of the acquisition date. *See*, for example, ASC 805-20-25-1.

(36) *Push down accounting*. The term *push down accounting* means the practice, under financial accounting principles, of an acquired CAMT entity adjusting the AFS basis of its assets and liabilities and the assets and liabilities of any lower-tier entities to fair value as of the date the CAMT entity is acquired. *See*, for example, ASC 805-50-25-4.

(37) *Qualified wireless spectrum*. The term *qualified wireless spectrum* has the meaning provided in §1.56A-16(b)(4).

(38) *Restated AFS*. The term *restated AFS* means an AFS for a specific accounting period that is revised and reissued to correct the original AFS issued for that accounting period. Adjustments to the financial results of a prior accounting period that are disclosed in an original AFS for comparison purposes (for example, in the case of a change in accounting principle) do not constitute a restated AFS for that prior accounting period.

(39) *Section 56A regulations*. The term *section 56A regulations* means the regulations provided in this section and §§1.56A-2 through 1.56A-27 and 1.1502-56A.

(40) *Section 168 property*. The term *section 168 property* has the meaning provided in §1.56A-15(b)(6).

(41) *Separate financial statement*. The term *separate financial statement* means a financial statement that is not a consolidated financial statement and that presents the assets, liabilities, equity, income, and expenses of a single CAMT entity (including the assets, liabilities, equity, income, and expenses of that single CAMT entity with respect to its investment in other CAMT entities).

(42) *Statutory references*—(i) *Chapter 1*. The term *chapter 1* means chapter 1 of subtitle A.

(ii) *Code*. The term *Code* means the Internal Revenue Code.

(iii) *Subchapter K*. The term *subchapter K* means subchapter K of chapter 1.

(iv) *Subtitle A*. The term *subtitle A* means subtitle A of the Code.

(43) *Tax consolidated group*. The term *tax consolidated group* has the meaning given the term *consolidated group* in §1.1502-1(h).

(44) *United States shareholder*. The term *United States shareholder* has the meaning provided under section 951(b) of the Code or, if applicable, section 953(c)(1)(A) of the Code.

(c) *General rules for determining FSI*—(1) *Federal income tax treatment not relevant for FSI*. FSI includes all items of income, expense, gain, and loss reflected in the net income or loss of a CAMT entity set forth in the income statement included in the CAMT entity's AFS, regardless of whether the amounts are realized, recognized, or otherwise taken into account for regular tax purposes. For example, FSI includes income reported on the income statement included in a CAMT entity's AFS for a taxable year even if the income is not treated as AFS revenue for that taxable year for purposes of the AFS income inclusion rule under §1.451-3(b). Similarly, FSI includes gain or loss reported on the income statement included in a CAMT entity's AFS for a taxable year even if the gain or loss is deferred or not recognized for regular tax purposes (for example, gain on a like-kind exchange that qualifies for nonrecognition treatment under section 1031 of the Code).

(2) *Tax consolidated groups; CAMT entities that own disregarded entities*—(i) *Tax consolidated groups*. For purposes of the section 56A regulations, if the AFS of each member of a tax consolidated group is not the same consolidated financial statement after the application of §1.56A-2(g), then the tax consolidated group combines the financial results of all CAMT entities reflected in the different AFSs of its members to form one consolidated financial statement that is treated as the AFS of the tax consolidated group (tax consolidated group AFS). For purposes of the preceding sentence, the financial results of each CAMT entity may not be included in the tax consolidated group AFS more than once, and the tax consolidated group makes any AFS consolidation entries not otherwise reflected in the AFS of any member that would have been made if the tax consolidated group AFS actually had been prepared. For additional rules for determining the FSI of a tax consolidated group, *see* §1.1502-56A.

(ii) *CAMT entities that own a disregarded entity or branch*. For rules for determining the FSI of a CAMT entity that owns a disregarded entity or branch, *see* §1.56A-9.

(3) *Determining FSI from a consolidated AFS*. If a CAMT entity's AFS is a consolidated financial statement under paragraph (c)(2)(i) of this section or §1.56A-2(g) (consolidated AFS), the CAMT entity applies this paragraph (c)(3) to determine the amount of the net income or loss of the financial statement group set forth on the income statement included in the consolidated AFS (consolidated FSI) that is the CAMT entity's FSI. Except as provided in §1.1502-56A(c), the CAMT entity's FSI is determined in accordance with this paragraph (c)(3).

(i) *In general.* The amount of consolidated FSI that is the CAMT entity's FSI must be supported by the CAMT entity's separate books and records (including trial balances) used to create the consolidated AFS.

(ii) *No netting losses against income within the consolidated AFS*. Except as provided in paragraphs (c)(3)(iii)(B) and (C) of this section, the amount of consolidated FSI that is the CAMT entity's FSI is determined without regard to the financial results of other CAMT entities that are members of the financial statement group for which the consolidated AFS is prepared. Accordingly, if two or more CAMT entities are members of that financial statement group, the loss of one CAMT entity may not offset the income of another CAMT entity for purposes of determining the FSI of either CAMT entity, notwithstanding that the amounts are reflected in the consolidated FSI on a net basis.

(iii) *Elimination journal entries.* In determining the amount of consolidated FSI that is the CAMT entity's FSI:

(A) AFS consolidation entries that eliminate the effect of transactions between the CAMT entity and another CAMT entity that is a member of the financial statement group for which the consolidated AFS is prepared are disregarded.

(B) AFS consolidation entries that eliminate any income, loss, expense, asset, liability, or other item of the CAMT entity with respect to its investment in another CAMT entity (for example, an interest in a partnership or stock in a corporation) that is a member of the financial statement group for which the consolidated AFS is prepared are disregarded.

(C) If a CAMT entity has an investment in a partnership or a domestic corporation that is a member of the CAMT entity's financial statement group for which the consolidated AFS is prepared, the income or loss reflected in the FSI of the CAMT entity with respect to the investment (after the application of paragraph (c)(3)(iii)(B) of this section) and any balance sheet accounts reflected in the CAMT entity's separate books and records with respect to the investment are determined as though the CAMT entity prepared a separate financial statement in which the investment was properly accounted for under the relevant accounting standards for investments in other entities (for example, the Parent-Entity Financial Statement accounting standards described in ASC 810-10-45-11), if the CAMT entity does not so account for the investment in the CAMT entity's separate books and records used to prepare the consolidated AFS.

(iv) *Consolidation entries other than elimination entries.* AFS consolidation entries, other than elimination entries described in paragraphs (c)(3)(iii)(A) and (B) of this section, that relate to one or more CAMT entities that are members of the financial statement group for which the consolidated AFS is prepared and that are not reflected in the separate books and records of one or more of the CAMT entities are appropriately allocated or pushed down (or both), as applicable, to each CAMT entity to which the AFS consolidation entries relate and taken into account in each CAMT entity's FSI.

(v) *Reconciliation requirement.* The CAMT entity must maintain books and records sufficient to demonstrate how its FSI (as determined under this paragraph (c)(3)) reconciles to consolidated FSI.

(4) *Determining AFS basis and balance sheet account amounts if the CAMT entity's AFS is a consolidated financial statement*—(i) *In general.* If, under §1.56A-2(g), a CAMT entity's AFS is a consolidated financial statement, and if the CAMT entity's balance sheet accounts or AFS basis in any item is relevant for determining the CAMT entity's AFSI, then the CAMT entity uses the balance sheet accounts or AFS basis reflected in the CAMT entity's

separate books and records (including the CAMT entity's trial balance) used to create the consolidated financial statement. The balance sheet accounts or AFS basis are determined without regard to any AFS consolidation entries described in paragraphs (c)(3)(iii)(A) and (B) of this section, but with regard to paragraphs (c)(3)(iii)(C) and (c)(3)(iv) of this section.

(ii) *Purchase accounting and push down accounting*. In the case of a CAMT entity subject to the accounting standards for business combinations, the application of paragraphs (c)(3) and (c)(4)(i) of this section will result in any purchase accounting and push down accounting adjustments, as applicable, being reflected in the CAMT entity's AFS basis, balance sheet accounts, and FSI. However, the purchase accounting and push down accounting adjustments, as applicable, may be disregarded under other sections of the section 56A regulations for purposes of determining the CAMT entity's CAMT basis and AFSI (*see, for example*, §§1.56A-18(c)(3) and 1.56A-4(c)(4) and (d)(4)).

(5) *Coordination rule*. This paragraph (c) applies before paragraphs (d) and (e) of this section and before all other sections of the section 56A regulations other than §1.56A-2. Accordingly, references to AFS basis and FSI in paragraphs (d) and (e) of this section and in §§1.56A-3 through 1.56A-27 mean AFS basis and FSI as determined under this paragraph (c).

(6) *Examples*. The following examples illustrate the application of paragraph (c)(3) of this section.

(i) *Example 1: FSI of component members of a financial statement group*—(A) *General Facts*. X is a domestic corporation and Y is a domestic partnership. X is a general partner in Y with a 40% interest in Y. The financial results of X are consolidated with the financial results of Y on a consolidated AFS (XY Consolidated AFS) for the financial reporting period beginning January 1, 2024, and ending December 31, 2024. X and Y are the only CAMT entities whose financial results are reflected in the XY Consolidated AFS. Under §1.56A-2(g), X's AFS and Y's AFS is the XY Consolidated AFS.

(B) *Facts: Consolidation entries*. The XY Consolidated AFS, which is prepared under GAAP, reflects consolidated FSI of $1,650x. X's and Y's separate books and records used to prepare the XY Consolidated AFS disclose that X had net income of $2,000x and that Y had a net loss of $500x. Further, the $2,000x net income of X includes $1x of income for services rendered to Y and a loss of $200x reflecting X's share of Y's net loss, which is consistent with the loss that X would have reported with respect to X's investment in Y had it prepared a nonconsolidated AFS in which X's investment in Y was accounted for under the Parent-Entity Statement accounting standards described in ASC 810-10-45-11. These amounts are eliminated from consolidated FSI through AFS consolidation entries made in preparing the XY Consolidated AFS. Y's loss of $500x includes $1x of expense that Y incurred for services provided by X. The $1x expense is also eliminated from consolidated FSI through AFS consolidation entries made in preparing the XY Consolidated AFS. An AFS consolidation entry is also made to take into account in consolidated FSI $50x of expenses incurred by X to a third party and not reflected in X's separate books and records. Accordingly, the information from X's and Y's source documents, the AFS consolidation entries, and consolidated FSI for the XY Consolidated AFS are summarized as follows (all amounts are stated in U.S. dollars):

Table 1 to Paragraph (c)(6)(i)(B)

	X	Y	AFS consolidation entries	Consolidated FSI
Net income or loss from transactions outside financial statement group	2,199x	(499x)	-	1,700x
Income from transactions between X and Y (services)	1x	-	(1x)	-
Expenses from transactions between X and Y (services)	-	(1x)	1x	-
Investment in Y (X's 40% share of Y's 500,000,000 loss)	(200x)	-	200x	-
Expense of X recorded in consolidation	-	-	(50x)	(50x)
Net income or loss	2,000x	(500x)	150x	1,650x

(C) *Analysis: X's FSI*. X and Y determine their respective portions of the consolidated FSI set forth on the XY Consolidated AFS by applying the rules in paragraph (c)(3) of this section. Accordingly, the amount of consolidated FSI that is X's FSI is based upon X's separate books and records used in preparing the XY Consolidated AFS. These disclose net income of $2,000x. In determining X's FSI, this amount is not reduced by the $500x net loss reflected in Y's separate books and records (even though consolidated FSI is reduced by the net loss). Further, pursuant to paragraph (c)(3)(iii)(A) of this section, the AFS consolidation entries eliminating the $1x of income from services rendered to Y and the $200x loss from X's investment in Y is disregarded. That is, X's FSI includes these two amounts. Additionally, because X accounts for X's investment in Y in X's separate books and records in a manner consistent with how the investment would have been accounted for had X prepared a nonconsolidated AFS in which X's investment in Y was accounted for under the Parent-Entity Statement accounting standards described in ASC 810-10-45-11, X is not required to further adjust the amount that it reports with respect to X's investment in Y under paragraph (c)(3)(iii)(B) of this section. Finally, pursuant to paragraph (c)(3)(iv) of this section, X reduces its FSI by $50x, the AFS consolidation entry for administrative costs of X that were not reflected in X's separate books and records. Accordingly, the amount of consolidated FSI that is X's FSI is $1,950x ($2,000x - $50x).

(D) *Analysis: Y's FSI*. The amount of consolidated FSI that is Y's FSI is similarly determined. Y's separate books and records disclose a net loss of $500x. In determining Y's FSI, this amount is not offset by any portion of X's net income (even though the amounts are netted in consolidated FSI). Further, pursuant to paragraph (c)(3)(iii)(A) of this section, the AFS consolidation entry eliminating $1x of expense for services provided by X is disregarded. That is, such expense is included in Y's FSI. Accordingly, the amount of consolidated FSI that is Y's FSI is a net loss of $500x. Pursuant to paragraph (c)(3) of this section, the amounts of consolidated FSI that are X's FSI and Y's FSI are determined as follows:

Table 2 to Paragraph (c)(6)(i)(D)

	FSI of X	FSI of Y
Separate net income or Loss	2,000x	(500x)
Expenses of X recorded in consolidation	(50x)	-
FSI[2]	1,950x	(500x)

[2] Given the application of paragraph (c)(3)(iii)(B) of this section to disregard the AFS consolidation entry eliminating the $200x loss from X's investment in Y, the sum of the separate amounts of consolidated FSI that are X's FSI and Y's FSI ($1,950x less 500x, or $1,450x) is $200x less than the consolidated FSI for the XY Consolidated AFS ($1,650x).

(ii) *Example 2: Consolidation entries if an item is converted from one financial accounting standard to another*—(A) *Facts*. X is a domestic corporation and a wholly-owned subsidiary of FC, a foreign corporation. Each of X and FC uses the calendar year as its taxable year. The financial results of X are consolidated with the financial results of FC on a consolidated AFS (XFC Consolidated AFS) for the financial reporting period beginning January 1, 2024, and ending December 31, 2024. X and FC are the only CAMT entities whose financial results are reflected in the XFC Consolidated AFS (XFC financial statement group). Under §1.56A-2(g), X's AFS and FC's AFS is the XFC Consolidated AFS. The XFC Consolidated AFS, which is prepared under IFRS, reflects consolidated FSI of $2,000x. X maintains its separate books and records under GAAP, which reflect that X had net income of $500x, applying the last-in, first-out (LIFO) method of inventory identification as permitted under GAAP. FC's separate books and records reflect net income of $1,400x as reported under IFRS. The XFC financial statement group records AFS consolidation entries to convert X's separate books and records from GAAP to IFRS, which requires the use of the FIFO method of inventory identification. The entries result in an additional $100x of net income to the XFC financial statement group. The additional $100x of net income is not reflected in the separate books and records of X.

(B) *Analysis.* X applies paragraph (c)(3)(iv) of this section to determine the amount of consolidated FSI that is X's FSI. Accordingly, the amount of consolidated FSI that is X's FSI is based upon X's separate books and records used in preparing the XFC Consolidated AFS. Although X's separate books and records reflected net income of $500x under GAAP, X increases its FSI by $100x pursuant to paragraph (c)(3)(iv) of this section to reflect the AFS consolidation entries to convert X's books and records from GAAP to IFRS. Accordingly, the amount of consolidated FSI that is X's FSI is $600x ($500x + $100x).

(d) *General rules for determining AFSI*—(1) *Federal income tax treatment not relevant for AFSI except as otherwise provided in guidance*. Except as otherwise provided in section 56A of the Code or the section 56A regulations, AFSI includes all items of income, expense, gain, and loss reflected in a CAMT entity's FSI regardless of whether those items are realized, recognized, or otherwise taken into account for regular tax purposes. For example, if FSI reflects gain or loss from a transaction that qualifies for nonrecognition treatment for regular tax purposes, and if no provision in the section 56A regulations provides for an adjustment to apply nonrecognition treatment for AFSI purposes, then the gain or loss is included in AFSI.

(2) *Limitation on AFSI adjustments*. Except as otherwise provided in the section 56A regulations, a CAMT entity may not make any adjustments to its FSI in determining its AFSI.

(3) *AFSI adjustments for taxable years beginning before January 1, 2023*—(i) *In general*. Except as otherwise provided in the section 56A regulations, the AFSI adjustments described in the section 56A regulations, including those adjustments that affect the CAMT basis of an item, are made for taxable years ending after December 31, 2019.

(ii) *Exception for AFSI adjustments that arise from transactions or events that occur in taxable years ending on or before December 31, 2019*. Except as otherwise provided in the section 56A regulations (for example, in §1.56A-15(c)(6) and (e)(2)(ii)(A) for AFSI adjustments for section 168 property, §1.56A-16(e)(2)(ii)(A) for AFSI adjustments for qualified wireless spectrum, and §1.56A-24(c)(3) for AFSI adjustments for hedging transactions and hedged items), for purposes of paragraph (d)(3)(i) of this section, any AFSI adjustment described in the section 56A regulations that arises from an event or a transaction that occurs in a taxable year that ends on or before December 31, 2019, is not made in determining AFSI for taxable years ending after December 31, 2019.

(4) *Redetermination of FSI gains and losses*. Except as otherwise provided in the section 56A regulations, if a gain or loss is reflected in FSI with respect to an item that has a CAMT basis that is different from its AFS basis, and if the gain or loss is recognized for AFSI purposes under the section 56A regulations, then the gain or loss reflected in FSI is redetermined for AFSI purposes by reference to the CAMT basis of the item.

(5) *Tax consolidated groups*. For rules for determining the AFSI of a tax consolidated group, *see* §1.1502-56A.

(6) *CAMT entities that own disregarded entities*. For rules for determining the AFSI of a CAMT entity that owns a disregarded entity, *see* §1.56A-9.

(e) *Rules for translating AFSI to U.S. dollars.* AFSI must be expressed in U.S. dollars. A CAMT entity whose AFSI is not expressed in U.S. dollars must translate its AFSI, after having made all other applicable adjustments under the section 56A regulations except for those adjustments that already are expressed in U.S. dollars, to U.S. dollars using the weighted average exchange rate, as defined in §1.989(b)-1, for the CAMT entity's taxable year. *See* §1.56A-6(c)(1) for separate rules that apply for translating a controlled foreign corporation's adjusted net income or loss to U.S. dollars.

(f) *Entity classification and treatment*—(1) *Entity classification.* The classification of an entity for regular tax purposes applies for purposes of the section 56A regulations, regardless of whether the entity is classified differently for AFS purposes. For example, if an entity is classified as a partnership for regular tax purposes, the entity is classified as a partnership for purposes of the section 56A regulations, regardless of whether the entity is classified as a partnership for AFS purposes. As another example, if an entity is classified as a disregarded entity for regular tax purposes, the entity is classified as a disregarded entity for purposes of the section 56A regulations, regardless of whether the entity is treated as a regarded entity for AFS purposes.

(2) *Treatment of an entity as domestic or foreign*. The treatment of an entity as domestic or foreign for regular tax purposes applies for purposes of the section 56A regulations, regardless of whether the entity is treated differently for AFS purposes. For example, if an entity created or organized under the law of a foreign jurisdiction is treated as a domestic corporation for regular tax purposes under section 1504(d) (regarding subsidiaries formed to comply with foreign law) or section 7874(b) of the Code (regarding inverted corporations), the entity is treated as a domestic corporation for AFS purposes.

(g) *Substantiation requirement*—(1) *In general*. In accordance with §1.6001-1(a), a corporation that is an applicable corporation for any taxable year must maintain books and records sufficient to demonstrate how it complies with the section 56A regulations, including:

(i) The identification of the corporation's AFS;

(ii) The determination of the corporation's FSI, including how its FSI (if

determined under paragraph (c)(3) of this section) reconciles to consolidated FSI as required pursuant to paragraph (c)(3)(v) of this section;

(iii) The substantiation of any AFSI adjustments required by the section 56A regulations, including those required under §1.56A-6 in determining the adjusted net income or loss of a CFC in which the corporation is a shareholder; and

(iv) The substantiation of AFS basis and CAMT basis.

(2) *Other CAMT entity recordkeeping requirements*. *See* §§1.56A-5(h), 1.56A-5(i), and 1.56A-20(g) for recordkeeping requirements for partnerships and their CAMT entity partners.

(3) *Applicable corporation determination record keeping requirements*. *See* §1.59-2(i) for recordkeeping requirements related to the determination of whether a corporation is an applicable corporation.

(h) *Reporting requirement*—(1) *Applicable corporations*. A corporation that is an applicable corporation for any taxable year must make an annual return on Form 4626, *Alternative Minimum Tax - Corporations* (or any successor form), for such year, setting forth the required information in the form and manner as the Form 4626 (or any successor form) or its instructions prescribe. Returns on Form 4626 (or any successor form) for a taxable year must be filed with the corporation's Federal income tax return on or before the due date (taking into account extensions) for filing the corporation's Federal income tax return. *See* §§1.6011-1 and 601.602 of this chapter.

(2) *Applicable corporation determination reporting requirement*. *See* §1.59-2(j) for reporting requirements related to the determination of whether a corporation is an applicable corporation.

(3) *Other reporting required for CAMT entities*—(i) *Special rules for reporting distributive shares of AFSI and application of subchapter K*. *See* §§1.56A-5(h)(1), 1.56A-5(i), and 1.56A-20(g)(2) for reporting requirements for partnerships and their CAMT entity partners.

(ii) *Other reporting requirements*. Forms filed for CAMT entities pursuant to sections 6011, 6031, 6038, and 6038A of the Code and the regulations under these sections (for example, Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*) must set forth and furnish the required information in the form and manner as the applicable form or its instructions prescribe, including information relevant to the determination of an applicable corporation's tentative minimum tax under section 55(b)(2)(A).

(i) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-2 Definition of applicable financial statement (AFS) and AFS priority rules.

(a) *Overview*. This section provides rules under section 56A(b) of the Code for determining the applicable financial statement (AFS) of a CAMT entity. Paragraph (b) of this section provides the definition of an AFS for purposes of the section 56A regulations. Paragraph (c) of this section provides a priority listing of financial statements for purposes of the AFS definition. Paragraph (d) of this section describes what it means for a financial statement to be certified. Paragraph (e) of this section provides rules for prioritizing a restated financial statement over an original financial statement. Paragraph (f) of this section provides rules for prioritizing an annual financial statement over a financial statement that covers a period of less than 12 months. Paragraph (g) of this section provides rules for determining whether a separate financial statement should be prioritized over a consolidated financial statement. Paragraph (h) of this section provides rules with respect to disregarded entities or branches. Paragraph (i) of this section provides examples illustrating the application of the rules in this section. Paragraph (j) of this section provides the applicability date of this section.

(b) *Definition of applicable financial statement*. Subject to paragraphs (d) through (g) of this section, for purposes of the section 56A regulations, the term *applicable financial statement* (AFS) means a CAMT entity's financial statement listed in paragraph (c) of this section that has the highest priority, including priority within paragraphs (c)(1), (c)(1)(ii), (c)(2), (c)(2)(ii), (c)(3), (c)(3)(ii), and (c)(5) of this section. For example, a financial statement listed in paragraph (c)(1)(ii)(A) of this section has priority over a financial statement listed in paragraph (c)(1)(ii)(B) of this section.

(c) *General financial statement priority*. For purposes of paragraph (b) of this section, the financial statements are, in order of descending priority—

(1) *GAAP statements*. An audited financial statement, other than a tax return, that is certified, within the meaning of paragraph (d) of this section, as being prepared in accordance with GAAP and is—

(i) A financial statement included with Form 10-K (or any successor form), or annual statement to shareholders, filed with the SEC;

(ii) Used for—

(A) Credit purposes;

(B) Reporting to shareholders, partners, or other proprietors, or to beneficiaries; or

(C) Any other substantial non-tax purpose; or

(iii) Filed with the Federal Government or any Federal agency, other than the SEC or the Internal Revenue Service (IRS);

(2) *IFRS statements*. An audited financial statement, other than a tax return, that is certified, within the meaning of paragraph (d) of this section, as being prepared in accordance with IFRS and is—

(i) Filed by the CAMT entity with the SEC or with an agency of a foreign government that is equivalent to the SEC;

(ii) Used for—

(A) Credit purposes;

(B) Reporting to shareholders, partners, or other proprietors, or to beneficiaries; or

(C) Any other substantial non-tax purpose; or

(iii) Filed with the Federal Government, a Federal agency, a foreign government, or an agency of a foreign government, other than the SEC, the IRS, or an agency that is equivalent to the SEC or the IRS;

(3) *Financial statements prepared in accordance with other generally accepted accounting standards*. An audited financial statement, other than a tax return, that is certified, within the meaning of paragraph (d) of this section, as being prepared in accordance with accepted accounting standards other than GAAP and IFRS that are issued by an accounting standards board charged with developing account-

ing standards for one or more jurisdictions and is—

(i) Filed by the CAMT entity with the SEC or with an agency of a foreign government that is equivalent to the SEC;

(ii) Used for—

(A) Credit purposes;

(B) Reporting to shareholders, partners, or other proprietors, or to beneficiaries; or

(C) Any other substantial non-tax purpose; or

(iii) Filed with the Federal Government, a Federal agency, a foreign government, or an agency of a foreign government, other than the SEC, the IRS, or an agency that is equivalent to the SEC or the IRS;

(4) *Other government and regulatory statements*. A financial statement, other than a tax return or a financial statement described in paragraph (c)(1), (2), or (3) of this section, filed with the Federal Government or any Federal agency, a State government or State agency, a foreign government or foreign agency, or a self-regulatory organization, including, for example, a financial statement filed with a State agency that regulates insurance companies, the Financial Industry Regulatory Authority, or a comparable foreign self-regulatory organization;

(5) *Unaudited external statements*. A financial statement, other than a tax return or a financial statement described in paragraph (c)(1), (2), (3), or (4) of this section, that is unaudited (or audited but not certified, within the meaning of paragraph (d) of this section) and prepared for an external non-tax purpose using—

(i) GAAP;

(ii) IFRS; or

(iii) Any other accepted accounting standards that are issued by an accounting standards board charged with developing accounting standards for one or more jurisdictions; or

(6) *Return*. For a CAMT entity that is not a controlled foreign corporation, the Federal income tax return or information return filed with the IRS; or for a CAMT entity that is a controlled foreign corporation, Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations* (or any successor form).

(d) *Certified financial statement*. A financial statement is *certified* for purposes of paragraph (c) of this section if it is—

(1) Certified by an independent financial statement auditor to present fairly the financial position and results of operations of a CAMT entity (or a financial statement group) in conformity with the relevant financial accounting standards (that is, an unqualified or unmodified clean opinion);

(2) Subject to a qualified or modified opinion by an independent financial statement auditor that the financial statement presents fairly the financial position and results of operations of a CAMT entity (or a financial statement group) in conformity with the relevant financial accounting standards, except for the effects of the matter to which the qualification or modification relates (that is, a qualified or modified except for opinion); or

(3) Subject to an adverse opinion by an independent financial statement auditor, but only if the auditor discloses the amount of the disagreement with the statement.

(e) *Restatements*. If a CAMT entity restates FSI for a taxable year (or a portion of a taxable year) on a restated AFS that is issued prior to the date that the CAMT entity files its original Federal income tax return for that taxable year, that restated AFS must be prioritized over the AFS being restated. If a CAMT entity restates FSI for a taxable year (or a portion of a taxable year) on a restated AFS that is issued on or after the date that the CAMT entity files an original Federal income tax return for that taxable year, *see* §1.56A-17(d).

(f) *Annual and periodic financial statements*. If a CAMT entity is required to file both annual financial statements and periodic financial statements covering less than a 12-month period with a government or government agency, the CAMT entity must prioritize the annual financial statements over the periodic financial statements in accordance with this section.

(g) *AFS priority rules for consolidated financial statements*—(1) *In general*. Except as provided in paragraph (g)(2) of this section, if a CAMT entity's financial results are consolidated with the financial results of one or more other CAMT entities on one or more consolidated financial statements described in paragraphs (c)(1) through (5) of this section, the CAMT entity's AFS is the consolidated financial statement with the highest priority under paragraphs (c)(1) through (5) of this section. However, except as provided in paragraph (g)(2) of this section, if the CAMT entity's financial results are also reported on one or more separate financial statements that are of equal or higher priority to that highest priority consolidated financial statement, then the CAMT entity's AFS is the separate financial statement with the highest priority under paragraph (c) of this section.

(2) *Exceptions to use of separate AFS*—(i) *Tax consolidated group member has only one consolidated financial statement that contains the financial results of all members of the tax consolidated group*. Except as provided in paragraph (g)(2)(v) of this section, if there is only one consolidated financial statement described in paragraphs (c)(1) through (5) of this section that contains the financial results of all members of a tax consolidated group, then a member of the tax consolidated group uses that consolidated financial statement as the AFS, regardless of whether the member's financial results also are reported on—

(A) A separate financial statement that is of equal or higher priority to that consolidated financial statement; or

(B) A consolidated financial statement that contains the financial results of some, but not all, members of the tax consolidated group, and that is of equal or higher priority to that consolidated financial statement.

(ii) *Tax consolidated group member has more than one consolidated financial statement that contains the financial results of all members of the tax consolidated group.* Except as provided in paragraph (g)(2)(v) of this section, if there is more than one consolidated financial statement described in paragraphs (c)(1) through (5) of this section that contains the financial results of all members of a tax consolidated group, then a member of the tax consolidated group uses the consolidated financial statement with the highest priority under paragraphs (c)(1) through (5) of this section that contains the financial results of all members of the tax consolidated group, regardless of whether the member's financial results also are reported on—

(A) A separate financial statement that is of equal or higher priority to that consolidated financial statement; or

(B) A consolidated financial statement that contains the financial results of some, but not all, members of the tax consolidated group, and that is of equal or higher priority to that consolidated financial statement.

(iii) *Tax consolidated group member has only one consolidated financial statement that contains its financial results and the financial results of some, but not all, members of the tax consolidated group*. Except as provided in paragraph (g)(2)(v) of this section, if a member of a tax consolidated group is not described in paragraph (g)(2)(i) or (ii) of this section and there is only one consolidated financial statement described in paragraphs (c)(1) through (5) of this section that contains the member's financial results and the financial results of at least one other member of the tax consolidated group, but not all members of the tax consolidated group, then the member uses that consolidated financial statement as its AFS, regardless of whether member's financial results also are reported on a separate financial statement that is of equal or higher priority to that consolidated financial statement.

(iv) *Tax consolidated group member has more than one consolidated financial statement that contains its financial results and the financial results of some, but not all, members of the tax consolidated group*. Except as provided in paragraph (g)(2)(v) of this section, if a member of a tax consolidated group is not described in paragraph (g)(2)(i) or (ii) of this section and there is more than one consolidated financial statement described in paragraphs (c)(1) through (5) of this section that contains the member's financial results and the financial results of at least one other member of the tax consolidated group, but not all members of the tax consolidated group, then the member uses as its AFS the consolidated financial statement described in paragraphs (c)(1) through (5) of this section that contains its financial results and the financial results of the greatest number of members of the tax consolidated group (if there is more than one such consolidated financial statement, the member uses the one with the highest priority under paragraphs (c)(1) through (5) of this section), regardless of whether the member's financial results also are reported on—

(A) A separate financial statement that is of equal or higher priority to that consolidated financial statement; or

(B) A consolidated financial statement that contains its financial results and the financial results of fewer members of the tax consolidated group, and that is of equal or higher priority to that consolidated financial statement.

(v) *Members of an FPMG*. If a CAMT entity is a member of an FPMG, and if the FPMG common parent prepares a consolidated financial statement for a financial statement group that includes the CAMT entity (FPMG consolidated AFS), then the CAMT entity uses the FPMG consolidated AFS as its AFS, regardless of whether the CAMT entity's financial results also are reported on a separate financial statement that is of equal or higher priority to the FPMG consolidated AFS.

(h) *Disregarded entities or branches*. If the financial results of a disregarded entity or branch are reflected in the CAMT entity owner's AFS (as determined by applying the rules of this section), the disregarded entity or branch may not determine its own AFS under the rules of this section as if it were a separate CAMT entity (that is, the CAMT entity owner uses its AFS to determine its FSI and AFSI under the rules in §1.56A-9). If the financial results of a disregarded entity or branch are not reflected in the CAMT entity owner's AFS (as determined by applying the rules of this section), the disregarded entity or branch determines its own AFS under the rules of this section as if it were a separate CAMT entity. *See* §1.56A-9(b)(3) for rules for determining the FSI and AFSI of a CAMT entity that owns a disregarded entity or branch described in the preceding sentence.

(i) *Examples*. The following examples illustrate the application of paragraphs (c) and (g) of this section.

(1) *Example 1: No substantial non-tax purpose*—(i) *Facts.* FP is a foreign partnership (FP) that owns a controlling interest in X, a domestic corporation that is an applicable corporation. X is not a member of an FPMG under §1.59-3 and is not a member of a tax consolidated group. FP prepares a consolidated AFS that includes X and other entities using IFRS. After the auditor provides an opinion certifying that the consolidated financial statements of FP present fairly the financial position and results of operations of FP and FP's investments in other entities in conformity with IFRS, X receives advice that its Federal income tax liability would be lower if it were to obtain a certified financial statement prepared in accordance with GAAP to use in determining its tentative minimum tax under section 55(b)(2)(A) of the Code. Solely to minimize Federal income taxes, X engages the auditor to provide a separate opinion certifying that X's financial statements as converted from IFRS to GAAP present fairly the financial position and results of operations of X in conformity with GAAP. Other than the consolidated AFS prepared by FP and X's audited GAAP financial statement, X does not prepare any other financial statement and X is not a member of any other consolidated financial statement.

(ii) *Analysis*. X's audited GAAP financial statement is not a financial statement described in paragraph (c)(1)(ii) of this section because X's sole purpose for obtaining the statement was to minimize X's Federal income taxes, which is not a substantial non-tax purpose. Accordingly, under paragraph (g)(1) of this section, X's AFS is the consolidated AFS prepared by FP because X is not a member of any other consolidated financial statement and X does not have a separate financial statement that is of equal or higher priority to the consolidated AFS prepared by FP.

(2) *Example 2: Substantial non-tax purpose*—(i) *Facts.* The facts are the same as in paragraph (i)(1) of this section (*Example 1*), except that X is required by County G to obtain an audited GAAP financial statement that it provides to County G as part of its acquisition of a controlling interest in a public-private partnership for a significant transportation infrastructure project. X therefore engages the auditor to provide a separate opinion certifying that X's financial statements as converted from IFRS to GAAP present fairly the financial position and results of operations of X in conformity with GAAP.

(ii) *Analysis*. X's audited GAAP financial statement is a financial statement described in paragraph (c)(1)(ii) of this section because it was prepared for a substantial non-tax purpose. Accordingly, under paragraph (g)(1) of this section, X's AFS is the audited GAAP financial statement as it is a separate financial statement that is of equal or higher priority to the consolidated AFS prepared by FP.

(j) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-3 AFSI adjustments for AFS year and taxable year differences.

(a) *Overview*. This section provides rules under section 56A(c)(1) of the Code for computing FSI and AFSI if a CAMT entity's AFS is prepared on the basis of a financial accounting period that differs from the taxable year.

(b) *AFSI adjustment for mismatched years*—(1) *In general*. If the AFS of a CAMT entity is prepared on the basis of a financial accounting period that differs

from the CAMT entity's taxable year (including a taxable year of less than 12 months), the CAMT entity computes its FSI and AFSI as if the CAMT entity's financial accounting period were the same as its taxable year by conducting an interim closing of the books using the accounting standards the CAMT entity uses to prepare its AFS. For purposes of computing FSI and AFSI for the current taxable year under this paragraph (b)(1), the CAMT entity performs an interim closing of the books as of the end of the current taxable year and uses the interim closing of the books completed as of the end of the immediately preceding taxable year in computing FSI and AFSI for such prior year (if any). If the CAMT entity did not compute FSI and AFSI for the prior taxable year, the CAMT entity also performs an interim closing of the books as of the end of the immediately preceding taxable year.

(2) *Examples*. The following examples illustrate the application of the rules in paragraph (b)(1) of this section.

(i) *Example 1: Calendar-year taxpayer with fiscal annual financial accounting period*—(A) *Facts*. X is a domestic corporation that uses the calendar year as its taxable year. X's AFS is prepared based on a financial accounting period that begins on November 1 and ends on October 31. X computes FSI and AFSI under the section 56A regulations for the taxable year that begins on January 1, 2024, and ends on December 31, 2024, and the taxable year that begins on January 1, 2025, and ends on December 31, 2025.

(B) *Analysis: Taxable year ending December 31, 2024*. Pursuant to paragraph (b)(1) of this section, X conducts an interim closing of the books as of the close of business on December 31, 2023, and December 31, 2024, respectively, to compute FSI and AFSI for the 2024 taxable year (that is, the calendar year). Accordingly, X uses the financial results and accounting principles from the October 31, 2024, AFS to prepare an interim closing of the books as of December 31, 2023, and determine FSI and AFSI from January 1, 2024, through October 31, 2024. In addition, X uses the financial results and accounting principles for the annual financial accounting period ending October 31, 2025, to prepare an interim closing of the books as of December 31, 2024, and determine FSI and AFSI from November 1, 2024, through December 31, 2024.

(C) *Analysis: Taxable year ending December 31, 2025*. Pursuant to paragraph (b)(1) of this section, X conducts an interim closing of the books as of the close of business on December 31, 2025, to compute FSI and AFSI for its 2025 taxable year. In addition, X uses the interim closing of the books conducted as of December 31, 2024, in computing FSI and AFSI for its 2025 taxable year. Accordingly, X uses the financial results and accounting principles from the October 31, 2025, AFS and the interim closing of the books prepared as of December 31, 2024, to determine FSI and AFSI from January 1, 2025, through October 31, 2025. In addition, X uses the financial results and accounting principles for the annual financial accounting period ending October 31, 2026, to prepare an interim closing of the books as of December 31, 2025, and determine FSI and AFSI from November 1, 2025, through December 31, 2025.

(ii) *Example 2: Fiscal-year taxpayer with calendar-year financial accounting period*—(A) *Facts*. X is a domestic corporation that uses the 12-month period ending September 30 as its taxable year. The accounting period for X's AFS begins on January 1 and ends on December 31. X computes FSI and AFSI under the section 56A regulations for the taxable year that begins on October 1, 2023, and ends on September 30, 2024, and the taxable year that begins on October 1, 2024, and ends on September 30, 2025.

(B) *Analysis: Taxable year ending September 30, 2024*. Pursuant to paragraph (b)(1) of this section, X conducts an interim closing of the books as of the close of business on September 30, 2023, and September 30, 2024, respectively, to compute FSI and AFSI for the taxable year ending September 30, 2024. Accordingly, X uses the financial results and accounting principles from the December 31, 2023, AFS to prepare an interim closing of the books as of September 30, 2023, and determine FSI and AFSI from October 1, 2023, through December 31, 2023. In addition, X uses the financial results and accounting principles for the annual financial accounting period ending December 31, 2024, to prepare an interim closing of the books as of September 30, 2024, and determine FSI and AFSI from January 1, 2024, through September 30, 2024.

(C) *Analysis: Taxable year ending September 30, 2025*. Pursuant to paragraph (b)(1) of this section, X conducts an interim closing of the books as of the close of business on September 30, 2025, to compute FSI and AFSI for the taxable year ending September 30, 2025. In addition, X uses the interim closing of the books prepared as of September 30, 2024, in computing FSI and AFSI for the taxable year ending September 30, 2025. Accordingly, X uses the financial results and accounting principles for its December 31, 2024, AFS and the interim closing of the books prepared as of September 30, 2024, to determine FSI and AFSI from October 1, 2024, through December 31, 2024. In addition, X uses the financial results and accounting principles for the annual financial accounting period ending December 31, 2025, to prepare an interim closing of the books as of September 30, 2025, and determine FSI and AFSI from January 1, 2025, through September 30, 2025.

(c) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-4 AFSI adjustments and basis determinations with respect to foreign corporations.

(a) *Overview*. This section provides rules under section 56A(c)(2)(C) of the Code for determining the amount of AFSI of a CAMT entity that results solely from the CAMT entity's ownership of stock of a foreign corporation, as well as rules for determining the AFSI and CAMT basis consequences of certain transactions involving foreign corporations, including rules under section 56A(c)(15)(B) of the Code. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides the AFSI adjustments with respect to foreign stock and certain transactions involving foreign corporations. Paragraph (d) of this section provides rules for determining the CAMT basis of assets transferred in certain transactions involving foreign corporations. Paragraph (e) of this section provides a rule that applies if a partnership owns stock of a foreign corporation. Paragraph (f) of this section provides rules for adjusting AFSI in certain cases in which the basis of foreign stock received is determined under section 358 of the Code for regular tax purposes. Paragraph (g) of this section provides rules for adjusting AFSI in certain cases in which foreign stock is distributed by a partnership. Paragraph (h) of this section provides examples illustrating the application of the rules in this section. Paragraph (i) of this section provides the applicability date of this section. *See* §1.56A-6 for determining AFSI adjustments under section 56A(c)(3) with respect to controlled foreign corporations. *See* §§1.56A-18 and 1.56A-19 for rules that apply to transactions involving corporations not described in this section.

(b) *Definitions*. The following definitions apply for purposes of this section. Terms used in this section that are not defined in this section have the meanings provided in §1.56A-1(b).

(1) *Covered asset transaction*. The term *covered asset transaction* means the following:

(i) A component transaction (within the meaning of §1.56A-18(b)(6)) in which one or more assets are—

(A) Transferred by a foreign corporation in a transfer to which section 311 of the Code applies;

(B) Transferred by a foreign corporation in a transfer that is part of a complete liquidation to which sections 332 and 337 of the Code apply;

(C) Transferred to a foreign corporation in a transfer to which section 351 or section 361 of the Code applies;

(D) Transferred by a foreign corporation in a transfer to which section 361 applies;

(E) Stock, or stock and securities, of a domestic corporation described in section 355(a)(1)(A) of the Code and transferred by a foreign corporation in a transfer to which section 355 applies; or

(F) Securities of a foreign corporation that is a party to a reorganization described in section 368(a)(1) and transferred in a transfer to which section 354 or 356 applies.

(ii) A component transaction (within the meaning of §1.56A-18(b)(6)) in which one or more assets, at least one of which is stock of a foreign corporation, are—

(A) Transferred by a domestic corporation in a transfer to which section 311 applies;

(B) Transferred by a domestic corporation in a transfer that is part of a complete liquidation to which sections 332 and 337 apply;

(C) Transferred to a domestic corporation in a transfer to section 351 or section 361 applies;

(D) Transferred by a domestic corporation in a transfer to which section 361 applies;

(E) Stock, or stock and securities, of a foreign corporation described in section 355(a)(1)(A) and transferred by a domestic corporation in a transfer to which section 355 applies; or

(F) Securities of a domestic corporation that is a party to a reorganization described in section 368(a)(1) and transferred in a transfer to which section 354 or 356 applies, provided the securities are exchanged for stock or securities of a foreign corporation that is a party to the reorganization.

(2) *Section 338(g) transaction*. The term *section 338(g) transaction* means a purchase, as defined in section 338(h)(3) of the Code, of stock of a foreign corporation with respect to which the purchaser makes an election under section 338(g).

(3) *Transfer*. The term *transfer (or transferred or transfers or transferring)*, when used with respect to an asset, means a sale, distribution, exchange, or any other disposition of the asset. If the asset is stock or securities of a corporation, the term transfer includes an issuance or a redemption of stock or securities by the corporation.

(c) *Adjustments to AFSI*—(1) *Adjustments with respect to stock of a foreign corporation*. If a CAMT entity directly owns stock of a foreign corporation, the AFSI of the CAMT entity with respect to its ownership of stock of the foreign corporation is adjusted to—

(i) Disregard any items of income, expense, gain, and loss resulting from ownership of stock of the foreign corporation, including any items that result from acquiring or transferring the stock, reflected in the CAMT entity's FSI; and

(ii) Include any items of income, deduction, gain, and loss for regular tax purposes resulting from ownership of stock of the foreign corporation, including any items that result from acquiring or transferring the stock, other than any items of income, deduction, gain, and loss resulting from the application of section 78, 250, 951, or 951A of the Code.

(2) *Adjustments with respect to covered asset transactions*. If a CAMT entity transfers an asset, other than stock of a foreign corporation, in a covered asset transaction, the AFSI of the CAMT entity must be adjusted to—

(i) Disregard any items of income, expense, gain, and loss with respect to the transferred asset resulting from the covered asset transaction reflected in the CAMT entity's FSI; and

(ii) Include any items of income, deduction, gain, and loss for regular tax purposes with respect to the transferred asset resulting from the covered asset transaction; however, for this purpose, the amount of each such item is computed by substituting the CAMT entity's CAMT basis in the transferred asset for the CAMT entity's basis in the transferred asset for regular tax purposes.

(3) *Adjustments with respect to section 338(g) transactions*. If stock of a foreign corporation is acquired in a section 338(g) transaction, the AFSI of the foreign corporation is adjusted to include any net gain or loss that results for regular tax purposes with respect to all assets the foreign corporation is treated as selling by reason of the section 338(g) transaction; however, for this purpose, the amount of gain or loss with respect to each asset that the foreign corporation is deemed to have sold by reason of the section 338(g) transaction is computed by substituting the foreign corporation's CAMT basis in the asset for the foreign corporation's basis in the asset for regular tax purposes.

(4) *Adjustments with respect to purchase accounting and push down accounting*. If a CAMT entity acquires the stock of a foreign corporation, then any purchase accounting and push down accounting adjustments, as applicable, with respect to the acquisition of the stock of the foreign corporation are disregarded for purposes of determining the CAMT entity's AFSI.

(d) *Certain rules for determining CAMT basis*—(1) *Covered asset transactions.* If an asset is transferred in a covered asset transaction, the following rules apply to determine the transferee's CAMT basis in the asset transferred (or the transferee's CAMT basis in the asset retained, in the case of stock of a distributing corporation in certain distributions under section 355)—

(i) If the asset is transferred in a transaction described in section 311, the transferee's CAMT basis in the asset is determined in the manner described in section 301(d) of the Code;

(ii) If the asset is transferred in a transaction described in sections 332 and 337, the transferee's CAMT basis in the asset is determined in the manner described in section 334(b) of the Code, substituting the transferor's CAMT basis in the asset for the transferor's basis in the asset for regular tax purposes;

(iii) If the asset is transferred in a transaction described in section 351 or 361, then—

(A) If the transferor is a CAMT entity, the transferee's CAMT basis in the asset is determined in the manner described in section 362 of the Code, substituting the transferor's CAMT basis in the asset for the transferor's basis in the asset for regular tax purposes and substituting the amount of gain included in the transferor's AFSI for the amount of gain recognized to the transferor for regular tax purposes; or

(B) If the transferor is not a CAMT entity, the transferee's CAMT basis in the asset is equal to the transferee's basis in the asset for regular tax purposes;

(iv) If the asset transferred is stock or securities of a domestic corporation described in section 355(a)(1)(A) and the asset is transferred by a foreign corporation in a transaction to which section 355 applies, the transferee's CAMT basis in the transferred stock or securities of the domestic corporation is equal to the transferee's basis in such stock or securities for regular tax purposes;

(v) If the asset transferred is stock or securities of a foreign corporation described in section 355(a)(1)(A) and the asset is transferred by a domestic corporation in a transaction to which section 355 applies, the transferee's CAMT basis in the stock or securities of the domestic transferor corporation is determined by applying section 358 of the Code, substituting the transferee's CAMT basis in the stock or securities of the domestic corporation for the transferee's basis in the stock or securities of the domestic corporation for regular tax purposes; and

(vi) If the asset transferred is securities of a foreign corporation that is a party to a reorganization described in section 368(a)(1) and the asset received in exchange for the securities is not stock of a foreign corporation that is a party to the reorganization, the transferee's CAMT basis in the asset received is determined by applying section 358, substituting the transferee's CAMT basis in the securities of the foreign corporation for the transferee's basis in such securities for regular tax purposes.

(vii) If the asset transferred is securities of a domestic corporation that is a party to a reorganization described in section 368(a)(1) and the asset received in exchange for the securities is not stock of a foreign corporation that is a party to the reorganization, the transferee's CAMT basis in the asset received is determined by applying section 358, substituting the transferee's CAMT basis in the securities of the domestic corporation for the transferee's basis in such securities for regular tax purposes.

(2) *Section 338(g) transaction*. If stock of a foreign corporation is acquired in a section 338(g) transaction, immediately after the section 338(g) transaction, the foreign corporation's CAMT basis in the assets it is deemed to have purchased by reason of the section 338(g) transaction is equal to the foreign corporation's basis in those assets for regular tax purposes.

(3) *Transfers of stock of a foreign corporation involving a partnership.* For rules that adjust a partner's basis in its investment in a partnership for certain transfers of stock of a foreign corporation by the partner to the partnership or by the partnership to the partner, *see* §1.56A-5(j)(3)(xi) and (xii).

(4) *Purchase accounting and push down accounting*. If a CAMT entity acquires stock of a foreign corporation, then any purchase accounting and push down accounting adjustments, as applicable, with respect to the acquisition of the stock of the foreign corporation are disregarded for purposes of determining the CAMT basis in the foreign corporation's assets.

(5) *Stock of a foreign corporation*. The CAMT basis in stock of a foreign corporation is equal to the basis in the stock for regular tax purposes.

(e) *Stock of a foreign corporation owned by a partnership*. If a partnership directly owns stock of a foreign corporation, then in determining the AFSI of a CAMT entity that is a partner in the partnership (or an indirect partner, in the case of tiered partnerships), the partner takes into account the items described in paragraph (c)(1)(ii) of this section that are allocated to the partner for regular tax purposes. *See also* §1.56A-5(e)(4)(iii).

(f) *AFSI adjustments when basis in foreign stock is determined under section 358*—(1) *In general*. If a CAMT entity receives stock of a foreign corporation as part of a covered asset transaction, the basis in the stock of the foreign corporation received is determined under section 358 of the Code, and at least one of the requirements in paragraphs (f)(1)(i) and (ii) of this section is satisfied, then to the extent the basis for regular tax purposes in such stock of the foreign corporation is greater than the hypothetical CAMT basis in such stock of the foreign corporation (as determined under paragraph (f)(2) of this section), the CAMT entity increases its AFSI for the taxable year in which such stock is received by the amount of such excess.

(i) *Principal purpose rule*. For purposes of this paragraph (f)(1), the requirement of this paragraph (f)(1)(i) is satisfied if a principal purpose of the covered asset transaction is to avoid treatment of the CAMT entity or another CAMT entity as an applicable corporation or to reduce or otherwise avoid a liability under section 55(a) of the Code.

(ii) *Two-year rule*. For purposes of this paragraph (f)(1), the requirement of this paragraph (f)(1)(ii) is satisfied if within two years of the date the stock of the foreign corporation is received, the basis in such stock of the foreign corporation is taken into account, in whole or in part, in determining the AFSI of the recipient CAMT entity or another CAMT entity. The principles of this paragraph (f)(1)(ii) apply with respect to any asset whose basis for regular tax purposes is determined in whole or in part by reference to the basis of the foreign stock received.

(2) *Hypothetical CAMT basis*. For purposes of paragraph (f)(1) of this section, the hypothetical CAMT basis in the stock of the foreign corporation received is the basis computed under section 358; however, for this purpose, the CAMT basis is used instead of the basis for regular tax purposes with respect to the property by reference to which the basis in the stock of the foreign corporation for regular tax purposes is determined in whole or in part.

(g) *AFSI adjustments when certain foreign stock is distributed by a partnership*—(1) *In general*. If a partnership distributes stock of a foreign corporation to a partner that is a related CAMT entity—

(i) If both—

(A) The basis for regular tax purposes in the distributed foreign stock to the related CAMT entity distributee under section 732(b) of the Code exceeds the basis for regular tax purposes in the foreign stock to the distributing partnership immediately before the distribution (distributee step-up amount); and

(B) The distributee step-up amount is greater than the amount, if any, the distributing partnership is required to decrease its basis for regular tax purposes in any remaining foreign stock held by the distributing partnership immediately after the distribution under section 734(b)(2)(B) of the Code (partnership basis decrease amount); then

(ii) The distributing partnership must increase its modified FSI for the taxable year of the distribution by any excess of

the distributee step-up amount over the partnership basis decrease amount.

(2) *Related CAMT entity.* For purposes of paragraph (g)(1) of this section, a partner is a related CAMT entity if immediately prior to the distribution, the partner is related to the distributing partnership or any partner in the distributing partnership within the meaning of section 267(b) or 707(b)(1) of the Code, without regard to section 267(c)(3) of the Code.

(h) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, all entities have a functional currency of the U.S. dollar, each entity uses the calendar year as its taxable year and for AFS purposes, and no covered asset transaction in which stock of a foreign corporation is received is described in paragraph (f) of this section.

(1) *Example 1: Dividend received from a foreign corporation*—(i) *Facts*. X is a domestic corporation that owns all the stock of FC, a controlled foreign corporation. FC distributes $100x of earnings and profits described in section 959(c)(3) of the Code to X, and, with respect to the dividend, X qualifies for a $100x dividends-received deduction under section 245A of the Code. The $100x dividend received by X does not result in any item of income, expense, gain, or loss being reflected in the FSI of X.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, no adjustment is required to the AFSI of X because the $100x dividend received from FC does not result in any item of income, expense, gain, or loss being reflected in the FSI of X. Under paragraph (c)(1)(ii) of this section, the AFSI of X is adjusted to include the $100x dividend recognized by X for regular tax purposes. Furthermore, under paragraph (c)(1)(ii) of this section, the AFSI of X is also adjusted to include the $100x dividends-received deduction under section 245A.

(2) *Example 2: Stock of a foreign corporation owned by a partnership*—(i) *Facts.* The facts are the same as in paragraph (h)(1)(i) of this section (*Example 1*), except that all the stock of FC is owned by PRS, a partnership in which X is a partner, X is not a United States shareholder with respect to FC, FC makes a distribution of earnings and profits described in section 959(c)(3) to PRS, the $100x dividend received by PRS does not result in any item of income, expense, gain, or loss being reflected in the FSI of PRS, and X is allocated $9x of the dividend income for regular tax purposes.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, no adjustment to AFSI is required because the $100x dividend received from FC does not result in any item of income, expense, gain, or loss being reflected in the FSI of PRS. Under §1.56A-5(e)(3) and (e)(4)(i), the AFSI adjustment provided in paragraph (c)(1)(ii) of this section is not taken into account by PRS in determining its modified FSI and instead the AFSI adjustment resulting from the dividend is separately stated to the partners. Under paragraph (e) of this section, X's AFSI is increased by $9x, the amount of the dividend received by PRS that is reported to X for regular tax purposes. Under §1.56A-5(j)(3)(v), X's CAMT basis in its partnership investment in PRS is increased by $9x.

(3) *Example 3: Sale of stock of a foreign corporation*—(i) *Facts*. The facts are the same as in paragraph (h)(1)(i) of this section (*Example 1*), except that FC does not make a distribution and instead X sells all the stock of FC. As a result of the sale, for regular tax purposes, X recognizes $200x of gain, of which $100x is recharacterized as a dividend under section 1248 of the Code. X qualifies for (and claims) a $100x dividends-received deduction under section 245A (*see* section 1248(j)). X's sale of the stock of FC results in $150x of gain being reflected in the FSI of X.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, the AFSI of X is adjusted to disregard the $150x of gain reflected in the FSI of X. Under paragraph (c)(1)(ii) of this section, the AFSI of X is adjusted to include the $100x dividend and $100x gain recognized by X for regular tax purposes and to include the $100x dividends-received deduction under section 245A.

(4) *Example 4: Foreign corporation reported on equity method*—(i) *Facts*. X is a domestic corporation that owns 30% of the single class of stock of FC, a foreign corporation that is not a controlled foreign corporation or a passive foreign investment company (within the meaning of section 1297 of the Code). X reflects FC's income, expense, gain, and loss in X's FSI using the equity method. FC earns $100x of operating income, $30x of which is reflected in X's FSI under the equity method.

(ii) *Analysis*. Under paragraph (c)(1)(i) of this section, the AFSI of X is adjusted to disregard the $30x of FC income reflected in the FSI of X under the equity method. Under paragraph (c)(1)(ii) of this section, there is no adjustment to the AFSI of X.

(5) *Example 5: Section 351 transfer*—(i) *Facts*. FC1, a foreign corporation, holds stock of a domestic corporation (DC stock) with a basis of $10x for regular tax purposes, CAMT basis of $12x, and fair market value of $15x. FC1 transfers DC stock to FC2, a foreign corporation, solely in exchange for stock of FC2 in an exchange described in section 351(a) of the Code. FC1 reflects $3x of gain in FSI as a result of the transfer of DC stock to FC2.

(ii) *Analysis*. The transfer of DC stock is a covered asset transaction described in paragraph (b)(1)(i)(C) of this section. Under paragraph (c)(2)(i) of this section, FC1's AFSI is adjusted to disregard the $3x of gain reflected in its FSI. Under paragraph (c)(2)(ii) of this section, FC1 will not include any gain in its AFSI as a result of the transfer of DC stock because for regular tax purposes, under section 351(a), FC1 does not recognize any gain as a result of the transfer of DC stock. For regular tax purposes, under section 358, FC1's basis in the stock of FC2 received in the exchange is $10x, which is the amount equal to FC1's $10x basis in DC stock for regular tax purposes. Under paragraph (d)(5) of this section, FC1's CAMT basis in the stock of FC2 is also $10x. Upon a subsequent disposition of the stock of FC2, the AFSI consequences to FC1 will be determined under paragraph (c)(1)(ii) of this section by reference to FC1's basis in the stock of FC2 for regular tax purposes. Under paragraph (d)(1)(iii) of this section, FC2's CAMT basis in DC stock is $12x, which is the amount equal to FC1's $12x CAMT basis in DC stock.

(6) *Example 6*: *Section 351 transfer with boot*—(i) *Facts*. FC1, a foreign corporation, holds an asset other than stock of a corporation (Asset A) with a basis of $10x for regular tax purposes, CAMT basis of $12x, and fair market value of $15x. FC1 transfers Asset A to FC2, a foreign corporation, in exchange for stock of FC2 with a fair market value of $5x and cash of $10x. FC1 reflects $3x of gain in FSI as a result of the transfer of Asset A to FC2.

(ii) *Analysis*. The transfer of Asset A is a covered asset transaction described in paragraph (b)(1)(i)(C) of this section. Under paragraph (c)(2)(i) of this section, FC1's AFSI is adjusted to disregard the $3x of gain reflected in its FSI as a result of the transfer of Asset A. Under paragraph (c)(2)(ii) of this section, as a result of the transfer of Asset A, FC1's AFSI is adjusted to include gain of $3x, which is the amount equal to the lesser of FC1's $3x gain (the sum of $5x fair market value of the stock of FC2 and $10x of cash received, less FC1's $12x CAMT basis in Asset A) and the $10x of cash received. For regular tax purposes, under section 351(b) of the Code, FC1 recognizes gain of $5x as a result of the transfer, which is the amount equal to the lesser of its $5x gain (the sum of $5x of fair market value of the stock of FC2 and $10x of cash received, less FC1's $10x basis in asset for regular tax purposes) and the $10x of cash received. For regular tax purposes, under section 358, FC1's basis in the stock of FC2 is $5x, which is equal to its $10x basis in Asset A for regular tax purposes, decreased by the $10x of cash received, and increased by the $5x of gain recognized for regular tax purposes. Under paragraph (d)(5) of this section, FC1's CAMT basis in the stock of FC2 is also $5x. Upon a subsequent disposition of the stock of FC2, the AFSI consequences to FC1 will be determined under paragraph (c)(1)(ii) of this section by reference to FC1's basis in the stock of FC2 for regular tax purposes. Under paragraph (d)(1)(iii) of this section, FC2's CAMT basis in Asset A is $15x, which is the amount equal to FC1's $12x CAMT basis in Asset A, increased by the $3x of gain included in FC1's AFSI.

(7) *Example 7*: *Transfer subject to section 367(a)*—(i) *Facts*. X, a domestic corporation, holds an asset which is not stock or securities in a corporation or intangible property within the meaning of section 367(d)(4) of the Code (Asset A), with basis of $10x for regular tax purposes, CAMT basis of $12x, and fair market value of $15x. X transfers Asset A to FC, a foreign corporation, solely in exchange for stock of FC in an exchange described in section 351(a). X reflects $3x of gain in FSI as a result of the transfer of Asset A to FC.

(ii) *Analysis*. The transfer of Asset A is a covered asset transaction described in paragraph (b)(1)(i)(C) of this section. Under paragraph (c)(2)(i) of this section, X's AFSI is adjusted to disregard the $3x of gain reflected in its FSI as a result of the transfer of Asset A. Because section 367(a) of the Code applies to the transfer of Asset A, under paragraph (c)(2)(ii) of this section, X's AFSI is adjusted to include gain of $3x as a result of the transfer ($15x fair market value of Asset X less $12X CAMT basis in Asset

A). For regular tax purposes, because section 367(a) applies to the transfer of Asset A, X recognizes gain of $5x ($15x fair market value of Asset A less $10x basis in Asset A for regular tax purposes). For regular tax purposes, X's basis in the stock of FC is $15x, which is equal to its $10x basis in Asset A for regular tax purposes, increased by the $5x of gain recognized for regular tax purposes under section 367(a). Under paragraph (d)(5) of this section, X's CAMT basis in the stock of FC is also $15x. Upon a subsequent disposition of the stock of FC, the AFSI consequences to X will be determined under paragraph (c)(1)(ii) of this section by reference to X's basis in the stock of FC for regular tax purposes. Under paragraph (d)(1)(iii) of this section, FC's CAMT basis in Asset A is $15x, which is the amount equal to X's $12x CAMT basis in Asset A, increased by the $3x of gain included in FC's AFSI.

(8) *Example 8*: *Inbound liquidation subject to section 367(b)*—(i) *Facts*. X, a domestic corporation, owns all the stock of FC, a controlled foreign corporation. FC owns a single asset which is not stock or securities of a corporation (Asset A), with basis of $10x for regular tax purposes, CAMT basis of $12x, and fair market value of $15x. Pursuant to a complete liquidation described in sections 332 and 337, FC transfers Asset A to X (FC liquidation). FC has earnings and profits of $15x, none of which are either previously taxed earnings and profits or earnings and profits (or deficit in earnings and profits) effectively connected with the conduct of a trade or business within the United States (or attributable to a permanent establishment in the United States, in the context of an applicable United States income tax treaty). X's all earnings and profits amount (within the meaning of §1.367(b)-2(d)(1)) with respect to the stock of FC is $10x. As a result of the FC liquidation, under §1.367(b)-3(b)(3)(i), X includes in income a deemed dividend of $10x. Furthermore, under §1.367(b)-3(f)(1), no earnings and profits of FC carryover to X under section 381(c)(2) of the Code. FC reflects $3x of gain in FSI as a result of the transfer of Asset A to X in the FC liquidation, and X reflects $3x of gain in FSI as a result of the FC liquidation.

(ii) *Analysis*. The FC liquidation is a covered asset transaction described in paragraph (b)(1)(i)(B) of this section. Under paragraph (c)(1)(i) of this section, X's AFSI is adjusted to disregard the $3x of gain reflected in its FSI as a result of the FC liquidation. Under paragraph (c)(1)(ii) of this section, X's AFSI is adjusted to include the $10x deemed dividend recognized by X for regular tax purposes. Furthermore, under paragraph (c)(1)(ii) of this section, if X is eligible for the section 245A dividends-received deduction with respect to the deemed dividend, the AFSI of X is also adjusted to include the section 245A dividends-received deduction. Under paragraph (c)(2)(i) of this section, FC's AFSI is adjusted to disregard the $3x of gain reflected in its FSI as a result of the transfer of Asset A in the FC liquidation. There is no adjustment to FC's AFSI under paragraph (c)(2)(ii) of this section. Under paragraph (d)(1)(ii) of this section, X's CAMT basis in Asset A is $12x, which is the amount equal to FC's CAMT basis in Asset A. Under §1.56A-18(c)(7)(i), none of FC's earnings and profits are carried over to X for purposes of determining X's CAMT retained earnings, because none of FC's earnings and profits carryover to X under section 381(c)(2) for regular tax purposes.

(i) *Applicability date*—(1) *In general*. Except as provided in paragraph (i)(2) of this section, this section applies to taxable years of CAMT entities ending after September 13, 2024.

(2) *Rule for transfers*. In the case of rules in this section that apply to transfers, those rules are applicable to transfers occurring after September 13, 2024.

§1.56A-5 AFSI adjustments to partner's distributive share of partnership AFSI.

(a) *Overview*. This section provides rules under section 56A(c)(2)(D) of the Code for determining a CAMT entity's AFSI adjustment for its distributive share of AFSI with respect to a partnership investment (that is, a CAMT entity's interest in a partnership). Paragraph (b) of this section provides the general rule regarding adjustments to a CAMT entity's AFSI with respect to its partnership investment. Paragraph (c) of this section describes the applicable method used to adjust a CAMT entity's AFSI with respect to its partnership investment. Paragraph (d) of this section provides rules regarding items reflected in a CAMT entity's FSI with respect to a partnership investment that are not disregarded for AFSI purposes under the applicable method. Paragraph (e) of this section describes how a distributive share amount is determined under the applicable method. Paragraph (f) of this section describes how the applicable method is applied in tiered partnerships. Paragraph (g) of this section provides rules for determining the taxable year in which the CAMT entity includes the distributive share amount in AFSI if the CAMT entity and the partnership have different taxable years. Paragraph (h) of this section describes reporting and filing requirements for a CAMT entity that is a partner in a partnership. Paragraph (i) of this section lists reporting and filing requirements for partnerships with CAMT entities as partners. Paragraph (j) of this section provides rules limiting the use of a CAMT entity's distributive share amount. Paragraph (k) of this section provides examples illustrating the application of the rules in this section. Paragraph (l) of this section provides the applicability date of this section.

(b) *In general*. If a CAMT entity is a partner in a partnership, the CAMT entity's AFSI with respect to its partnership investment is adjusted as required under the applicable method described in paragraph (c) of this section and the rules in §1.56A-20, regardless of the method the CAMT entity uses to account for its partnership investment for AFS purposes.

(c) *Applicable method*. Under the *applicable method*, a CAMT entity's AFSI with respect to its partnership investment—

(1) First, except for the amounts described in paragraph (d) of this section, is adjusted to disregard any amount the CAMT entity reflects in its FSI with respect to its partnership investment for the taxable year (for example, changes in the fair value of the partnership investment that are reflected in the CAMT entity's FSI under the fair value method, or the CAMT entity's share of the partnership's earnings that are reflected in the CAMT entity's FSI under the equity method);

(2) Second, is adjusted to include the CAMT entity's distributive share amount for the taxable year as computed under paragraph (e) of this section (except for paragraph (e)(5) of this section), taking into account paragraphs (f), (g) and (j) of this section; and

(3) Third, to the extent applicable, is adjusted as required under paragraph (e)(5) of this section.

(d) *FSI amounts with respect to a partnership investment that are not disregarded under paragraph (c)(1) of this section*. For purposes of paragraph (c)(1) of this section, a CAMT entity's AFSI with respect to its partnership investment is not adjusted to disregard any FSI amounts attributable to a transfer, sale or exchange, contribution, distribution, dilution, deconsolidation, change in ownership, or any other transaction between any partners (including the CAMT entity) of a partnership and the partnership, or between any partners of the partnership (including the CAMT entity), that are not derived from, and included in, the partnership's FSI. However, these FSI amounts may be subject to modification or redetermination for AFSI purposes under §§1.56A-1(d)(4) and 1.56A-20.

(e) *Distributive share amount*—(1) *In general*. Except as provided in paragraph (e)(6) of this section, for purposes of this section, the *distributive share amount* of a CAMT entity that is a partner in a partnership is computed by—

(i) The CAMT entity determining its distributive share percentage in accordance with paragraph (e)(2) of this section;

(ii) The partnership determining its modified FSI in accordance with paragraph (e)(3) of this section;

(iii) The CAMT entity multiplying its distributive share percentage by the modified FSI of the partnership; and

(iv) The CAMT entity adjusting the amount determined under paragraph (e)(1)(iii) of this section in accordance with paragraph (e)(4)(ii) of this section.

(2) *Computing the distributive share percentage*. The *distributive share percentage* is a fraction, the numerator of which is the FSI amount that is disregarded by a CAMT entity under paragraph (c)(1) of this section, redetermined based on the partnership's taxable year if the taxable year of the partnership and the CAMT entity are different, and the denominator of which is:

(i) In the case of a CAMT entity, other than a CAMT entity described in paragraph (e)(2)(ii), (iii), (iv) or (v) of this section, and a partnership that are members of the same financial statement group, or in the case of a CAMT entity that uses the equity method to account for its partnership investment, 100 percent of the partnership's FSI for the partnership's taxable year.

(ii) In the case of a CAMT entity that uses the fair value method to account for its partnership investment, the total change in the fair value of the partnership during the partnership's taxable year, as determined by the CAMT entity for purposes of determining the CAMT entity's share of the total change in its AFS.

(iii) In the case of a CAMT entity that treats its partnership investment as other than an equity investment for AFS purposes (for example, as debt) (AFS non-partner), 100 percent of the partnership's FSI for the partnership's taxable year plus the FSI amount included in the numerator for the CAMT entity under this paragraph (e)(2) for the taxable year.

(iv) In the case of a CAMT entity that treats itself as owning 100 percent of the equity in the partnership for AFS purposes because the CAMT entity treats all other partners in the partnership as AFS non-partners, 100 percent of the partnership's FSI for the partnership's taxable year plus the sum of any amounts reflected in the partnership's FSI that are treated as paid or accrued to the other partners for the partnership's taxable year.

(v) In the case of a CAMT entity that uses any other AFS method to account for its partnership investment, an amount determined under the principles of paragraphs (e)(2)(i) and (ii) of this section that is reasonable under the facts and circumstances and reflective of the proportionate amount of the partnership's FSI the CAMT entity is reporting for AFS purposes.

(3) *Computing the modified FSI of the partnership*. A partnership's modified FSI is equal to the partnership's FSI for the partnership's taxable year, adjusted for all relevant AFSI adjustments provided in the section 56A regulations (that is, those AFSI adjustments that can apply to partnerships), except for the AFSI adjustments in §§1.56A-4(c)(1)(ii), 1.56A-15(d)(2)(ii) and (iv), and 1.56A-16(d)(2)(ii) and (iv). For purposes of determining a partnership's modified FSI, references to AFSI in other sections of the section 56A regulations (except for the references to AFSI in §1.56A-1(b)(1)) are treated as references to modified FSI.

(4) *AFSI items that are separately stated*—(i) *In general*. The AFSI items described in §§1.56A-4(c)(1)(ii), 1.56A-6(c)(2)(iii), 1.56A-8(c), 1.56A-15(d)(2)(ii) and (iv), and (e)(3)(iii) and (iv), 1.56A-16(d)(2)(ii) and (iv), and (e)(3)(iii) and (iv), 1.56A-20(d)(1)(ii), and 1.56A-21(e)(2)(iii) are separately stated to the partners in the partnership that are CAMT entities (CAMT entity partners) and taken into account by the CAMT entity partners in the manner provided in paragraphs (e)(4)(ii) and (iii) of this section, as applicable.

(ii) *Adjustments to a partner's distributive share amount*. The following separately stated AFSI items are taken into account as adjustments to a CAMT entity partner's distributive share amount of a partnership's modified FSI as provided in paragraph (e)(1)(iv) of this section:

(A) A CAMT entity partner's distributive share of the AFSI items described in §§1.56A-15(d)(2)(ii) and (iv) and 1.56A-16(d)(2)(ii) and (iv), which is equal to the CAMT entity partner's distributive share of the items for regular tax purposes for the taxable year;

(B) A CAMT entity partner's distributive share of the AFSI items described in §§1.56A-15(e)(3)(iii) and (iv) and 1.56A-16(e)(3)(iii) and (iv), as provided under §§1.56A-15(e)(3)(iii) and (iv) and 1.56A-16(e)(3)(iii) and (iv); and

(C) A CAMT entity partner's distributive share of the AFSI items described in §1.56A-20(d)(1)(ii), which is equal to the CAMT entity partner's allocable share of the items as provided in §1.56A-20(d)(2)(i) for the taxable year, taking into account any acceleration event described in §1.56A-20(d)(1)(iii) and (d)(2)(ii).

(iii) *Adjustments to a partner's AFSI.* The separately stated AFSI items described in §§1.56A-4(c)(1)(ii), 1.56A-6(c)(2)(iii), 1.56A-8(c), and 1.56A-21(e)(2)(iii) are not taken into account in determining a CAMT entity partner's distributive share amount, and instead are taken into account in determining a CAMT entity partner's AFSI as follows:

(A) The CAMT entity partner takes into account the AFSI items described in §1.56A-4(c)(1)(ii) that are separately stated to the CAMT entity partner, as provided under §1.56A-4(e);

(B) The CAMT entity partner takes into account the AFSI items described in §1.56A-6(c)(2)(iii) that are separately stated to the CAMT entity partner, as provided under §1.56A-6(c)(2)(iv);

(C) The CAMT entity partner takes into account the AFSI items described in §1.56A-8(c) that are separately stated to the CAMT entity partner, as provided under §1.56A-8(c); and

(D) The CAMT entity partner takes into account the AFSI item described in §1.56A-21(e)(2)(iii) that is separately stated to the CAMT entity partner, as provided under §1.56A-21(e)(2)(ii).

(5) *Effect of equity method basis adjustments to a CAMT entity's FSI.* If a CAMT entity partner includes in its FSI any amortization of an equity method basis adjustment with respect to the partnership investment that is attributable to section 168 property or qualified wireless

spectrum held by the partnership, and if the CAMT entity partner has a basis adjustment under section 743(b) of the Code with respect to the same property that affects the CAMT entity partner's distributive share amount, then the CAMT entity partner adjusts its AFSI to disregard any such FSI amortization.

(6) *Computing a partner's distributive share amount when the partnership's AFS is its Federal income tax return*—(i) *In general*. If a partnership treats as its AFS the partnership's Federal income tax return under §1.56A-2(c)(6), a CAMT entity partner's distributive share amount with respect to the partnership for a taxable year is equal to the amount of the CAMT entity partner's FSI that the partner disregards under paragraph (c)(1) of this section for the taxable year (except for any items described in §§1.56A-4(c)(1)(i) and 1.56A-8(b) that would otherwise be reflected in such amount).

(ii) *Separately stated AFSI items*. If a CAMT entity partner determines its distributive share amount in accordance with paragraph (e)(6)(i) of this section, paragraphs (e)(4)(iii)(A) through (C) of this section apply to determine the CAMT entity partner's AFSI, but paragraph (e)(4)(iii)(D) of this section does not apply.

(f) *Computation in the case of tiered partnerships*. If a CAMT entity is a partner in a partnership (UTP) that directly or indirectly owns an investment in a lower-tier partnership (LTP), each partnership, starting with the lowest-tier partnership and going in order up the tiered-partnership chain, applies the rules and principles of paragraphs (b) through (e) of this section to determine the distributive share amounts of each CAMT entity partner in the tiered-partnership chain.

(g) *Taxable year*. The distributive share amount that is required to be included in a CAMT entity's AFSI for a taxable year of the CAMT entity under paragraph (c)(2) of this section with respect to the CAMT entity's partnership investment is based on the modified FSI of the partnership for any taxable year of the partnership ending with or within the taxable year of the CAMT entity.

(h) *Reporting and filing requirements for a CAMT entity that is a partner in a partnership*—(1) *In general*. If a CAMT entity is a partner in a partnership, and if the CAMT entity cannot determine its distributive share of the partnership's AFSI without receiving certain information from the partnership, the CAMT entity must request such information from that partnership by the 30th day after the close of the taxable year of the partnership to which the information request relates, except as provided in paragraph (i)(2)(iii) of this section. The CAMT entity must maintain the information, and requests made for the information, in its books and records. After the first taxable year in which the CAMT entity requests information from the partnership, the partnership must continue to provide the information to the CAMT entity each subsequent taxable year of the partnership unless the partnership receives written notification from the CAMT entity that the information is not required.

(2) *Failure to obtain information*—(i) *In general*. If a partnership fails to furnish the information requested by a CAMT entity that is a partner in the partnership under paragraph (h)(1) of this section, the CAMT entity must determine its distributive share amount with respect to the partnership investment by making a required good-faith estimate in accordance with paragraph (h)(2)(ii) of this section.

(ii) *Required estimate*. If a CAMT entity is required to estimate its distributive share amount under paragraph (h)(2)(i) of this section with respect to a partnership investment, it must base its estimate on whatever information it can reasonably obtain, if received before the expiration of the period of limitations under section 6501 of the Code, and it must continue to use its best efforts to obtain the requested information from the partnership. Except as provided in paragraph (h)(2)(iii)(B) of this section, once the CAMT entity receives the information from the partnership, the CAMT entity (if not also an applicable corporation) should report the information to its partners, including any UTP (which would then report the information to its partners), until the information is received by an applicable corporation. A partnership that fails to furnish the required information may be subject to penalties and adjustment in accordance with paragraph (i)(6) of this section.

(iii) *Partnerships subject to subchapter C of chapter 63 of the Code*—(A) *Required estimate.* If a partnership is subject to the centralized partnership audit regime in subchapter C of chapter 63 of the Code (BBA partnership), a CAMT entity that is a partner in the partnership must file a notice of inconsistent treatment in accordance with section 6222 of the Code if making the required estimate requires the CAMT entity to treat a partnership-related item, as defined in §301.6241-1(a)(6)(ii) of this chapter, inconsistently with how the partnership treated the partnership-related item on its partnership return.

(B) *Information obtained after the filing of the partnership return.* If a BBA partnership previously filed its partnership return for the taxable year, and if the due date for filing the partnership return has passed, the BBA partnership must file an administrative adjustment request (AAR) in accordance with section 6227 of the Code in order to adjust any partnership-related items, including as part of furnishing information to a CAMT entity that is a partner in a partnership. Any such adjustment is determined and taken into account in accordance with section 6227 and the regulations.

(i) *Reporting and filing requirements for partnerships in which a CAMT entity is a partner*—(1) *Requirement to file information with the IRS and to furnish information to a CAMT entity*. If a CAMT entity that is a partner in a partnership requests information from the partnership in accordance with paragraph (h) of this section, the partnership must file such information with the IRS as the Commissioner may require in forms, instructions, or other guidance for the Commissioner to determine that the partnership and its partners have complied with the rules of this section. The partnership also must furnish the information to the CAMT entity in such manner as the Commissioner may require in forms, instructions, or other guidance. This information includes—

(i) Information necessary to determine the denominator for the distributive share percentage under paragraph (e)(2) of this section;

(ii) The partnership's modified FSI as determined under paragraph (e)(3) of this section;

(iii) Information required for the CAMT entity to make the adjustments provided in paragraph (e)(4) of this section;

(iv) If the CAMT entity is a United States shareholder, information required for the CAMT entity to make the adjustments provided in §1.56A-6(b); and

(v) If the CAMT entity is a controlled foreign corporation, information required for the United States shareholders of the controlled foreign corporation to make the adjustments provided in §1.56A-6(b).

(2) *Special rules for tiered structures*—(i) *Requirement to request information*. If a UTP requires information from an LTP to meet the UTP's reporting and filing requirements under this section (including any information required to be furnished under paragraph (i)(1) of this section to a CAMT entity that is a partner in UTP), the UTP must request the information from the LTP.

(ii) *Requirement to furnish and file information*. If information is requested from an LTP under paragraph (i)(2)(i) of this section, the LTP must file the information with the IRS and must furnish the information to the UTP as required under paragraph (i)(1) of this section.

(iii) *Timing of requesting information*. A UTP described in paragraph (i)(2)(i) of this section must request any necessary information by the later of—

(A) The 30th day after the close of the taxable year of the partnership to which the information request relates; or

(B) 14 days after the date the UTP receives a request for the information from another UTP.

(3) *Timing of furnishing information*—(i) *In general*. Except as provided in paragraph (i)(3)(ii) of this section, requested information must be furnished by the date on which the partnership is required to furnish information under section 6031(b) of the Code.

(ii) *Late requests*. Except as provided in paragraph (h)(2)(iii)(B) of this section, information with respect to a taxable year that is requested by a UTP after the date that is 14 days prior to the due date for an LTP to furnish and file information under section 6031(b) must be furnished and filed in the time and manner prescribed by forms, instructions, or other guidance.

(iii) *Partnership not required to furnish information to a CAMT entity until it has notice of a request.* A partnership is not required to furnish information to a CAMT entity that is a partner in the partnership under this paragraph (i)(3)(iii) until it has notice of a request. For purposes of this paragraph (i)(3)(iii), a partnership has notice of a request when—

(A) The partnership has received a request in the manner described in paragraph (h)(1) of this section from the CAMT entity; or

(B) The partnership has an obligation to continue providing information to a CAMT entity partner under paragraph (h)(1) of this section due to a request made by the CAMT entity in a prior taxable year.

(4) *Manner of furnishing information*. Information may be furnished in any written manner, including electronically, that is agreed to by the parties.

(5) *Recordkeeping requirement*. Any partnership receiving a request for information must retain a copy of the request and calculations related to distributive share amounts, and the date the request was received, in its books and records.

(6) *Penalties*. The information required to be furnished under this paragraph (i) also is required to be furnished under section 6031(b). *See also* section 6722 of the Code.

(j) *Limitation on allowance of negative distributive share amount*—(1) *In general*. If a CAMT entity's distributive share amount (as determined under paragraph (e) of this section) with respect to a partnership investment is negative for a taxable year, the CAMT entity includes the negative distributive share amount in its AFSI for the taxable year only to the extent the negative distributive share amount does not exceed the CAMT entity's CAMT basis in its partnership investment (as determined under paragraph (j)(3) of this section) at the end of the partnership taxable year in which the negative distributive share amount occurred. Ordering rules similar to the rules in §1.704-1(d)(2) apply in computing a CAMT entity's CAMT basis in its partnership investment for purposes of applying the rules in this section.

(2) *Carryover of suspended negative distributive share amount*. Any negative distributive share amount that is not allowed for a taxable year under paragraph (j)(1) of this section is included in determining the CAMT entity's distributive share amount (as determined under paragraph (e) of this section) in the succeeding taxable year, subject to the limitation provided in paragraph (j)(1) of this section.

(3) *CAMT basis in a partnership investment*. For purposes of the section 56A regulations, a CAMT entity's CAMT basis in its partnership investment is equal to the CAMT entity's AFS basis in the partnership investment as of the first day of the partnership's first taxable year ending after December 31, 2019, in which the CAMT entity held its interest in the partnership, adjusted for the following items for each taxable year of the partnership ending after December 31, 2019 (but not adjusted below zero), as applicable—

(i) Include any amounts reflected in the AFS basis of the CAMT entity's partnership investment that are not derived from, and included in, the partnership's FSI (for example, amounts described in paragraph (d) of this section);

(ii) Increase by the CAMT entity's distributive share amount included in its AFSI, if the distributive share amount is positive;

(iii) Decrease by the CAMT entity's distributive share amount included in its AFSI, if the distributive share amount is negative;

(iv) Increase or decrease, as appropriate, to take into account the treatment of contributions of property by the CAMT entity under §1.56A-20(c)(3)(ii);

(v) Increase or decrease, as appropriate, to take into account any adjustments that are separately stated under paragraph (e)(4)(iii) of this section and made to the basis in the CAMT entity's partnership investment for regular tax purposes under section 705 of the Code;

(vi) Decrease to take into account any adjustments made to the basis in the CAMT entity's partnership investment for regular tax purposes under §1.1017-1(g)(2) in accordance with §1.56A-21(e);

(vii) Increase or decrease, as appropriate, to take into account any adjustments made to the basis in the CAMT entity's partnership investment for regular tax purposes under section 961(a) or (b) of the Code;

(viii) Decrease to take into account any adjustments made to the basis in the CAMT entity's partnership investment for regular tax purposes under section 50(c)(5) of the Code;

(ix) Exclude any FSI amortization disallowed in the calculation of the CAMT entity's AFSI under paragraph (e)(5) of this section;

(x) Increase to take into account any adjustments described in §1.56A-21(e) that are separately stated to the CAMT entity under paragraph (e)(4)(iii) of this section;

(xi) Exclude any amounts that are included in the AFS basis of the CAMT entity's partnership investment as a result of a contribution of stock of a foreign corporation and increase to take into account any adjustments made to the basis in the CAMT entity's partnership investment for regular tax purposes under section 722 of the Code resulting from a contribution of stock of a foreign corporation; and

(xii) Include any amounts that are excluded from the AFS basis of the CAMT entity's partnership investment as a result of a non-liquidating distribution of stock of a foreign corporation and decrease to take into account any adjustments made to the basis of the CAMT entity's partnership investment for regular tax purposes under section 733 of the Code resulting from a non-liquidating distribution of stock of a foreign corporation.

(k) *Examples*. The following examples illustrate the application of the rules in this section.

(1) *Example 1: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method*—(i) *Facts*. PRS1 is a partnership, X is a corporation, and A is an individual. PRS1 is owned by X and A. PRS1 and X have the same tax and AFS years, and both use the calendar year as its taxable year and for AFS purposes. For 2024, X has FSI of $250x, consisting of $200x from its direct operations and $50x from its investment in PRS1, which it accounts for under the equity method. Also, for 2024, PRS1 has $100x of FSI which includes $20x of income from a covered benefit plan and $10x of covered book depreciation expense, as defined in §1.56A-15(b)(3). For regular tax purposes, the $20x of income from the covered benefit plan is excludable from gross income and the $10x of covered book depreciation expense is equal to deductible tax depreciation, as defined in §1.56A-15(b)(5), with respect to section 168 property. Under the equity method, X includes 50% of PRS1's FSI for 2024 on its AFS.

(ii) *Analysis*. The following steps are used to compute X's distributive share amount from PRS1 for 2024:

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under paragraph (c)(1) of this section, X disregards the $50x of FSI it includes on its AFS with respect to its investment in PRS1 for 2024.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(i) of this section, X must compute a fraction, the numerator of which is $50x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $100x (100% of PRS1's FSI for 2024). The resulting distributive share percentage is 50% ($50x/$100x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS1's FSI of $100x must be adjusted under §1.56A-13(b) to disregard the $20x of income from the covered benefit plan within the meaning §1.56A-13(c)(1) that was included for AFS purposes, and to include none of the gross income from the covered benefit plan since it was all excluded from gross income for regular tax purposes. PRS1's FSI must also be adjusted to disregard the covered book depreciation expense, or $10x, under §1.56A-15(d)(1)(iii), and reduced by the deductible tax depreciation, or $10x, under §1.56A-15(d)(1)(ii). Accordingly, PRS1's modified FSI is $80x ($100x - $20x + $10x - $10x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, X must multiply its distributive share percentage (50%) by the modified FSI of PRS1, or $80x, resulting in $40x of modified FSI for X.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, X must adjust its share of PRS1's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, X's distributive share amount of PRS1's AFSI for 2024 is $40x.

(F) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, X includes in its AFSI the $40x distributive share amount from PRS1. Thus, after reducing X's AFSI from $250x to $200x (*Step 1*), it is increased to $240x for 2024.

(2) *Example 2: Adjustment of AFSI with respect to a partnership investment accounted for using the hypothetical liquidation at book value under the equity method*—(i) *Facts*. PRS1 is a partnership, X is a corporation, and A is an individual. PRS1 is owned by X and A. PRS1 and X have the same tax and AFS years. For 2024, X has FSI of $250x, consisting of $190x from its direct operations and $60x from its investment in PRS1, which it accounts for under the hypothetical liquidation at book value method under the equity method. Also, for 2024, PRS1 has $100x of FSI which includes $20x of income from a covered benefit plan and $10x of covered book depreciation expense, as defined in §1.56A-15(b)(3). For regular tax purposes, the $20x of income from the covered benefit plan is excludable from gross income and the $10x of covered book depreciation expense is equal to deductible tax depreciation, as defined in §1.56A-15(b)(5), with respect to section 168 property.

(ii) *Analysis*. The following steps are used to compute X's distributive share amount from PRS1 for 2024:

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under paragraph (c)(1) of this section, X disregards the $60x of FSI it includes on its AFS with respect to its investment in PRS1 for 2024.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(i) of this section, X must compute a fraction, the numerator of which is $60x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $100x (100% of PRS1's FSI for 2024). The resulting distributive share percentage is 60% ($60x/$100x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS1's FSI of $100x must be adjusted under §1.56A-13(b) to disregard the $20x of income from the covered benefit plan within the meaning §1.56A-13(c)(1) that was included for AFS purposes, and to include none of the gross income from the covered benefit plan since it was all excluded from gross income for regular tax purposes. PRS1's FSI must also be adjusted to disregard the covered book depreciation expense, or $10x, under §1.56A-15(d)(1)(iii) and reduced by the deductible tax depreciation, or $10x, under §1.56A-15(d)(1)(ii). Accordingly, PRS1's modified FSI is $80x ($100x - $20x + $10x - $10x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, X must multiply its distributive share percentage (60%) by the modified FSI of PRS1, or $80x, resulting in $48x of modified FSI for X.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, X must adjust its share of PRS1's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, X's distributive share amount of PRS1's AFSI for 2024 is $48x.

(F) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, X includes in its AFSI the $48x distributive share amount from PRS1. Thus, after reducing X's AFSI from $250x to $190x (*Step 1*), it is increased to $238x for 2024.

(3) *Example 3: Adjustment of AFSI with respect to a partnership investment accounted for using the hypothetical liquidation at book value under the equity method and involving a loss on the investment*—(i) *Facts*. PRS1 is owned by X, a corporation and a tax-equity investor in PRS, and A, an individual developer. For 2024, X has FSI of $50x, consisting of $200x of income from its direct operations and $150x of loss from its investment in PRS1, which it accounts for under the hypothetical liquidation at book value method under the equity method. Also, for 2024, PRS1 has -$100x of FSI which includes $20x of income from a covered benefit plan and $10x of covered book depreciation expense, as defined in §1.56A-15(b)(3). For regular tax purposes, the $20x of income from the covered benefit plan is excludable from gross income and the $10x of covered book depreciation expense is deductible tax depreciation, as defined in §1.56A-15(b)(5), with respect to section 168 property.

(ii) *Analysis*. The following steps are used to compute X's distributive share amount from PRS1 for 2024:

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under

paragraph (c)(1) of this section, X disregards the -$150x of FSI it includes on its AFS with respect to its investment in PRS1 for 2024.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(i) of this section, X must compute a fraction, the numerator of which is -$150x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is -$100x (100% of PRS1's FSI for 2024). The resulting distributive share percentage is 150% (-$150x/-$100x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS1's FSI of -$100x must be adjusted under §1.56A-13(b) to disregard the $20x of income from the covered benefit plan within the meaning §1.56A-13(c)(1) that was included for AFS purposes, and to include none of the gross income from the covered benefit plan since it was all excluded from gross income for regular tax purposes. PRS1's FSI must also be adjusted to disregard the covered book depreciation expense, or $10x, under §1.56A-15(d)(1)(iii) and reduced by the deductible tax depreciation, or $10x, under §1.56A-15(d)(1)(ii). Accordingly, PRS1's modified FSI is -$120x (-$100x - $20x + $10x - $10x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, X must multiply its distributive share percentage (150%) by the modified FSI of PRS1, or -$120x, resulting in -$180x of modified FSI for X.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, X must adjust its share of PRS1's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, X's distributive share amount of PRS1's AFSI for 2024 is -$180x.

(F) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, X includes in its AFSI the -$180x distributive share amount from PRS1 (subject to the rules in paragraph (j)(1) of this section). Thus, after increasing X's AFSI from $50x to $200x (*Step 1*), it is decreased to $20x for 2024.

(4) *Example 4: Determining distributive share percentage for AFS non-partner*—(i) *Facts*. PRS1 is treated as a partnership for Federal income tax purposes owned by X and Y, each of which is a corporation. X is subject to the CAMT. For AFS purposes, X treats itself as a creditor to PRS1 and PRS1 treats itself as a debtor to X. For 2024, under their methods of financial accounting and under the terms of the loan, X reports on its AFS $50x of interest income from its investment in PRS1, and PRS1 reports on its AFS $50x of interest expense paid to X. Also, for 2024, PRS1 has $75x of FSI after deducting its interest expense paid to X.

(ii) *Analysis*. Under §1.56A-1(f), the classification of PRS1 for regular tax purposes applies for purposes of the section 56A regulations. Accordingly, X must determine its distributive share percentage with respect to PRS1 under paragraph (e)(2)(iii) of this section by computing a fraction, the numerator of which is $50x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $125x (100% of PRS1's FSI for 2024 plus the FSI amount included in the numerator for X's distributive share percentage). The resulting distributive share percentage is 40% ($50x/$125x).

(5*) Example 5: Determining distributive share percentage for entity that treats itself as owning 100 percent of the equity in the partnership for AFS purposes because the CAMT entity treats all other partners in the partnership as AFS non-partners*—(i) *Facts*. PRS1 is treated as a partnership for Federal income tax purposes owned by X and Y, each of which is a corporation. For AFS purposes, X treats itself as owning 100% of the equity in PRS1. X also treats Y as a creditor with respect to PRS1 and treats PRS1 as a debtor with respect to Y. X is subject to the CAMT. For 2024, X reports on its AFS $75x of FSI from its investment in PRS1. Also, for 2024, PRS1 has $75x of FSI after deducting its interest expense paid to Y. As such, under their methods of financial accounting, X reports on its AFS $75x from its equity investment in PRS1, Y reports on its AFS $50x of interest income from its investment in PRS1, and PRS1 reports on its AFS $50x of interest expense paid to Y.

(ii) *Analysis*. Under §1.56A-1(f), the classification of PRS1 for regular tax purposes applies for purposes of the section 56A regulations. Accordingly, X must determine its distributive share percentage with respect to PRS1 under paragraph (e)(2)(iv) of this section by computing a fraction, the numerator of which is $75x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $125x (100% of PRS1's FSI for 2024 plus the sum of any amounts reflected in the PRS1's FSI that are treated as paid or accrued to Y). The resulting distributive share percentage is 60% ($75x/$125x).

(6) *Example 6: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method in a tiered partnership structure*—(i) *Facts*. The facts are the same as in paragraph (k)(1)(i) of this section (*Example 1*), except that included in PRS1's $100x of FSI is $50x of FSI from its investment in PRS2, a partnership owned by PRS1 and A. PRS1 and PRS2 have the same taxable year and AFS year. For AFS purposes, PRS1 accounts for its interest in PRS2 using the equity method. For 2024, PRS2 has FSI of $150x, which includes $15x of covered book depreciation expense. For regular tax purposes, PRS2 has $45x of deductible tax depreciation with respect to section 168 property. Under the equity method, PRS1 includes 33 1/3% of PRS2's FSI for 2024 on its AFS.

(ii) *Analysis: Computation beginning with respect to lowest-tier partnership*. The following steps are used to compute X's distributive share amount from PRS1 for 2024, beginning with respect to the lowest-tier partnership. Under paragraphs (e)(3) and (f) of this section, PRS1 must determine its distributive share amount with respect to its investment in PRS2 in accordance with this section before X determines its distributive share amount with respect to PRS1.

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year:* Under paragraph (c)(1) of this section, PRS1 disregards the $50x of FSI included on its AFS with respect to its investment in PRS2.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(i) of this section, PRS1 computes a fraction, the numerator of which is $50x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $150x (100% of PRS2's FSI). The resulting distributive share percentage is 33 1/3% ($50x/$150x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS2's FSI of $150x must be adjusted to disregard the covered book depreciation expense, or $15x, under §1.56A-15(d)(1)(iii) and reduced by the deductible tax depreciation, or $45x, under §1.56A-15(d)(1)(ii). Accordingly, PRS2's modified FSI is $120x ($150x + $15x - $45x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, PRS1 must multiply its distributive share percentage (33 1/3%) by the modified FSI of PRS2, or $120x, resulting in an amount of $40x.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraph (e)(1)(iv) and (e)(4) of this section, PRS1 must adjust its share of PRS2's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, PRS1's distributive share amount of PRS2's AFSI for Year 1 is $40x.

(F) *Step 6: Include distributive share amount in AFSI (or modified FSI if a CAMT entity is a partnership)*. Under paragraph (c)(2) of this section, PRS1 includes in its modified FSI the $40x distributive share amount from PRS2. Thus, after reducing PRS1's modified FSI from $100x to $50x, it is increased to $90x.

(iii) *Analysis: Computation with respect to PRS1*. Under paragraphs (e)(3) and (f) of this section, because PRS1 is the last partnership in the chain, X determines its distributive share amount with respect to its investment in PRS1.

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under paragraph (c)(1) of this section, X disregards the $50x of FSI it includes on its AFS with respect to its investment in PRS1 for Year 1.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(i) of this section, X computes a fraction, the numerator of which is $50x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $100x (100% of PRS1's FSI for Year 1). The resulting distributive share percentage is 50% ($50x/$100x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS1's FSI of $100x must be adjusted under §1.56A-13(b) to disregard the $20x of income from the covered benefit plan within the meaning §1.56A-13(c)(1) that was included for AFS purposes. PRS1's FSI must also be adjusted to disregard the covered book depreciation expense, or $10x, under §1.56A-15(d)(1)(iii) and reduced by the deductible tax depreciation, or $10x under §1.56A-15(d)(1)(ii). PRS1's FSI must further be adjusted to exclude its $50x of FSI with respect to its investment in PRS2 and to include its distributive share amount with respect to PRS2 of $40x, as determined in paragraph (k)(6)(ii)(F) of this section. Accordingly, PRS1's modified FSI is $70x ($100x - $20x + $10x - $10x - $50x + $40x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*.

Under paragraph (e)(1)(iii) of this section, X must multiply its distributive share percentage, or 50%, by the modified FSI of PRS1, or $70x, resulting in X having a share of $35x of the modified FSI of PRS1.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, X must adjust its share of PRS1's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, X's distributive share amount of PRS1's AFSI for 2024 is $35x.

(F) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, X includes in its AFSI the $35x distributive share amount from PRS1. Thus, after reducing X's AFSI from $250x to $200x, it is increased to $235x for 2024.

(7) *Example 7: Adjustment of AFSI with respect to a partnership investment accounted for using the equity method with a basis adjustment under section 743(b) related to section 168 property*—(i) *Facts*. The facts are the same as in paragraph (k)(1)(i) of this section (*Example 1*), except that X has a basis adjustment under section 743(b) with respect to its investment in PRS1, in turn with respect to section 168 property owned by PRS1. As a result of the section 743(b) basis adjustment, X is allocated an additional $10x of deductible tax depreciation from PRS1's section 168 property. X does not have a corresponding equity interest method basis adjustment for financial statement purposes.

(ii) *Analysis*. The analysis is the same as in paragraphs (k)(1)(ii)(A) through (D) of this section (*Example 1*), and the remaining steps are as follows:

(A) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, X must adjust its share of PRS1's modified FSI by its section 704(b) of the Code distributive share amount of PRS1's deductible tax depreciation for section 168 property from its section 743(b) basis adjustment with respect to its investment in PRS1, or $10x. X's distributive share amount of PRS1's AFSI for 2024 is $30x ($40x - $10x).

(B) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, X includes in its AFSI the $30x distributive share amount with respect to its investment in PRS1. Thus, after reducing X's AFSI from $250x to $200x, it is increased to $230x for 2024.

(8) *Example 8: Adjustment of AFSI with respect to a partnership investment accounted for using the fair value method*—(i) *Facts*—(A) *General facts*. PRS3 is a partnership, Y is a corporation, and B is an individual. PRS3 is directly owned by Y and B. PRS3 and Y have the same taxable year and AFS year. For 2024, Y has FSI of $275x, consisting of $200x from its direct operations and $75x from its investment in PRS3, which it accounts for using the fair value method of accounting pursuant to which the FSI reported on its AFS with respect to PRS3 reflects the net change in the fair value of its investment in PRS3 during the taxable year.

(B) *Facts*: *PRS3*. PRS3 has an interest in PRS4. PRS4 is a partnership. For 2024, PRS3 has FSI of $100x, which includes $14x of covered book depreciation expense and $50x from its investment in PRS4. PRS3 uses the fair value method to account for its assets and its FSI includes the total change in the fair value with respect to its assets. The FSI reported by PRS3 on its AFS with respect to its investment in PRS4 reflects the net change in the fair value of its investment in PRS4 during the taxable year, including changes in cash amounts. For regular tax purposes, PRS3 has deductible tax depreciation with respect to section 168 property of $36x per year for ten years. PRS3 and PRS4 have the same taxable year and AFS year.

(C) *Facts: PRS4*. PRS4 uses the fair value method to account for its investment in its assets. The FSI reported on its AFS with respect to those assets reflects the net change in fair value of the assets during the taxable year, including changes in cash accounts. For Year 1, PRS4 has FSI of $150x, consisting of a $100x increase to cash amounts and a $50x increase to the value of certain property. PRS4 has no covered book depreciation expense for the section 168 property. For regular tax purposes, PRS4 has deductible tax depreciation with respect to section 168 property of $18x per year for ten years.

(ii) *Analysis: Begin computation with respect to lowest-tier partnership*. Under paragraphs (e)(3) and (f) of this section, PRS3 must determine its distributive share amount with respect to its investment in PRS4 in accordance with this section before Y determines its distributive share amount with respect to PRS3.

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under paragraph (c)(1) of this section, PRS3 disregards the $50x of FSI it includes on its AFS with respect to its investment in PRS4 for 2024.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(ii) of this section, PRS3 must compute a fraction, the numerator of which is $50x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $150x (the total change in the fair value of PRS4's assets, including changes in cash amounts and increases in the value of property, for PRS4's taxable year). The resulting distributive share percentage is 33 1/3% ($50x/$150x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS4's FSI of $150x is reduced by the deductible tax depreciation, or $18x, under §1.56A-15(d)(1)(ii). As a result, PRS4's modified FSI is $132x ($150x - $18x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, PRS3 multiplies its distributive share percentage (33 1/3%) by the modified FSI of PRS4, or $132x, resulting in PRS3 having a share of $44x of the modified FSI of PRS4.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, PRS3 must adjust its share of PRS4's modified FSI by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, PRS3's distributive share amount of PRS4's AFSI for 2024 is $44x.

(F) *Step 6: Include distributive share amount in AFSI (or modified FSI if a CAMT entity is a partnership)*. Under paragraph (c)(2) of this section, PRS3 includes in its modified FSI the $44x distributive share amount from PRS4. Thus, after reducing PRS3's modified FSI with respect to its investment in PRS4 from $100x to $50x, it is increased to $94x for 2024.

(iii) *Analysis: Computation with respect to PRS3*. Under paragraph (e)(3) of this section, because PRS3 is the last partnership in the chain, Y determines its distributive share amount with respect to its investment in PRS3.

(A) *Step 1: Disregard FSI amount with respect to partnership investment for the taxable year*. Under paragraph (c)(1) of this section, Y disregards the $75x of FSI it includes on its AFS with respect to its investment in PRS3 for 2024.

(B) *Step 2: Calculate the distributive share percentage*. Under paragraph (e)(2)(ii) of this section, Y must compute a fraction, the numerator of which is $75x (the amount disregarded under paragraph (c)(1) of this section) and the denominator of which is $100x (the total change in the fair value of PRS3's assets, including changes in cash amounts, during the PRS3's taxable year). The resulting distributive share percentage is 75% ($75x/$100x).

(C) *Step 3: Compute the modified FSI of the partnership*. Under paragraph (e)(3) of this section, PRS3's FSI of $100x must be adjusted to disregard the covered book depreciation expense, or $14x, under §1.56A-15(d)(1)(iii), and reduced by the deductible tax depreciation, or $36x, under §1.56A-15(d)(1)(ii). PRS3's FSI must further be adjusted to exclude its $50x of FSI with respect to its investment in PRS4 and to include its distributive share amount with respect to PRS4, or $44x, as determined under paragraph (k)(4)(ii) of this section. Accordingly, PRS3's modified FSI is $72x ($100x + $14x - $36x - $50x + $44x).

(D) *Step 4: Multiply the distributive share percentage by the modified FSI of the partnership*. Under paragraph (e)(1)(iii) of this section, Y must multiply its distributive share percentage, or 75%, by the modified FSI of PRS3, or $72x, resulting in Corporation Y having a share of $54x of modified FSI of Partnership C.

(E) *Step 5: Adjust the share of modified FSI by separately stated adjustments*. Under paragraphs (e)(1)(iv) and (e)(4) of this section, Y must adjust its share of PRS3's modified FSI of $54x by any separately stated amounts listed in paragraph (e)(4)(ii) of this section. Because there are none, Y's distributive share amount of PRS3's AFSI for 2024 is $54x.

(F) *Step 6: Include distributive share amount in AFSI*. Under paragraph (c)(2) of this section, Y includes in its AFSI the $54x distributive share amount from PRS3. Thus, after reducing Y's AFSI from $275x to $200x, it is increased to $254x for 2024.

(9) *Example 9: Computation of CAMT basis in partnership investment*—(i) *Facts*. The facts are the same as in paragraph (k)(1)(i) of this section (*Example 1*), except that PRS1 is formed on January 1, 2024, at which time X and A each contributes $50x to PRS. During 2024, X and A each contributes an additional $10x to PRS1 to meet its respective capital contribution requirement under the terms of the PRS1 agreement.

(ii) *Analysis*—(A) *Compute the CAMT basis in the partnership investment.* Under paragraph (j)(3) of this section, X's initial CAMT basis in its

PRS1 investment is equal to X's AFS basis in its PRS1 investment as of the first day of the partnership's first taxable year ending after December 31, 2019. Accordingly, because PRS1 was formed on January 1, 2024, X's initial AFS and CAMT basis under paragraph (j)(3) of this section is $0x. Under §1.56A-20(c)(3)(ii) and paragraph (j)(3)(iv) of this section, X's $50x contribution results in X having an initial CAMT basis in its PRS1 investment of $50x on January 1, 2024, which is equal to its AFS basis in its PRS1 investment following the contribution. Under §1.56A-20(c)(3)(ii) and paragraph (j)(3)(iv) of this section, X's CAMT basis in its PRS1 investment of $50x is increased by $10x at the time of X's additional $10x contribution in 2024.

(B) *Increase by the CAMT entity's positive distributive share amount under paragraph (j)(3)(ii) of this section or decrease (but not below zero) by its negative distributive share amount paragraph (j)(3)(iii) of this section for the taxable year*. Under paragraph (j)(3)(ii) of this section, X must increase its CAMT basis in PRS1 by its distributive share amount of $40x (computed in paragraph (k)(1)(ii)(E) of this section) resulting in X having a CAMT basis of $100x ($60x + $40x) in its PRS 1 investment at the end of 2024.

(10) *Example 10: Limitation of negative distributive share amount in excess of CAMT basis*—(i) *Facts*. The facts are the same as in paragraph (k)(9)(i) of this section (*Example 9*). In 2025, X's distributive share amount with respect to its investment in PRS1, determined under paragraph (e) of this section, is -$120x. Further, in 2025 each of X and A contributes $10x to meet its respective capital contribution requirement under the terms of the PRS1 agreement.

(ii) *Analysis*—(A) *Limitation on allowance of negative distributive share*. Under paragraph (j)(1) of this section, X must limit its 2025 negative distributive share amount with respect to its investment in PRS1 to its CAMT basis in the partnership.

(B) *Computation of CAMT basis in partnership investment*. X must compute its CAMT basis in its investment in PRS1 for 2025. Under paragraph (j)(3) of this section, X's CAMT basis is adjusted by the items described in paragraph (j)(3) of this section for each taxable year and prior taxable years ending after December 31, 2019. Under paragraph (j)(3)(iv) of this section, X increases its CAMT basis of $100x as of the end of 2024 (which includes all of X's paragraph (j)(3) of this section items for 2024) by its 2025 contribution of $10x to $110x. Under paragraph (j)(3)(iii) of this section, X must decrease its CAMT basis (but not below zero) by its 2025 negative distributive share amount of -$120x.

(C) *Carryover of suspended negative distributive share amount*. Under paragraph (j)(1) of this section, X includes the -$120x distributive amount in its AFSI for the 2025 taxable year only to the extent it does not exceed its CAMT basis in its partnership investment. Under paragraph (j)(2) of this section, X's excess negative distributive share amount of -$10x ($110x - $120x) is included in determining X's distributive share amount in the subsequent taxable year, subject to the limitation in paragraph (j)(1) of this section.

(l) *Applicability dates*—(1) *In general*. Except as provided in paragraph (l)(2) of this section, this section applies to partnership taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***] and to taxable years of CAMT entities that are partners in which or with which such partnership taxable years end.

(2) *Exceptions*—(i) *Paragraph (d)*. Paragraph (d) of this section applies to taxable years of a CAMT entity ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

(ii) *Coordination with certain other provisions during prior years*—(A) *Information reporting during prior years*. A partnership must furnish to the IRS and any CAMT entity that is a partner in the partnership the information described in paragraphs (i)(1)(iv) and (v) of this section in a manner consistent with paragraphs (h) and (i) of this section.

(B) *Certain basis adjustments during prior years*. A CAMT entity that is a partner in a partnership must make adjustments to the CAMT basis in its partnership investment consistent with those described in paragraphs (j)(3)(v), (vii), (xi), and (xii) of this section.

(C) *Certain adjustments during prior years*. A CAMT entity's AFSI with respect to a partnership investment is determined without regard to any items included in the partnership's FSI that are described in §1.56A-4(c)(1)(i) or 1.56A-8(b)(2).

(iii) *Applicability dates for rules described in paragraph (l)(2)(ii)*. The following are the applicability dates for the rules described in paragraph (l)(2)(ii) of this section:

(A) Paragraph (l)(2)(ii)(A) of this section applies to taxable years of partnerships ending after September 13, 2024 and on or before [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***];

(B) Paragraph (l)(2)(ii)(B) of this section applies to taxable years of CAMT entities ending after September 13, 2024 and on or before [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***]; and

(C) Except as provided in paragraph (l)(2)(iii)(D) of this section, paragraph (l)(2)(ii)(C) of this section applies to taxable years of partnerships ending after September 13, 2024 and on or before [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

(D) When the items described in paragraph (l)(2)(ii)(C) of this section result from the occurrence of transfers (as defined in §1.56A-4(b)(3)), paragraph (l)(2)(ii)(C) of this section applies to transfers occurring after September 13, 2024 and on or before [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-6 AFSI adjustments with respect to controlled foreign corporations.

(a) *Overview*. This section provides rules under section 56A(c)(3) of the Code for determining adjustments to AFSI with respect to controlled foreign corporations. Paragraph (b) of this section provides rules for determining a CAMT entity's adjustment to AFSI with respect to controlled foreign corporations in which the CAMT entity is a United States shareholder. Paragraph (c) of this section provides rules for computing a controlled foreign corporation's adjusted net income or loss. Paragraph (d) of this section defines the type of dividends excluded from a controlled foreign corporation's adjusted net income or loss. Paragraph (e) of this section provides examples illustrating the application of the rules in this section. Paragraph (f) of this section provides the applicability date of this section.

(b) *Section 56A(c)(3) adjustment to AFSI*—(1) *Aggregate adjustment*. Except as provided under paragraph (b)(3) of this section, for any taxable year, a CAMT entity that is a United States shareholder of one or more controlled foreign corporations makes a single adjustment to its AFSI for its taxable year that is equal to the aggregate of its pro rata share of the adjusted net income or loss of each such controlled foreign corporation, with such aggregate amount reduced as provided under paragraphs (b)(2) and (4) of this section. The CAMT entity's pro rata share of the adjusted net income or loss of a controlled foreign corporation is determined for the taxable year of the controlled foreign corporation that ends with or within the taxable year of the CAMT entity and is determined under the principles of section 951(a)(2) of the

Code (including the aggregation rules in §1.958-1(d)).

(2) *Tax reduction*. An applicable corporation that does not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 for the taxable year reduces the amount of the adjustment otherwise determined under paragraph (b)(1) of this section by the amount that would be described in §1.59-4(d)(3) if the applicable corporation were to choose to have such benefits, reduced to reflect the suspensions and disallowances described in §1.59-4(b)(1) that apply at the level of the United States shareholder.

(3) *Aggregate negative adjustment.* If the adjustment determined under paragraph (b)(1) of this section with respect to a taxable year of a United States shareholder would be negative (after taking into account the reduction provided under paragraph (b)(2) of this section but before taking paragraph (b)(4) of this section into account), then there is no adjustment under paragraph (b)(1) of this section for the taxable year.

(4) *Reduction for utilization of a CFC adjustment carryover*. If the adjustment determined under paragraph (b)(1) of this section with respect to a taxable year of a United States shareholder would be positive (after taking into account the reduction provided under paragraph (b)(2) of this section but before taking this paragraph (b)(4) into account), then the adjustment under paragraph (b)(1) of this section (after taking into account the reduction provided under paragraph (b)(2) of this section) is reduced by the aggregate amount of CFC adjustment carryovers to the taxable year (as determined under paragraph (b)(5) of this section), but not below zero.

(5) *CFC adjustment carryover mechanics*. A CFC adjustment carryover for any taxable year (including a taxable year in which the corporation is not an applicable corporation) is carried forward to each taxable year following the taxable year in which the CFC adjustment carryover arose. The amount of a CFC adjustment carryover carried forward to a taxable year is the amount of the CFC adjustment carryover remaining (if any) after the application of paragraph (b)(4) of this section. CFC adjustment carryovers are used in the order of the taxable years in which the CFC adjustment carryovers arose. For purposes of determining the amount of a CFC adjustment carryover carried forward to the first taxable year a corporation is an applicable corporation (and any subsequent taxable year), paragraph (b)(4) of this section applies to reduce the CFC adjustment carryover in taxable years beginning after the taxable year the CFC adjustment carryover arose and before the first taxable year in which the corporation is an applicable corporation.

(6) *Definition of CFC adjustment carryover*. The term *CFC adjustment carryover* means, with respect to a United States shareholder for any taxable year ending after December 31, 2019, the amount of the negative adjustment, if any, described in paragraph (b)(3) of this section.

(7) *Tax consolidated groups*. Members of a tax consolidated group are treated as a single entity for purposes of this paragraph (b). *See also* §1.1502-56A(a)(2). For rules regarding the use of CFC adjustment carryovers by a tax consolidated group, *see* §1.1502-56A(h).

(c) *Computing the adjusted net income or loss of a controlled foreign corporation*—(1) *In general*. A controlled foreign corporation's adjusted net income or loss is equal to the controlled foreign corporation's FSI for the taxable year of the controlled foreign corporation, adjusted for all AFSI adjustments provided under the section 56A regulations, except as provided under paragraphs (c)(2) through (5) of this section. For purposes of determining a controlled foreign corporation's adjusted net income or loss, references to AFSI in other sections of the section 56A regulations, except for references to AFSI in §1.56A-1(b)(1) and (e), are treated as references to adjusted net income or loss. Adjusted net income or loss must be expressed in U.S. dollars. Any item included in adjusted net income or loss that is not expressed in U.S. dollars must be translated from the relevant currency to U.S. dollars using the relevant weighted average exchange rate, as defined in §1.989(b)-1, for the controlled foreign corporation's taxable year.

(2) *Adjustments relating to ownership of stock of a foreign corporation*—(i) *In general*. Adjustments in this paragraph (c)(2) apply in lieu of the adjustments described in §1.56A-4(c)(1) (providing adjustments to AFSI with respect to ownership of stock in a foreign corporation).

(ii) *Amounts relating to ownership of stock of a foreign corporation reflected in controlled foreign corporation's FSI*. Adjusted net income or loss of a controlled foreign corporation excludes any items of income, expense, gain, and loss resulting from ownership of stock of a foreign corporation, including acquiring or disposing of such stock, reflected in the controlled foreign corporation's FSI.

(iii) *Amounts relating to ownership of stock of a foreign corporation included for regular tax purposes*—(A) *In general*. Except as provided under paragraph (c)(2)(iii)(B) of this section, adjusted net income or loss of a controlled foreign corporation includes any items of income, deduction, gain, and loss resulting from the controlled foreign corporation's ownership of stock of a foreign corporation, including acquiring or transferring such stock, for regular tax purposes (taking into account section 961(c) of the Code).

(B) *Dividends received from another foreign corporation.* Adjusted net income or loss of a controlled foreign corporation does not include the amount of any dividend received from another foreign corporation to the extent the dividend is a CAMT excluded dividend as defined in paragraph (d) of this section.

(iv) *Stock of a foreign corporation owned by a partnership*. If a partnership directly owns stock of a foreign corporation, then in determining the adjusted net income or loss of a controlled foreign corporation that is a partner in the partnership (or an indirect partner, in the case of tiered partnerships), the partner takes into account the items described in paragraph (c)(2)(iii) of this section (including taking into account the exception provided in paragraph (c)(2)(iii)(B) of this section) that are allocated to the partner by the partnership for regular tax purposes.

(3) *Controlled foreign corporations engaged in a U.S. trade or business*. A controlled foreign corporation's adjusted net income or loss is not limited to amounts taken into account in determining AFSI under §1.56A-7 (providing that the AFSI of a foreign corporation is limited to income that is effectively connected with the conduct of a trade or business within the United States). If a controlled foreign

corporation is an applicable corporation, the controlled foreign corporation's adjusted net income or loss is reduced by the amount of AFSI of the controlled foreign corporation (such AFSI determined by taking §1.56A-7 into account).

(4) *Foreign income tax expense*. The AFSI adjustment provided under §1.56A-8(c) does not apply in computing a controlled foreign corporation's adjusted net income or loss.

(5) *FSNOL carryovers*. The AFSI adjustment provided under §1.56A-23(c) (providing a reduction to AFSI for FSNOL carryovers) does not apply in computing a controlled foreign corporation's adjusted net income or loss.

(d) *Definition of CAMT excluded dividend*. The term *CAMT excluded dividend* means a dividend received by a controlled foreign corporation to the extent the dividend is excluded from—

(1) The recipient controlled foreign corporation's gross income under section 959(b) of the Code; or

(2) Both—

(i) The recipient controlled foreign corporation's foreign personal holding company income under section 954(c)(3) (relating to certain income received from related persons) or 954(c)(6) (relating to certain amounts received from related controlled foreign corporations) of the Code; and

(ii) The recipient controlled foreign corporation's gross tested income under §1.951A-2(c)(1)(iv) (relating to dividends received from related persons).

(e) *Examples*. The following examples illustrate the application of the rules in this section. For purposes of these examples, no entity is a member of a tax consolidated group, each entities' functional currency is the U.S. dollar, and each entity uses the calendar year as its taxable year and for AFS purposes.

(1) *Example 1: Dividend received by a controlled foreign corporation from another controlled foreign corporation*—(i) *Facts*. X is a domestic corporation that owns all the stock of FC1, a controlled foreign corporation, which owns all the stock of FC2, a controlled foreign corporation. FC2 distributes $100x of earnings and profits described in section 959(c)(3) to FC1, and the dividend qualifies for the exception to foreign personal holding company income under section 954(c)(6) and the exception to gross tested income under §1.951A-2(c)(1)(iv). The $100x dividend received by FC1 does not result in any item of income, expense, gain, or loss being reflected in the FSI of FC1.

(ii) *Analysis*. Under paragraph (b)(1) of this section, X's AFSI includes the sum of X's pro rata shares of the adjusted net income or loss of each of FC1 and FC2, because X is a United States shareholder of FC1 and FC2, both of which are controlled foreign corporations. For purposes of computing FC1's adjusted net income or loss, there is no adjustment under paragraph (c)(2)(ii) of this section, because the dividend received by FC1 does not result in any item of income, expense, gain, or loss being reflected in the FSI of FC1. Under paragraph (c)(2)(iii) of this section, the entire dividend is excluded from FC1's adjusted net income or loss because the dividend is a CAMT excluded dividend. The dividend is a CAMT excluded dividend because the dividend qualifies for the exception to subpart F income under section 954(c)(6) and the exception to tested income under §1.951A-2(c)(1)(iv).

(2) *Example 2: Sale of stock of lower-tier controlled foreign corporation*—(i) *Facts*. The facts are the same as in paragraph (e)(1) of this section (*Example 1*), except that FC2 does not pay a dividend to FC1, and instead FC1 sells all the stock of FC2 to a third party for cash. For regular tax purposes, FC1 recognizes $100x of gain, all of which is recharacterized as a dividend under section 964(e)(1) of the Code and treated as subpart F income of FC1 under section 964(e)(4)(A)(i). Furthermore, under section 964(e)(4)(A)(iii), X qualifies for a $100x dividends-received deduction under section 245A of the Code. FC1's sale of the stock of FC2 results in $100x of gain being reflected in the FSI of FC1.

(ii) *Analysis*. Under paragraph (c)(2)(ii) of this section, the $100x of gain reflected in the FSI of FC1 is excluded from FC1's adjusted net income or loss. Under paragraph (c)(2)(iii) of this section, FC1's adjusted net income or loss includes the $100x of recharacterized dividend income because the dividend is included in FC1's subpart F income and therefore is not a CAMT excluded dividend. Under §1.56A-4(c)(1)(ii), X's AFSI is reduced by $100x as a result of the dividends-received deduction under section 245A.

(3) *Example 3: Controlled foreign corporation held through a partnership*—(i) *Facts*. X is a domestic corporation that owns 20% of the partnership interests in PRS, a domestic partnership. PRS owns all the stock of FC, a controlled foreign corporation. In Year 1, FC's adjusted net income or loss is $100x and X's pro rata share of FC's adjusted net income or loss is $20x.

(ii) *Analysis*. Under paragraph (b)(1) of this section, a CAMT entity's pro rata share of the adjusted net income or loss of a controlled foreign corporation is determined under the principles of section 951(a)(2). Under these principles, a partnership is not treated as owning stock of a controlled foreign corporation for purposes of determining pro rata share under paragraph (b)(1) of this section. *See* §§1.951-1(a)(4) (directing taxpayers to §1.958-1(d) for rules regarding the ownership of stock of a foreign corporation through a domestic partnership for purposes of section 951) and 1.958-1(d) (providing generally that for purposes of applying section 951, a domestic partnership is not treated as owning stock of a foreign corporation). Accordingly, PRS is not treated as owning stock of FC, and no adjustment is made to PRS's modified FSI under paragraph (b)(1) of this section. However, under paragraph (b)(1) of this section, in Year 1, X's AFSI includes X's pro rata share of the adjusted net income or loss of FC, because X is a United States shareholder of FC, a controlled foreign corporation. Therefore, in Year 1, X includes in its AFSI $20x of FC's adjusted net income or loss.

(f) *Applicability date*—(1) *In general*. Except as described in paragraph (f)(3) of this section, if the conditions described in paragraphs (f)(2)(i) and (ii) of this section are not satisfied, this section applies to taxable years of CAMT entities that are United States shareholders ending after September 13, 2024, and to taxable years of controlled foreign corporations that end with or within such taxable years.

(2) *Multiple United States shareholders with different taxable years.* Except as described in paragraph (f)(3) of this section, this section applies to taxable years of controlled foreign corporations ending after September 13, 2024, and to taxable years of CAMT entities that are United States shareholders in which or with which such taxable years end, if:

(i) More than one CAMT entity that is a United States shareholder but not a domestic partnership owns (within the meaning of section 958(a)) stock in the controlled foreign corporation; and

(ii) At least one, but not all, of the United States shareholders referred to in paragraph (f)(2)(i) has a taxable year ending after September 13, 2024 and the controlled foreign corporation's taxable year that ends with or within such taxable year ends on or before September 13, 2024.

(3) *Transactions involving foreign stock.* To the extent a controlled foreign corporation's adjusted net income or loss would include an item resulting from the occurrence of a transfer (as defined in §1.56A-4(b)(3)), this section applies to transfers occurring after September 13, 2024.

§1.56A-7 AFSI adjustments with respect to effectively connected income.

(a) *Overview*. This section provides rules under section 56A of the Code for determining the AFSI of a foreign corporation engaged in (or treated as engaged in) a trade or business within the United States. Paragraph (b) of this section provides rules under section 56A(c)(4) of the Code for determining a foreign corporation's AFSI. Paragraph (c) of this section

provides the applicability date of this section.

(b) *Adjusted financial statement income of foreign corporations*. A foreign corporation determines its AFSI by applying the principles of section 882 of the Code. The AFSI of a foreign corporation is adjusted to take into account only amounts and items of FSI that would be included in income effectively connected with the conduct of a trade or business within the United States or allowable as a deduction by such corporation for purposes of section 882(c) had such amount or item accrued for regular tax purposes in the taxable year.

(c) *Applicability date*. This section applies to taxable years of foreign corporations ending after September 13, 2024.

§1.56A-8 AFSI adjustments for certain Federal and foreign income taxes.

(a) *Overview*. This section provides rules under section 56A(c)(5) of the Code for adjusting AFSI with regard to certain income taxes. Paragraph (b) of this section provides general rules for adjusting AFSI with regard to certain income taxes. Paragraph (c) of this section provides a rule for applicable corporations that do not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 of the Code. Paragraph (d) of this section provides rules for determining if an income tax is considered to be taken into account in an AFS. Paragraph (e) of this section provides examples illustrating the application of the rules in this section. Paragraph (f) of this section provides the applicability date of this section.

(b) *AFSI adjustment for applicable income taxes*—(1) *In general*. AFSI is adjusted to disregard any applicable income taxes, as defined in paragraph (b)(2) of this section, that are taken into account (within the meaning of paragraph (d) of this section) in a CAMT entity's AFS.

(2) *Definition of applicable income taxes*. The term *applicable income taxes* means Federal income taxes and foreign income taxes that are taken into account (within the meaning of paragraph (d) of this section) in a CAMT entity's AFS as current tax expense (or benefit), as deferred tax expense (or benefit), or through increases or decreases to other AFS accounts of the CAMT entity (for example, AFS accounts used to account for FSI from investments in other CAMT entities, AFS accounts used to account for section 168 property, or AFS accounts used to account for other items of income and expense).

(c) *Applicable corporations that choose not to credit foreign income taxes*. An applicable corporation that does not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 for the taxable year reduces its AFSI for the taxable year by an amount equal to the deduction for foreign income taxes allowed to the applicable corporation for regular tax purposes under section 164 of the Code (taking into account all other relevant provisions) for the taxable year. For purposes of the immediately preceding sentence, foreign income taxes allowed to the applicable corporation for regular tax purposes include foreign income taxes paid or accrued by a disregarded entity if the applicable corporation is the owner for regular tax purposes, any creditable foreign tax expenditures (within the meaning of §1.704-1(b)(4)(viii)) of a partnership that are allocated to the applicable corporation as a partner or indirect partner in a tiered partnership, and any other foreign income taxes that are allocated to the applicable corporation as an owner of any other type of pass-through entity.

(d) *Requirements for an applicable income tax to be considered taken into account in an AFS*. For purposes of paragraph (b) of this section and §1.59-4, the following rules apply—

(1) Applicable income taxes are considered taken into account in an AFS of a CAMT entity if any journal entry has been recorded in the books and records used to determine an amount in the AFS of the CAMT entity for any year, or in another AFS that includes the CAMT entity, to reflect the taxes;

(2) Such applicable income taxes are considered taken into account in an AFS of a CAMT entity even if the taxes do not increase or decrease the CAMT entity's FSI at the time of the journal entry; and

(3) If applicable income taxes are taken into account in a partnership's AFS, they also are considered taken into account in any AFS of the partnership's partners.

(e) *Examples*. The following examples illustrate the application of the rules in this section. For purposes of these examples, each of X and Y is a domestic corporation that uses the calendar year as its taxable year and has a calendar-year financial accounting period.

(1) *Example 1*—(i) *Facts*. X does not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 for its 2024 taxable year. In 2024, X pays $200x of foreign income taxes to Country G, for which X claims a deduction for regular tax purposes under section 164. In X's 2024 AFS, X records a current foreign income tax expense of $200x for the foreign income taxes paid to Country G. X also records in its 2024 AFS a deferred Federal tax liability and deferred Federal income tax expense of $50x with respect to an installment sale that occurred in 2024.

(ii) *Analysis*. Under paragraph (b) of this section, X adjusts its AFSI to disregard the $200x of current foreign income tax expense for Country G taxes and the $50x of deferred Federal income tax expense from the installment sale that are reflected in X's FSI for the 2024 taxable year because both such taxes are applicable income taxes. If X is an applicable corporation for the 2024 taxable year, then for purposes of determining its tentative minimum tax under section 55(b)(2)(A) of the Code for the 2024 taxable year, X also reduces AFSI under paragraph (c) of this section by an amount equal to the $200x deduction for regular tax purposes under section 164 for the Country G taxes because X does not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 for the 2024 taxable year.

(2) *Example 2*—(i) *Facts*. X is an applicable corporation for its 2024 taxable year and chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for the 2024 taxable year. In 2024, X pays $100x of foreign income taxes to Country G for which X is eligible to claim a credit under section 901 of the Code. X also pays $75x of foreign income taxes to Country H, a country with which the United States has severed diplomatic relations. X is not allowed to claim a credit for the taxes paid to Country H under section 901(j) but is allowed to take a deduction for regular tax purposes under section 164 for those taxes. Both taxes are taken into account as current tax expense in X's 2024 AFS.

(ii) *Analysis*. In determining X's AFSI for its 2024 taxable year, under paragraph (b) of this section, X adjusts AFSI to disregard both the $100x of Country G taxes and the $75 of Country H taxes because both such taxes are applicable income taxes. Because X chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for the 2024 taxable year, paragraph (c) of this section does not apply and therefore X is not allowed to reduce AFSI by an amount equal to the deduction taken for the $75x of Country H taxes.

(3) *Example 3*—(i) *Facts*. X and Y are applicable corporations for the 2024 taxable year. X and Y each own a 50% interest in PRS, a domestic partnership that uses the calendar year as its taxable year. In 2024, PRS paid $300x of foreign income taxes to Country G, which PRS accounted for as a current tax expense on its AFS. The $300x of foreign income

taxes paid to Country G are creditable foreign tax expenditures (within the meaning of §1.704-1(b)(4)(viii)) of PRS. For the 2024 taxable year, X chooses to have the benefits of subpart A of part III of subchapter N of chapter 1, and therefore claims a credit under section 901 for the $150x of Country G taxes that are allocated to X as a partner. Y does not choose to have the benefits of subpart A of part III of subchapter N of chapter 1 for its 2024 taxable year, and therefore takes a deduction for regular tax purposes for the $150x of Country G taxes that are allocated to Y as a partner.

(ii) *Analysis*. For purposes of determining PRS's modified FSI under §1.56A-5(e)(3), PRS disregards the $300x of current tax expense for Country G taxes that are reflected in PRS's FSI. Under paragraph (c) of this section, Y (not PRS) reduces its AFSI by an amount equal to the $150x deduction for regular tax purposes under section 164 for the Country G taxes allocated to Y as a partner. Paragraph (c) of this section does not apply to X because X chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for its 2024 taxable year.

(f) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-9 AFSI adjustments for owners of disregarded entities or branches.

(a) *Overview*. This section provides rules under section 56A(c)(6) of the Code for determining the AFSI of a CAMT entity that owns a disregarded entity or branch.

(b) *Rules for determining the FSI and AFSI of a CAMT entity that owns a disregarded entity or branch*—(1) *In general*. A disregarded entity or branch and the CAMT entity that owns the disregarded entity or branch (including through other disregarded entities or branches) are treated as a single CAMT entity for purposes of the section 56A regulations. Thus, except as otherwise provided in the section 56A regulations (for example, in §1.56A-21), for purposes of the section 56A regulations, a CAMT entity that owns a disregarded entity or branch is treated as—

(i) Directly owning the assets of the disregarded entity or branch;

(ii) Being directly liable for the liabilities of the disregarded entity or branch; and

(iii) Directly earning or incurring any income, expense, gain, loss, or other similar item of the disregarded entity or branch.

(2) *Transactions disregarded*. For purposes of determining the FSI and AFSI of a CAMT entity that owns a disregarded entity or branch (CAMT entity owner)—

(i) Transactions between the disregarded entity or branch and the CAMT entity owner (or between disregarded entities or branches owned by the same CAMT entity owner) are disregarded; and

(ii) Any balance sheet account or income statement account that reflects the CAMT entity owner's investment in the disregarded entity or branch (or a disregarded entity's or branch's investment in another disregarded entity or branch that is ultimately owned by the same CAMT entity owner) is disregarded.

(3) *Certain disregarded entities or branches subject to the rules in §1.56A-2(h)*. If a disregarded entity or branch is required to determine its own AFS under §1.56A-2(h), then for purposes of the section 56A regulations, the CAMT entity that owns the disregarded entity or branch treats the separate AFS of the disregarded entity or branch (as determined under §1.56A-2(h)) as part of the CAMT entity's own AFS, and applies the rules of this section by reference to that separate AFS.

(c) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-10 AFSI adjustments for cooperatives.

(a) *Overview*. This section provides rules under section 56A(c)(7) of the Code for adjusting the AFSI of a cooperative.

(b) *AFSI adjustments for cooperatives*. In the case of a cooperative to which section 1381 of the Code applies, the AFSI of the cooperative is reduced by the amounts referred to in section 1382(b) of the Code and the regulations under section 1382(b) (relating to patronage dividends and per-unit retain allocations), but only to the extent such amounts were not otherwise taken into account in determining the AFSI of the cooperative.

(c) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-11 AFSI adjustments for Alaska Native Corporations.

(a) *Overview*. This section provides rules under section 56A(c)(8) of the Code for adjusting the AFSI of Alaska Native Corporations. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides rules for adjusting AFSI for cost recovery and depletion with respect to certain property held by an Alaska Native Corporation. Paragraph (d) of this section provides rules for adjusting AFSI for certain payments made by an Alaska Native Corporation. Paragraph (e) of this section provides the applicability date of this section.

(b) *Definitions*. For purposes of this section:

(1) *Alaska Native Corporation*. The term *Alaska Native Corporation* has the meaning provided in section 3 of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)).

(2) *ANCSA property*. The term *ANCSA property* means property the basis of which is determined under 43 U.S.C. 1620(c).

(3) *Specified payments*. The term *specified payments* means amounts payable made pursuant to 43 U.S.C. 1606(i) or (j).

(c) *Cost recovery and depletion*. The AFSI of an Alaska Native Corporation is—

(1) Reduced by cost recovery and depletion attributable to ANCSA property (including cost recovery that occurs as part of the computation of gain or loss) upon the disposition of ANCSA property) to the extent of the amount recovered for regular tax purposes for the taxable year; and

(2) Adjusted to disregard any cost recovery and depletion attributable to ANCSA property (including cost recovery that occurs as part of the computation of gain or loss upon the disposition of ANCSA property) reflected in the FSI of the Alaska Native Corporation.

(d) *Deduction for specified payments*. The AFSI of an Alaska Native Corporation is—

(1) Reduced by deductions for specified payments to the extent of the amount allowed as deduction for regular tax purposes for the taxable year; and

(2) Adjusted to disregard expenses or other FSI reductions reflected in the Alaska Native Corporation's FSI with respect to specified payments.

(e) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-12 AFSI adjustments with respect to certain tax credits.

(a) *Overview*. This section provides rules under section 56A(c)(9) of the Code for adjusting AFSI with regard to amounts described in section 56A(c)(9) and certain other amounts related to credits to which sections 48D, 6417, and 6418 of the Code apply. Paragraph (b) of this section provides rules for adjusting AFSI with regard to proceeds from credits to which sections 48D, 6417, and 6418 apply. Paragraph (c) of this section provides rules for adjusting the AFSI of a CAMT entity that acquires a credit to which section 6418 applies. Paragraph (d) of this section provides rules for adjusting AFSI with regard to amounts recaptured under sections 6417 and 6418. Paragraph (e) of this section provides the applicability date of this section.

(b) *Proceeds from certain credits excluded from AFSI*. AFSI is adjusted to disregard the following amounts, provided that any such amount (or portion thereof) is not otherwise disregarded under §1.56A-8—

(1) Any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under section 48D(d) or 6417;

(2) Any amount received from the transfer of an eligible credit, as defined in section 6418(f)(1)(A), that is not includible in the gross income of the CAMT entity by application of section 6418(b) or that is treated as tax exempt income under section 6418(c)(1)(A); and

(3) Any amount received pursuant to an election under section 48D(d)(2) or 6417(c) that is treated as tax exempt income under section 48D(d)(2)(A)(i)(III) or 6417(c)(1)(C).

(c) *Treatment of transferee taxpayer*. If a transferee taxpayer, as defined in section 6418(a), is a CAMT entity, AFSI is adjusted to disregard—

(1) Any amount paid by the transferee taxpayer to the eligible taxpayer, as defined in section 6418(f)(2), as consideration for the transfer of the eligible credit, as defined in section 6418(f)(1)(A), provided that the amount is not otherwise disregarded under §1.56A-8; and

(2) Any increase in the transferee taxpayer's FSI resulting from the utilization of the eligible credit, provided that the increase is not otherwise disregarded under §1.56A-8.

(d) *Recapture disregarded as expense in determining AFSI*. AFSI is adjusted to disregard any decrease in FSI resulting from an increase in tax under section 48D(d)(5), 50(a)(3), 6417(g), or 6418(g)(3) of the Code, provided that the decrease in FSI is not otherwise disregarded under §1.56A-8.

(e) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-13 AFSI adjustments for covered benefit plans.

(a) *Overview*. This section provides rules under section 56A(c)(11) of the Code for adjusting AFSI with respect to covered benefit plans. Paragraph (b) of this section provides for adjustments to AFSI with respect to covered benefit plans. Paragraph (c) of this section defines a covered benefit plan for purposes of this section. Paragraph (d) of this section provides the applicability date of this section.

(b) *Adjustments to AFSI for covered benefit plans*. AFSI is—

(1) Adjusted to disregard any amount of income, cost, expense, gain, or loss that otherwise would be included on a CAMT entity's AFS in connection with any covered benefit plan;

(2) Increased by any amount of income in connection with any covered benefit plan that is included in gross income for the taxable year under any provision of chapter 1; and

(3) Reduced by deductions allowed for the taxable year under any provision of chapter 1 with respect to any covered benefit plan.

(c) *Covered benefit plan*—(1) *General definition*. For purposes of section 56A(c)(11), a *covered benefit plan* is a plan described in paragraph (c)(2), (3), or (4) of this section.

(2) *Qualified defined benefit pension plan*. A plan is described in this paragraph (c)(2) if the plan is—

(i) A defined benefit plan for which the trust that is part of the plan is an employees' trust described in section 401(a) of the Code that is exempt from tax under section 501(a) of the Code; and

(ii) Not a multiemployer plan described in section 414(f) of the Code.

(3) *Qualified foreign plan*. A plan is described in this paragraph (c)(3) if the plan is a qualified foreign plan as defined in section 404A(e) of the Code.

(4) *Other defined benefit plan*. A plan is described in this paragraph (c)(4) if, under the accounting standards that apply to the AFS, the plan is treated as a defined benefit plan that provides post-employment benefits other than pension benefits.

(d) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-14 AFSI adjustments for tax-exempt entities.

(a) *Overview*. This section provides rules under section 56A(c)(12) of the Code for adjusting the AFSI of tax-exempt entities.

(b) *AFSI adjustments for tax-exempt entities*. In the case of an organization subject to tax under section 511 of the Code, AFSI is adjusted to take into account only the AFSI (if any) of an unrelated trade or business (as defined in section 513 of the Code) of such organization, subject to the modifications to unrelated business taxable income described in section 512(b) of the Code. AFSI determined under the preceding sentence includes any unrelated debt-financed income determined under section 514 of the Code. *See* section 512(b)(4).

(c) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-15 AFSI adjustments for section 168 property.

(a) *Overview*. This section provides rules under section 56A(c)(13) of the Code for determining AFSI adjustments with respect to section 168 property. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides rules for determining the extent to which property (or an expenditure with respect to property) is section 168 property. Paragraph (d) of this section provides rules for adjusting AFSI for depreciation and other amounts with respect to section 168 prop-

erty. Paragraph (e) of this section provides rules for adjusting AFSI upon the disposition of section 168 property. Paragraph (f) of this section provides the applicability date of this section.

(b) *Definitions*. For purposes of this section:

(1) *Covered book inventoriable depreciation*. The term *covered book inventoriable depreciation* means any of the following items that are included in inventoriable cost (or capitalized as part of the cost of non-inventory property held for sale) in a CAMT entity's AFS with respect to section 168 property—

(i) Depreciation expense;

(ii) Other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition of section 168 property occurs for regular tax purposes; or

(iii) Impairment loss reversal.

(2) *Covered book COGS depreciation*. The term *covered book COGS depreciation* means any of the following items that are taken into account as part of cost of goods sold (or as part of the computation of gain or loss from the sale or exchange of property held for sale) in FSI with respect to section 168 property—

(i) Depreciation expense;

(ii) Other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition of section 168 property occurs for regular tax purposes; or

(iii) Impairment loss reversal.

(3) *Covered book depreciation expense*. The term *covered book depreciation expense* means any of the following items other than covered book COGS depreciation that are taken into account in FSI with respect to section 168 property—

(i) Depreciation expense;

(ii) Other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition of section 168 property occurs for regular tax purposes; or

(iii) Impairment loss reversal.

(4) *Covered book expense*. The term *covered book expense* means an amount, other than covered book COGS depreciation and covered book depreciation expense, that—

(i) Reduces FSI; and

(ii) Is reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of section 168 property for regular tax purposes.

(5) *Deductible tax depreciation*. The term *deductible tax depreciation* means tax depreciation, as defined in paragraph (b)(8) of this section, that is allowed as a deduction in computing taxable income, including tax depreciation that is capitalized and subsequently recovered as a deduction in computing taxable income (even if the deduction is allowed under a provision of the Code other than section 167 of the Code).

(6) *Section 168 property*. The term *section 168 property* means property to which section 168 of the Code applies, as described in paragraph (c) of this section.

(7) *Tax COGS depreciation*. The term *tax COGS depreciation* means—

(i) Tax depreciation that is capitalized to inventory under section 263A of the Code and is recovered as part of cost of goods sold in computing gross income; and

(ii) Tax depreciation that is capitalized under section 263A to the basis of property described in section 1221(a)(1) of the Code that is not inventory and is recovered as part of the computation of gain or loss from the sale or exchange of such property in computing taxable income.

(8) *Tax depreciation*. The term *tax depreciation* means depreciation deductions allowed under section 167 with respect to section 168 property.

(9) *Tax depreciation section 481(a) adjustment*. The term *tax depreciation section 481(a) adjustment* means the net amount of the adjustments required under section 481(a) of the Code for a change in method of accounting for depreciation for any item of section 168 property. The term also includes an adjustment (or portion thereof) required under section 481(a) for any other change in method of accounting (other than a change in method of accounting described in paragraph (b)(10) of this section) that impacts the timing of taking into account depreciation with respect to section 168 property in computing taxable income (for example, a change in method of accounting involving a change from deducting depreciation with respect to section 168 property to capitalizing such depreciation under section 263A or another capitalization provision, or vice versa).

(10) *Tax capitalization method change*. The term *tax capitalization method change* means a change in method of accounting for regular tax purposes involving a change from capitalizing and depreciating costs as section 168 property (including costs that were capitalized to such property under section 263A or another capitalization provision) to deducting the costs (or vice versa).

(11) *Tax capitalization method change AFSI adjustment*. The term *tax capitalization method change AFSI adjustment* means an adjustment to AFSI that is required under paragraph (d)(1) of this section if a CAMT entity makes a tax capitalization method change. The tax capitalization method change AFSI adjustment is computed separately for each tax capitalization method change and equals the difference between the following amounts computed as of the beginning of the tax year of change—

(i) The cumulative amount of adjustments to AFSI under paragraph (d)(1) of this section with respect to the cost(s) subject to the tax capitalization method change that were made with respect to taxable years beginning after December 31, 2019, and before the tax year of change; and

(ii) The cumulative amount of adjustments to AFSI under paragraph (d)(1) of this section with respect to the cost(s) subject to the tax capitalization method change that would have been made with respect to taxable years beginning after December 31, 2019, and before the tax year of change, if the new method of accounting for the cost(s) had been applied for regular tax purposes in those taxable years.

(c) *Property to which section 168 applies*—(1) *In general*. For purposes of section 56A(c)(13) and this section, property to which section 168 applies consists of the following (but only to the extent provided in this paragraph (c))—

(i) MACRS property, as defined in §1.168(b)-1(a)(2), that is depreciable under section 168;

(ii) Computer software that is qualified property as defined in §1.168(k)-1(b)(1) or 1.168(k)-2(b)(1), as applicable, and depreciable under section 168; and

(iii) Other property depreciable under section 168 that is—

(A) Qualified property as defined in §1.168(k)-2(b)(1); and

(B) Described in §1.168(k)-2(b)(2)(i)(E), (F), or (G).

(2) *Property to which section 168 applies includes only the portion of property for which a depreciation deduction is allowable under section 167*. If a CAMT entity deducts or otherwise recovers the cost of property described in paragraph (c)(1) of this section (or a portion thereof) under sections 179, 179C, or 181 of the Code, or any similar provision, property to which section 168 applies is limited to the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of such property.

(3) *Deductible expenditures are not property to which section 168 applies*. Property to which section 168 applies does not include any expenditure (or portion thereof) that is deducted for regular tax purposes, even if the expenditure is made with respect to property to which section 168 applies. For example, an expenditure to repair property to which section 168 applies that is deducted for regular tax purposes but capitalized and depreciated as an improvement for FSI purposes is not property to which section 168 applies.

(4) *Property to which section 168 applies does not include property that is not depreciable under section 168 for regular tax purposes*. Except as provided in paragraph (c)(5) of this section, property to which section 168 applies does not include property that is not depreciable under section 168 for regular tax purposes. For example, if a foreign corporation other than a controlled foreign corporation is not subject to U.S. taxation, then property owned by the foreign corporation is not treated as property to which section 168 applies.

(5) *Effect of election out of additional first year depreciation*. Property to which section 168 applies includes property described in paragraph (c)(1) of this section regardless of whether the CAMT entity makes an election out of the additional first year depreciation deduction under section 168(k) with respect to such property.

(6) *Property placed in service in taxable years beginning before the CAMT effective date*. Notwithstanding §1.56A-1(d)(3), property to which section 168 applies includes property placed in service by the CAMT entity in any taxable year, including taxable years ending on or before December 31, 2019.

(d) *AFSI adjustments for depreciation and other amounts with respect to section 168 property*—(1) *In general*. The AFSI of a CAMT entity for a taxable year is—

(i) Reduced by tax COGS depreciation with respect to section 168 property, but only to the extent of the amount recovered—

(A) As part of cost of goods sold in computing gross income for the taxable year; or

(B) As part of the computation of gain or loss from the sale or exchange of non-inventory property described in section 1221(a)(1) that is included in taxable income, or deducted in computing taxable income, respectively, for the taxable year;

(ii) Reduced by deductible tax depreciation with respect to section 168 property, but only to the extent of the amount allowed as a deduction in computing taxable income for the taxable year;

(iii) Adjusted to disregard covered book COGS depreciation, covered book depreciation expense, covered book expense, and amounts described in paragraph (e)(6) of this section with respect to section 168 property, including section 168 property placed in service for regular tax purposes in a taxable year subsequent to the taxable year the property is treated as placed in service for AFS purposes;

(iv) Reduced by any tax depreciation section 481(a) adjustment with respect to section 168 property that is negative, but only to the extent of the amount of the adjustment that is taken into account in computing taxable income for the taxable year;

(v) Increased by any tax depreciation section 481(a) adjustment with respect to section 168 property that is positive, but only to the extent of the amount of the adjustment that is taken into account in computing taxable income for the taxable year;

(vi) Increased or decreased, as appropriate, by any tax capitalization method change AFSI adjustment in accordance with paragraph (d)(4) of this section; and

(vii) Adjusted for other items as provided in IRB guidance the IRS may publish.

(2) *Special rules for section 168 property held by a partnership*—(i) *In general*. If section 168 property is held by a partnership, *see* §1.56A-5(e) for the manner in which the adjustments provided in paragraph (d)(1) of this section are taken into account by the partnership and its CAMT entity partners under the applicable method described in §1.56A-5(c).

(ii) *Basis adjustment under section 743(b) of the Code*. If section 168 property is held by a partnership, the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section do not include amounts resulting from any basis adjustment under section 743(b) of the Code attributable to the section 168 property that are treated as increases or decreases to tax depreciation or a tax depreciation section 481(a) adjustment for regular tax purposes. *See* §1.743-1(j)(4). Instead, such amounts resulting from any basis adjustment under section 743(b) attributable to the section 168 property that would have been included in the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section are separately stated to the CAMT entity partners under §1.56A-5(e)(4)(i) and are taken into account by the CAMT entity partners in the manner provided in §1.56A-5(e)(4)(ii)(A).

(iii) *Basis adjustment under section 734(b) of the Code*. If section 168 property is held by a partnership, the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section include amounts resulting from any basis adjustment under section 734(b) of the Code attributable to the section 168 property that are treated as increases or decreases to tax depreciation or a tax depreciation section 481(a) adjustment for regular tax purposes. *See* §1.734-1(e).

(iv) *Basis adjustment under* §1.1017-1(g)(2). If section 168 property is held by a partnership, the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section do not include any decreases in tax depreciation or income amounts for regular tax purposes, as applicable, resulting from any basis adjustment under §1.1017-1(g)(2) attributable to section 168 property (as calculated

under §1.743-1(j)(4)(ii)). Instead, such decreases in tax depreciation or income amounts, as applicable, resulting from any basis adjustment under §1.1017-1(g)(2) attributable to section 168 property that would have been included in the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section are separately stated to the CAMT entity partners under §1.56A-5(e)(4)(i) and are taken into account by the CAMT entity partners in the manner provided in §1.56A-5(e)(4)(ii)(A).

(3) *Special rules for determining tax COGS depreciation and covered book COGS depreciation adjustments*—(i) *In general.* Except as provided in paragraph (d)(3)(ii) of this section, a CAMT entity is required—

(A) To apply the method(s) of accounting under section 263A that the CAMT entity uses for regular tax purposes (and, in the case of inventory property, the method(s) of accounting that the CAMT entity uses to identify and value inventories under sections 471 and 472 of the Code) to determine the tax COGS depreciation adjustments under paragraph (d)(1)(i) of this section; and

(B) To apply the method(s) of accounting the CAMT entity uses for FSI purposes to determine the covered book COGS depreciation adjustments under paragraph (d)(1)(iii) of this section.

(ii) *Simplifying methods*. A CAMT entity is permitted to use the simplifying methods of determining depreciation in ending inventory provided in this paragraph (d)(3)(ii) to determine the tax COGS depreciation and covered book COGS depreciation adjustments under paragraphs (d)(1)(i) and (iii) of this section, respectively.

(A) *Tax depreciation in inventory for FIFO method taxpayers.* For a CAMT entity that uses the First-In-First-Out (FIFO) method to identify inventories for regular tax purposes, the tax depreciation in additional section 263A costs in ending inventory may be computed by multiplying the section 471 costs in ending inventory by the ratio of the tax depreciation in additional section 263A costs incurred during the taxable year to the section 471 costs incurred during the taxable year (tax depreciation absorption ratio). *See* §1.263A-1(d)(2) and (3), respectively, for the definitions of section 471 costs and additional section 263A costs.

(B) *Tax depreciation in inventory for LIFO method taxpayers*. For a CAMT entity that uses the LIFO method to identify inventories for regular tax purposes, the tax depreciation in section 471 costs in a LIFO increment may be computed by multiplying the tax depreciation in section 471 costs incurred during the taxable year by the ratio of the section 471 costs in the increment to the section 471 costs incurred during the taxable year (tax increment to current-year cost ratio). The tax depreciation in additional section 263A costs in a LIFO increment may be computed by multiplying the tax depreciation in additional section 263A costs incurred during the taxable year by the tax increment to current-year cost ratio. The total tax depreciation that remains in a LIFO increment after a decrement is determined by multiplying the tax depreciation in the section 471 costs and the tax depreciation in additional section 263A costs in the LIFO increment before the decrement by the ratio of the section 471 costs in the increment after the decrement to the section 471 costs in the LIFO increment before the decrement. *See* §1.263A-1(d)(2) and (3), respectively, for the definitions of section 471 costs and additional section 263A costs.

(C) *Covered book inventoriable depreciation in inventory for LIFO method taxpayers*. For a CAMT entity that uses the LIFO method to identify inventories for AFS and FSI purposes, the covered book inventoriable depreciation in a LIFO increment may be computed by multiplying the covered book inventoriable depreciation incurred during the taxable year by the ratio of inventoriable costs in the increment in the CAMT entity's AFS to the inventoriable costs incurred during the taxable year in the CAMT entity's AFS (book increment to current-year cost ratio). The covered book inventoriable depreciation that remains in a LIFO increment after a decrement is determined by multiplying the covered book inventoriable depreciation in the LIFO increment before the decrement by the ratio of the inventoriable costs in the increment after the decrement to the inventoriable costs in the LIFO increment before the decrement.

(4) *Adjustment period for tax capitalization method change AFSI adjustments*. A tax capitalization method change AFSI adjustment that is negative reduces AFSI under paragraph (d)(1)(vi) of this section in the tax year of change by the full amount of the adjustment. A tax capitalization method change AFSI adjustment that is positive increases AFSI under paragraph (d)(1)(vi) of this section ratably over four taxable years beginning with the tax year of change. For purposes of this paragraph (d)(4), if any taxable year during the four-year spread period for a tax capitalization method change AFSI adjustment that is positive is a short taxable year, the CAMT entity takes the adjustment into account as if that short taxable year were a full 12-month taxable year. If, in any taxable year, a CAMT entity ceases to engage in the trade or business to which the tax capitalization method change AFSI adjustment relates, the CAMT entity includes in AFSI for such taxable year any portion of the adjustment not included in AFSI for a previous taxable year.

(5) *Examples*. The following examples illustrate the application of the rules in this paragraph (d). For purposes of paragraphs (d)(5)(i) through (viii) of this section *(Examples 1 through 8),* each of X and Y is a corporation that uses the calendar year as its taxable year and has a calendar-year financial accounting period. Unless otherwise stated, each of X and Y has elected out of additional first year depreciation under section 168(k), and the tax depreciation with respect to any section 168 property is not required to be capitalized under any capitalization provision in the Code.

(i) *Example 1*: *Tax COGS depreciation and covered book COGS depreciation adjustments under FIFO method*—(A) *General facts*. X is a manufacturer that uses the FIFO method to identify inventories and values inventories at the lower of cost or market for regular tax and FSI purposes. X uses the simplified service cost method to determine capitalizable mixed service costs under §1.263A-1(h) and the modified simplified production method to allocate additional section 263A costs to ending inventory under §1.263A-2(c)(3). X determines both the type and amount of section 471 costs by reference to its financial statements in accordance with §1.263A-1(d)(2)(iii)(A). All depreciation for regular tax and FSI purposes is attributable to section 168 property. There were no write downs of inventory for regular tax purposes and no disposition or book impairment losses for FSI purposes in 2024. X uses the same method(s) of allocating section 471 costs to ending inventory for regular tax purposes that it uses to allo-

cate inventoriable costs to ending inventory for AFS purposes, so the tax depreciation in section 471 costs in ending inventory and the covered book inventoriable depreciation in ending inventory are equal.

(B) *Facts: Beginning inventory for 2024.* X's beginning inventory for 2024 is $2,500,000x, consisting of $2,000,000x of section 471 costs and $500,000x of additional section 263A costs. The section 471 costs in beginning inventory include $100,000x of book depreciation based on X's financial statement method of accounting. The additional section 263A costs in beginning inventory include $10,000x of tax depreciation computed under the simplifying method in paragraph (d)(3)(ii) of this section for the preceding year.

(C) *Facts: Current-year costs for 2024*. During 2024, X incurs $11,000,000x of inventoriable costs, consisting of $10,000,000x of section 471 costs and $1,000,000x of additional section 263A costs. The section 471 costs include $500,000x of book depreciation based on X's financial statement method of accounting and the additional section 263A costs include $40,000x of tax depreciation, which is comprised of book depreciation in capitalizable mixed service costs determined under the simplified service cost method, as well as the excess of tax depreciation over book depreciation under §1.263A-1(d)(2)(iii)(B) related to the book depreciation in section 471 costs and capitalizable mixed service costs.

(D) *Facts: Ending inventory for 2024*. X's ending inventory for 2024 is $3,300,000x, consisting of $3,000,000x of section 471 costs and $300,000x of additional section 263A costs computed under the modified simplified production method. The section 471 costs include $150,000x of book depreciation based on X's financial statement method of accounting.

(E) *Facts: Cost of goods sold for 2024*. X's cost of goods sold for 2024 is $10,200,000x ($2,500,000x beginning inventory + $11,000,000x inventoriable costs incurred during the year - $3,300,000x ending inventory).

(F) *Analysis: Ending inventory for 2024.* X determines the tax depreciation in additional section 263A costs in ending inventory for 2024 using the simplifying method in paragraph (d)(3)(ii)(A) of this section as follows: X's tax depreciation absorption ratio is 0.4% ($40,000x tax depreciation in additional section 263A costs incurred during the year / $10,000,000x section 471 costs incurred during the year) and its tax depreciation in additional section 263A costs in ending inventory is $12,000x (tax depreciation absorption ratio of 0.4% x $3,000,000x of section 471 costs remaining in ending inventory).

(G) A*nalysis: Taxable year 2024: Tax COGS depreciation.* X's tax COGS depreciation for 2024 is $488,000x ($100,000x tax depreciation in section 471 costs in beginning inventory + $10,000x tax depreciation in additional section 263A costs in beginning inventory + $500,000x tax depreciation in section 471 costs incurred during the year + $40,000x tax depreciation in additional section 263A costs incurred during the year - $150,000x tax depreciation in section 471 costs in ending inventory - $12,000x of tax depreciation in additional section 263A costs in ending inventory). Pursuant to paragraph (d)(1)(i)(A) of this section, X reduces AFSI by $488,000x, the tax COGS depreciation for taxable year 2024.

(H) *Analysis: Taxable year 2024: Covered book COGS depreciation.* X's covered book COGS depreciation for 2024 is $450,000x ($100,000x covered book inventoriable depreciation in beginning inventory + $500,000x covered book inventoriable depreciation incurred during the year - $150,000x covered book inventoriable depreciation in ending inventory). Pursuant to paragraph (d)(1)(iii) of this section, X adjusts AFSI to disregard the covered book COGS depreciation by increasing AFSI by $450,000x for 2024.

(ii) *Example 2: Tax COGS depreciation and covered book COGS depreciation adjustments under LIFO method*—(A) *General facts*. The facts are the same as in paragraph (d)(5)(i) of this section (*Example 1*), except that X uses the same dollar-value LIFO method to identify inventory for regular tax and AFS purposes. X uses the simplifying method in paragraph (d)(3)(ii)(B) of this section to determine the tax depreciation in section 471 costs and the tax depreciation in additional section 263A costs in its LIFO increments for purposes of computing tax COGS depreciation. X also uses the simplifying method in paragraph (d)(3)(ii)(C) of this section to determine the covered book inventoriable depreciation in its LIFO increments for purposes of computing covered book COGS depreciation. Based on X's methods of accounting for determining and allocating section 471 costs for regular tax purposes described in paragraph (d)(5)(i) of this section (*Example 1*), X's section 471 costs (including tax depreciation) incurred for the taxable year and X's inventoriable costs (including covered book inventoriable depreciation) incurred for the taxable year in X's AFS are equal, and X's section 471 costs (including tax depreciation) in any LIFO increment and the inventoriable costs (including covered book inventoriable depreciation) in such increment in X's AFS are equal.

(B) *Facts: Beginning inventory for 2024.* X's beginning inventory for 2024 is $2,500,000x, consisting of a base layer of $2,000,000x and a 2023 increment of $500,000x. The base layer consists of $1,800,000x of section 471 costs and $200,000x of additional section 263A costs and the 2023 increment consists of $450,000x of section 471 costs and $50,000x of additional section 263A costs. The base layer includes $100,000x of tax depreciation ($90,000x of tax depreciation in section 471 costs + $10,000x of tax depreciation in additional section 263A costs) and the 2023 increment includes $25,000x of tax depreciation ($22,500x of tax depreciation in section 471 costs + $2,500x of tax depreciation in additional section 263A costs), computed under the simplifying method in paragraph (d)(3)(ii)(B) of this section for the preceding year. The covered book inventoriable depreciation in X's beginning inventory for 2024 computed under the simplifying method in paragraph (d)(3)(ii)(C) of this section equals the tax depreciation in section 471 costs in X's beginning inventory for 2024 computed under the simplifying method in paragraph (d)(3)(ii)(B) of this section (that is, the covered book inventoriable depreciation in the base layer equals $90,000x and covered book inventoriable depreciation in the 2023 increment equals $22,500x).

(C) *Facts: Current-year costs for 2024*. During 2024, X incurs $11,000,000x of inventoriable costs, consisting of $10,000,000x of section 471 costs and $1,000,000x of additional section 263A costs. The section 471 costs include $500,000x of book depreciation based on X's financial statement method of accounting and the additional section 263A costs include $40,000x of tax depreciation, which includes book depreciation in capitalizable mixed service costs determined under the simplified service cost method, as well as for the excess of tax depreciation over book depreciation under §1.263A-1(d)(2)(iii)(B) related to the book depreciation in section 471 costs and capitalizable mixed service costs.

(D) *Facts: Ending inventory for 2024*. X's ending inventory for 2024 is $2,750,000x, consisting of the base layer of $2,000,000x, the 2023 increment of $500,000x, and a 2024 increment of $250,000x. The 2024 increment consists of $225,000x of section 471 costs and $25,000x of additional section 263A costs.

(E) *Facts: Cost of goods sold for 2024*. X's cost of goods sold for 2024 is $10,750,000x ($2,500,000x beginning inventory + $11,000,000x inventoriable costs incurred during the year - $2,750,000x ending inventory).

(F) *Analysis: Ending inventory for 2024.* X determines the tax depreciation in section 471 costs and the tax depreciation in additional section 263A costs in the 2024 increment under the simplifying method in paragraph (d)(3)(ii)(B) of this section as follows: X computes a tax increment to current-year cost ratio of 2.25% by dividing the section 471 costs in the increment, or $225,000x, by the section 471 costs incurred during the year, or $10,000,000x. X determines the tax depreciation in section 471 costs for the 2024 increment of $11,250x by multiplying the tax increment to current-year cost ratio, or 2.25%, by the tax depreciation in section 471 costs incurred during the year, or $500,000x. X determines the tax depreciation in additional section 263A costs for the 2024 increment of $900x by multiplying the tax increment to current-year cost ratio, or 2.25%, by the tax depreciation in additional section 263A costs incurred during the year, or $40,000x. X determines the covered book inventoriable depreciation in the 2024 increment under the simplifying method in paragraph (d)(3)(ii)(C) of this section as follows: X computes a book increment to current-year cost ratio of 2.25% by dividing the inventoriable costs in the increment in X's AFS, or $225,000x, by the inventoriable costs incurred during the taxable year in X's AFS, or $10,000,000x. X determines the covered book inventoriable depreciation for the 2024 increment of $11,250x by multiplying the book increment to current-year cost ratio, or 2.25%, by covered book inventoriable depreciation incurred for the year, or $500,000x.

(G) *Analysis: Taxable year 2024: Tax COGS depreciation.* X's tax COGS depreciation for 2024 of $527,850x is equal to the tax depreciation in section 471 costs in beginning inventory of $112,500x ($90,000x from the base layer + $22,500x from the 2023 increment), plus the tax depreciation in additional section 263A costs in beginning inventory of $12,500x ($10,000x from the base layer + $2,500x from the 2023 increment), plus the $500,000x of tax depreciation in section 471 costs incurred during the year, plus the $40,000x of tax depreciation in

additional section 263A costs incurred during the year, less the tax depreciation in section 471 costs in ending inventory of $123,750x ($90,000x from the base layer + $22,500x from the 2023 increment + $11,250x from the 2024 increment), less the tax depreciation in additional section 263A costs in ending inventory of $13,400x ($10,000x from the base layer + $2,500x from the 2023 increment + $900x from the 2024 increment). Pursuant to paragraph (d)(1)(i)(A) of this section, X reduces AFSI by $527,850x, the tax COGS depreciation for taxable year 2024.

(H) *Analysis: Taxable year 2024: Covered book COGS depreciation.* X's covered book COGS depreciation for 2024 of $488,750x is equal to the covered book inventoriable depreciation in beginning inventory of $112,500x ($90,000x from the base layer + $22,500x from the 2023 increment), plus the $500,000x of covered book inventoriable depreciation incurred during the year, less the $123,750x of covered book inventoriable depreciation in ending inventory ($90,000x from the base layer + $22,500x from the 2023 increment + $11,250x from the 2024 increment). Pursuant to paragraph (d)(1)(iii) of this section, X adjusts AFSI to disregard the covered book COGS depreciation by increasing AFSI by $488,750x for 2024.

(iii) *Example 3: Tax COGS depreciation and covered book COGS depreciation adjustments under LIFO method*—(A) *General facts.* The facts are the same as in paragraph (d)(5)(ii) of this section (*Example 2*), except that X continues to use the dollar-value LIFO method for regular tax and AFS purposes for 2025.

(B) *Facts: Current-year costs for 2025*. During 2025, X incurs $13,250,000x of inventoriable costs, consisting of $12,000,000x of section 471 costs and $1,250,000x of additional section 263A costs. The section 471 costs include $750,000x of book depreciation based on X's financial statement method of accounting and the additional section 263A costs include $100,000x of tax depreciation which is comprised of book depreciation in capitalizable mixed service costs determined under the simplified service cost method and a positive book-to-tax adjustment for the excess of tax depreciation over book depreciation under §1.263A-1(d)(2)(iii)(B) related to the book depreciation in section 471 costs and capitalizable mixed service costs.

(C) *Facts: Ending inventory for 2025*. X incurs a LIFO decrement in 2025 that eliminates the entire 2024 increment and a portion of the 2023 increment. X's ending inventory is $2,250,000x, consisting of the base layer of $2,000,000x and a remaining 2023 increment of $250,000x. The base layer consists of $1,800,000x of section 471 costs and $200,000x of additional section 263A costs. The remaining portion of the 2023 increment consists of $225,000x of section 471 costs and $25,000x of additional section 263A costs.

(D) *Facts: Cost of goods sold for 2025*. X's cost of goods sold for 2025 is $13,750,000x ($2,750,000x beginning inventory + $13,250,000x inventoriable costs incurred during the year - $2,250,000x ending inventory).

(E) *Analysis: Ending inventory for 2025.* X determines the tax depreciation in section 471 costs and the tax depreciation in additional section 263A costs that remain in the 2023 increment under the simplifying method in paragraph (d)(3)(ii)(B) of this section as follows: After taking into account the 2025 decrement, 50% of the 2023 increment remains ($225,000x of section 471 costs in the increment after the decrement / $450,000x of section 471 costs in the increment before the decrement). The tax depreciation in section 471 costs that remains in the 2023 increment is $11,250x (50% surviving proportion of the increment x $22,500x tax depreciation in section 471 costs in the 2023 increment before the decrement). X's tax depreciation in additional section 263A costs that remains in the 2023 increment is $1,250x (50% surviving proportion of the increment x $2,500x tax depreciation in additional section 263A costs in the 2023 increment before the decrement, or $2,500x). X determines the covered book inventoriable depreciation that remains in the 2023 increment under the simplifying method in paragraph (d)(3)(ii)(C) of this section as follows: After taking into account the 2025 decrement, 50% of the 2023 increment remains ($225,000x of inventoriable costs in the increment in X's AFS after the decrement / $450,000x of inventoriable costs in the increment before the decrement). The covered book inventoriable depreciation that remains in the 2023 increment is $11,250x (50% surviving proportion of the increment x $22,500x of covered book inventoriable depreciation in the 2023 increment before the decrement).

(F) *Analysis: Taxable year 2025: Tax COGS depreciation.* X's tax COGS depreciation for 2025 of $874,650x is equal to the tax depreciation in section 471 costs in beginning inventory of $123,750 ($90,000x from the base layer + $22,500x from the 2023 increment + $11,250x from the 2024 increment), plus the tax depreciation in additional section 263A costs in beginning inventory of $13,400x ($10,000x from the base layer + $2,500x from the 2023 increment + $900x from the 2024 increment), plus $750,000x of tax depreciation in section 471 costs incurred during the year, plus $100,000x of tax depreciation in additional section 263A costs incurred during the year, less the tax depreciation in section 471 costs in ending inventory of $101,250x ($90,000x from the base layer + $11,250x from the 2023 increment), less the tax depreciation in additional section 263A costs in ending inventory of $11,250x ($10,000x from the base layer + $1,250x from the 2023 increment). Pursuant to paragraph (d)(1)(i)(A) of this section, B reduces AFSI by $874,650x, the tax COGS depreciation for taxable year 2025.

(G) *Analysis: Taxable year 2025: Covered book COGS depreciation.* X's covered book COGS depreciation for 2025 of $772,500x is equal to the covered book inventoriable depreciation in beginning inventory of $123,750x ($90,000x from the base layer + $22,500x from the 2023 increment + $11,250x from the 2024 increment), plus the $750,000x of covered book inventoriable depreciation incurred during the year, less $101,250x of covered book inventoriable depreciation in ending inventory ($90,000x from the base layer + $11,250x from the 2023 increment). Pursuant to paragraph (d)(1)(iii) of this section, X adjusts AFSI to disregard the covered book COGS depreciation by increasing AFSI by $772,500x for 2025.

(iv) *Example 4: Net positive tax depreciation section 481(a) adjustment*—(A) *Facts*. Y timely files a Form 3115, *Application for Change in Accounting Method*, under Rev. Proc. 2015-13 (2015-5 I.R.B. 419) for the calendar year ending December 31, 2024, to change its method of accounting for depreciation for an item of section 168 property, and the Commissioner consents to the change. The adjustment required under section 481(a) to implement the change is positive because the total amount of depreciation taken by Y with respect to the section 168 property under its present method was $1,000x greater than the total amount of depreciation allowable under the new method of accounting. Y takes the $1,000x net positive section 481(a) adjustment into account in computing taxable income ratably over the section 481(a) adjustment period of 4 taxable years, beginning with the year of change (2024 through 2027).

(B) *Analysis: Taxable years 2024 through 2027*. Pursuant to paragraph (d)(1)(v) of this section, Y takes the $1,000x net positive tax depreciation section 481(a) adjustment into account in determining AFSI under section 56A(c)(13) for taxable years 2024 through 2027. Because the adjustment is positive, A increases AFSI by $250x each year.

(v) *Example 5*: *Change in method of accounting to treat the replacement of a portion of section 168 property as a deductible repair*—(A) *Facts: Taxable years 2024 through 2026*. On January 1, 2024, Y replaces a component of section 168 property (replacement property), at a cost of $10,000x. For regular tax purposes, Y capitalized the cost of the replacement property and depreciates it under the general depreciation system by using the 200 percent declining balance method, the half-year convention, and a 5-year recovery period. For regular tax purposes, Y claims $2,000x ($10,000x cost x 20%) of deductible tax depreciation in 2024, $3,200x ($10,000x x 32%) of deductible tax depreciation in 2025, and $1,920x ($10,000x x 19.2%) of deductible tax depreciation in 2026. For AFS purposes, Y depreciates the replacement property over 10 years using the straight-line method and the half-year convention. Y takes into account $500x ($10,000x cost / 10 years / 2) of covered book depreciation expense in 2024, and $1,000x ($10,000x cost / 10 years) of covered book depreciation expense in each of 2025 and 2026.

(B) *Facts: Taxable year 2027*. Y timely files a Form 3115, *Application for Change in Accounting Method*, under Rev. Proc. 2015-13 for the calendar year ending December 31, 2027, to change its method of accounting from capitalizing and depreciating the cost of the replacement property to deducting those costs as a repair under section 162, and the Commissioner consents to the change. The section 481(a) adjustment to implement the method change is negative $2,880x (the difference between the total amount of tax depreciation Y claimed under its present method of $7,120x ($2,000x + $3,200x + $1,920x) and the $10,000x repair expense deductible under Y's new method of accounting). Y takes the $2,880x negative section 481(a) adjustment into account in computing taxable income for regular tax purposes in 2027, the year of change.

(C) *Analysis: Adjustment to AFSI under paragraph (d)(1) of this section*. Because repair expendi-

tures deductible under section 162 are not property to which section 168 applies, the replacement property is no longer section 168 property. Accordingly, the negative section 481(a) adjustment of $2,880x does not reduce AFSI for 2027 under paragraph (d)(1)(ii) or (iv) of this section because the negative section 481(a) adjustment is neither tax depreciation nor a tax depreciation section 481(a) adjustment (that is, it is not attributable to change in method of accounting for depreciation with respect to section 168 property). Further, except as provided in the analysis in paragraph (d)(5)(v)(D) of this section, beginning in 2027, Y will not make any other AFSI adjustments under paragraph (d)(1) of this section with respect to the replacement property because, following the accounting method change, the replacement property is not section 168 property.

(D) *Analysis: Tax capitalization method change AFSI adjustment*. The change in method of accounting implemented by Y for its taxable year ending December 31, 2027, is a tax capitalization method change. Accordingly, Y must compute and take into account the corresponding tax capitalization method change AFSI adjustment under paragraph (d)(1)(vi) of this section. The tax capitalization method change AFSI adjustment is $4,620x, and is computed as the difference between the amount determined under paragraph (b)(11)(i) of this section of $4,620x (the cumulative amount of deductible tax depreciation taken into account under paragraph (d)(1)(ii) of this section with respect to taxable years ending on or after December 31, 2019, and before the tax year of change, of $7,120x ($2,000x + $3,200x + $1,920x), less the cumulative amount of covered book depreciation expense that was disregarded under paragraph (d)(1)(iii) of this section with respect to taxable years ending on or after December 31, 2019, and before the tax year of change, of $2,500x ($500x + $1,000x + $1,000x)), and the amount determined under paragraph (b)(11)(ii) of this section of $0x (following the tax capitalization method change, the replacement property is not section 168 property and, therefore, no adjustments under paragraph (d)(1) of this section would have been required with respect to taxable years ending on or after December 31, 2019, and before the tax year of change under the new method of accounting). Under paragraphs (d)(1)(vi) and (d)(4) of this section, Y takes the $4,620x positive tax capitalization method change AFSI adjustment into account as an increase to AFSI ratably over four taxable years beginning in 2027.

(vi) *Example 6: Change in method of accounting to capitalize costs to section 168 property as required under section 263A*—(A) *Facts: Taxable years 2024 through 2026.* During 2024, Y produces and places in service section 168 property with a cost of $20,000x. For regular tax purposes, Y depreciates the section 168 property under the general depreciation system by using the 200 percent declining balance method, the half-year convention, and a 5-year recovery period. For regular tax purposes, Y claims $4,000x ($20,000x cost x 20%) of deductible tax depreciation in 2024, $6,400 ($20,000x x 32%) of deductible tax depreciation in 2025, and $3,840 ($20,000x x 19.2%) of deductible tax depreciation in 2026. For AFS purposes, Y depreciates the section 168 property over 10 years using the straight-line method and the half-year convention. Y takes into account in its FSI $1,000x ($20,000x cost / 10 years / 2) of covered book depreciation expense for 2024 and $2,000x ($20,000x cost / 10 years) of covered book depreciation expense for each of 2025 and 2026. Further, Y deducts $10,000x of general and administrative costs in computing taxable income for 2024 consistent with its established method of accounting for regular tax purposes with respect to those costs. Y also takes into account the $10,000x of general and administrative costs as an expense in its FSI for 2024.

(B) *Facts: Taxable year 2027.* During 2027, Y determines that the $10,000x of general and administrative costs deducted in computing taxable income for 2024 were incurred by reason of the production of the section 168 property Y produced and placed in service in 2024, and therefore Y should have capitalized the $10,000x of general and administrative costs to the basis of the section 168 property under section 263A and depreciated those costs under sections 167 and 168. Accordingly, Y timely files a Form 3115, *Application for Change in Accounting Method*, under Rev. Proc. 2015-13 for its taxable year ending December 31, 2027, to change its method of accounting to capitalize and depreciate the $10,000x of general and administrative costs as part of the basis of the corresponding section 168 property. The Commissioner consents to the change. The section 481(a) adjustment required to implement the method change is positive $2,880x (the difference between the amount of the general and administrative costs Y deducted under its present method of accounting prior to the tax year of change of $10,000x, and the amount that would have been deducted under Y's proposed method of accounting prior to the tax year of change of $7,120x (this amount equals the deductible tax depreciation that would have been claimed prior to the tax year of change ($2,000x for 2024 + $3,200x for 2025 + $1,920x for 2026)). Y takes one fourth of the $2,880x positive section 481(a) adjustment into account in computing taxable income for regular tax purposes for 2027, the tax year of change.

(C) *Analysis: Tax capitalization method change AFSI adjustment*. The change in method of accounting for regular tax purposes implemented by Y for its taxable year ending December 31, 2027, is a tax capitalization method change as defined in paragraph (b)(10) of this section. Accordingly, Y must compute and take into account in AFSI a tax capitalization method change AFSI adjustment pursuant to paragraphs (b)(11) and (d)(1)(vi) of this section. The tax capitalization method change AFSI adjustment equals positive $2,880x, computed as the difference between the amount determined under paragraph (b)(11)(i) of this section of $0x (under Y's prior method of accounting, the $10,000x of general and administrative costs did not constitute section 168 property as those costs were deducted, and therefore no adjustments under paragraph (d)(1) of this section were made with respect to taxable years ending on or after December 31, 2019, and before the tax year of change) and the amount determined under paragraph (b)(11)(ii) of this section of $2,880x (the cumulative amount of deductible tax depreciation that would have reduced AFSI under paragraph (d)(1)(ii) of this section with respect to taxable years ending on or after December 31, 2019, and before the tax year of change of $7,120x ($2,000x + $3,200x + $1,920x), plus the cumulative amount of covered book expense that would have been disregarded under paragraph (d)(1)(iii) of this section with respect to taxable years ending on or after December 31, 2019, and before the tax year of change of $10,000x). Y takes the $2,880x positive tax capitalization method change AFSI adjustment into account in computing AFSI ratably over four taxable years beginning in 2027 under paragraph (d)(4) of this section.

(D) *Analysis: Adjustments to AFSI under paragraph (d)(1) of this section for 2027 and subsequent taxable years*. Following the tax capitalization method change, the $10,000x of general and administrative costs constitute section 168 property as those costs become part of the unadjusted basis of the underlying section 168 property produced and placed in service in 2024, resulting in total unadjusted basis of the section 168 property of $30,000x. Therefore, in addition to taking into account the tax capitalization method change AFSI adjustment described in paragraph (d)(5)(vi)(C) of this section, Y is required to begin making adjustments to AFSI under paragraph (d)(1) of this section with respect to the general and administrative costs. Accordingly, Y reduces AFSI for 2027 and subsequent taxable years by the deductible tax depreciation it claims for the particular taxable year with respect to the section 168 property (including the $10,000x of general and administrative costs) under paragraph (d)(1)(ii) of this section (that is, $3,456x for 2027 ($30,000x x 11.52%)). Y increases AFSI for 2027 and subsequent taxable years by the covered book depreciation expense with respect to the section 168 property under paragraph (d)(1)(iii) of this section (that is, $2,000x for 2027). As the covered book expense attributable to the $10,000x of general and administrative costs was taken into account in Y's FSI for 2024, there is no covered book expense for Y to disregard under paragraph (d)(1)(iii) of this section when computing AFSI for 2027 and subsequent taxable years with respect to those costs.

(vii) *Example 7: Deductible tax depreciation under section 174*—(A) *Facts*. Y is engaged in the business of developing chemical products. On January 1, 2024, Y begins a research project in the United States to develop a new product. Y pays or incurs costs for the research project that are considered specified research or experimental expenditures under section 174 of the Code. Y owns a facility that is used exclusively for research. Tax depreciation on the facility is $200,000x in 2024. Y treats the $200,000x of 2024 tax depreciation as a specified research or experimental expenditure under section 174. Accordingly, Y capitalizes and amortizes the $200,000x of 2024 tax depreciation ratably over a 5-year period under section 174(a)(2), beginning at the midpoint of 2024. Thus, $20,000x of the capitalized amount ($200,000x depreciation / 5 years x 6/12 months) results in a deduction (through section 174 amortization) in computing taxable income in 2024.

(B) *Analysis*. Pursuant to paragraph (d)(1)(ii) of this section, Y reduces AFSI for 2024 by deductible tax depreciation of $20,000x, which is the portion of the 2024 tax depreciation that reduced Y's taxable income for 2024.

(viii) *Example 8: Section 168 property treated as leased property for AFS purposes*—(A) *Facts*. On January 1, 2024, Y enters into an agreement to

obtain the right to use equipment in its trade or business for seven years. Under the agreement, Y will make seven annual payments of $10,000x at the end of each year. At the end of the agreement, Y will take ownership of the equipment at no additional cost. For regular tax purposes, Y treats the agreement as a financed purchase of equipment and capitalizes the cost of the equipment of $57,750x (equal to the present value of the annual payments based on a 5% rate stated in the agreement) and depreciates the equipment under the general depreciation system using the 200 percent declining balance method, the half-year convention, and a 5-year recovery period. For regular tax purposes, Y claims $11,550x ($57,750x cost x 20%) of deductible tax depreciation in 2024 and $18,480x ($57,750x cost x 32%) of deductible tax depreciation in 2025. For regular tax purposes, Y also incurs interest expense on the remaining liability as of the end of the year equal to $2,900x for 2024 and $2,550x for 2025, based on the 5% interest rate stated in the agreement. Y prepares its AFS on the basis of GAAP and accounts for the agreement as a finance lease under ASC 842. Accordingly, Y capitalizes a right of use asset of $57,750x (equal to the present value of the annual lease payments) and recognizes right of use asset amortization each year of $8,250x ($57,750x right of use asset / 7 years). For AFS purposes, Y also recognizes interest expense each year equal to the amounts incurred for regular tax purposes.

(B) *Analysis*: *Taxable year 2024.* The right of use asset amortization of $8,250x is a covered book depreciation expense under paragraph (b)(3) of this section. Pursuant to paragraph (d)(1)(iii) of this section, Y makes an adjustment to AFSI to disregard the covered book depreciation expense of $8,250x for 2024 (equal to the right of use asset amortization of $8,250x). Pursuant to paragraph (d)(1)(ii) of this section, AFSI is also reduced by the deductible tax depreciation of $11,550x for 2024. The interest expense of $2,900x incurred for regular tax and AFS purposes is not a covered book expense as such amount is not reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the equipment for regular tax purposes and, accordingly, does not give rise to an AFSI adjustment under this paragraph (d).

(C) *Analysis*: *Taxable year 2025.* Pursuant to paragraph (d)(1)(iii) of this section, Y makes an adjustment to AFSI to disregard the covered book depreciation expense of $8,250x for 2025 (equal to the right of use asset amortization for 2025 of $8,250x). Pursuant to paragraph (d)(1)(ii) of this section, AFSI is also reduced by the deductible tax depreciation of $18,480x for 2025. The interest expense of $2,550x incurred for regular tax and AFS purposes is not a covered book expense as such amount is not reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the equipment for regular tax purposes and, accordingly, does not give rise to an AFSI adjustment under this paragraph (d).

(D) *Analysis*: *Taxable years 2026 through 2029.* Pursuant to paragraph (d)(1)(iii) of this section, Y continues to make an annual adjustment to AFSI to disregard the covered book depreciation expense of $8,250x for each year (equal to the right of use asset amortization of $8,250x). Pursuant to paragraph (d)(1)(ii) of this section, Y continues to reduce AFSI by the deductible tax depreciation for each taxable year. As of the end of 2029, the equipment is fully depreciated for regular tax purposes. Interest expense incurred for regular tax and AFS purposes for each year is not a covered book expense as such amount is not reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the equipment for regular tax purposes and, accordingly, does not give rise to an AFSI adjustment under this paragraph (d).

(E) *Analysis*: *Taxable year 2030.* Although the equipment is fully depreciated for regular tax purposes, the right of use asset amortization of $8,250x for 2030 continues to be treated as a covered book depreciation expense under paragraph (b)(3) of this section. Pursuant to paragraph (d)(1)(iii) of this section, Y makes an adjustment to AFSI to disregard the covered book depreciation expense of $8,250x for 2030 (equal to the right of use asset amortization for 2030 of $8,250x). As the equipment was fully depreciated as of the end of 2029, there is no reduction to AFSI needed under paragraph (d)(1)(ii) of this section, as the deductible tax depreciation for the equipment for 2030 is zero. Interest expense incurred for regular tax and AFS purposes for 2030 is not a covered book expense as such amount is not reflected in the unadjusted depreciable basis, as defined in §1.168(b)-1(a)(3), of the equipment for regular tax purposes and, accordingly, does not give rise to an AFSI adjustment under this paragraph (d).

(ix) *Example 9: Basis adjustment under section 743(b) to section 168 property*—(A) *Facts.* PRS1, a partnership for Federal tax and AFS purposes, is owned by X, a C corporation, and A, an individual. PRS1 was formed in 2022, uses the calendar year as its taxable year, and has a calendar-year financial accounting period. For 2024, PRS1 has $100x of FSI, which includes $20x of covered book depreciation expense. For regular tax purposes, PRS1's deductible tax depreciation with respect to its section 168 property is $30x. X has a basis adjustment under section 743(b) with respect to its investment in PRS1 that relates to section 168 property owned by PRS1. As a result of the basis adjustment, X is allocated an additional $5x of tax depreciation that relates to PRS1's section 168 property. X does not have a corresponding equity interest method basis adjustment for AFS purposes.

(B) *Analysis: PRS1's modified FSI adjustment*. In computing its modified FSI for the 2024 taxable year, pursuant to §1.56A-5(e)(3) and paragraph (d)(2)(i) of this section, PRS1 adjusts the $100x FSI to disregard the covered book depreciation expense of $20x, and reduces modified FSI by the deductible tax depreciation of $30x, which under paragraph (d)(2)(ii) of this section does not include X's $5x tax depreciation resulting from the basis adjustment under section 743(b). Accordingly, PRS1's modified FSI is $90x ($100x FSI + $20x covered book depreciation expense - $30x deductible tax depreciation).

(C) *Analysis: X's adjustments to its share of PRS1's modified FSI.* Pursuant to §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) and paragraph (d)(2)(ii) of this section, X adjusts its share of PRS1's modified FSI by deductible tax depreciation resulting from the basis adjustment under section 743(b) attributable to section 168 property under paragraph (d)(2)(ii) of this section. Accordingly, X reduces its share of modified FSI by deductible tax depreciation of $5x.

(x) *Example 10: Basis adjustment under section 734(b) to section 168 property*—(A) *Facts*. The facts are the same as in paragraph (d)(5)(ix) of this section (*Example 9)*, except that on December 31, 2023, PRS1 distributed property, that is not section 168 property, to A. The distribution of property to A required PRS1 to increase its basis in its remaining partnership property under section 734(b), including its section 168 property. For 2024, as a result of the positive basis adjustment under section 734(b), PRS1 has additional tax depreciation with respect to section 168 property of $10x, increasing the deductible tax depreciation with respect to section 168 property from $30x to $40x. Consistent with paragraph (d)(5)(ix) of this section (*Example 9*), X has a basis adjustment under section 743(b) with respect to its investment in PRS1 that relates to section 168 property owned by PRS1. As a result of the basis adjustment, X is allocated an additional $5x of tax depreciation that relates to PRS1's section 168 property for 2024.

(B) *Analysis: PRS1's modified FSI adjustment*. In computing its modified FSI for the 2024 taxable year, pursuant to §1.56A-5(e)(3) and paragraph (d)(2)(i) of this section, PRS1 adjusts the $100x FSI to disregard the covered book depreciation expense of $20x, and reduces modified FSI by the deductible tax depreciation of $40x, which under paragraph (d)(2)(iii) of this section includes the deductible tax depreciation resulting from the basis adjustment under section 734(b). Accordingly, PRS1's modified FSI is $80x ($100x FSI + $20x covered book depreciation expense - $40x deductible tax depreciation).

(C) *Analysis: X's adjustments to its share of PRS1's modified FSI.* Pursuant to §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) and paragraph (d)(2)(ii) of this section, X adjusts its share of PRS1's modified FSI by deductible tax depreciation resulting from the basis adjustment under section 743(b) attributable to section 168 property under paragraph (d)(2)(ii) of this section. Accordingly, X reduces its share of modified FSI by deductible tax depreciation of $5x.

(e) *AFSI adjustments upon disposition of section 168 property*—(1) *In general*. Except as otherwise provided in paragraph (e)(7) of this section, if a CAMT entity disposes of section 168 property for regular tax purposes, the CAMT entity adjusts AFSI for the taxable year in which the disposition occurs to redetermine any gain or loss taken into account in the CAMT entity's FSI with respect to the disposition for the taxable year (including a gain or loss of zero) by reference to the CAMT basis (in lieu of the AFS basis) of the section 168 property as of the date of the disposition (disposition date), as determined under paragraph (e)(2)(i) of this section. To the extent the CAMT basis of the section 168 property is negative (for example, because of differences between regular tax basis and AFS basis), this negative amount is required to be recognized

as AFSI gain upon disposition of the section 168 property.

(2) *Adjustments to the AFS basis of section 168 property*—(i) *In general*. For purposes of applying paragraph (e)(1) of this section, and subject to paragraphs (e)(2)(ii) and (e)(3) of this section, the CAMT basis of the section 168 property as of the disposition date is the AFS basis of the section 168 property as of that date—

(A) Decreased by the full amount of tax depreciation with respect to such property as of the disposition date (regardless of whether any amount of tax depreciation was capitalized for regular tax purposes and not yet taken into account as a reduction to AFSI through an adjustment described in paragraph (d)(1)(i) or (ii) of this section as of the disposition date);

(B) Increased by the amount of any covered book expense with respect to such property;

(C) Increased by the amount of any covered book COGS depreciation and covered book depreciation expense that reduced the AFS basis of such property as of the disposition date, including covered book COGS depreciation and covered book depreciation expense with respect to AFS basis increases that are otherwise disregarded for AFSI and CAMT basis purposes (for example, AFS basis increases that are disregarded for AFSI and CAMT basis purposes under §§1.56A-18 and 1.56A-19);

(D) Decreased by any reductions to the CAMT basis of such property under §1.56A-21(c)(4) and (5);

(E) Decreased by any amount allowed as a credit against tax imposed by subtitle A with respect to such property, but only to the extent of the amount that reduces the basis of such property for regular tax purposes; and

(F) Increased or decreased, as appropriate, by the amount of any adjustments to AFS basis that are disregarded for AFSI and CAMT basis purposes under other sections of the section 56A regulations with respect to such property (for example, AFS basis decreases that are disregarded for AFSI and CAMT basis purposes under §1.56A-8 and AFS basis adjustments that are disregarded for AFSI and CAMT basis purposes under §1.56A-18 or §1.56A-19).

(ii) *Special rules regarding adjustments to the AFS basis of section 168 property*—(A) *Property placed in service prior to the effective date of CAMT*. In the case of section 168 property placed in service by a CAMT entity in a taxable year that begins before January 1, 2023, the amounts described in paragraph (e)(2)(i) of this section include amounts attributable to all taxable years beginning before January 1, 2023 (including taxable years beginning on or before December 31, 2019).

(B) *Property acquired in certain transactions to which section 168(i)(7) applies*. In the case of section 168 property that was acquired by a CAMT entity in a transaction that is a covered recognition transaction, as defined in §1.56A-18(b)(10), with respect to at least one party to the transaction, or in a transaction described in §1.56A-20, the amounts described in paragraph (e)(2)(i) of this section include only amounts attributable to the period following the transaction, regardless of whether section 168(i)(7) applies to any portion of the transaction for regular tax purposes.

(C) *Coordination with section 56A(c)(5)*. The adjustment described in paragraph (e)(2)(i)(E) of this section applies regardless of the treatment of the tax credit for AFS purposes. *See* §1.56A-8(b) and paragraph (e)(2)(i)(F) of this section.

(D) *Determination of CAMT basis of section 168 property following a change in method of accounting for depreciation or a tax capitalization method change.* In the case of section 168 property for which the CAMT entity made a change in method of accounting for depreciation for regular tax purposes or a tax capitalization method change, the amounts described in paragraph (e)(2)(i) of this section are determined as though the CAMT entity used the method of accounting to which it changed under the corresponding method change when making the adjustments under paragraph (d)(1) of this section in all taxable years prior to the taxable year in which the disposition of the section 168 property occurs. The immediately preceding sentence applies regardless of whether the full amount of a corresponding tax depreciation section 481(a) adjustment or a tax capitalization method change AFSI adjustment has been taken into account in AFSI under paragraph (d)(1) of this section as of the end of the taxable year in which the disposition of the section 168 property occurs.

(E) *Adjustments to the AFS basis of section 168 property include only the covered book amounts actually disregarded in determining AFSI.* The adjustments described in paragraphs (e)(2)(i)(B) and (C) of this section include only the amounts that were actually disregarded by the CAMT entity under paragraph (d)(1)(iii) of this section in computing its AFSI, modified FSI, or adjusted net income or loss for the relevant taxable years. Accordingly, for a taxable year ending after December 31, 2019, only the amounts disregarded under paragraph (d)(1)(iii) of this section in computing the AFSI, modified FSI, or adjusted net income or loss reported by the CAMT entity as required by the section 56A regulations or other sections of the Code (for example, on its annual return on Form 4626 (or any successor), on its Form 5471, or in accordance with the reporting requirements in §1.56A-5(h)) for such taxable year with respect to the section 168 property are taken into account in computing the adjustments described in paragraphs (e)(2)(i)(B) and (C) of this section. For a taxable year ending on or before December 31, 2019, or for a taxable year in which the CAMT entity satisfies the simplified method under §1.59-2(g) (including a taxable year included in the relevant three-taxable-year period), the CAMT entity is deemed to have disregarded the appropriate amounts under paragraph (d)(1)(iii) with respect to the section 168 property for such taxable year.

(3) *Special rules for section 168 property disposed of by a partnership*. If a partnership disposes of section 168 property—

(i) The adjustment under paragraph (e)(1) of this section with respect to the section 168 property is taken into account in determining the partnership's modified FSI under §1.56A-5(e)(3); and

(ii) For purposes of determining the adjustment under paragraph (e)(1) of this section with respect to the section 168 property, the adjustment to the partnership's AFS basis in the section 168 property under paragraph (e)(2)(i)(A) of this section—

(A) Includes any tax depreciation (including any reduction in tax deprecia-

tion) with respect to a section 734(b) basis adjustment;

(B) Excludes any tax depreciation (including any reduction in tax depreciation) with respect to a section 743(b) basis adjustment; and

(C) Excludes any tax depreciation (including any reduction in tax depreciation) with respect to a basis adjustment under §1.1017-1(g)(2).

(iii) For purposes of determining the adjustment under paragraph (e)(1) of this section with respect to the section 168 property, the adjustment to the partnership's AFS basis in the section 168 property under paragraph (e)(2)(i)(D) of this section excludes any basis adjustment under §1.1017-1(g)(2), regardless of whether any partner in the partnership is subject to the attribute reduction rules under §1.56A-21(c)(5) and (6). However, if a partner in the partnership is subject to the attribute reduction rules under §1.56A-21(c)(5) and (6), the partner increases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the section 168 property by the amount of any basis adjustment under §1.1017-1(g)(2) with respect to the section 168 property that has not yet been taken into account for regular tax purposes. *See* §1.1017-1(g)(2)(v).

(iv) If a partner has a basis adjustment under section 743(b) with respect to section 168 property held by a partnership that is disposed of by the partnership for regular tax purposes, the partner—

(A) Increases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the section 168 property by an amount equal to the total amount of any tax depreciation or tax depreciation section 481(a) adjustment(s) with respect to a section 743(b) basis adjustment that decreased the partner's distributive share amount under §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition; and

(B) Decreases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the section 168 property by an amount equal to the total amount of any tax depreciation or tax depreciation section 481(a) adjustment(s) with respect to a section 743(b) basis adjustment that increased the partner's distributive share amount under §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition.

(4) *Treatment of amounts recognized in FSI upon the disposition of section 168 property*. Except as provided in other sections of the section 56A regulations, if a CAMT entity disposes of section 168 property for regular tax purposes and recognizes gain or loss from the disposition in its FSI, the gain or loss (as redetermined under paragraph (e)(1) of this section) is recognized for AFSI purposes in the taxable year of the disposition, regardless of whether any gain or loss with respect to the disposition is realized, recognized, deferred, or otherwise taken into account for regular tax purposes.

(5) *Determining the appropriate asset*. For purposes of determining the appropriate asset to ascertain whether section 168 property has been disposed of, the unit of property determination under §1.263(a)-3(e) does not apply. Instead, section 168 and the regulations under section 168 apply. *See* §1.168(i)-8(c)(4).

(6) *Subsequent AFS dispositions*. If section 168 property is disposed of for regular tax purposes before it is treated as disposed of for AFS purposes, any AFS basis recovery with respect to such property that is reflected in FSI following the date such property is disposed of for regular tax purposes is disregarded in determining AFSI.

(7) *Intercompany transactions*. If a member of a tax consolidated group disposes of section 168 property for regular tax purposes in an intercompany transaction, as defined in §1.1502-13(b)(1)(i), for which the AFS consolidation entries are taken into account under §1.1502-56A(c)(3)(i) in determining AFSI of the tax consolidated group for the taxable year that includes the intercompany transaction, the tax consolidated group member's AFSI adjustment under paragraph (e)(1) of this section is determined as of the date of the intercompany transaction. However, such AFSI adjustment is deferred, and the tax consolidated group does not adjust AFSI under this paragraph (e), until the taxable year in which the AFS consolidation entries related to the disposition become disregarded under §1.1502-56A(c)(3)(ii). *See* §1.1502-56A(e)(3).

(8) *Examples*. The following examples illustrate the application of the rules in this paragraph (e). For purposes of paragraphs (e)(8)(i) through (ix) of this section *(Examples 1* through *9)*, each of X and Y is a corporation that uses the calendar year as its taxable year and has a calendar-year financial accounting period. Unless otherwise stated, Y has elected out of additional first year depreciation under section 168(k), and the tax depreciation with respect to any section 168 property is not required to be capitalized under any capitalization provision in the Code.

(i) *Example 1: Disposition of section 168 property*—(A) *Facts*. X is an applicable corporation for the calendar year ending December 31, 2024. On January 1, 2019, X purchased and placed in service Property 1, which is section 168 property, at a cost of $1,000x. Property 1 qualified for, and X claimed, the 100-percent additional first year depreciation deduction allowable under section 168(k) for its taxable year ending December 31, 2019. For AFS purposes, X depreciates Property 1 over 40 years on a straight-line method and recognizes $25x ($1,000x cost / 40 years) of covered book depreciation expense in 2019 and each year thereafter until X sells Property 1 (a disposition for regular tax and AFS purposes) on January 1, 2025, for $900x. For 2025, X takes into account $50x of net gain from the sale of Property 1 in its FSI ($900x consideration - $850x of AFS basis ($1,000x cost - $150x accumulated covered book depreciation expense as of January 1, 2025)).

(B) *Analysis: Taxable year 2024*. In determining AFSI for the taxable year ending December 31, 2024, X does not have any tax COGS depreciation or deductible tax depreciation in computing taxable income with respect to Property 1, and thus, the adjustments under paragraphs (d)(1)(i) and (ii) of this section are zero. In addition, X adjusts AFSI under paragraph (d)(1)(iii) of this section to disregard the $25x of covered book depreciation expense with respect to Property 1.

(C) *Analysis: Taxable year 2025*. To determine the AFSI adjustment for the gain or loss from the sale of Property 1 under paragraph (e)(1) of this section, X determines the CAMT basis of Property 1 by adjusting the AFS basis of Property 1 by the amounts described in paragraph (e)(2)(i) of this section with respect to Property 1, including those amounts attributable to taxable years beginning before January 1, 2023 (as required by paragraph (e)(2)(ii)(A) of this section). Accordingly, the CAMT basis of Property 1 for AFSI purposes is zero ($850x AFS basis + $150x accumulated covered book depreciation expense - $1,000x accumulated tax depreciation). Thus, the redetermined gain on the sale of Property 1 for AFSI purposes is $900x ($900x consideration - $0x CAMT basis), and X's AFSI adjustment under paragraph (e)(1) of this section required to reflect the redetermined gain is a positive adjustment of $850x ($900x redetermined gain - $50x net gain in FSI).

(ii) *Example 2: Property acquired in a covered nonrecognition transaction*—(A) *Facts*: *Property 1*. The facts are the same as in paragraph (e)(8)(i)(A) of this section (*Example 1*), except that X does not sell Property 1.

(B) *Facts: Merger.* On January 1, 2024, X merges with and into Y, a corporation, in a transaction that qualifies as a reorganization under section 368(a)(1)(A) of the Code (Merger). The sole consideration received by X's shareholders in the Merger is Y voting stock. On X's AFS and Y's AFS for the 2024 taxable year, the Merger results in $165x net gain included in FSI and a corresponding $165x increase in the AFS basis of the assets exchanged in the transaction. As a result, Y's AFS basis of Property 1 as of January 1, 2024, is $1,040x ($1,000x AFS basis on January 1, 2019 - $125x accumulated covered book depreciation expense + $165x net gain in FSI from the Merger). For AFS purposes, Y depreciates Property 1 over 40 years on a straight-line method and recognizes $26x ($1,040x AFS basis following the Merger / 40 years) of covered book depreciation expense in the 2024 taxable year.

(C) *Facts: Disposition of Property 1.* On January 1, 2025, Y sells Property 1 for $900x. For 2025, Y takes into account $114x of net loss from the sale of Property 1 in its FSI ($900x consideration - $1,014x AFS basis ($1,040x AFS basis following the Merger - $26x of covered book depreciation expense for the 2024 taxable year)).

(D) *Analysis: Merger in 2024.* The Merger is a covered nonrecognition transaction, as defined in §1.56A-18(b)(9). Under §1.56A-19(c)(1)(i)(A), in computing AFSI resulting from the Merger, X disregards any gain or loss reflected in its FSI resulting from the exchange of X's assets for the Y stock in the Merger. As a result, X's AFSI does not include the $165x net gain that was taken into account on its AFS as a result of the transfer of its assets to Y in the Merger. Under §1.56A-19(c)(3)(i)(A), Y disregards any gain or loss reflected in its FSI resulting from the exchange of its stock for X's assets in the Merger. Under §1.56A-19(c)(3)(ii), Y takes Property 1 (acquired from X in the Merger) with a CAMT basis of $0x, equal to X's CAMT basis in Property 1 prior to the Merger ($875x AFS basis + $125x accumulated covered book depreciation expense - $1,000x accumulated tax depreciation). Under §1.56A-19(c)(4)(i), X's shareholders' AFSI is adjusted to disregard the $165x net gain in FSI and, thus, includes no gain or loss in AFSI resulting from the exchange of X stock for Y stock in the Merger.

(E) *Analysis: Property 1 in taxable year 2024.* For regular tax purposes, Y is treated as X for purposes of computing tax depreciation with respect to Property 1 under section 168(i)(7). Because Property 1 was already fully depreciated by X prior to the Merger, Y's tax depreciation with respect to Property 1 is zero. As a result, Y does not have any tax COGS depreciation or deductible tax depreciation with respect to Property 1 for 2024, and thus, the adjustments under paragraphs (d)(1)(i) and (ii) of this section are zero. In addition, Y adjusts AFSI under paragraph (d)(1)(iii) of this section to disregard the $26x of covered book depreciation expense with respect to Property 1.

(F) *Analysis: Taxable year 2025.* To determine the AFSI adjustment for gain or loss resulting from the sale of Property 1 under paragraph (e)(1) of this section, Y determines the CAMT basis of Property 1 by adjusting the AFS basis by the amounts described in paragraph (e)(2)(i) of this section with respect to Property 1, including those amounts attributable to taxable years beginning before January 1, 2024 (as required by paragraph (e)(2)(ii)(A) of this section). Because the Merger in 2024 is a covered nonrecognition transaction, paragraph (e)(2)(ii)(B) of this section does not apply and, thus, depreciation with respect to years prior to the Merger is accounted for in determining the CAMT basis of Property 1. Accordingly, the CAMT basis of Property 1 for AFSI purposes is zero ($1,014x AFS basis + $125x accumulated covered book depreciation expense from years prior to the Merger + $26x accumulated covered book depreciation expense from years after the Merger - $1,000x of accumulated tax depreciation - $165x increase in AFS basis from the Merger that is disregarded for CAMT purposes under §1.56A-19(c)(3)(ii)). Thus, the redetermined gain on the sale of Property 1 for AFSI purposes is $900x ($900x consideration - $0x CAMT basis) and Y's AFSI adjustment under paragraph (e)(1) of this section to reflect the redetermined gain is a positive adjustment of $1,014x ($900x redetermined gain - $114x net loss in FSI).

(iii) *Example 3: Property acquired in a covered recognition transaction*—(A) *Facts: Property 1 before the transaction*. The facts are the same as in paragraph (e)(8)(i)(A) of this section (*Example 1*), except that X does not sell Property 1, and Property 1 has a fair market value of $900x on January 1, 2024.

(B) *Facts: Section 351 transfer with boot*. On January 1, 2024, X transfers Property 1 to Y, an unrelated applicable corporation, in exchange for 100 shares of Y stock with a fair market value of $700x and $200x cash in a transaction that qualifies under section 351(b) of the Code (Exchange). The Exchange is made pursuant to an integrated transaction in which unrelated Z transfers non-depreciable Property 2 to Y. Following the Exchange, X and Y are not members of the same controlled group of corporations, as defined in §1.59-2(e), and do not report their FSI on a consolidated financial statement. On X's AFS for the 2024 taxable year, the Exchange results in $25x net gain in FSI ($900x consideration - $875x AFS basis ($1,000x cost - $125x accumulated book depreciation)). On Y's AFS for the 2024 taxable year, Y has a corresponding $25x increase in the AFS basis of Property 1. As a result, Y's AFS basis of Property 1 is $900x ($1,000x AFS basis on January 1, 2019 - $125x X's accumulated covered book depreciation expense + $25x net gain in X's FSI from the Exchange). For AFS purposes, Y depreciates Property 1 over 40 years using the straight line method and recognizes $22.5x ($900x AFS basis following the Exchange / 40 years) of covered book depreciation expense in the 2024 taxable year.

(C) *Facts: Tax depreciation for Property 1 in taxable year 2024*. Y is treated as acquiring Property 1 on January 1, 2024. For regular tax purposes, under section 168(i)(7), Y is treated as X for purposes of computing depreciation deductions with respect to so much of the basis of Property 1 in the hands of Y as does not exceed the adjusted basis of Property 1 in the hands of X. Because X fully depreciated Property 1 prior to the Exchange, the adjusted basis of Property 1 in the hands of X prior to the Exchange is zero and, thus, the amount of Y's tax depreciation for Property 1 that is determined under section 168(i)(7) is also zero. However, under section 362(a) of the Code, the $200x cash X received from Y in the Exchange increases Y's adjusted basis of Property 1. Y depreciates the $200x adjusted basis of Property 1 under the general depreciation system by using the 200 percent declining balance method, 5-year recovery period, and half-year convention. For regular tax purposes, Y recognizes $40x ($200x x 20%) of deductible tax depreciation in 2024 with respect to Property 1.

(D) *Facts: Disposition of Property 1.* On January 1, 2025, Y sells Property 1 for $800x. For 2025, Y takes into account $77.5x of net loss for the sale of Property 1 in its FSI ($800x consideration - $877.5x AFS basis ($900x AFS basis following the Exchange - $22.5x of covered book depreciation expense for the 2024 taxable year)).

(E) *Analysis: Exchange in 2024*. Because Y transferred cash to X in addition to Y stock, under §1.56A-19(g)(4)(i), the Exchange is a covered recognition transaction, as defined in §1.56A-18(b)(10). Under §1.56A-19(g)(3)(i), to determine AFSI resulting from the Exchange, X redetermines the gain or loss reflected in FSI by reference to CAMT basis. Thus, X's redetermined gain from the Exchange is $900x ($900x consideration - $0x CAMT basis in Property 1 ($875x AFS basis + $125x accumulated covered book depreciation expense - $1,000x accumulated tax depreciation)) and X's AFSI adjustment to reflect the redetermined gain is a positive adjustment of $875x ($900x redetermined gain - $25x net gain in FSI). Under §1.56A-19(g)(5)(ii), Y's CAMT basis in Property 1 is equal to its AFS basis of $900x.

(F) *Analysis: Property 1 in taxable year 2024.* In determining AFSI for the taxable year ending December 31, 2024, Y does not have any tax COGS depreciation in computing taxable income with respect to Property 1, and thus, the adjustment under paragraph (d)(1)(i) of this section is zero. In addition, Y reduces AFSI under paragraph (d)(1)(ii) of this section by deductible tax depreciation of $40x, and Y adjusts AFSI under paragraph (d)(1)(iii) of this section to disregard the $22.5x of covered book depreciation expense with respect to Property 1.

(G) *Analysis: Taxable year 2025*. To determine the AFSI adjustment for the gain or loss from the sale of Property 1 under paragraph (e)(1) of this section, Y determines the CAMT basis of Property 1 by adjusting the AFS basis of Property 1 by the amounts described in paragraph (e)(2)(i) of this section, which generally include amounts attributable to taxable years beginning before January 1, 2024 (as required by paragraph (e)(2)(ii)(A) of this section). However, because the Exchange is a covered recognition transaction, under paragraph (e)(2)(ii)(B) of this section, the amounts described in paragraph (e)(2)(i) of this section taken into account to determine Y's CAMT basis of Property 1 include only amounts attributable to the period following the date Property 1 was acquired in the Exchange, or January 1, 2024. Accordingly, the CAMT basis of Property 1 is $860x ($877.5x AFS basis ($900x AFS basis following the Exchange - $22.5x of covered book depreciation expense for the 2024 taxable year) + $22.5x accumulated covered book depreciation expense following the Exchange - $40x of tax depreciation following the Exchange). Thus, the redetermined loss on the sale of Property 1 for AFSI purposes is $60x ($800x consideration - $860x CAMT basis) and Y's AFSI adjustment under paragraph (e)(1) of this section to

reflect the redetermined loss is a positive adjustment of $17.5x ($60x redetermined loss - $77.5x net loss in FSI).

(iv) *Example 4: Property for which a tax credit was claimed*—(A) *Facts*. X is a domestic corporation that uses the calendar year as its taxable year and has a calendar-year financial accounting period. On January 1, 2018, X purchased and placed in service Property A, which is section 168 property, at a cost of $1,000x. Property A qualified for, and X claimed, a $200x investment tax credit for its taxable year ending December 31, 2018. X reduced its regular tax basis in Property A under section 50(c)(1) of the Code and its AFS basis in Property A under the accounting standards used to prepare its AFS to $800x ($1,000x cost basis - $200x basis reduction for the credit received). For regular tax purposes, Property A qualified for, and X claimed, the 100-percent additional first year depreciation deduction allowable under section 168(k) for its taxable year ending December 31, 2018, for the remaining $800x of regular tax basis. For AFS purposes, X depreciates Property A over 40 years on a straight-line method and recognizes $20x ($800x AFS basis / 40 years) of depreciation expense in its FSI in 2018 and each year thereafter until it sells Property A (a disposition for regular tax and AFS purposes) on January 1, 2024, for $900x. For 2024, X recognizes $220x of net gain for the sale of Property A in its FSI ($900x consideration - $680x AFS basis ($1,000x cost - $200x investment tax credit - $120x accumulated depreciation expense as of January 1, 2024)). Under §1.56A-8(b), X disregards the $200x investment tax credit claimed with respect to Property A in determining its AFSI. Had X determined its depreciation expense for AFS purposes without regard to the $200x investment tax credit, X would have instead recognized $25x ($1,000x AFS basis / 40 years) of depreciation expense each year and $50x of net gain in 2024 from the sale of Property A ($900x consideration - $850x AFS basis ($1,000x cost - $150x accumulated depreciation expense)).

(B) *Analysis for taxable year 2023.* In determining AFSI for the taxable year ending December 31, 2023, X does not have any tax COGS depreciation or deductible tax depreciation in computing taxable income with respect to Property A, and thus, the adjustments to AFSI under paragraphs (d)(1)(i) and (ii) of this section are zero. In addition, X is required to adjust AFSI under paragraph (d)(1)(iii) of this section to disregard covered book depreciation expense with respect to Property A. Notwithstanding that the depreciation expense reflected in X's FSI is reduced as a result of the AFS treatment of the investment tax credit, and that the investment tax credit is disregarded under §1.56A-8(b), covered book depreciation expense for 2023 is $20x (as opposed to $25x), which is the amount of depreciation expense that X actually reflects in its FSI for 2023. That is, the adjustment to AFSI under paragraph (d)(1)(iii) of this section encompasses the adjustment required under §1.56A-8(b).

(C) *Analysis for taxable year 2024*. To determine the AFSI adjustment for the gain or loss from the sale of Property A under paragraph (e)(1) of this section, X determines the CAMT basis of such property by adjusting the AFS basis of such property as of the disposition date by the amounts described in paragraph (e)(2)(i) of this section, including those amounts attributable to taxable years beginning before January 1, 2023 (as required by paragraph (e)(2)(ii)(A) of this section). The AFS basis of Property A as of the disposition date is $680x. Such amount is decreased by the $800x of tax depreciation with respect to Property A under paragraph (e)(2)(i)(A) of this section, increased by the $120x of covered book depreciation expense under paragraph (e)(2)(i)(C) of this section (which is the amount of covered book depreciation expense that reduced the AFS basis of Property A as of the disposition date), decreased by the $200x investment tax credit under paragraph (e)(2)(i)(E) of this section (which equals the amount by which X reduced its basis in Property A for regular tax purposes), and increased, under paragraph (e)(2)(i)(F) of this section, by the $200x reduction to AFS basis that is disregarded under §1.56A-8(b). Accordingly, the CAMT basis of Property A is $0, and the redetermined gain on the sale of Property A for AFSI purposes is $900x ($900x consideration - $0x CAMT basis). Thus, X's AFSI adjustment under paragraph (e)(1) of this section is an increase to AFSI of $680x ($900x redetermined gain - $220x FSI gain).

(v) *Example 5: Disposition of property that was subject to a tax capitalization method change and is not section 168 property at time of disposition*—(A) *General facts.* The facts are the same as in paragraph (d)(5)(v) of this section (*Example 5)*, except Y transfers the replacement property to a scrap account on January 1, 2030, and sells it on the same day for $5,000x. Y's AFS basis in the replacement property as of January 1, 2030, is $4,000x ($10,000x cost - $6,000x of cumulative book depreciation expense as of January 1, 2030 ($500x for 2024, $1,000x for each year in the period 2025 through 2029, and $500x for 2030)). Accordingly, Y takes into account $1,000x of net gain for the sale of the replacement property in its FSI for 2030 ($5,000x consideration - $4,000x of AFS basis).

(B) *Analysis: Taxable years 2027 through 2029.* As discussed in the analysis in paragraph (d)(5)(v)(C) of this section, the replacement property is no longer section 168 property beginning in 2027. Therefore, except as provided in the analysis in paragraph (d)(5)(v)(D) of this section (regarding the tax capitalization method change AFSI adjustment), Y does not make any AFSI adjustments under paragraph (d)(1) of this section with respect to the replacement property for taxable years 2027 through 2029. Accordingly, Y's AFSI for taxable years 2027 through 2029 includes the book depreciation expense taken into account in Y's FSI for those years ($1,000x for each of 2027, 2028, and 2029) and the portion of the tax capitalization method change AFSI adjustment pursuant to paragraph (d)(4) of this section.

(C) *Analysis: Taxable year 2030.* If a CAMT entity disposes of section 168 property, this paragraph (e) requires the CAMT entity to adjust AFSI for the taxable year of the disposition to redetermine any gain or loss taken into account in the CAMT entity's FSI by reference to the CAMT basis of the section 168 property, as determined under paragraph (e)(2)(i) of this section. However, as discussed in the analysis in paragraph (d)(5)(v)(C) of this section, the replacement property is no longer section 168 property under the method of accounting Y changed to under the tax capitalization method change, and therefore the replacement property is not section 168 property at the time of disposition. Accordingly, this paragraph (e) does not apply for purposes of determining the CAMT basis and any corresponding amount of any gain or loss Y takes into account in computing AFSI for 2030 with respect to the disposition of the replacement property. Therefore, the net gain from the sale of the replacement property that Y takes into account in its AFSI for 2030 is the same as the amount taken into account in Y's FSI for 2030 ($1,000x).

(vi) *Example 6: Disposition of property that was subject to a tax capitalization method change and is section 168 property at time of disposition*—(A) *General facts.* The facts are the same as in paragraph (d)(5)(vi) of this section (*Example 6)*, except Y sells the section 168 property on December 31, 2029, for $5,000x.

(B) *Facts: Basis of the section 168 property for regular tax and AFS purposes at disposition.* As provided in the analysis in paragraph (d)(5)(vi)(D) of this section, Y's unadjusted basis in the section 168 property is $30,000x following the tax capitalization method change. Based on Y's depreciation methods of accounting with respect to the section 168 property for regular tax purposes (described in paragraph (d)(5)(vi)(A) of this section), the section 168 property is fully depreciated for regular tax purposes as of December 31, 2029 (that is, cumulative deductible tax depreciation as of December 31, 2029 equals $30,000x), resulting in adjusted basis for regular tax purposes at disposition of zero. For AFS purposes, Y's cumulative covered book depreciation expense taken into account in Y's FSI as of December 31, 2029 with respect to the section 168 property is $10,000x ($1,000x in 2024, $2,000x in each year for the period 2025 through 2028, and $1,000x in 2029), resulting in AFS basis at the time of disposition with respect to the section 168 property of $10,000x ($20,000x original cost less $10,000x of cumulative covered book depreciation expense).

(C) *Facts: AFS gain or loss for taxable year 2029.* For its taxable year 2029, Y takes into account a net loss equal to $5,000x in its FSI with respect to the disposition of the section 168 property ($5,000x consideration less $10,000x AFS basis).

(D) *Analysis: AFSI gain or loss for taxable year 2029*. If a CAMT entity disposes of section 168 property, this paragraph (e) requires the CAMT entity to adjust AFSI for the taxable year of the disposition to redetermine any gain or loss taken into account in the CAMT entity's FSI by reference to the CAMT basis of the section 168 property, as determined under paragraph (e)(2)(i) of this section. In addition, pursuant to the special rule in paragraph (e)(2)(ii)(E) of this section, if a CAMT entity made a tax capitalization method change with respect to the section 168 property disposed of, the amounts described in paragraph (e)(2)(i) of this section are determined as though the CAMT entity used the method of accounting it changed to under the corresponding method change. As provided in the analysis in paragraph (d)(5)(vi)(D) of this section, the $10,000x of general and administrative costs taken into account in computing taxable income for 2024 constitute section 168 property beginning in 2027. Accordingly, the CAMT basis of the section 168 property for purposes of determining any gain or

loss to take into account in AFSI upon the sale of the property on December 31, 2029 is zero ($10,000x AFS basis + $10,000x accumulated covered book depreciation expense + $10,000x of covered book expense (the general and administrative costs taken into account in FSI for 2024) - $30,000x of accumulated tax depreciation). Pursuant to the special rule in paragraph (e)(2)(ii)(E) of this section, CAMT basis is zero notwithstanding that Y has not yet taken into account in AFSI the full amount of the tax capitalization method change AFSI adjustment that resulted from the tax capitalization method change (as of December 31, 2029, Y has included 75% of the tax capitalization method change AFSI adjustment in AFSI ($720x for each of 2027, 2028, and 2029)). Thus, the redetermined gain on the sale of the section 168 property for AFSI purposes is $5,000x ($5,000x consideration - $0x CAMT basis), and Y's AFSI adjustment under paragraph (e)(1) of this section required to reflect the redetermined gain is a positive adjustment of $10,000x ($5,000x redetermined gain less $5,000x of net loss in FSI).

(vii) *Example 7: Installment sale under section 453*—(A) *Facts*. X is a CAMT entity that uses the calendar year as its taxable year and has a calendar-year financial accounting period. On January 1, 2018, X purchased for $550x and placed in service residential rental property (Real Property 1), which is section 168 property. For regular tax purposes, X depreciates Real Property 1 under the general depreciation system by using the straight-line method, a 27.5-year recovery period, and the mid-month convention. X depreciates Real Property 1 for AFS purposes using the same recovery period, depreciation method, and convention that is used for regular tax purposes. X becomes an applicable corporation for the calendar year ending December 31, 2024. On January 1, 2024, X sells Real Property 1 to Y, an unrelated taxpayer, for $1,000x with the following payment structure: $100x payable at closing and the remainder payable in equal annual installments over the next 9 years, together with adequate stated interest. As of the date of the installment sale, X's adjusted basis for regular tax purposes, AFS basis, and CAMT basis for AFSI purposes (as determined under paragraph (e)(1) of this section) for Real Property 1 is $430x. X does not elect out of the installment method under section 453 of the Code. The gross profit to be realized on the sale is $570x ($1,000x selling price - $430x adjusted regular tax/AFS/CAMT basis). The gross profit percentage is 57% ($570x gross profit / $1,000x contract price). No provision in section 56A or the section 56A regulations provides for an adjustment to AFSI to apply the installment method under section 453.

(B) *Analysis*. For taxable year 2024, X realizes $570x ($1,000x selling price - $430x basis) of gain for both regular tax and FSI purposes from the disposition of Real Property 1 in the installment sale. X recognizes $570x of the gain in FSI, but for regular tax purposes, X recognizes only $57x (57% of the $100x payment received in 2024) of the gain, and the remaining $513x of gain is deferred and recognized as subsequent payments are received under the installment method. Pursuant to paragraph (e)(4) of this section, the installment method in section 453 does not apply for purposes of determining the AFSI gain or loss on the disposition of Real Property 1. Accordingly, X recognizes the entire $570x FSI gain in AFSI, notwithstanding that $513x was deferred under section 453 for regular tax purposes.

(viii) *Example 8: Like-kind exchange under section 1031*—(A) *Facts*. The facts are the same as paragraph (e)(8)(vii)(A) of this section (*Example 7*), except that, on January 1, 2024, instead of an installment sale, X transfers Real Property 1 to Y in exchange for Real Property 2 with a fair market value of $440x and $20x cash. The exchange qualifies as an exchange of real property held for productive use or investment under section 1031 of the Code. As of the date of the exchange, X's adjusted basis for regular tax purposes, AFS basis, and CAMT basis for AFSI purposes (as determined under paragraph (e)(1) of this section) for Real Property 1 is $430x. No provision in section 56A or the section 56A regulations provides for an adjustment to AFSI to apply the nonrecognition rules under section 1031.

(B) *Analysis*. For taxable year 2024, X realizes $30x of gain under section 1001(a) of the Code ($460x amount realized ($440x fair market value of replacement Real Property B + $20x cash) - $430x adjusted regular tax basis of relinquished property). Of the $30x realized gain, only $20x is recognized by X under section 1031(b) for regular tax purposes, as this is the amount of non-like-kind consideration received in the exchange ($20x cash). For AFS purposes, X recognizes $30x of gain in its FSI ($460x amount realized ($440x fair market value of Real Property 2 + $20x cash) - $430x AFS basis of Real Property 1). Pursuant to paragraph (e)(4) of this section, the nonrecognition rules in section 1031 do not apply for purposes of determining the AFSI gain or loss on the disposition of Real Property 1. Accordingly, for AFSI purposes, X recognizes the entire redetermined gain of $30x ($460x amount realized - $430x of CAMT basis under paragraph (e)(1) of this section) for purposes of computing AFSI, notwithstanding that X recognized only $20x of the $30x gain realized for regular tax purposes.

(ix) *Example 9: Replacement property received in a like-kind exchange*—(A) *Facts*. The facts are the same as in paragraph (e)(8)(viii)(A) of this section (*Example 8*). In addition, for regular tax purposes, X's regular tax basis in the replacement Real Property 2 as of the date of the exchange is $430x ($430x adjusted regular tax basis in relinquished Real Property 1 - $20x cash + $20x gain recognized). X's AFS basis in Real Property 2 as of the date of the exchange is $440x, which is the fair market value of Real Property 2 as of the date of the exchange. Under §1.168(i)-6(c)(3)(ii) and paragraph (c)(4) of this section, X depreciates the $430x regular tax basis of Real Property 2 over the remaining recovery period of, and using the same depreciation method and convention as that of, Real Property 1. For AFS purposes, X depreciates the $440x AFS basis of Real Property 2 using the straight-line method and a 27.5-year recovery period and recognizes $16x ($440x / 27.5 years) of covered book depreciation expense each year. On January 1, 2032, X sells Real Property 2 with a regular tax basis of $270x ($430x exchange basis - $160x accumulated tax depreciation) and a AFS basis of $312x ($440x AFS basis - $128x accumulated book depreciation) to Z for $500x cash.

(B) *Analysis*. For regular tax purposes, X recognizes a gain on the sale of Real Property 2 of $230x ($500x amount realized - $270x regular tax basis). For AFS purposes, X recognizes a gain of $188x in its FSI ($500x amount realized - $312x AFS basis). Pursuant to paragraph (e)(1) of this section, X adjusts AFSI for taxable year 2032 to redetermine the gain or loss taken into account in FSI with respect to the disposition of Real Property 2 by reference to the CAMT basis of Real Property 2, as determined under paragraph (e)(2)(i) of this section. Accordingly, the CAMT basis of Real Property 2 for AFSI purposes is $280x ($312x AFS basis + $128x accumulated covered book depreciation expense - $160x of accumulated tax depreciation). Thus, the redetermined gain on the sale of Real Property 2 for AFSI purposes is $220x ($500x consideration - $280x CAMT basis), and Y's AFSI adjustment under paragraph (e)(1) of this section required to reflect the redetermined gain is a positive adjustment of $32x ($220x redetermined gain - $188x of net gain in FSI).

(x) *Example 10: Section 168 property disposed of by a partnership*—(A) *Facts*. PRS1, a partnership for Federal tax and AFS purposes, is owned by X, a C corporation, and A, an individual. PRS1 was formed in 2022, uses the calendar year as its taxable year, and has a calendar-year financial accounting period. PRS1 purchased and placed in service section 168 property on January 1, 2023, at a cost of $210x. For AFS purposes, PRS1 depreciates the section 168 property over 10 years on a straight-line method, recognizing $21x ($210x cost basis / 10 years) of covered book depreciation expense in 2023 and each year thereafter. For regular tax purposes, the applicable recovery period of the section 168 property is 7 years and PRS1 makes an election under section 168(b)(5) to depreciate the section 168 property on a straight-line basis using the half-year convention. Accordingly, the deductible tax depreciation with respect to the section 168 property is $15x for 2023 and $30x for each of 2024 and 2025. In addition, the deductible tax depreciation with respect to the section 168 property is increased in 2024 and subsequent years by $10x each year as a result of a positive basis adjustment under section 734(b) on December 31, 2023, so that the deductible tax depreciation with respect to the section 168 property is $40x in each of 2024 and 2025. On January 1, 2026, PRS1 sells the section 168 property for $100x (a disposition for regular tax and AFS purposes). For 2026, PRS1 takes into account $47x of net loss from the sale of the section 168 property in its FSI ($100x consideration - $147x AFS basis ($210x cost - $63x accumulated covered book depreciation expense as of January 1, 2026)).

(B) *Analysis: Taxable years 2023 through 2025*. In determining modified FSI for the 2023, 2024, and 2025 taxable years, PRS1 adjusts its modified FSI under §1.56A-5(e)(3) and paragraph (d)(2)(i) of this section to disregard the $21x of covered book depreciation expense each year with respect to the section 168 property and reduces modified FSI by deductible tax depreciation of $15x for 2023 and $40x for each of 2024 and 2025, which under paragraph (d)(2)(iii) of this section includes the deductible tax depreciation with respect to the basis adjustment under section 734(b).

(C) *Analysis: Taxable year 2026*. Under paragraphs (e)(1) and (e)(3)(i) of this section, PRS1 adjusts its modified FSI for 2026 to redetermine any gain or loss taken into account in its FSI with

respect to the disposition of the section 168 property by reference to the CAMT basis of the section 168 property, taking into account the adjustments under paragraphs (e)(2)(i) and (e)(3)(ii) of this section. Under paragraphs (e)(2)(i)(A) and (e)(3)(ii)(A) of this section, PRS1 adjusts the AFS basis, decreasing it by the full amount of tax depreciation with respect to the property as of the disposition date. Accordingly, the CAMT basis of the section 168 property is $115x ($147x AFS basis + $63x accumulated covered book depreciation expense - $95x accumulated tax depreciation). Thus, the redetermined loss on the sale of the section 168 property is $15x ($100x consideration - $115x CAMT basis) and PRS1's adjustment to modified FSI under paragraph (e)(1) of this section to reflect the redetermined loss is a positive adjustment of $32x ($15x redetermined loss - $47x net loss in FSI).

(xi) *Example 11: Section 168 property disposed of by a partnership with a section 743(b) basis adjustment in place*—(A) *Facts*. The facts are the same as in paragraph (e)(8)(x)(A) of this section (*Example 10*). In addition, on January 1, 2024, X purchased additional interests in PRS1 that resulted in a $50x basis adjustment under section 743(b) with respect to its investment in PRS1 that relates to section 168 property owned by PRS1. As a result of the basis adjustment, X is allocated an additional $5x of tax depreciation that relates to PRS1's section 168 property for each of 2024 and 2025. X does not have a corresponding equity interest method basis adjustment for AFS purposes.

(B) *Analysis: Taxable years 2024 and 2025*. Pursuant to §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) and paragraph (d)(2)(i) of this section, X adjusts its share of PRS1's modified FSI by deductible tax depreciation resulting from the basis adjustment under section 743(b) attributable to section 168 property under paragraph (d)(2)(ii) of this section. Accordingly, X reduces its share of modified FSI by deductible tax depreciation of $5x for each of 2024 and 2025.

(C) *Analysis: Taxable year 2026*. Pursuant to §1.56A-5(e)(1)(iv) and (e)(4)(ii)(B) and paragraph (e)(3)(iv) of this section, X increases its distributive share amount for 2026 by an amount equal to the total amount of tax depreciation with respect to its section 743(b) basis adjustment that decreased its distributive share amount under §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A), that is, an increase of $10x.

(f) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-16 AFSI adjustments for qualified wireless spectrum property.

(a) *Overview*. This section provides rules under section 56A(c)(14) of the Code for determining AFSI adjustments with respect to qualified wireless spectrum. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides rules for determining the extent to which property is qualified wireless spectrum. Paragraph (d) of this section provides rules for adjusting AFSI for amortization and other amounts with respect to qualified wireless spectrum. Paragraph (e) of this section provides rules for adjusting AFSI upon the disposition of qualified wireless spectrum. Paragraph (f) of this section provides the applicability date of this section.

(b) *Definitions*. For purposes of this section:

(1) *Covered book amortization expense*. The term *covered book amortization expense* means any of the following items that are taken into account in FSI with respect to qualified wireless spectrum—

(i) Amortization expense;

(ii) Other recovery of AFS basis (including from an impairment loss) that occurs prior to the taxable year in which the disposition occurs for regular tax purposes; or

(iii) Impairment loss reversal.

(2) *Covered book wireless spectrum expense*. The term *covered book wireless spectrum expense* means an amount, other than covered book amortization expense, that—

(i) Reduces FSI; and

(ii) Is reflected in the basis for depreciation, as defined in §§1.167(g)-1 and 1.197-2(f)(1)(ii) (without regard to any adjustments described in section 1016(a)(2) and (3) of the Code), of qualified wireless spectrum for regular tax purposes.

(3) *Deductible tax amortization*. The term *deductible tax amortization* means tax amortization, as defined in paragraph (b)(5) of this section, that is allowed as a deduction in computing taxable income.

(4) *Qualified wireless spectrum*. The term *qualified wireless spectrum* means property that meets the requirements of paragraph (c) of this section.

(5) *Tax amortization*. The term *tax amortization* means amortization deductions allowed under section 197 of the Code with respect to qualified wireless spectrum.

(6) *Tax amortization section 481(a) adjustment*. The term *tax amortization section 481(a) adjustment* means the net amount of the adjustments required under section 481(a) of the Code for a change in method of accounting for amortization for any item of qualified wireless spectrum.

(7) *Tax capitalization method change for qualified wireless spectrum*. The term *tax capitalization method change for qualified wireless spectrum* means a change in method of accounting for regular tax purposes involving a change from capitalizing and depreciating costs as qualified wireless spectrum to deducting the costs (or vice versa).

(8) *Tax capitalization method change AFSI adjustment for qualified wireless spectrum*. The term *tax capitalization method change AFSI adjustment for qualified wireless spectrum* means an adjustment to AFSI that is required under paragraph (d)(1) of this section if a CAMT entity makes a tax capitalization method change for qualified wireless spectrum. The tax capitalization method change AFSI adjustment for qualified wireless spectrum is computed separately for each tax capitalization method change for qualified wireless spectrum and equals the difference between the following amounts computed as of the beginning of the tax year of change—

(i) The cumulative amount of adjustments to AFSI under paragraph (d)(1) of this section with respect to the cost(s) subject to the tax capitalization method change for qualified wireless spectrum that were made with respect to taxable years beginning after December 31, 2019, and before the tax year of change; and

(ii) The cumulative amount of adjustments to AFSI under paragraph (d)(1) of this section with respect to the cost(s) subject to the tax capitalization method change for qualified wireless spectrum that would have been made with respect to taxable years beginning after December 31, 2019, and before the tax year of change, if the new method of accounting for the cost(s) had been applied for regular tax purposes in those taxable years.

(c) *Qualified wireless spectrum*—(1) *In general*. For purposes of section 56A(c)(14) and this section, qualified wireless spectrum is wireless spectrum that is—

(i) Used in the trade or business of a wireless telecommunications carrier;

(ii) An amortizable section 197 intangible under section 197(c)(1) and (d)(1)(D); and

(iii) Acquired after December 31, 2007, and before August 16, 2022.

(2) *Qualified wireless spectrum does not include wireless spectrum that is not*

depreciable under section 197 for regular tax purposes. Qualified wireless spectrum does not include wireless spectrum that is not subject to amortization under section 197 for regular tax purposes. For example, if a foreign corporation other than a controlled foreign corporation is not subject to U.S. taxation, then wireless spectrum owned by the foreign corporation is not treated as qualified wireless spectrum.

(d) *AFSI adjustments for amortization and other amounts with respect to qualified wireless spectrum*—(1) *In general*. The AFSI of a CAMT entity for a taxable year is—

(i) Reduced by deductible tax amortization with respect to qualified wireless spectrum, but only to the extent of the amount allowed as a deduction in computing taxable income for the taxable year;

(ii) Adjusted to disregard covered book amortization expense, covered book wireless spectrum expense, and amounts described in paragraph (e)(5) of this section with respect to qualified wireless spectrum, including qualified wireless spectrum placed in service for regular tax purposes in a taxable year subsequent to the taxable year the wireless spectrum is treated as placed in service for AFS purposes;

(iii) Reduced by any tax amortization section 481(a) adjustment with respect to qualified wireless spectrum that is negative, but only to the extent of the amount of the adjustment that is taken into account in computing taxable income for the taxable year;

(iv) Increased by any tax amortization section 481(a) adjustment with respect to qualified wireless spectrum that is positive, but only to the extent of the amount of the adjustment that is taken into account in computing taxable income for the taxable year;

(v) Increased or decreased, as appropriate, by any tax capitalization method change AFSI adjustment for qualified wireless spectrum in accordance with paragraph (d)(3) of this section; and

(vi) Adjusted for other items as provided in IRB guidance the IRS may publish.

(2) *Special rules for qualified wireless spectrum held by a partnership*—(i) *In general*. If qualified wireless spectrum is held by a partnership, *see* §1.56A-5(e) for the manner in which the adjustments provided in paragraph (d)(1) of this section are taken into account by the partnership and its CAMT entity partners under the applicable method described in §1.56A-5(c).

(ii) *Basis adjustment under section 743(b) of the Code*. If qualified wireless spectrum is held by a partnership, the adjustments provided in paragraphs (d)(1)(i) and (iii) through (vi) of this section do not include any amounts resulting from any basis adjustment under section 743(b) of the Code attributable to the qualified wireless spectrum that are treated as increases or decreases to tax amortization or a tax amortization section 481(a) adjustment for regular tax purposes. *See* §1.743-1(j)(4). Instead, such amounts resulting from any basis adjustment under section 743(b) attributable to the qualified wireless spectrum that would have been included in the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vi) of this section are separately stated to the CAMT entity partners under §1.56A-5(e)(4)(i) and are taken into account by the CAMT entity partners in the manner provided in §1.56A-5(e)(4)(ii)(A).

(iii) *Basis adjustment under section 734(b) of the Code*. If qualified wireless spectrum is held by a partnership, the adjustments provided in paragraphs (d)(1)(i) and (iii) through (vi) of this section include amounts resulting from any basis adjustment under section 734(b) of the Code attributable to the qualified wireless spectrum that are treated as increases or decreases to tax amortization or a tax amortization section 481(a) adjustment for regular tax purposes. *See* §1.734-1(e).

(iv) *Basis adjustment under §1.1017-1(g)(2)*. If qualified wireless spectrum is held by a partnership, the adjustments provided in paragraphs (d)(1)(i) and (iii) through (vi) of this section do not include any decreases in tax amortization or income amounts for regular tax purposes, as applicable, resulting from any basis adjustment under §1.1017-1(g)(2) attributable to qualified wireless spectrum (as calculated under §1.743-1(j)(4)(ii)). Instead, such decreases in tax depreciation or income amounts, as applicable, resulting from any basis adjustment under §1.1017-1(g)(2) attributable to section 168 property that would have been included in the adjustments provided in paragraphs (d)(1)(i), (ii), and (iv) through (vii) of this section are separately stated to the CAMT entity partners under §1.56A-5(e)(4)(i) and are taken into account by the CAMT entity partners in the manner provided in §1.56A-5(e)(4)(ii)(A).

(3) *Adjustment period for tax capitalization method change AFSI adjustments for qualified wireless spectrum*. A tax capitalization method change AFSI adjustment for qualified wireless spectrum that is negative reduces AFSI under paragraph (d)(1)(v) of this section in the tax year of change by the full amount of the adjustment. A tax capitalization method change AFSI adjustment for qualified wireless spectrum that is positive increases AFSI under paragraph (d)(1)(v) of this section ratably over four taxable years beginning with the tax year of change. For purposes of this paragraph (d)(3), if any taxable year during the four-year spread period for a tax capitalization method change AFSI adjustment for qualified wireless spectrum that is positive is a short taxable year, the CAMT entity takes the adjustment into account as if that short taxable year were a full 12-month taxable year. If, in any taxable year, a CAMT entity ceases to engage in the trade or business to which the tax capitalization method change AFSI adjustment for qualified wireless spectrum relates, the CAMT entity includes in AFSI for such taxable year any portion of the adjustment not included in AFSI for a previous taxable year.

(e) *AFSI adjustments upon disposition of qualified wireless spectrum*—(1) *In general*. Except as otherwise provided in paragraph (e)(7) of this section, if a CAMT entity disposes of qualified wireless spectrum for regular tax purposes, the CAMT entity adjusts AFSI for the taxable year in which the disposition occurs to redetermine any gain or loss taken into account in the CAMT entity's FSI with respect to the disposition for the taxable year (including a gain or loss of zero) by reference to the CAMT basis (in lieu of the AFS basis) of the qualified wireless spectrum as of the date of the disposition (disposition date), as determined under paragraph (e)(2)(i) of this section. To the extent the CAMT basis of the qualified wireless spectrum is negative (for example, because of differences between regular tax basis and AFS basis), this negative amount is required to be recognized as AFSI gain upon disposition of the qualified wireless spectrum.

(2) *Adjustments to the AFS basis of qualified wireless spectrum*—(i) *In general*. For purposes of applying paragraph (e)(1) of this section, and subject to paragraphs (e)(2)(ii) and (e)(3) of this section, the CAMT basis of the qualified wireless spectrum as of the disposition date is the AFS basis of the qualified wireless spectrum as of that date—

(A) Decreased by the full amount of tax amortization with respect to such property as of the disposition date;

(B) Increased by the amount of any covered book wireless spectrum expense with respect to such property;

(C) Increased by the amount of any covered book amortization expense that reduced the AFS basis of such property as of the disposition date, including covered book amortization expense with respect to AFS basis increases that are otherwise disregarded for AFSI and CAMT basis purposes (for example, AFS basis increases that are disregarded for AFSI and CAMT basis purposes under §§1.56A-18 and 1.56A-19);

(D) Decreased by any reductions to the CAMT basis of such property under §1.56A-21(c)(4) and (5); and

(E) Increased or decreased, as appropriate, by the amount of any adjustments to AFS basis that are disregarded for AFSI and CAMT basis purposes under other sections of the section 56A regulations with respect to such property (for example, AFS basis adjustments that are disregarded for AFSI and CAMT basis purposes under §§1.56A-18 and 1.56A-19).

(ii) *Special rules regarding adjustments to the AFS basis of qualified wireless spectrum*—(A) *Qualified wireless spectrum placed in service prior to the effective date of CAMT*. The amounts described in paragraph (e)(2)(i) of this section include amounts attributable to all taxable years beginning before January 1, 2023 (including taxable years beginning on or before December 31, 2019).

(B) *Qualified wireless spectrum acquired in certain transactions to which section 197(f)(2) applies*. In the case of qualified wireless spectrum that was acquired by a CAMT entity in a transaction that is a covered recognition transaction, as defined in §1.56A-18(b)(10), with respect to at least one party to the transaction, or in a transaction described in §1.56A-20, the amounts described in paragraph (e)(2)(i) of this section include only amounts attributable to the period following the transaction, regardless of whether section 197(f)(2) applies to any portion of the transaction for regular tax purposes. For rules regarding transactions involving members of a tax consolidated group, *see* §1.1502-56A(e).

(C) *Determination of CAMT basis of qualified wireless spectrum following a change in method of accounting for amortization or a tax capitalization method change for qualified wireless spectrum.* In the case of qualified wireless spectrum for which the CAMT entity made a change in method of accounting for amortization for regular tax purposes or a tax capitalization method change for qualified wireless spectrum, the amounts described in paragraph (e)(2)(i) of this section are determined as though the CAMT entity used the method of accounting to which it changed to under the corresponding method change when making the adjustments under paragraph (d)(1) of this section in all taxable years prior to the taxable year in which the disposition of the qualified wireless spectrum occurs. The immediately preceding sentence applies regardless of whether the full amount of a corresponding tax amortization section 481(a) adjustment or a tax capitalization method change AFSI adjustment for qualified wireless spectrum has been taken into account in AFSI under paragraph (d)(1) of this section as of the end of the taxable year in which the disposition of the qualified wireless spectrum occurs.

(D) *Adjustments to the AFS basis of qualified wireless spectrum include only the covered book amounts actually disregarded in determining AFSI.* The adjustments described in paragraphs (e)(2)(i)(B) and (C) of this section include only amounts that were actually disregarded by the CAMT entity under paragraph (d)(1)(ii) of this section in computing its AFSI, modified FSI, or adjusted net income or loss for the relevant taxable years. Accordingly, for a taxable year ending after December 31, 2019, only the amounts disregarded under paragraph (d)(1)(ii) of this section in computing the AFSI, modified FSI, or adjusted net income or loss reported by the CAMT entity as required by the section 56A regulations or other sections of the Code (for example, on its annual return on Form 4626 (or any successor), on its Form 5471, or in accordance with the reporting requirements in §1.56A-5(h)) for such taxable year with respect to the qualified wireless spectrum are taken into account in computing the adjustments described in paragraphs (e)(2)(i)(B) and (C) of this section. For a taxable year ending on or before December 31, 2019, or for a taxable year in which the CAMT entity satisfied the simplified method under §1.59-2(g) (including a taxable year included in the relevant three-taxable-year period), the CAMT entity is deemed to have disregarded the appropriate amounts under paragraph (d)(1)(ii) of this section with respect to the qualified wireless spectrum for such taxable year.

(3) *Special rule for qualified wireless spectrum disposed of by a partnership*. If a partnership disposes of qualified wireless spectrum—

(i) The adjustment under paragraph (e)(1) of this section with respect to the qualified wireless spectrum is taken into account in determining the partnership's modified FSI under §1.56A-5(e)(3); and

(ii) For purposes of determining the adjustment under paragraph (e)(1) of this section with respect to the qualified wireless spectrum, the adjustment to the partnership's AFS basis in the qualified wireless spectrum under paragraph (e)(2)(i)(A) of this section—

(A) Includes any curative allocation under §1.704-3(c) or remedial item under §1.704-3(d) that is treated as tax amortization, but excludes any other curative allocation or offsetting remedial income item;

(B) Includes any tax amortization (including any reduction in tax amortization) with respect to a section 734(b) adjustment;

(C) Excludes any tax amortization (including any reduction in tax amortization) with respect to a section 743(b) basis adjustment; and

(D) Excludes any tax amortization (including any reduction in tax amortization) with respect to a basis adjustment under §1.1017-1(g)(2).

(iii) For purposes of determining the adjustment under paragraph (e)(1) of this section with respect to the qualified wireless spectrum, the adjustment to the partnership's AFS basis in the qualified wireless spectrum under paragraph (e)(2)(i)(D) of this section excludes any basis adjustment under §1.1017-1(g)

(2), regardless of whether any partner in the partnership is subject to the attribute reduction rules under §1.56A-21(c)(5) and (6). However, if a partner in the partnership is subject to the attribute reduction rules under §1.56A-21(c)(5) and (6), the partner increases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the qualified wireless spectrum by the amount of any basis adjustment under §1.1017-1(g)(2) with respect to the qualified wireless spectrum that has not yet been taken into account for regular tax purposes. *See* §1.1017-1(g)(2)(v).

(iv) If a partner has a basis adjustment under section 743(b) in place with respect to qualified wireless spectrum held by a partnership that is disposed of by the partnership, the partner—

(A) Increases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the qualified wireless spectrum by an amount equal to the total amount of any tax amortization or tax amortization section 481(a) adjustment(s) with respect to a section 743(b) basis adjustment that decreased the partner's distributive share amount under §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition; and

(B) Decreases its distributive share amount (under §1.56A-5(e)(4)(ii)(B)) for the taxable year of the disposition of the qualified wireless spectrum by an amount equal to the total amount of any tax amortization or tax amortization section 481(a) adjustment(s) with respect to a section 743(b) basis adjustment that increased the partner's distributive share amount under §1.56A-5(e)(1)(iv) and (e)(4)(ii)(A) for taxable years prior to the disposition.

(4) *Treatment of amounts recognized in FSI upon the disposition of qualified wireless spectrum*. Except as otherwise provided in other sections of the section 56A regulations, if a CAMT entity disposes of qualified wireless spectrum for regular tax purposes and recognizes gain or loss from the disposition in its FSI, the gain or loss (as redetermined under paragraph (e)(1) of this section) is recognized for AFSI purposes in the taxable year of disposition, regardless of whether any gain or loss with respect to the disposition is realized, recognized, deferred, or otherwise taken into account for regular tax purposes.

(5) *Subsequent AFS dispositions*. If qualified wireless spectrum is disposed of for regular tax purposes before it is treated as disposed of for AFS purposes, any AFS basis recovery with respect to such wireless spectrum that is reflected in FSI following the date such wireless spectrum is disposed of for regular tax purposes is disregarded in determining AFSI.

(6) *Intercompany transactions*. If a member of a tax consolidated group disposes of qualified wireless spectrum for regular tax purposes in an intercompany transaction, as defined in §1.1502-13(b)(1)(i), for which the AFS consolidation entries are taken into account under §1.1502-56A(c)(3)(i) in determining AFSI of the tax consolidated group for the taxable year that includes the intercompany transaction, the member's AFSI adjustment under paragraph (e)(1) of this section is determined as of the date of the intercompany transaction. However, the AFSI adjustment is deferred, and the tax consolidated group does not adjust AFSI under this paragraph (e), until the taxable year in which the AFS consolidation entries related to the disposition become disregarded under §1.1502-56A(c)(3)(ii). *See* §1.1502-56A(e)(3).

(7) *Example*. The following example illustrates the application of this paragraph (e).

(i) *Facts*. X is an applicable corporation for the calendar year ending December 31, 2024. On January 1, 2019, X acquired Wireless Spectrum 1, which is qualified wireless spectrum, at a cost of $1,000x. For AFS purposes, X does not amortize Wireless Spectrum 1. For regular tax purposes, X amortizes Wireless Spectrum 1 ratably over 15 years and recognizes $67x ($1,000x cost / 15 years) of deductible tax amortization in 2019 and each year thereafter until X sells Wireless Spectrum 1 (a disposition for regular tax and AFS purposes) on January 1, 2025, for $900x. For 2025, X takes into account $100x of net loss from the sale of Wireless Spectrum 1 in its FSI ($900x consideration - $1,000x of AFS basis ($1,000x cost - $0x accumulated covered book amortization expense as of January 1, 2025)).

(ii) *Analysis: Taxable year 2024*. In determining AFSI for the taxable year ending December 31, 2024, X does not have any covered book amortization expense or covered book wireless spectrum expense reflected in X's FSI with respect to Wireless Spectrum 1, and thus, the adjustment to disregard the amounts under paragraph (d)(1)(ii) of this section is zero. In addition, X reduces AFSI under paragraph (d)(1)(i) of this section for the $67x of deductible tax amortization with respect to Wireless Spectrum 1.

(iii) *Analysis: Taxable year 2025*. To determine the AFSI adjustment for the gain or loss from the sale of Wireless Spectrum 1 under paragraph (e)(1) of this section, X determines the CAMT basis of such property by adjusting the AFS basis of such property by the amounts described in paragraph (e)(2)(i) of this section with respect to such property, including those amounts attributable to taxable years beginning before January 1, 2023 (as required by paragraph (e)(2)(ii)(A) of this section). Accordingly, the CAMT basis of Wireless Spectrum 1 for AFSI purposes is $598x ($1,000x AFS basis + $0x accumulated covered book amortization expense - $402x of accumulated tax amortization). Thus, the redetermined gain on the sale of Wireless Spectrum 1 for AFSI purposes is $302x ($900x consideration - $598x CAMT basis), and X's AFSI adjustment under paragraph (e)(1) of this section to reflect the redetermined gain is a positive adjustment of $402x ($302x redetermined gain - $100x net loss in FSI).

(f) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-17 AFSI adjustments to prevent certain duplications or omissions.

(a) *Overview*. This section provides rules under section 56A(c)(15)(A) of the Code regarding AFSI adjustments to prevent the duplication or omission of income, expense, gain, or loss. Paragraph (b) of this section provides general rules for adjusting AFSI to prevent such duplications or omissions. Paragraph (c) of this section provides rules for adjusting AFSI to prevent duplications or omissions that arise from a change in accounting principle. Paragraph (d) of this section provides rules for adjusting AFSI to prevent duplications or omissions that arise from an AFS restatement. Paragraph (e) of this section provides rules for adjusting AFSI to prevent the omission of amounts disclosed in an auditor's opinion. Paragraph (f) of this section provides rules on timing differences that do not give rise to a duplication or omission. Paragraph (g) of this section provides the applicability date of this section.

(b) *In general*. To prevent duplications or omissions of items of income, expense,

gain, or loss, AFSI is adjusted for the items described in paragraphs (c) through (e) of this section and for such other items as required or permitted in other sections of the section 56A regulations (for example, §1.56A-4(c)(1)). *See* §1.59-2 for modifications to AFSI to prevent duplications or omissions that apply solely for purposes of section 59(k) of the Code.

(c) *Change in accounting principle*—(1) *In general*. If a CAMT entity implements a change in accounting principle in its AFS, or if the CAMT entity is treated as implementing a change in accounting principle under paragraph (c)(5) of this section, AFSI of the CAMT entity is adjusted to include the accounting principle change amount (as determined under paragraph (c)(2) of this section) for the taxable year(s) provided in paragraphs (c)(3) and (4) of this section.

(2) *Accounting principle change amount*—(i) *In general*. If a CAMT entity implements a change in accounting principle in its AFS for a taxable year, the accounting principle change amount is equal to the amount of the net cumulative adjustment to the CAMT entity's beginning retained earnings for the taxable year that results from the change in accounting principle, adjusted to—

(A) Disregard any portion of the cumulative retained earnings adjustment attributable to taxable years beginning on or before December 31, 2019; and

(B) Reflect the AFSI adjustments provided in other sections of the section 56A regulations to the extent the cumulative retained earnings adjustment is attributable to FSI items to which those AFSI adjustments apply.

(ii) *Change in AFS under paragraph (c)(5) of this section*. If a CAMT entity is treated as implementing a change in accounting principle under paragraph (c)(5) of this section for a taxable year, the accounting principle change amount is equal to the difference between the CAMT entity's beginning retained earnings reflected in the CAMT entity's current AFS as of the beginning of the taxable year and the CAMT entity's ending retained earnings reflected in the CAMT entity's former AFS as of the end of the immediately preceding taxable year (retained earnings difference), adjusted to—

(A) Disregard any portion of the retained earnings difference attributable to taxable years beginning on or before December 31, 2019; and

(B) Reflect the AFSI adjustments provided in other sections of the section 56A regulations to the extent the retained earnings difference is attributable to FSI items to which those AFSI adjustments apply.

(3) *Adjustment spread period rule*—(i) *Duplications*—(A) *General rule*. Except as provided in paragraph (c)(3)(i)(B) of this section, if an accounting principle change amount prevents a net duplication for AFSI purposes, the amount is included in the CAMT entity's AFSI ratably over four taxable years beginning with the taxable year for which the change in accounting principle is implemented in the CAMT entity's AFS.

(B) *Duplication over different period*. If the CAMT entity is able to demonstrate that the net duplication described in paragraph (c)(3)(i)(A) of this section is reasonably anticipated to occur over a different period (not to exceed fifteen taxable years), then the accounting principle change amount may be included in the CAMT entity's AFSI ratably over such period, beginning with the taxable year for which the change in accounting principle is implemented in the CAMT entity's AFS.

(ii) *Omissions*—(A) *Increase to AFSI*. If an accounting principle change amount prevents a net omission for AFSI purposes and results in an increase to AFSI, the amount is included in the CAMT entity's AFSI ratably over four taxable years beginning with the taxable year for which the change in accounting principle is implemented in the CAMT entity's AFS.

(B) *Decrease to AFSI*. If an accounting principle change amount prevents a net omission for AFSI purposes and results in a decrease to AFSI, the amount is included in the CAMT entity's AFSI in full in the taxable year for which the change in accounting principle is implemented in the CAMT entity's AFS.

(iii) *Short periods*. For purposes of paragraphs (c)(3)(i) and (ii) of this section, if any taxable year during the relevant spread period is a short taxable year, the CAMT entity takes the accounting principle change amount into account as if that short taxable year were a full 12-month taxable year.

(4) *Acceleration of accounting principle change amount*. If, in any taxable year, a CAMT entity ceases to engage in a trade or business to which an accounting principle change amount relates, the CAMT entity includes in AFSI for such taxable year any portion of such amount not included in AFSI for a previous taxable year.

(5) *Use of different priority AFSs in consecutive taxable years*. If the priority of a CAMT entity's AFS (as determined under §1.56A-2(c)) for the taxable year is different than the priority of the CAMT entity's AFS for the immediately preceding taxable year, the CAMT entity is treated as having implemented a change in accounting principle for the taxable year and adjusts AFSI to the extent required under this paragraph (c).

(6) *Examples.* The following examples illustrate the application of the rules in this paragraph (c). For purposes of these examples, the adjustments to retained earnings due to the change in accounting principle are shown on a pre-tax basis.

(i) *Example 1*: *Adjustment spread period: duplicated income spread over 2 years*—(A) *Facts*. X is a CAMT entity that uses the calendar year as its taxable year and has a calendar-year financial accounting period. Under the accounting standards that X uses to prepare its AFS, X reports income from contracts under an acceleration method. The applicable regulatory body that issues the accounting standards that X uses to prepare its AFS changed the accounting standards to require income from contracts accounted for under an acceleration method to be accounted for under an end-of-contract deferral method, effective for financial statements issued for financial accounting periods beginning after December 31, 2023. This change in accounting standards constitutes a change in accounting principle. On January 1, 2024, X has outstanding contracts that are subject to this change in accounting principle (Affected Contracts), and the term of the longest Affected Contract ends in 2025. In X's 2024 AFS, X makes a $150x negative cumulative adjustment to its opening retained earnings for 2024 to reverse the income X previously reflected in its FSI after 2019 and prior to 2024 with respect to the Affected Contracts. Pursuant to the new accounting principle, X reflects the duplicated income from the Affected Contracts in FSI for 2024 and 2025.

(B) *Analysis.* Under paragraph (c)(1) of this section, X is required to adjust AFSI by the accounting principle change amount (the $150x negative cumulative adjustment) for the taxable years provided in paragraph (c)(3) of this section. Because the accounting principle change amount prevents a duplication of income, under paragraph (c)(3)(i)(A) of this section, X takes the negative $150x accounting principle change amount into account in AFSI ratably over four taxable years beginning with the 2024 taxable year ($150x / 4 years = $37.5x per year). Alternatively, because X is able to demonstrate that the duplicated income is reasonably expected to be included in FSI in 2024 and 2025, under para-

graph (c)(3)(i)(B) of this section X may choose to take the negative $150x accounting principle change amount into account in AFSI ratably over 2024 and 2025 ($150x / 2 years = $75x per year).

(ii) *Example 2: Adjustment spread period: duplicated income spread over 10 years*—(A) *Facts.* The facts are the same as in paragraph (c)(6)(i)(A) of this section (*Example 1*), except that the term of the longest Affected Contract ends in 2033.

(B) *Analysis.* Under paragraph (c)(3)(i)(A) of this section, X takes the negative $150x accounting principle change amount into account in AFSI ratably over four taxable years beginning with the 2024 taxable year ($150x / 4 years = $37.5x year). Alternatively, because X is able to demonstrate that the duplicated income is reasonably expected to be included in FSI over the 10-year period from 2024 through 2033, under paragraph (c)(3)(i)(B) of this section X may choose to take the negative $150x accounting principle change amount into account in AFSI ratably over the 10-year period from the 2024 taxable year through the 2033 taxable year ($150x / 10 years = $15x per year).

(iii) *Example 3: Adjustment spread period: duplications expected over twenty-year period*—(A) *Facts*. The facts are the same as in paragraph (c)(6)(i)(A) of this section (*Example 1*), except that the term of the longest Affected Contract ends in 2043.

(B) *Analysis*. Under paragraph (c)(3)(i)(A) of this section, X takes the negative $150x accounting principle change amount into account in AFSI ratably over the four-taxable-year period beginning with the 2024 taxable year ($150x / 4 years = $37.5x per year). Alternatively, because X is able to demonstrate that the duplicated income is reasonably expected to be included in FSI over a period in excess of 15 taxable years, under paragraph (c)(3)(i)(B) of this section X may choose to take the negative $150x accounting principle change amount into account in AFSI ratably over the 15-year period from the 2024 taxable year through the 2038 taxable year ($150x / 15 years = $10x per year).

(d) *Restatement of a prior year's AFS*—(1) *In general*—(i) *Adjustments to AFSI*. Except as provided in paragraph (d)(2) of this section, if a CAMT entity issues a restated AFS and, as a result, the CAMT entity's FSI for a taxable year beginning after December 31, 2019, is restated on or after the date the CAMT entity filed its original Federal income tax return for such taxable year (restatement year), the CAMT entity accounts for the restatement by adjusting its AFSI for the taxable year in which the restated AFS is issued (AFSI restatement adjustment). Subject to paragraph (d)(1)(ii) of this section, the AFSI restatement adjustment takes into account the cumulative effect of the restatement on the CAMT entity's FSI for the restatement year, including any restatement of the CAMT entity's beginning retained earnings for the restatement year (but only to the extent the retained earnings restatement is attributable to taxable years beginning after December 31, 2019). *See* §1.56A-2(e) for rules relating to the issuance of a restated AFS prior to the date the CAMT entity's return for the taxable year is filed.

(ii) *Further adjustments to AFSI*. The AFSI restatement adjustment described in paragraph (d)(1)(i) of this section is subject to further adjustment if it relates to one or more FSI items to which AFSI adjustments provided in other sections of the section 56A regulations apply. For example, to the extent the AFSI restatement adjustment includes a Federal income tax component, §1.56A-8 applies to disregard that component.

(2) *Exception for amended return*. If, after issuing a restated AFS for a taxable year, a CAMT entity files an amended return or an administrative adjustment request under section 6227 of the Code (AAR), as applicable, for the taxable year to adjust taxable income as a result of the restatement, the CAMT entity must use the restated AFS for purposes of determining AFSI on the amended return or AAR, as applicable, rather than make the AFSI restatement adjustment under paragraph (d)(1) of this section.

(3) *Reconciliation of retained earnings in AFS.* A CAMT entity is deemed to have issued a restated AFS for a preceding taxable year described in paragraph (d)(3)(i) of this section, and applies paragraph (d)(1) or (2) of this section, as applicable, if—

(i) The beginning retained earnings reflected in the CAMT entity's AFS for the current taxable year is adjusted to be different than the ending retained earnings reflected in the CAMT entity's AFS for the preceding taxable year (for example, as a result of a prior period adjustment);

(ii) The difference described in paragraph (d)(3)(i) of this section is attributable to items that otherwise would be reflected in the CAMT entity's FSI under the relevant accounting standards used to prepare the CAMT entity's AFS; and

(iii) The CAMT entity is not otherwise subject to paragraph (c) or (d)(1) or (2) of this section.

(4) *Example*. The following example illustrates the application of paragraph (d)(1) of this section.

(i) *Facts*. X is a CAMT entity that uses the calendar year as its taxable year and has a calendar-year financial accounting period. On September 15, 2024, X files its Federal income tax return for taxable year 2023 and reports FSI of $1,580x, which is the FSI set forth on X's original AFS for 2023, and AFSI of $2,000x (FSI of $1,580x adjusted to disregard $420x of Federal income tax expense under §1.56A-8). On November 1, 2024, X issues a restated AFS for 2023 that reflects FSI of $2,370x (which includes a reduction for Federal income tax expense of $630x). The restated AFS also includes an adjustment to increase the 2023 beginning balance of retained earnings by $79x ($100x income - $21x Federal income tax expense) related to income from a prior period that was underreported. X is not amending its taxable year 2023 Federal income tax return to adjust taxable income for such year. X is not subject to any AFSI adjustments other than the AFSI adjustment under §1.56A-8.

(ii) *Analysis*. X has restated its FSI for 2023 in a restated AFS issued after X filed its original 2023 Federal income tax return. Pursuant to paragraph (d)(1) of this section, X accounts for the restatement by adjusting its AFSI for taxable year 2024, the taxable year in which the restated AFS for 2023 is issued. On X's 2024 Federal income tax return, X will increase AFSI by $1,100x for taxable year 2024, which is the first taxable year for which X has not filed an original return as of the November 1, 2024, restatement date. The $1,100x adjustment represents the cumulative effect of the restatement on FSI, including any restatement of the beginning balance of retained earnings for the period being restated, or 2023. The $1,100x consists of $790x ($2,370x FSI reported on the restated AFS - $1,580x FSI reported on the original AFS), plus $210x ($630x Federal income tax expense reported on the restated AFS - $420x Federal income tax expense reported on the original AFS, which is required to be disregarded under section §1.56A-8 in determining AFSI), plus $100x ($79x net adjustment to the 2023 beginning balance of retained earnings reported on the restated AFS for 2023 + $21x disregarded Federal income tax expense (under §1.56A-8)).

(e) *Adjustment for amounts disclosed in an auditor's opinion*—(1) *In general*. AFSI is adjusted to include amounts disclosed in an auditor's opinion described in §1.56A-2(d)(2) and (3) to the extent such amounts would have increased FSI for the taxable year to which the auditor's opinion relates had the amounts been reflected in the CAMT entity's AFS for such taxable year (auditor increase to FSI). No AFSI adjustment is required to the extent the auditor increases to FSI were included in FSI for a prior taxable year. Moreover, if FSI for a subsequent taxable year includes amounts included in AFSI pursuant to an adjustment under this paragraph (e), AFSI for the subsequent taxable year is adjusted to prevent any duplication of income.

(2) *Further adjustments to AFSI*. The auditor increase to FSI described in paragraph (e)(1) of this section is subject to further adjustment if it relates to one or more FSI items to which AFSI adjustments provided in other sections of the section 56A regulations apply. For example, to the extent the auditor increase to FSI includes a Federal income tax component, §1.56A-8 applies to disregard that component.

(f) *No adjustment for timing differences*. No adjustment to AFSI is permitted to account for differences between the taxable year in which an item is taken into account in FSI and the taxable year in which that item is taken into account for regular tax purposes, even if the timing difference for that item originates in a taxable year that begins prior to January 1, 2023, and reverses in a taxable year that begins on or after January 1, 2023.

(g) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-18 AFSI, CAMT basis, and CAMT retained earnings resulting from certain corporate transactions.

(a) *Overview*—(1) *Scope*. Except as provided in paragraph (a)(2) of this section, this section provides rules under section 56A(c)(2)(C) and (c)(15)(B) of the Code for determining the AFSI, CAMT basis, and CAMT earnings consequences resulting from specified transactions between a domestic corporate CAMT entity and an individual or other CAMT entity, including a CAMT entity that is a shareholder of a domestic corporate CAMT entity. Paragraph (a)(3) of this section provides cross-references to other applicable rules. Paragraph (b) of this section provides definitions that apply for purposes of this section and §§1.56A-19 and 1.56A-21. Paragraph (c) of this section provides operating rules for this section and §§1.56A-19 and 1.56A-21. Paragraph (d) of this section provides rules for determining the CAMT consequences of certain non-liquidating stock and property distributions. Paragraph (e) of this section provides rules for determining the CAMT consequences of certain distributions for which an election under section 336(e) of the Code (section 336(e) election) is made. Paragraph (f) of this section provides rules for determining the CAMT consequences of liquidating distributions. Paragraph (g) of this section provides rules for determining the CAMT consequences of stock sales. Paragraph (h) of this section provides rules for determining the CAMT consequences of asset sales. Paragraph (i) of this section provides the applicability date of this section.

(2) *Exceptions*. This section and §1.56A-19 do not apply to any transaction—

(i) Between members of the same tax consolidated group during any period that they are members of the same tax consolidated group (*see* §1.1502-56A(c)(3) for treatment of members of a tax consolidated group when a party to a transaction or property subject to a transaction described in this section or §1.56A-19 leaves a tax consolidated group); or

(ii) That is a covered asset transaction (as defined in §1.56A-4(b)(1)), a section 338(g) transaction (as defined in §1.56A-4(b)(3)), or an acquisition or transfer of stock of a foreign corporation subject to §1.56A-4(c)(1).

(3) *Cross-references*—(i) *Corporate reorganizations and organizations*. For rules regarding the AFSI, CAMT basis, and CAMT earnings consequences resulting from certain corporate reorganizations and organizations not within a tax consolidated group, *see* §1.56A-19.

(ii) *Transactions within a tax consolidated group*. For rules regarding the AFSI, CAMT basis, and CAMT earnings consequences resulting from transactions between members of the same tax consolidated group (including rules regarding the timing of those determinations), *see* §1.1502-56A.

(iii) *Deferral of loss from disposition between certain members of a CAMT-related group*. For rules that require the deferral of any loss resulting from a sale, exchange, or any other disposition of property between two or more CAMT entities that are treated as a single employer under section 52(a) and (b) of the Code, *see* §1.56A-26(b).

(iv) *Certain arrangements disregarded or recharacterized*. For rules pursuant to which the Commissioner may disregard or recharacterize arrangements entered into by one or more CAMT entities, *see* §1.56A-26(c).

(v) *Clear reflection of income requirement*. For rules regarding adjustments to AFSI to reflect the principles of section 482 of the Code and the regulations under section 482, *see* §1.56A-26(d).

(vi) *AFSI and CAMT attribute rules regarding troubled corporations*. For rules to determine the CAMT consequences resulting from an insolvency or bankruptcy of a CAMT entity (including an emergence from bankruptcy of a CAMT entity), *see* §1.56A-21.

(vii) *Financial statement net operating losses*. For rules regarding the apportionment, transfer, and use of FSNOLs by a CAMT entity, *see* §§1.56A-23 and 1.1502-56A.

(viii) *Minimum tax credits*. For rules regarding limitations on the use of minimum tax credits, *see* section 383 of the Code and §1.383-1.

(ix) *AFSI history*. For rules regarding the determination of AFSI history of a CAMT entity described in this section, *see* §1.59-2(f).

(x) *Certain stock owned by insurance companies*. For rules regarding the AFSI consequences of an insurance company owning stock that relates to the insurance company's obligations under certain insurance contacts, *see* §1.56A-22(c).

(b) *Definitions*. For purposes of this section and §§1.56A-19 and 1.56A-21:

(1) *Acquiror corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *acquiror corporation* means a party

to the covered nonrecognition transaction that is—

(A) An *acquiring corporation* within the meaning of §1.368-2 (that is, an acquiring corporation with regard to a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(A) through (C) and (G) of the Code); or

(B) A *transferee corporation* within the meaning of §1.368-2(l)(1) (that is, a transferee corporation with regard to a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(D)), other than a controlled corporation.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *acquiror corporation* means a corporate party to the covered recognition transaction that is treated on the corporate party's AFS as acquiring stock or assets of a target corporation (for example, an acquiror under the Accounting Standards Codification). *See generally* paragraphs (g) and (h) of this section, which provide rules for determining the CAMT consequences of stock and asset sales.

(2) *B reorganization*. The term *B reorganization* means a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(B).

(3) *CAMT current earnings*. The term *CAMT current earnings*, for a taxable year of a corporate CAMT entity, means the AFSI of the corporate CAMT entity for the taxable year, taking into account the adjustments required by this section and §1.56A-19 (not otherwise reflected in AFSI).

(4) *CAMT earnings*. The term *CAMT earnings* means CAMT current earnings and CAMT retained earnings (as appropriate).

(5) *CAMT retained earnings*—(i) *In general*. The term *CAMT retained earnings*, with regard to a corporate CAMT entity, means the amount obtained by adding—

(A) The amount of earnings and profits (within the meaning of section 312 of the Code) of the CAMT entity as of the beginning of the first taxable year of the CAMT entity beginning after December 31, 2019 (even if negative); and

(B) The cumulative balance of the CAMT current earnings of the corporate CAMT entity, taking into account all taxable years of the corporate CAMT entity beginning after December 31, 2019 (that is, all subsequent taxable years).

(ii) *Timing of determination*. The CAMT retained earnings for a year of a corporate CAMT entity is determined immediately before the beginning of the corporate CAMT entity's current taxable year.

(6) *Component transaction*. The term *component transaction* means, with regard to a party to a transaction specified in this section or §1.56A-19, an element of the transaction (for example, an actual or a deemed transfer or other disposition of property by the party) the regular tax consequences of which are determined solely with regard to that party. For example, a section 351 transferor and section 351 transferee in the same section 351 exchange each would be a party to separate transfers of property that compose separate component transactions of that exchange, the regular tax consequences of which are determined under separate sections of the Code. For rules regarding component transactions, *see* paragraph (c)(5) of this section.

(7) *Controlled corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *controlled corporation* means a party to the covered nonrecognition transaction that is a controlled corporation described in section 355(a)(1)(A) of the Code.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *controlled corporation* means a party—

(A) To a covered recognition transaction that qualifies as a section 355 transaction; and

(B) That is treated as a corporation the stock of which is distributed by another corporation on the AFS of that other corporation (for example, a *spinnee* under the Accounting Standards Codification).

(8) *Corporate dissolution*. The term *corporate dissolution* means—

(i) The complete dissolution of a corporation pursuant to a plan reported on the original (but not a supplemented or an amended) Form 966, *Corporate Dissolution or Liquidation* (or any successor form); or

(ii) A deemed dissolution (for example, pursuant to an election to be treated as a disregarded entity under §301.7701-3 of this chapter).

(9) *Covered nonrecognition transaction*. The term *covered nonrecognition transaction* means a component transaction that, with regard to a party—

(i) Qualifies for nonrecognition treatment for regular tax purposes, under section 305, 311(a), 332, 337, 351, 354, 355, 357, 361, or 1032(a) of the Code, or a combination thereof, solely with regard to that party;

(ii) Is not treated as resulting in the recognition of any amount of gain or loss for regular tax purposes solely with regard to that party; and

(iii) Is not treated as a covered recognition transaction under any provision of this section or §1.56A-19.

(10) *Covered recognition transaction*. The term *covered recognition transaction* means a component transaction consisting of a transfer, sale, contribution, distribution, or other disposition of property that, with regard to a party, does not qualify as a covered nonrecognition transaction solely with regard to the party (and therefore, for example, could result in the recognition of gain or loss for regular tax purposes to the party).

(11) *Covered transaction*. The term *covered transaction* means a covered recognition transaction or a covered nonrecognition transaction (as appropriate).

(12) *Distributing corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *distributing corporation* means a party to the covered nonrecognition transaction that—

(A) Distributes stock or stock rights of the corporation under section 311(a); or

(B) With regard to a section 355 transaction, distributes stock or securities of a controlled corporation under section 355(c) or distributes stock or securities, or money or other property, of a controlled corporation under section 361(c).

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *distributing corporation* means a party to the covered recognition transaction that—

(A) Distributes property in a distribution described in section 311(b);

(B) Distributes stock in a distribution described in section 336(e); or

(C) With regard to a section 355 transaction, is treated on the party's AFS as the corporation that distributes the stock or securities of another corporation (for example, a *spinnor* under the Accounting Standards Codification) or distributes money or other property (in addition to stock or securities) of that other corporation.

(13) *Distributing corporation shareholder or security holder*. The term *distributing corporation shareholder or security holder* means, with regard to a section 355 transaction, a CAMT entity that receives in a distribution with respect to, or in exchange for, distributing corporation stock or securities (as appropriate)—

(i) Stock or securities of a controlled corporation under section 355; or

(ii) Money or other property (in addition to stock or securities) of the controlled corporation under section 356 of the Code.

(14) *Distribution recipient*. The term *distribution recipient* means, with regard to a covered transaction, a CAMT entity that receives from a distributing corporation—

(i) A distribution of property described in section 301 of the Code;

(ii) A distribution in redemption of stock of the distributing corporation under section 302 of the Code; or

(iii) A distribution of stock or stock rights of the distributing corporation under section 305.

(15) *E reorganization*. The term *E reorganization* means a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(E).

(16) *F reorganization*. The term *F reorganization* means a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(F).

(17) *Liquidating corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *liquidating corporation* means a party to the covered nonrecognition transaction that distributes, through one or more distributions, its property in a complete liquidation to which section 337(a) of the Code applies.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *liquidating corporation* means a party to the transaction that distributes, through one or more distributions, all of its property in—

(A) A complete liquidation to which section 336(a) applies; or

(B) Any other corporate dissolution.

(18) *Liquidation recipient*. The term *liquidation recipient* means, with regard to a covered transaction, a CAMT entity that receives one or more distributions of property from a liquidating corporation as part of—

(i) A complete liquidation under sections 331 and 336 of the Code, or sections 332 and 337, as appropriate; or

(ii) Any other corporate dissolution.

(19) *Party*. The term *party* means, with regard to a covered transaction—

(i) An acquiror corporation;

(ii) An acquiror corporation shareholder;

(iii) A controlled corporation;

(iv) A distributing corporation;

(v) A distributing corporation shareholder or security holder;

(vi) A liquidating corporation;

(vii) A liquidation recipient;

(viii) A recapitalizing corporation;

(ix) A recapitalizing corporation shareholder or security holder;

(x) A resulting corporation;

(xi) A section 351 transferee;

(xii) A section 351 transferor;

(xiii) A target corporation;

(xiv) A target corporation shareholder or security holder;

(xv) A transferor corporation; and

(xvi) A transferor corporation shareholder or security holder.

(20) *Property*. The term *property* means any asset, including stock.

(21) *Qualified property*. The term *qualified property* has the meaning given the term in section 355(c)(2)(B) or 361(c)(2)(B) (as appropriate).

(22) *Recapitalizing corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *recapitalizing corporation* means a corporate party to the covered nonrecognition transaction that recapitalizes its capital structure in a transaction that qualifies as an E reorganization or an exchange to which section 1036 of the Code applies.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *recapitalizing corporation* means a corporate party to the covered recognition transaction through which the party recapitalizes its capital structure.

(23) *Recapitalizing corporation shareholder or security holder*. The term *recapitalizing corporation shareholder or security holder* means, with regard to an E reorganization, a CAMT entity that receives in exchange for recapitalizing corporation stock or securities (as appropriate)—

(i) Stock or securities of a recapitalizing corporation under section 354; or

(ii) Money or other property (in addition to stock or securities) of the recapitalizing corporation under section 301.

(24) *Resulting corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *resulting corporation* means a resulting corporation within the meaning given the term in §1.368-2(m)(1) (that is, a resulting corporation with regard to an F reorganization) that is a party to the covered nonrecognition transaction.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *resulting corporation* means a corporate party—

(A) To a covered nonrecognition transaction that qualifies as an F reorganization; and

(B) That makes a distribution of property to a transferor corporation shareholder or security holder (*see* paragraph (d)(1)(ii) of this section for rules addressing non-liquidating corporate distributions).

(25) *Section 351 exchange*. The term *section 351 exchange* means one or more transfers by one or more persons (that is, section 351 transferors) of property to a corporation (that is, a section 351 transferee) in exchange for stock of that corporation, or stock and money or other property, that qualifies as an exchange under section 351.

(26) *Section 351 transferee*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *section 351 transferee* means a party to the section 351 exchange that transfers solely that party's stock to a section 351 transferor, in exchange for money or other property from the section 351 transferor, in a transaction to which section 1032(a) applies.

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *section 351 transferee* means a party to the section 351 exchange that transfers money or other property (in addition to that party's stock) to a section 351 transferor, in exchange for money or other property from the section 351 transferor, in a transaction to which section 1032(a) applies.

(27) *Section 351 transferor*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *section 351 transferor* means a party to the section 351 exchange that transfers property to a section 351 transferee solely in exchange for stock of the section 351 transferee in a transaction that qualifies the party solely for nonrecognition treatment under section 351(a).

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *section 351 transferor* means a party to the section 351 exchange that—

(A) Transfers property to a section 351 transferee in a transaction to which section 351 applies; and

(B) Receives from the section 351 transferee money or other property (in addition to stock of the section 351 transferee) under section 351(b).

(28) *Section 355 transaction*. The term *section 355 transaction* means—

(i) A series of transactions that qualify as a reorganization under sections 355(a) and 368(a)(1)(D) or (G), including a transfer of property by a distributing corporation to a controlled corporation and one or more distributions of controlled corporation stock or controlled corporation securities that are in pursuance of the plan of reorganization; or

(ii) A distribution of controlled corporation stock or controlled corporation securities that qualifies under section 355 (or so much of section 356 as relates to section 355) and that is not undertaken pursuant to a plan of reorganization.

(29) *Target corporation*—(i) *Covered nonrecognition transaction*. In the case of a covered nonrecognition transaction, the term *target corporation* means a party to the covered nonrecognition transaction that is—

(A) A target corporation within the meaning of §1.368-2 (that is, a target corporation with regard to a series of one or more transactions that qualify as a reorganization under section 368(a)(1)(A) through (C) and (G)); or

(B) A transferor corporation within the meaning of §1.368-2(l)(1).

(ii) *Covered recognition transaction*. In the case of a covered recognition transaction, the term *target corporation* means a corporate party to the covered recognition transaction the property (that is, stock or assets) of which is recorded as acquired on the AFS of the acquiror corporation (for example, an acquiree under the Accounting Standards Codification).

(30) *Target corporation shareholder or security holder*. The term *target corporation shareholder or security holder* means, with regard to a series of one or more transactions that qualify as a reorganization described in paragraph (b)(30)(i) of this section, a CAMT entity that receives in exchange for target corporation stock or securities (as appropriate)—

(i) Stock or securities of an acquiror corporation under section 354; or

(ii) Money or other property of the acquiror corporation under section 356 (in addition to stock or securities of the acquiror corporation).

(31) *Transferor corporation*. In the case of a covered nonrecognition transaction, the term *transferor corporation* means a *transferor corporation* within the meaning given the term in §1.368-2(m)(1) (that is, a transferor corporation with regard to an F reorganization) that is a party to the covered nonrecognition transaction.

(32) *Transferor corporation shareholder or security holder*. The term *transferor corporation shareholder or security holder* means, with regard to an F reorganization, a CAMT entity that receives in exchange for transferor corporation stock or securities (as appropriate)—

(i) Stock or securities of a resulting corporation under section 354; or

(ii) Money or other property of the resulting corporation under section 301 or 302 (in addition to stock or securities of the acquiror corporation).

(c) *Operating rules for this section and §1.56A-19*—(1) *Treatment of stock*. If a shareholder that is a CAMT entity owns stock of a corporate CAMT entity (for example, a subsidiary), for purposes of applying this section and §1.56A-19 with regard to the shareholder and subsidiary, as appropriate—

(i) The stock is treated as a directly held asset of the shareholder; and

(ii) The shareholder is not treated as directly holding the assets of the subsidiary.

(2) *FSI resulting from stock investments*—(i) *In general*. Except as provided in paragraph (c)(2)(ii) of this section, if a CAMT entity holds stock in a domestic corporation that is not a member of a tax consolidated group of which the CAMT entity is a member, the CAMT entity—

(A) Disregards in computing the CAMT entity's AFSI any amount reflected in the CAMT entity's FSI that results from holding stock in the domestic corporation (for example, the FSI of a shareholder CAMT entity that otherwise would result from the application of the equity method or fair value method with regard to the shareholder CAMT entity's investment in stock of the subsidiary domestic corporation);

(B) Disregards any adjustment to AFS basis of the stock of that corporation on the CAMT entity's AFS, and instead adjusts CAMT basis in the stock as provided in this section or §1.56A-19; and

(C) Disregards any adjustments to AFS retained earnings resulting from the ownership of that stock, and instead adjusts CAMT retained earnings as provided in this section or §1.56A-19.

(ii) *Exceptions*. Paragraph (c)(2)(i) of this section does not apply with regard to—

(A) Amounts that result from a transaction described in paragraphs (d) through (h) of this section or in §1.56A-19; or

(B) Gains or losses reflected in the CAMT entity's FSI that result from the remeasurement (to fair value) of its existing or remaining stock in a domestic corporation (that is, a subsidiary) when the CAMT entity acquires or disposes of some (but not all) stock in that subsidiary domestic corporation in a covered recognition transaction.

(iii) *Characterization of FSI resulting from stock investments*—(A) *In general*. Except as otherwise provided in paragraph (c)(2)(iii)(B) of this section, the shareholder of a distributing corporation or a target corporation determines the character of any distribution resulting from

a transaction described in paragraphs (d) through (h) of this section or in §1.56A-19 using the distributing corporation's or target corporation's regular tax earnings and profits.

(B) *Exception*. If the requirements of each of paragraphs (c)(2)(iii)(B)(*1*) and (*2*) of this section are met, the shareholder of a distributing corporation or a target corporation determines the character of any distribution resulting from a transaction described in paragraphs (d) through (h) of this section or in §1.56A-19 as set forth in paragraphs (d) through (h) of this section or in §1.56A-19, respectively.

(*1*) Immediately before the transaction, the shareholder owns at least 25 percent (by vote and value) of the stock or the distributing corporation or the target corporation.

(*2*) The distributing corporation or the target corporation would not qualify for the simplified method for determining applicable corporation status described in §1.59-2(g)(2).

(3) *Purchase accounting and push down accounting for stock acquisitions*. If an acquiror corporation acquires stock of a target corporation in a covered transaction for regular tax purposes, purchase accounting and push down accounting adjustments (as applicable) that otherwise would be reflected in an acquiror corporation's AFS basis, balance sheet accounts, or FSI are disregarded for purposes of determining the acquiror corporation's AFSI, CAMT basis, and CAMT earnings (as appropriate).

(4) *Purchase accounting and push down accounting for asset acquisitions*. If an acquiror corporation acquires assets of a target corporation in a covered transaction for regular tax purposes, then for purposes of determining the acquiror corporation's AFSI, CAMT basis, and CAMT earnings (as appropriate)—

(i) If the transaction is a covered recognition transaction, any purchase accounting adjustments reflected in a CAMT entity's AFS basis, balance sheet accounts, or FSI are regarded; and

(ii) If the transaction is a covered nonrecognition transaction, any purchase accounting adjustments reflected in a CAMT entity's AFS basis, balance sheet accounts, or FSI are disregarded.

(5) *Determination of CAMT consequences of component transactions*—(i) *Generally separate treatment*. Except as provided in paragraph (c)(5)(ii) of this section, each component transaction of a larger transaction is examined separately for qualification as a covered nonrecognition transaction or a covered recognition transaction with regard to each party to the component transaction. For example, a section 351 transferor and a section 351 transferee of the same section 351 exchange each would be a party to separate property transfers that compose separate component transactions of that exchange, the regular tax consequences of which are determined under separate sections of the Code.

(ii) *Effect of other component transactions*. The treatment of a component transaction as a covered nonrecognition transaction or covered recognition transaction may be affected by the treatment of any other component transaction for regular tax purposes, taking into account all relevant provisions of the Code and general principles of Federal tax law, including the step transaction doctrine.

(6) *CAMT stock basis transition rule*. The CAMT basis of stock in a corporation held by a CAMT entity equals the adjusted basis of the stock for regular tax purposes as of the beginning of the first taxable year of the CAMT entity beginning after December 31, 2019, taking into account all subsequent adjustments required under this section and §1.56A-19. For rules regarding the CAMT basis of stock in a corporation acquired by a CAMT entity during any taxable year of the CAMT entity beginning after December 31, 2019, *see* §1.56A-1(d)(3).

(7) *CAMT retained earnings following certain cross border transactions*—(i) *Inbound liquidations and reorganizations*. If a foreign corporation transfers property to a domestic corporation in a complete liquidation to which sections 332 and 337 apply or in an asset acquisition described in section 368(a)(1), the domestic corporation's CAMT retained earnings are increased to the extent of any earnings and profits of the foreign corporation that carryover to the domestic corporation under section 381(c)(2) of the Code. *See* §1.367(b)-3(f)(1); §1.56A-4(h)(8) (*Example 8*).

(ii) *Section 355 distributions*. If a foreign corporation transfers stock in a domestic corporation described in section 355(a)(1)(A) of the Code in a transfer to which section 355 of the Code applies, the domestic corporation's CAMT retained earnings are increased to the extent of any earnings and profits allocated to the domestic corporation under §1.312-10. Furthermore, if a domestic corporation transfers stock in a foreign corporation described in section 355(a)(1)(A) of the Code in a transfer to which section 355 of the Code applies, the domestic corporation's CAMT retained earnings are decreased to the extent the earnings and profits of the domestic corporation are reduced under §1.312-10.

(8) *Examples*. The following examples illustrate the application of the rules in this paragraph (c). For purposes of these examples, except as otherwise provided, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Treatment of stock*—(A) *Facts*. X owns all the stock of Y, which owns Asset 1 and Asset 2. On X's AFS, X is treated as owning directly Asset 1 and Asset 2.

(B) *Analysis*. For purposes of this section and §1.56A-19, X treats the Y stock as an asset that X directly owns. *See* paragraph (c)(1)(i) of this section. Accordingly, X is not treated as directly owning either Asset 1 or Asset 2. *See* paragraph (c)(1)(ii) of this section.

(ii) *Example 2: FSI resulting from stock investments marked to market*—(A) *Facts*. On February 1, 2024, X acquires stock in Y, a publicly traded company, for $100x. On X's AFS, X records the Y stock with an AFS basis of $100x. X does not acquire more, or dispose of any, Y stock. On March 31, 2024, X increases the AFS basis of the Y stock to its fair value of $110x and recognizes $10x of gain on X's AFS. For regular tax purposes, X does not mark X's Y stock to market.

(B) *Analysis*. The CAMT consequences to X are identical to the consequences that result for regular tax purposes. Therefore, in computing X's AFSI, X disregards the $10x of FSI resulting from the revaluation of X's Y stock to its fair value. *See* paragraph (c)(2)(i)(A) of this section. Accordingly, X does not adjust X's CAMT basis in the Y stock. *See* paragraph (c)(2)(i)(B) of this section. *See also generally* §1.56A-19 (providing no required adjustments to X's CAMT basis in the Y stock). Likewise, X does not adjust X's CAMT retained earnings. *See* paragraph (c)(2)(i)(C) of this section. *See also generally* §1.56A-19 (providing no required adjustments to X's CAMT retained earnings).

(iii) *Example 3: FSI resulting from stock investments due to equity method annual inclusions*—(A) *Facts*. X owns 35% of the stock of Y. In 2024, Y

reports $20x of net income on Y's AFS. Under the equity method, X includes on X's AFS $7x of Y's income (35% x $20x = $7x). Consequently, X increases the AFS basis of X's Y stock on X's AFS by $7x.

(B) *Analysis*. The CAMT consequences to X are identical to the consequences that result for regular tax purposes. Therefore, to compute X's AFSI, X disregards the $7x of Y's income reported as FSI on X's AFS. Accordingly, X does not adjust X's CAMT basis in the Y stock. *See* paragraph (c)(2)(i)(B) of this section. *See also generally* §1.56A-19 (providing no required adjustments to X's CAMT basis in the Y stock). Likewise, X does not adjust X's CAMT retained earnings. *See* paragraph (c)(2)(i)(C) of this section. *See also generally* §1.56A-19 (providing no required adjustments to X's CAMT retained earnings).

(iv) *Example 4: Remeasurement gain*—(A) *Facts*. X owns 5% of the stock of Y. X's AFS basis in the Y stock is $45x, and X's CAMT basis in the Y stock is $35x. X acquires an additional 25% of the Y stock for $250x in a covered recognition transaction. The imputed value of X's 5% interest in Y at the time of the acquisition is $50x (($250x / 0.25) x 0.05 = $50x). As a result of the acquisition, X reports on X's AFS gain of $5x ($50x - $45x = $5x), and X records X's 30% interest in Y with an AFS basis of $300x ($250x + $50x = $300x).

(B) *Analysis*. The adjustments to AFSI described in paragraph (c)(2)(i) of this section do not apply with respect to X's remeasurement gains resulting from X's acquisition of additional Y stock. *See* paragraph (c)(2)(ii)(B) of this section. Therefore, X takes into account the $5x of remeasurement gain reported on X's AFS, adjusts X's CAMT basis in the Y stock from $35x to $40x, and takes into account any adjustments to X's AFS retained earnings resulting from the ownership of the Y stock.

(v) *Example 5: Purchase accounting and push down accounting*—(A) *Facts*. Target is the parent of a tax consolidated group of which X is a subsidiary member. Target owns 100% of the stock of X, the fair market value and CAMT basis of which are $70x and $20x, respectively. X's assets have a fair market value and CAMT basis of $70x and $50x, respectively. During the taxable year, Acquiror acquires all the stock of Target from Target's shareholders for $100x, and Acquiror does not make a section 338 election with respect to the acquisition of Target stock. At the time of Target's acquisition by Acquiror, Target's assets (other than Target's stock in X) have a fair market value and CAMT basis of $30x and $15x, respectively. On Acquiror's AFS, Acquiror records Target's assets at $30x and X's assets at $70x.

(B) *Analysis*. The purchase accounting adjustments and push down accounting adjustments Acquiror made on Acquiror's AFS are disregarded in computing Acquiror's AFSI, CAMT basis, and CAMT earnings. *See* paragraph (c)(3) of this section. As a result, the purchase by Acquiror of the stock of Target does not affect Target's CAMT basis in Target's assets (including the X stock), nor does the acquisition affect X's CAMT basis in X's assets. Accordingly, the following results obtain from the purchase by Acquiror of the stock of Target: Target's CAMT basis in Target's stock in X equals $20x; Target's CAMT basis in Target's assets other than Target's X stock equals $15x; and X's CAMT basis in X's assets equals $50x.

(vi) *Example 6: Identification of component transactions*—(A) *Facts*. X and Y respectively contribute Asset 1 and Asset 2 to Z in exchange solely for stock of newly formed Z (XYZ exchange). The XYZ exchange qualifies for nonrecognition treatment under section 351(a) with regard to each of X and Y, and nonrecognition treatment under section 1032(a) with regard to Z. Immediately before the XYZ exchange, Asset 1 had a fair market value and CAMT basis of $50x and $25x, respectively. At that time, Asset 2 had a fair market value and CAMT basis of $50x and $15x, respectively.

(B) *Analysis*: *General application of component transaction rule*. X, Y, and Z each identifies the component transactions of the larger transaction (that is, the XYZ exchange) specific to X, Y, and Z to determine the CAMT consequences of that larger transaction specific to each of those parties. *See generally* paragraph (c)(5) of this section. Under paragraph (c)(5)(i) of this section, the XYZ exchange consists of a total of four component transactions among all of X, Y, and Z. *See* paragraphs (c)(8)(vi)(C) through (E) of this section (providing greater detail regarding the identification of each component transaction specific to X, Y, and Z, respectively).

(C) *Analysis: X's component transaction*. X has one component transaction, which is X's transfer of property to Z solely in exchange for stock of Z. This transaction is the sole component transaction relevant to X because it is the sole component transaction of the larger transaction (that is, the XYZ exchange) that is relevant for the determination of the CAMT consequences of the larger transaction with regard to X. *See* paragraphs (b)(27) and (c)(5)(i) of this section. Based on the treatment of this component transaction for regular tax purposes, the XYZ exchange is a covered nonrecognition transaction with regard to X.

(D) *Analysis: Y's component transaction*. Y has one component transaction, which is Y's transfer of property to Z solely in exchange for stock of Z. This transaction is the sole component transaction relevant to Y because it is the sole component transaction of the larger transaction (that is, the XYZ exchange) that is relevant for the determination of the CAMT consequences of the larger transaction with regard to Y. *See* paragraphs (b)(27) and (c)(5)(i) of this section. Based on the treatment of this component transaction for regular tax purposes, the XYZ transaction is a covered nonrecognition transaction with regard to Y.

(E) *Analysis: Z's two component transactions*. Z has two component transactions, which are Z's respective transfers of stock to X and Y in exchange for property transferred by those parties to Z. Those two transactions are the sole component transactions relevant to Z because they are the sole component transactions of the larger transaction (that is, the XYZ exchange) that are relevant for the determination of the CAMT consequences of the larger transaction with regard to Z. *See* paragraphs (b)(26) and (c)(5)(i) of this section. Based on the treatment of these component transactions for regular tax purposes, the XYZ exchange is a covered nonrecognition transaction with regard to Z.

(vii) *Example 7: Effect of component transaction on other component transactions*—(A) *Facts*. The facts are the same as in paragraph (c)(8)(vi)(A) of this section (*Example 6*), except that, prior to the XYZ exchange, X enters into a binding commitment to sell the Z stock that X receives in the XYZ exchange to W, which is unrelated to X and Y.

(B) *Analysis: General application of component transaction rule*. X's binding commitment to sell the Z stock that it received in X's component transaction with regard to the XYZ exchange (that is, the larger transaction) causes the receipt of that stock to be disregarded for purposes of satisfying the control requirement in section 351(a). As a result, section 351(a) does not apply to either X or Y. Because X received 50 percent of the total shares of Z stock in the XYZ exchange, X's binding commitment to sell to W the Z stock that X received in the XYZ exchange forecloses qualification of that exchange under section 351. *See* paragraph (c)(5)(ii) of this section.

(C) *Analysis: Effect on X's component transaction*. Because the XYZ exchange fails to qualify under section 351, X's component transaction (that is, X's transfer of property to Z solely in exchange for stock of Z) is treated as a covered recognition transaction with regard to X.

(D) *Analysis: Effect on Y's component transaction*. Because the XYZ exchange fails to qualify under section 351, Y's component transaction (that is, Y's transfer of property to Z solely in exchange for stock of Z) is treated as a covered recognition transaction with regard to Y.

(E) *Analysis: Effect on Z's two component transactions*. The failure of the XYZ exchange to qualify under section 351 does not affect the CAMT consequences of either of Z's two component transactions (which are Z's respective transfers of stock to X and Y in exchange for property transferred by those parties to Z). This result obtains because Z's qualification for nonrecognition treatment under section 1032(a) is not conditioned on the qualification of the XYZ exchange under section 351 or any other nonrecognition provision of the Code. Accordingly, each of Z's two component transactions of the XYZ exchange (that is, the larger transaction) qualifies as a covered nonrecognition transaction with regard to Z.

(viii) *Example 8: CAMT stock basis transition rule*—(A) *Facts*. X owns a minority interest in Y. On January 1, 2020, X's AFS basis in X's interest in Y was $120x, and X's adjusted basis in X's Y stock for regular tax purposes was $45x.

(B) *Analysis*. Under paragraph (c)(6) of this section, X's CAMT basis in X's Y stock is $45x, subject to any subsequent adjustments required under this section and §1.56A-19.

(ix) *Example 9: CAMT retained earnings*—(A) *Facts.* On January 1, 2020, X has $340x of accumulated earnings and profits (as determined under section 312). In taxable years 2020, 2021, 2022, and 2023, X has CAMT current earnings of $0x, $50x, $27x, and $33x, respectively.

(B) *Analysis*. To determine X's CAMT retained earnings for the taxable year beginning January 1, 2024, under paragraph (b)(5)(i) of this section, X adds together X's earnings and profits as of the first day of X's taxable year beginning after December

31, 2019, or $340x, and the cumulative balance of CAMT current earnings for taxable years beginning after December 31, 2019, or $110x ($0x + $50x + $27x + $33x). As a result, X's CAMT retained earnings for the taxable year beginning January 1, 2024, are $450x.

(d) *CAMT consequences of certain non-liquidating stock and property distributions*—(1) *Distributing corporation in covered nonrecognition transaction*. If a distributing corporation distributes solely the distributing corporation's stock (or rights to acquire stock) or other property to a distribution recipient in a transaction that qualifies the distributing corporation for nonrecognition treatment under section 311(a) (that is, a covered nonrecognition transaction, determined using CAMT basis in lieu of AFS basis or regular tax basis), the distributing corporation—

(i) Determines the distributing corporation's AFSI resulting from the distribution by—

(A) Disregarding any resulting gain or loss reflected in the distributing corporation's FSI; and

(B) Applying section 311(a) to the distribution (that is, no AFSI is recognized by the distributing corporation); and

(ii) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312 (by, for example, reference to CAMT basis).

(2) *Distributing corporation in covered recognition transaction*. Subject to paragraph (e) of this section, if a distributing corporation distributes property to a distribution recipient in a transaction in which section 311(b) applies to the distributing corporation (that is, a covered recognition transaction, determined using CAMT basis in lieu of AFS basis or regular tax basis), the distributing corporation—

(i) Determines the distributing corporation's AFSI resulting from the distribution by redetermining any gain or loss reflected in the distributing corporation's FSI by reference to the distributing corporation's CAMT basis (in lieu of AFS basis) in the distributed property; and

(ii) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution based on the distributing corporation's AFSI.

(3) *Section 355(c) distributions in covered recognition transactions*. If a distributing corporation distributes property under section 355(c)(2) that results in any recognition treatment to the distributing corporation (that is, a covered recognition transaction), the distributing corporation—

(i) Determines the distributing corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the distributing corporation's FSI by reference to the distributing corporation's CAMT basis in the property (in lieu of AFS basis); and

(ii) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution based on the distributing corporation's AFSI.

(4) *Distribution recipient*. A distribution recipient in a covered transaction described in paragraph (d)(1) or (2) of this section—

(i) Determines the distribution recipient's AFSI resulting from that distribution by—

(A) Disregarding any resulting gain or loss reflected in the distribution recipient's FSI;

(B) Applying the relevant sections of the Code (for example, sections 243, 301, 302, 305, 306, and 1059 of the Code); and

(C) Using the amount of the distribution (distribution amount) of property other than the distributing corporation stock reflected on the distribution recipient's AFS, taking into account (for purposes of the relevant section of the Code) the distribution recipient's CAMT basis in its distributing corporation stock;

(ii) Determines the characterization of the distribution amount of property other than the distributing corporation stock (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of earnings and profits) of the distributing corporation;

(iii) Determines the distribution recipient's CAMT basis in the stock of the distributing corporation resulting from the distribution by applying the relevant sections of the Code, using the distribution recipient's CAMT basis in the stock in lieu of regular tax basis;

(iv) Determines the distribution recipient's CAMT basis in the other property received from the distributing corporation by applying the relevant sections of the Code, using CAMT basis in lieu of AFS basis; and

(v) Adjusts (to the extent applicable) the distribution recipient's CAMT current earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312 based on the distribution recipient's AFSI, as determined under paragraph (d)(4)(i) of this section.

(5) *Examples*. The following examples illustrate the application of the rules in this paragraph (d). For purposes of these examples, except as otherwise provided, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Stock distribution*—(A) *Facts*. X owns 25 shares of the stock of Y. X's stock in Y has a fair market value of $125x and a CAMT basis of $60x. X does not qualify for a dividends received deduction for any distribution from Y. Y distributes solely newly-issued stock to X (that is, a distribution recipient) in a transaction that qualifies X for nonrecognition treatment under section 305(a) and that qualifies Y (that is, the distributing corporation) for nonrecognition treatment under section 311(a). Y has CAMT earnings of $100x.

(B) *Analysis*: *Treatment of distributing corporation*. Y's distribution of the additional shares of Y stock is a covered nonrecognition transaction. *See* paragraph (d)(1) of this section. As a result, in determining the amount of Y's AFSI resulting from the distribution, Y disregards any FSI reflected on Y's AFS resulting from the distribution, and Y applies section 311(a) to the distribution. No FSI is reflected in Y's AFS resulting from the distribution. Accordingly, Y has $0x of AFSI resulting from the distribution. *See* paragraph (d)(1)(i) of this section. Y adjusts Y's CAMT earnings under section 312 by the amount of Y's AFSI resulting from the distribution, or $0x. *See* paragraph (d)(1)(ii) of this section.

(C) *Analysis: Treatment of distribution recipient*. X's receipt of the additional Y stock is a covered nonrecognition transaction with regard to X. *See* paragraph (d)(1) of this section. In determining the amount of AFSI resulting from the distribution, X first disregards any FSI reflected in X's AFS, and X then applies section 305(a) to the distribution. *See* paragraph (d)(4)(i) of this section. Accordingly, X has $0x of AFSI resulting from the distribution. X determines X's CAMT basis in the additional Y stock by applying section 307(a) and §1.307-1(a), and therefore allocating CAMT basis in proportion to fair market value. *See* paragraph (d)(4)(iii) of this section. As a result, X allocates $10x of X's existing CAMT basis in X's Y stock to the new Y stock (($25x / ($125x + $25x)) x $60x = $10x). X adjusts X's CAMT earnings under section 312 by the amount of X's AFSI resulting from the distribution, or $0x. *See* paragraph (d)(4)(v) of this section.

(ii) *Example 2: Property distribution*—(A) *Facts*. The facts are the same as in paragraph (d)(5)(i) of this section (*Example 1*), except that, instead

of distributing additional shares of Y stock to X, Y distributes Asset 1 to X. Asset 1 has a fair market value of $25x, a CAMT basis of $15x, a regular tax basis of $30x, and an AFS basis on Y's AFS of $20x. Y's FSI is increased by $5x ($25x - $20x) as a result of the distribution.

(B) *Analysis: Treatment of distributing corporation*. The determination of whether section 311(a) or 311(b) applies to the distribution is determined using CAMT basis. As a result, Y's distribution of Asset 1 is a covered recognition transaction under section 311(b). *See* paragraph (d)(2) of this section. Thus, in determining the amount of Y's AFSI resulting from the distribution, Y uses Y's CAMT basis in lieu of Y's AFS basis in Asset 1 (in other words, Y redetermines any gain or loss reflected in Y's FSI by reference to Y's CAMT basis, in lieu of AFS basis in the distributed property). *See* paragraph (d)(2)(i) of this section. Accordingly, Y has $10x ($25x - $15x) of AFSI resulting from the distribution. Y adjusts Y's CAMT earnings (in lieu of AFS retained earnings) upward by the amount of AFSI resulting from the distribution, or $10x, and downward by the fair market value of the property distributed, or $25x. *See* section 312(b) and paragraph (d)(2)(ii) of this section.

(C) *Analysis: Treatment of distribution recipient*. X's receipt of Asset 1 is a covered recognition transaction with regard to X. *See* paragraph (d)(2) of this section. In determining the amount of AFSI resulting from the distribution, X first disregards the $25x of FSI reflected on X's AFS, and X then applies section 301 to the distribution. *See* paragraph (d)(4)(i) of this section. Under section 301(b)(1), the amount of the distribution is the fair market value of the property distributed, or $25x. The characterization of the distribution is determined by reference to Y's CAMT earnings. *See* paragraph (d)(4)(ii) of this section. Because Y has sufficient CAMT earnings, under section 301(c)(1), the entire amount of the distribution is a dividend to X. Accordingly, X has $25x of AFSI resulting from the distribution. X determines X's CAMT basis in Asset 1 by applying section 301(d), or $25x. *See* paragraph (d)(4)(iv) of this section. X adjusts X's CAMT earnings under section 312 by the amount of X's AFSI resulting from the distribution, or $25x. *See* paragraph (d)(4)(v) of this section.

(iii) *Example 3: Redemption*—(A) *Facts*. X owns 70 of the 200 outstanding shares of Y stock with an AFS basis of $77x on X's AFS and a CAMT basis of $1x per share, or $70x. In 2024, Y redeems 50 shares from X for $60x. After the redemption, X owns 20 (70 - 50) of the 150 outstanding shares of Y stock. X's CAMT basis in the redeemed shares is $50x, and the AFS basis of the redeemed shares on X's AFS is $55x. Y has CAMT earnings of $100x. The imputed value of the 20 retained shares at the time of the redemption is $24x (($60x / 50) x 20 = $24x), X's CAMT basis in those shares is $20x, and the AFS basis of those shares on X's AFS is $22x. As a result of the redemption, X reports on X's AFS gain of $5x ($60x - $55x = $5x) on the redeemed shares and gain of $2x ($24x - $22x = $2x) on the retained shares, and X records X's retained shares with a AFS basis of $24x.

(B) *Analysis: Treatment of shareholder*. Under paragraph (d)(4)(i) of this section, in determining the amount of AFSI resulting from the redemption, X disregards any FSI reflected on X's AFS, and X applies section 302 to the redemption. Under paragraph (d)(4)(ii) of this section, X determines that the redemption qualifies under section 302(a). Accordingly, X has $10x ($60x - $50x) of AFSI resulting from the redemption. Under paragraph (d)(4)(iii) of this section, the distribution does not affect the CAMT basis of X's retained stock. As a result, X holds X's retained Y stock with a CAMT basis of $20x. Under paragraph (d)(4)(v) of this section, X adjusts X's CAMT earnings under section 312 by the amount of AFSI resulting from the redemption, or $10x.

(iv) *Example 4: Dividends received deduction*—(A) *Facts*. The facts are the same as in paragraph (d)(5)(i) of this section (*Example 1*), except that, instead of distributing additional shares of Y stock to X, Y makes a pro rata distribution of cash to Y's shareholders out of Y's retained earnings, of which X receives $25x. Additionally, X's 25 shares of Y stock constitute 10% of all the stock of Y. X records $25x of FSI resulting from the distribution on X's AFS.

(B) *Analysis*. Under paragraph (d)(4)(i) of this section, in determining the amount of AFSI resulting from the distribution, X disregards the $25x of FSI reflected in X's AFS, and X applies section 301 to the distribution. Under paragraph (d)(4)(ii) of this section, the characterization of the distribution is determined under the relevant provisions of the Code by reference to Y's CAMT earnings. Under sections 301(c)(1) and 243(a)(1), the entire amount of the distribution is a dividend to X that is eligible for a 50% dividends received deduction. Accordingly, X has $12.5x ($25x - $25x x 50%) of AFSI resulting from the distribution. Under paragraph (d)(4)(v) of this section, X adjusts X's CAMT earnings under section 312 by the amount of the cash distribution, or $25x.

(v) *Example 5: Extraordinary dividend*—(A) *Facts.* The facts are the same as in paragraph (d)(5)(iv)(A) of this section (*Example 4*), except that the distribution is an extraordinary dividend within the meaning of section 1059(c) of the Code.

(B) *Analysis*. The analysis is the same as in paragraph (d)(5)(iv)(B) of this section (*Example 4*), except that, under paragraph (d)(4)(iii) of this section, the CAMT basis of X's stock in Y is reduced by $12.5x (*see* section 1059(a)). In addition, X adjusts its CAMT earnings under section 312 by $12.5x. *See* section 312(f)(2) and paragraph (d)(4)(v) of this section.

(e) *Section 336(e) elections*—(1) *Distributing corporation with regard to dispositions described in section 355(d)(2) or (e)(2)*. If a distributing corporation distributes property under section 355(c) or 361(c) that results in any recognition treatment to the distributing corporation (that is, a covered recognition transaction), and if the distribution is the subject of a section 336(e) election described in §1.336-2(b)(2), the distributing corporation determines the distributing corporation's AFSI by—

(i) Disregarding any resulting gain or loss reflected in the distributing corporation's FSI;

(ii) Applying section 336(e) to the distribution (that is, no AFSI is recognized by the distributing corporation); and

(iii) If stock of the target corporation (that is, the controlled corporation) is sold, exchanged, or distributed outside of the section 355 transaction but is described in §1.336-2(b)(2)(iii), applying section 336(e) to the sale, exchange, or distribution (that is, no AFSI is recognized by the distributing corporation).

(2) *Target corporation with regard to dispositions described in section 355(d)(2) or (e)(2)*. As the result of a distribution described in paragraph (e)(1) of this section, the target corporation (that is, the controlled corporation)—

(i) Determines the target corporation's AFSI resulting from the deemed sale under section 336(e) by redetermining any resulting gain or loss reflected in the target corporation's FSI as being equal to the gain or loss that would result for regular tax purposes, determined by using the CAMT basis in the target corporation's assets rather than the basis in the target corporation's assets for regular tax purposes; and

(ii) Determines the target corporation's CAMT basis in the property received in the deemed purchase under section 336(e) to be equal to the target corporation's regular tax basis in that property as a result of that deemed purchase.

(3) *Distributing corporation shareholder or security holder with regard to dispositions described in section 355(d)(2) or (e)(2)*. A distributing corporation shareholder or security holder in a covered transaction described in paragraph (e)(1) of this section—

(i) Determines the distributing corporation shareholder's or security holder's AFSI resulting from the distribution by—

(A) Disregarding any resulting gain or loss reflected in the distributing corporation shareholder's or security holder's FSI and applying the relevant sections of the Code; and

(B) Using the distribution amount of the property other than distributing corporation stock reflected on the AFS of the

distributing corporation shareholder or security holder, taking into account (for purposes of the relevant section of the Code) the CAMT basis of the distributing corporation shareholder or security holder in its distributing corporation stock;

(ii) Determines the characterization of the distribution of the property other than distributing corporation stock (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of earnings and profits) of the distributing corporation;

(iii) Determines the distributing corporation shareholder's or security holder's CAMT basis in the stock of the distributing corporation resulting from the distribution by applying the relevant section of the Code, using the CAMT basis of the distributing corporation shareholder or security holder in the stock (in lieu of basis for regular tax purposes);

(iv) Determines the distributing corporation shareholder's or security holder's CAMT basis in the property received from the distributing corporation by applying the relevant section of the Code, using CAMT basis (in lieu of AFS basis); and

(v) Adjusts the distributing corporation shareholder's or security holder's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312 (taking into account CAMT basis).

(4) *Distributing corporation with regard to distributions not described in section 355(d)(2) or (e)(2) for which a section 336(e) election is made*. If a distributing corporation distributes solely the distributing corporation's stock in a subsidiary corporation to a distribution recipient in a transaction that is the subject of a section 336(e) election described in §1.336-2(b)(1), the distributing corporation determines the distributing corporation's AFSI resulting from the distribution by—

(i) Disregarding any resulting gain or loss reflected in the distributing corporation's FSI; and

(ii) Applying section 336(e) to the distribution (that is, no AFSI is recognized by the distributing corporation).

(5) *Target corporation with regard to distributions not described in section 355(d)(2) or (e)(2)*. As the result of a distribution described in paragraph (e)(4) of this section, the target corporation determines the target corporation's AFSI resulting from the deemed sale under section 336(e) by redetermining any resulting gain or loss reflected in the target corporation's FSI to be equal to the gain or loss that would result for regular tax purposes, determined by using the CAMT basis in the target corporation's assets rather than the basis in the target corporation's assets for regular tax purposes.

(6) *New target corporation with regard to distributions not described in section 355(d)(2) or (e)(2)*. As the result of a distribution described in paragraph (e)(4) of this section, the new target corporation (within the meaning of §1.336-1(b)(3)) determines the new target corporation's CAMT basis in the property received in the deemed purchase under section 336(e) to be equal to the new target corporation's regular tax basis in that property as a result of that deemed purchase.

(7) *Example.* The following example illustrates the application of the rules in this paragraph (e).

(i) *Facts*. Distributing is a distributing corporation, and Controlled is a controlled corporation. Each of Distributing and Controlled is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group. On February 1, 2024, Distributing contributes assets with a fair market value of $100x, a regular tax basis of $65x, and a CAMT basis of $60x to Controlled in exchange for all the stock of Controlled (Contribution), and Distributing distributes all the stock of Controlled to Distributing's shareholders pro rata (Distribution). The Contribution and Distribution qualify as a section 355 transaction, but the Distribution is taxable under section 355(e). Because the Distribution is described in section 355(e), Distributing makes a section 336(e) election described in §1.336-2(b)(2) with respect to the Distribution.

(ii) *Analysis*. Under paragraph (e)(1) of this section, in determining the amount of AFSI resulting from the Distribution, Distributing disregards any FSI resulting from the Distribution, and X applies section 336(e) to the Distribution. Accordingly, Distributing has $0x of AFSI resulting from the Distribution. Under paragraph (e)(2)(i) of this section, the target corporation (that is, Controlled) applies section 336(e) and redetermines Controlled's AFSI to be Controlled's gain or loss for regular tax purposes, determined by using its CAMT basis in its assets rather than its regular tax basis in its assets, or $40x ($100x - $60x). Under paragraph (e)(2)(ii) of this section, Controlled's CAMT basis in Controlled's assets is Controlled's regular tax basis, or $100x.

(f) *CAMT consequences of certain liquidating distributions*—(1) *Liquidating corporation in covered nonrecognition transaction*. If a liquidating corporation distributes property to a liquidation recipient in a transaction that qualifies the liquidating corporation solely for nonrecognition treatment under section 337(a) (that is, a covered nonrecognition transaction), the liquidating corporation—

(i) Determines the liquidating corporation's AFSI resulting from the liquidation by—

(A) Disregarding any resulting gain or loss reflected in the liquidating corporation's FSI; and

(B) Applying section 337(a) to the one or more liquidating distributions composing the liquidation (that is, no AFSI is recognized by the liquidating corporation); and

(ii) Adjusts the liquidating corporation's CAMT retained earnings (in lieu of AFS retained earnings) resulting from the liquidation by applying section 312 based on the liquidating corporation's AFSI, as determined under paragraph (f)(1)(i) of this section.

(2) *Liquidating corporation in covered recognition transaction*. If a liquidating corporation distributes property to a liquidation recipient in a transaction in which section 336(a) applies to the liquidating corporation, or in a corporate dissolution of the liquidating corporation (each, a covered recognition transaction), the liquidating corporation—

(i) Determines the liquidating corporation's AFSI, if any, resulting from the one or more liquidating distributions composing the liquidation or corporate dissolution by redetermining any resulting gain or loss reflected in the liquidating corporation's FSI by reference to the CAMT basis in the liquidating corporation's liquidated property (in lieu of AFS basis); and

(ii) Adjusts the liquidating corporation's CAMT retained earnings (in lieu of

AFS retained earnings) based on the liquidating corporation's AFSI, as determined under paragraph (f)(2)(i) of this section.

(3) *Component transactions of a liquidation consisting of covered recognition and covered nonrecognition transactions*. If a liquidating corporation distributes property to at least one liquidation recipient in a covered nonrecognition transaction to the liquidating corporation and transfers property to at least one liquidation recipient in a covered recognition transaction to the liquidating corporation, the liquidating corporation determines the liquidating corporation's aggregate resulting AFSI and CAMT retained earnings by treating each of the following component transactions separately—

(i) Each component transaction that is a covered nonrecognition transaction to the liquidating corporation; and

(ii) Each component transaction that is a covered recognition transaction to the liquidating corporation.

(4) *Consequences to liquidation recipient in covered nonrecognition transaction*. A liquidation recipient in a covered nonrecognition transaction described in paragraph (f)(1) of this section—

(i) Determines the liquidation recipient's AFSI resulting from the one or more liquidating distributions received by the liquidation recipient by—

(A) Disregarding any resulting gain or loss reflected in the liquidation recipient's FSI; and

(B) Applying section 332 to the one or more liquidating distributions received by the liquidation recipient (that is, no AFSI is recognized by the liquidation recipient);

(ii) Determines the liquidation recipient's CAMT basis in the property received from the liquidating corporation by applying section 334(b), using the CAMT basis of the property received by the liquidation recipient (in lieu of basis for regular tax purposes);

(iii) Adjusts the liquidation recipient's CAMT retained earnings (in lieu of AFS retained earnings) resulting from the one or more liquidating distributions received by the liquidation recipient by applying sections 381(c)(2) and 312; and

(iv) Applying section 381 to the liquidating corporation's other attributes (that is, the liquidation recipient succeeds to the liquidating corporation's other attributes).

(5) *Consequences to liquidation recipient in covered recognition transaction*. A liquidation recipient in a covered recognition transaction described in paragraph (f)(2) of this section—

(i) Determines the liquidation recipient's AFSI resulting from the one or more liquidating distributions by redetermining any resulting gain or loss reflected in the liquidation recipient's FSI by reference to the liquidation recipient's CAMT basis in the liquidation recipient's stock in the liquidating corporation (in lieu of AFS basis);

(ii) Determines the liquidation recipient's CAMT basis in the property received by the liquidation recipient to be equal to the liquidation recipient's AFS basis in that property; and

(iii) Adjusts the liquidation recipient's CAMT earnings (in lieu of earnings and profits) based on the liquidation recipient's AFSI, as determined under paragraph (f)(5)(i) of this section.

(6) *Examples*. The following examples illustrate the application of the rules in this paragraph (f). For purposes of these examples, except as otherwise provided, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Nonrecognition subsidiary liquidation*—(A) *Facts*. X owns all of the interests in Y, an LLC treated as a corporation for Federal income tax purposes, with a CAMT basis of $70x and a fair market value of $100x. Y has one asset (Asset 1) with a CAMT basis of $45x and a fair market value of $100x. Y has a FSNOL of $200x. Y has CAMT earnings of $50x, and X has CAMT retained earnings of $300x. X dissolves Y under State law and reports the dissolution on an original Form 966, *Corporate Dissolution or Liquidation*.

(B) *Analysis: Liquidating corporation*. The dissolution of Y is a covered nonrecognition transaction. Under paragraph (f)(1)(i) of this section, in determining the amount of Y's AFSI resulting from the dissolution, Y disregards any FSI reflected in its AFS resulting from the dissolution, and Y applies section 337(a) to the dissolution. Accordingly, Y has $0x of AFSI resulting from the dissolution. Under paragraph (f)(1)(ii) of this section, Y adjusts Y's CAMT retained earnings by applying section 312 based on the amount of AFSI, or $0x.

(C) *Analysis: Liquidation recipient*. Under paragraph (f)(4)(i) of this section, in determining the amount of X's AFSI resulting from the dissolution of Y, X disregards any FSI reflected in X's AFS resulting from the liquidating distribution from Y, and X applies section 332 to the liquidating distribution. Accordingly, X has $0x of AFSI resulting from the dissolution. Under paragraph (f)(4)(ii) of this section, X determines X's CAMT basis in Asset 1 by applying section 334(b), using the CAMT basis in the hands of Y, or $45x. Under paragraph (f)(4)(iii) of this section, X succeeds to Y's CAMT earnings. *See* sections 381(c)(2) and 312. Under paragraph (f)(4)(iv) of this section, X succeeds to Y's FSNOL.

(ii) *Example 2: Component transactions*—(A) *Facts*. X owns 85% of the stock of Y with a fair market value of $85x, an AFS basis of $60x, and a CAMT basis of $40x. Unrelated Z owns the remaining 15% of the stock of Y with a fair market value of $15x, an AFS basis of $20x, and a CAMT basis of $10x. X and Y do not file a consolidated financial statement. Y's assets include $10x cash, Asset 1, and Asset 2. Asset 1 has a fair market value of $13x, an AFS basis of $19x, and a CAMT basis of $10x. Asset 2 has a fair market value of $77x, an AFS basis of $50x, and a CAMT basis of $40x. Y's CAMT retained earnings are $50x. X and Z determine to dissolve Y, and they report the dissolution on an original Form 966, *Corporate Dissolution or Liquidation*. Y distributes Asset 1 and $2x cash to Z, and Y distributes Asset 2 and $8x cash to X, in exchange for each shareholder's Y stock.

(B) *Analysis: In general.* The dissolution of Y is a covered nonrecognition transaction to Y with respect to the liquidating distribution to X, and a covered recognition transaction to Y with respect to the liquidating distribution to Z. Under paragraph (f)(3) of this section, Y determines Y's AFSI and CAMT retained earnings by treating the component transactions separately.

(C) *Analysis: Covered nonrecognition transaction*. The liquidating distribution to X is a covered nonrecognition transaction. Under paragraph (f)(1)(i) of this section, in determining the amount of Y's AFSI resulting from the distribution to X, Y disregards any FSI reflected in Y's AFS resulting from the distribution to X, and Y applies section 337(a) to the distribution. Accordingly, Y has $0x of AFSI resulting from the distribution to X. Under paragraphs (f)(1)(ii) and (f)(3) of this section, Y adjusts Y's CAMT retained earnings by applying section 312 based on the amount of AFSI, or $0x. Under paragraph (f)(4)(i) of this section, in determining the amount of X's AFSI resulting from the dissolution of Y, X disregards any FSI reflected in X's AFS resulting from the liquidating distribution from Y, and X applies section 332 to the liquidating distribution. Accordingly, X has $0x of AFSI resulting from the dissolution. Under paragraph (f)(4)(ii) of this section, X determines X's CAMT basis in Asset 2 by applying section 334(b), using the CAMT basis in the hands of Y, or $40x. Under paragraph (f)(4)(iii) of this section, X succeeds to Y's CAMT earnings. *See* sections 381(c)(2) and 312.

(D) *Analysis: Covered recognition transaction*. The liquidating distribution to Z is a covered recognition transaction. Under paragraph (f)(2)(i) of this section, in determining the amount of Y's AFSI resulting from the distribution to Z, Y redetermines any resulting gain or loss reflected in Y's FSI using Y's CAMT basis in Asset 1. Accordingly, Y has $3x of AFSI resulting from the liquidating distribution to Z. Under paragraph (f)(2)(ii) of this section, Y adjusts Y's CAMT earnings based on Y's AFSI resulting from the liquidating distribution to Z, or $3x and reduces them by the CAMT basis of the property, or $10x, and $2x cash distributed to Z. Under paragraph

(f)(5)(i) of this section, in determining the amount of Z's AFSI resulting from the dissolution of Y, Z redetermines any resulting gain or loss reflected in Z's FSI using Z's CAMT basis in Z's Y stock, or $5x ($13x + $2x - $10x). Under paragraph (f)(5)(ii) of this section, Z takes a CAMT basis in Asset 1 equal to Z's AFS basis in Asset 1, or $13x. Under paragraph (f)(5)(iii) of this section, Z adjusts Z's CAMT retained earnings based on Z's AFSI resulting from the dissolution of Y, or $5x.

(g) *CAMT consequences of stock sales*—(1) *Target corporation shareholder*—(i) *In general*. Except as provided in paragraph (g)(1)(ii) of this section, if a target corporation shareholder transfers target corporation stock to an acquiror corporation in a transaction that results in recognition of gain or loss to the target corporation shareholder in a transaction described in section 304 or 1001 of the Code (each, a covered recognition transaction), the target corporation shareholder—

(A) Determines the target corporation shareholder's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the target corporation shareholder's FSI by reference to the target corporation shareholder's CAMT basis (in lieu of AFS basis) of the transferred stock;

(B) Determines the target corporation shareholder's CAMT basis in the property received from the acquiror corporation to be equal to the target corporation shareholder's AFS basis in that property; and

(C) Adjusts (to the extent applicable) the target corporation shareholder's CAMT current earnings (in lieu of AFS retained earnings) based on the target corporation shareholder's AFSI, as determined under paragraph (g)(1)(i)(A) of this section.

(ii) *Stock sales for which a section 336(e) or 338(h)(10) election is made*. If the transfer of stock described in paragraph (g)(1)(i) of this section is the subject of an election under section 336(e) or 338(h)(10) of the Code—

(A) Paragraph (g)(1)(i) of this section does not apply to the target corporation shareholder, and the transfer of target corporation stock by the target corporation shareholder is disregarded; and

(B) The target corporation shareholder adjusts (to the extent applicable) the target corporation shareholder's CAMT current earnings (in lieu of AFS retained earnings) to take into account the deemed liquidation of the target corporation under section 336(e) or 338(h)(10) (as appropriate).

(2) *Target corporation*—(i) *In general*. Except as provided in paragraph (g)(2)(ii) of this section, no CAMT consequences to the target corporation result from a transfer described in paragraph (g)(1)(i) of this section.

(ii) *Stock sales for which a section 336(e), 338(g), or 338(h)(10) election is made*. If the transfer described in paragraph (g)(1)(i) of this section is the subject of an election under section 336(e), 338(g), or 338(h)(10) (that is, a covered recognition transaction), the target corporation determines the target corporation's AFSI resulting from the deemed sale under that election by redetermining any resulting gain or loss reflected in the target corporation's FSI to be equal to the gain or loss that would result for regular tax purposes, determined by using the CAMT basis in the target corporation's assets rather than the basis in the target corporation's assets for regular tax purposes.

(3) *Acquiror corporation*. If an acquiror corporation transfers property (including stock) to a target corporation shareholder in a transaction described in section 304 or 1001 (each, a covered recognition transaction), the acquiror corporation—

(i) Determines the acquiror corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the acquiror corporation's FSI by reference to the acquiror corporation's CAMT basis (in lieu of AFS basis) in the acquiror corporation's transferred property;

(ii) Determines the acquiror corporation's CAMT basis in the target corporation stock received from the target corporation shareholder to be equal to the acquiror corporation's AFS basis in that property; and

(iii) Adjusts (to the extent applicable) the acquiror corporation's CAMT current earnings (in lieu of AFS retained earnings) based on the acquiror corporation's AFSI, as determined under paragraph (g)(3)(i) of this section.

(4) *New target corporation*. If the transfer described in paragraph (g)(1)(i) of this section is the subject of an election under section 336(e), 338(g), or 338(h)(10) (that is, a covered recognition transaction), the new target corporation determines the new target corporation's CAMT basis in the property deemed to be received from the target corporation to be equal to the new target corporation's regular tax basis in that property as a result of that election.

(5) *Section 304 transactions*. For purposes of this section, section 304 does not apply to any acquisition of stock of a corporation.

(6) *Examples*. The following examples illustrate the application of the rules in this paragraph (g). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Acquisition of stock of a target corporation*—(A) *Facts*. Acquiror acquires all the stock of Target from X for $100x cash. At the time of Target's acquisition by Acquiror, Target's assets have a CAMT basis of $15x and a value of $30x, and X has $40x of CAMT basis in X's Target stock.

(B) *Analysis*. Acquiror's acquisition of Target is a covered recognition transaction. Under paragraph (g)(3)(ii) of this section, Acquiror takes a $100x CAMT basis in the stock of Target. Under paragraph (g)(2)(i) of this section, Target has no CAMT consequences from the transaction, and Target's $15x of CAMT basis in its assets is unaffected by the transaction. Under paragraph (g)(1)(i)(A) of this section, X disregards any FSI reflected in X's AFS resulting from the transaction and uses X's CAMT basis in the Target stock to determine X's AFSI. As a result, X recognizes $60x of AFSI on the sale of the Target stock ($100x - $40x = $60x).

(ii) *Example 2: Covered recognition transaction stock sale: section 338(h)(10) election*—(A) *Facts*. The facts are the same as in paragraph (g)(6)(i)(A) of this section (*Example 1*), except that X is the common parent of a consolidated group of which Target is a member, and Acquiror and X make a section 338(h)(10) election with respect to the purchase of Target.

(B) *Analysis*. Because of the section 338(h)(10) election, old Target is treated as selling all of old Target's assets to an unrelated buyer for $100x, then liquidating and distributing the $100x to X. Then, new Target is treated as purchasing all of old Target's assets from an unrelated seller for $100x. Under paragraph (g)(1)(ii)(A) of this section, the transfer of the Target stock to Acquiror is disregarded. Under paragraph (g)(1)(ii)(B) of this section, X adjusts X's CAMT earnings to succeed to old Target's CAMT earnings (including old Target's earnings on the deemed sale of old Target's assets). Under paragraph (g)(2)(ii) of this section, old Target's AFSI on the deemed sale of old Target's assets determined using old Target's CAMT basis in those assets, or $85x ($100x - $15x). Under paragraph (g)(4) of this section, new Target's CAMT basis of new Target's assets is new Target's regular tax basis, or $100x.

(iii) *Example 3: Covered recognition transaction stock sale: section 336(e) election*—(A) *Facts*. X owns all the stock of Target. The Target stock has a fair market value of $100x, a CAMT basis of $35x,

and a regular tax basis of $40x. Target has assets with a fair market value of $100x, CAMT basis of $60x, and regular tax basis of $65x. Target has outstanding 100 shares of a single class of stock. On February 1, 2024, X sells 35 shares of Target stock to Y. On July 1, 2024, X sells 40 shares of Target stock to Z. On December 31, 2024, X sells the remaining 25 shares of Target stock to W. Y, Z, and W are each CAMT entities unrelated to X and unrelated to each other. X makes a section 336(e) election with respect to the disposition of Target.

(B) *Analysis*. Under paragraph (g)(2)(ii) of this section, old Target determines old Target's AFSI by redetermining any FSI appearing on old Target's AFS to be old Target's gain for regular tax purposes, except computed using old Target's CAMT basis in its assets, or $40x ($100x - $60x). Under paragraph (g)(4) of this section, new Target's CAMT basis in new Target's assets is equal to new Target's regular tax basis in those assets, or $100x.

(h) *CAMT consequences of asset sales*—(1) *Target corporation*. If a target corporation transfers property (including stock) to an acquiror corporation in a transaction that results in recognition of gain or loss to the target corporation under section 1001 (that is, a covered recognition transaction), the target corporation—

(i) Determines the target corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the target corporation's FSI by reference to the target corporation's CAMT basis (in lieu of AFS basis) in the target corporation's transferred property;

(ii) Determines the target corporation's CAMT basis in the property received from the acquiror corporation to be equal to the target corporation's AFS basis in that property; and

(iii) Adjusts (to the extent applicable) the target corporation's CAMT current earnings (in lieu of AFS retained earnings) based on the target corporation's AFSI, as determined under paragraph (h)(1)(i) of this section.

(2) *Acquiror corporation*. If an acquiror corporation transfers property (including stock) to a target corporation in a transaction that results in recognition of gain or loss to the acquiror corporation under section 1001 (that is, a covered recognition transaction), the acquiror corporation—

(i) Determines the acquiror corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the acquiror corporation's FSI by reference to the acquiror corporation's CAMT basis (in lieu of AFS basis) in the acquiror corporation's transferred property;

(ii) Determines the acquiror corporation's CAMT basis in the property received from the target corporation to be equal to the acquiror corporation's AFS basis in that property; and

(iii) Adjusts (to the extent applicable) the acquiror corporation's CAMT current earnings (in lieu of AFS retained earnings) based on the acquiror corporation's AFSI, as determined under paragraph (h)(2)(i) of this section.

(3) *Example*. The following example illustrates the application of the rules in this paragraph (h).

(i) *Facts*. Each of unrelated X and Y is a domestic corporation that uses the calendar year as its taxable year. X sells Asset 1 to Y in exchange for Asset 2 in a covered recognition transaction under section 1001. Asset 1 has a CAMT basis in X's hands of $40x and a fair market value of $100x. Asset 2 has a CAMT basis in Y's hands of $65x and a fair market value of $100x. After the transaction, X records Asset 2 on X's AFS at its fair value of $100x, and Y records Asset 1 on Y's AFS at its fair value of $100x.

(ii) *Analysis*—(A) *X*. Under paragraph (h)(1)(i) of this section, in determining the amount of X's AFSI resulting from the sale of Asset 1, X redetermines any resulting gain or loss reflected in X's FSI using its CAMT basis in Asset 1. Accordingly, X has $60x of AFSI ($100x - $40x) resulting from the sale. Under paragraph (h)(1)(ii) of this section, X takes a CAMT basis in Asset 2 equal to X's AFS basis in Asset 2, or $100x. Under paragraph (h)(1)(iii) of this section, X adjusts X's CAMT current earnings based on X's AFSI resulting from the exchange, or $60x.

(B) *Y*. Under paragraph (h)(2)(i) of this section, in determining the amount of Y's AFSI resulting from the acquisition of Asset 1, Y redetermines any resulting gain or loss reflected in Y's FSI using its CAMT basis in Asset 2. Accordingly, Y has $35x of AFSI ($100x - $65x) resulting from the acquisition. Under paragraph (h)(2)(ii) of this section, Y takes a CAMT basis in Asset 1 equal to Y's AFS basis in Asset 1, or $100x. Under paragraph (h)(2)(iii) of this section, Y adjusts Y's CAMT current earnings based on Y's AFSI resulting from the exchange, or $35x.

(i) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-19 AFSI, CAMT basis, and CAMT retained earnings resulting from certain corporate reorganizations and organizations.

(a) *Overview*. This section provides rules under section 56A(c)(2)(C) and (c)(15)(B) of the Code for determining the AFSI, CAMT basis, and CAMT earnings consequences of certain corporate reorganizations with respect to which a domestic corporate CAMT entity and an individual or other CAMT entity, including a CAMT entity that is a shareholder of a domestic corporate CAMT entity, is a party, and section 351 exchanges. This section incorporates the definitions in §1.56A-18. Paragraph (b) of this section provides rules for determining the CAMT consequences of B reorganizations. Paragraph (c) of this section provides rules for determining the CAMT consequences of certain acquisitive reorganizations. Paragraph (d) of this section provides rules for determining the CAMT consequences of section 355 transactions. Paragraph (e) of this section provides rules for determining the CAMT consequences of E reorganizations. Paragraph (f) of this section provides rules for determining the CAMT consequences of F reorganizations. Paragraph (g) of this section provides rules for determining the CAMT consequences of section 351 exchanges. Paragraph (h) of this section provides the applicability date of this section. For rules coordinating the application of this section with §1.56A-4, *see* §1.56A-18(a)(2)(ii).

(b) *CAMT consequences of B reorganizations*—(1) *Target corporation shareholder or security holder in covered nonrecognition transaction*. If a target corporation shareholder or security holder transfers solely stock or securities to an acquiror corporation in a B reorganization that qualifies the target corporation shareholder or security holder for nonrecognition treatment under section 354 of the Code (that is, a covered nonrecognition transaction), the target corporation shareholder or security holder—

(i) Determines the target corporation shareholder's or security holder's AFSI resulting from the transfer by—

(A) Disregarding any resulting gain or loss reflected in the target corporation shareholder's or security holder's FSI; and

(B) Applying section 354 to the transfer (that is, no AFSI is recognized by the target corporation shareholder or security holder);

(ii) Determines the target corporation shareholder's or security holder's CAMT basis in the stock received from the acquiror corporation by applying section 358 of the Code using the CAMT basis (in lieu of AFS basis) of the stock or securities transferred by the target corporation shareholder or security holder to the acquiror corporation; and

(iii) Adjusts the target corporation shareholder's or security holder's CAMT current earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312 of the Code.

(2) *Target corporation shareholder or security holder in covered recognition transaction*. If a target corporation shareholder or security holder receives stock or securities and other property (or solely property other than stock or securities) from an acquiror corporation in exchange for target corporation stock or securities (that is, in a transaction that fails to qualify as a B reorganization (a covered recognition transaction)), *see, for example,* §1.56A-18(g), which provides rules for determining the CAMT consequences of stock sales, and paragraph (g) of this section, which provides rules for determining the CAMT consequences of section 351(b) transactions.

(3) *Acquiror corporation in covered nonrecognition transaction*. If an acquiror corporation transfers solely stock to a target corporation shareholder as part of a B reorganization that qualifies the acquiror corporation for nonrecognition treatment under section 1032(a) of the Code or section 1032(a) and §1.1032-2(b) (that is, a covered nonrecognition transaction), the acquiror corporation—

(i) Determines the acquiror corporation's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in the acquiror corporation's FSI; and

(B) Applying section 1032(a), or section 1032(a) and §1.1032-2(b) to the transfer (that is, no AFSI is recognized by the acquiror corporation);

(ii) Determines the acquiror corporation's CAMT basis in the stock received from a target corporation shareholder by applying section 362 of the Code using the CAMT basis (in lieu of AFS basis) of that stock in the hands of the target corporation shareholder; and

(iii) Adjusts the acquiror corporation's CAMT retained earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(4) *Acquiror corporation in covered recognition transaction*—(i) *Failure to qualify as B reorganization*. If an acquiror corporation transfers stock and other property (or solely property other than stock) to a target corporation shareholder described in paragraph (b)(1) of this section in exchange for target corporation stock (that is, a covered recognition transaction), paragraphs (b)(1) through (3) of this section do not apply. *See* §1.56A-18(g), which provides rules for determining the CAMT consequences of stock sales, and paragraph (g) of this section, which provides rules for determining the CAMT consequences of section 351(b) transactions.

(ii) *Failure to qualify under §1.1032-2(b)*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of a B reorganization that does not satisfy §1.1032-2(b) with regard to all acquiror corporation parent stock (that is, a covered recognition transaction solely with regard to the acquiror corporation parent stock that does not satisfy §1.1032-2(b)), then solely with regard to the acquiror corporation parent stock that does not qualify under §1.1032-2(b), *see* §1.56A-18(g), which provides rules for determining the CAMT consequences of stock sales.

(5) *Acquiror corporation parent in covered nonrecognition transaction*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of a B reorganization that qualifies the acquiror corporation for nonrecognition treatment under section 1032(a) and §1.1032-2(b) (that is, a covered nonrecognition transaction), the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.358-6.

(6) *Acquiror corporation parent in covered recognition transaction*—(i) *Use of old and cold parent stock with qualifying B reorganization*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of a B reorganization that does not satisfy §1.1032-2(b) with regard to all acquiror corporation parent stock (that is, a covered recognition transaction solely with regard to the acquiror corporation parent stock that does not satisfy §1.1032-2(b)), the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.358-6.

(ii) *Use of parent stock with transaction that does not qualify as a B reorganization*. If an acquiror corporation transfers stock of the acquiror corporation parent and other property to a target corporation shareholder in exchange for target corporation stock (that is, a covered recognition transaction), with regard to all acquiror corporation parent stock transferred by the acquiror corporation, the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.1032-3.

(7) *Examples*. The following examples illustrate the application of the rules in this paragraph (b). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction*—(A) *Facts*. During the taxable year, Acquiror acquires all the stock of Target from X for 100 shares of Acquiror's voting stock in a transaction that qualifies as a B reorganization. At the time of the transaction, X's stock in Target has a CAMT basis of $35x and a fair market value of $100x, and Target has a CAMT basis of $30x in its assets.

(B) *Analysis*. Acquiror's acquisition of Target from X is a covered nonrecognition transaction to each of Acquiror and X. Under paragraph (b)(1)(i)(A) of this section, X disregards any FSI reflected in its AFS resulting from the exchange of Target stock for Acquiror stock. Under paragraph (b)(1)(i)(B) of this section, X records $0x in AFSI on the exchange. Under paragraph (b)(1)(ii) of this section, X takes the Acquiror stock received in the exchange with a CAMT basis of $35x. Under paragraph (b)(1)(iii) of this section, X adjusts its CAMT retained earnings by the amount of AFSI resulting from the exchange, or $0x.

Under paragraph (b)(3)(i) of this section, Acquiror disregards any FSI reflected in its AFS resulting from the exchange of Acquiror stock for Target stock and under paragraph (b)(3)(i) of this section, Acquiror records $0x in AFSI on the exchange. Under paragraph (b)(3)(ii) of this section, Acquiror takes the Target stock with a $35x CAMT basis. Under paragraph (b)(3)(iii) of this section, Acquiror adjusts its CAMT retained earnings by the amount of AFSI resulting from the exchange, or $0x. Under §1.56A-18(g)(2)(i), Target has no CAMT consequences from the transaction, and Target's $30x of CAMT basis in its assets is unaffected by the transaction.

(ii) *Example 2: Covered recognition transaction*. The facts are the same as in paragraph (b)(7)(i) of this section (*Example 1*), except that Acquiror acquires the Target stock for 90 shares of Acquiror voting stock and 10 shares of Acquiror nonqualified preferred stock (within the meaning of section 351(g)). Under paragraph (b)(2) of this section, Acquiror's acquisition of Target from X is a covered recognition transaction. Under §1.56A-18(g)(1)(i)(A), X disregards any FSI reflected in its AFS resulting from the transaction and uses its CAMT basis in the Target stock in determining its AFSI. As a result, X recognizes $65x of AFSI on the sale of the Target stock ($100x - $35x = $65x). Under §1.56A-18(g)(2)(i), Target has no CAMT consequences from the transaction, and Target's $30x of CAMT basis in its assets is unaffected by the transaction. Under §1.56A-18(g)(3)(ii), Acquiror takes a $100x CAMT basis in the stock of Target.

(c) *CAMT consequences of certain acquisitive reorganizations*—(1) *Target corporation in a covered nonrecognition transaction*—(i) *Reorganization exchanges*. If a target corporation transfers property to an acquiror corporation in an acquisitive reorganization that qualifies the target corporation solely for nonrecognition treatment under section 361 of the Code (that is, a covered nonrecognition transaction), the target corporation—

(A) Determines the target corporation's AFSI resulting from the transfer by disregarding any resulting gain or loss reflected in the target corporation's FSI and applying section 361(a) and (b) to the transfer (that is, no AFSI is recognized by the target corporation);

(B) Determines the target corporation's CAMT basis in the property received from the acquiror corporation by applying section 358 using the CAMT basis (in lieu of AFS basis) of the property transferred by the target corporation to the acquiror corporation; and

(C) Adjusts the target corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(ii) *Section 361(c) distributions*. As part of an acquisitive reorganization, if a target corporation distributes or transfers qualified property to a target corporation shareholder, or to a target corporation creditor, that qualifies solely for nonrecognition treatment to the target corporation under section 361(c), the target corporation determines its AFSI resulting from the transfer by—

(A) Disregarding any resulting gain or loss reflected in the target corporation's FSI; and

(B) Applying section 361(c) to the distribution (that is, no AFSI is recognized by the target corporation).

(2) *Target corporation in covered recognition transaction*. As part of an acquisitive reorganization, if a target corporation distributes or transfers property to a target corporation shareholder or security holder or target corporation creditor under section 361(c) that results in the recognition of gain to the target corporation (that is, a covered recognition transaction), the target corporation—

(i) Determines the target corporation's AFSI resulting from the distribution or transfer by redetermining any resulting gain or loss reflected in the target corporation's FSI by reference to its CAMT basis in the distributed or transferred property (in lieu of AFS basis); and

(ii) Adjusts the target corporation's CAMT earnings (in lieu of AFS retained earnings) based on the target corporation's AFSI, as determined under paragraph (c)(1)(ii)(A) of this section.

(3) *Acquiror corporation qualification for covered nonrecognition transaction*. If an acquiror corporation transfers solely stock, or stock and money or other property, to a target corporation as part of an acquisitive reorganization that qualifies the acquiror corporation for nonrecognition treatment under section 1032(a) or section 1032(a) and §1.1032-2(b) (that is, a covered nonrecognition transaction), the acquiror corporation—

(i) Determines the acquiror corporation's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in the acquiror corporation's FSI; and

(B) Applying section 1032(a), or section 1032(a) and §1.1032-2(b), to the transfer (that is, no AFSI is recognized by the acquiror corporation);

(ii) Determines the acquiror corporation's CAMT basis in the property received from the target corporation by applying section 362 using the CAMT basis (in lieu of AFS basis) of that property;

(iii) Adjusts the acquiror corporation's CAMT retained earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying sections 381(c)(2) and 312 of the Code; and

(iv) Applies section 381 to the target corporation's other attributes (that is, the acquiror corporation succeeds to the target corporation's other attributes).

(4) *Acquiror corporation in covered recognition transaction*—(i) *Failure to qualify as an asset reorganization*. If an acquiror corporation transfers stock and other property (or solely property other than stock) to a target corporation shareholder described in paragraph (b)(1) of this section in exchange for target corporation stock (that is, a covered recognition transaction), paragraphs (c)(1) through (3) of this section do not apply. *See* §1.56A-18(h), which provides rules for determining the CAMT consequences of asset sales.

(ii) *Failure to qualify under §1.1032-2(b)*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of an acquisitive reorganization that does not satisfy §1.1032-2(b) with regard to all acquiror corporation parent stock (that is, a covered recognition transaction solely with regard to the acquiror corporation parent stock that does not satisfy §1.1032-2(b)), then solely with regard to the acquiror corporation parent stock that does not qualify under §1.1032-2(b), *see* §1.56A-18(h), which provides rules for determining the CAMT consequences of asset sales.

(5) *Acquiror corporation parent in covered nonrecognition transaction*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of an acquisitive reorganization that qualifies the acquiror corporation for nonrecognition treatment under section 1032(a) and §1.1032-2(b) (that is, a covered nonrec-

ognition transaction), the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.358-6.

(6) *Acquiror corporation parent in covered recognition transaction*—(i) *Use of old and cold parent stock with qualifying acquisitive reorganization*. If an acquiror corporation transfers solely stock of the acquiror corporation parent to a target corporation shareholder as part of an acquisitive reorganization that does not satisfy §1.1032-2(b) with regard to all acquiror corporation parent stock (that is, a covered recognition transaction solely with regard to the acquiror corporation parent stock that does not satisfy §1.1032-2(b)), the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.358-6.

(ii) *Use of parent stock in a transaction that does not qualify as an acquisitive reorganization*. If an acquiror corporation transfers acquiror corporation parent stock and other property to a target corporation shareholder in exchange for target corporation stock (that is, a covered recognition transaction), with regard to all acquiror corporation parent stock transferred by the acquiror corporation, the acquiror corporation parent adjusts its CAMT basis in its acquiror corporation stock pursuant to §1.1032-3.

(7) *Target corporation shareholder or security holder in covered nonrecognition transaction*. A target corporation shareholder or security holder in a covered nonrecognition transaction described in paragraph (c)(1) of this section—

(i) Determines the target corporation shareholder or security holder's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in its FSI;

(B) Applying the relevant section of the Code (section 354 or 356 of the Code); and

(C) Using the distribution amount reflected on its AFS, taking into account (for purposes of the relevant section of the Code) the CAMT basis in its target corporation stock;

(ii) Determines the characterization of the distribution of property other than the acquiring corporation stock (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of earnings and profits) of the target corporation;

(iii) Determines its CAMT basis in the stock or securities of the acquiring corporation resulting from the distribution by applying the relevant section of the Code using the target corporation shareholder's or security holder's CAMT basis in the stock (in lieu of basis for regular tax purposes);

(iv) Determines its CAMT basis in the property received from the target corporation by applying the relevant section of the Code, using CAMT basis in lieu of AFS basis; and

(v) Adjusts (to the extent applicable) the target corporation shareholder's or security holder's CAMT current earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312 based on its AFSI, as determined under paragraph (c)(4)(i) of this section.

(8) *Examples*. The following examples illustrate the application of the rules in this paragraph (c). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction*—(A) *Facts*. During the taxable year, Target, whose stock is wholly owned by X, merges with and into Acquiror in a transaction that qualifies as a reorganization under section 368(a)(1)(A) of the Code. In the merger, X receives solely Acquiror stock with a fair market value of $100x. At the time of Target's merger into Acquiror, Target's assets have a CAMT basis of $15x and a value of $30x, Target has $10x CAMT retained earnings, and X has $40x of CAMT basis in its Target stock.

(B) *Analysis*. Acquiror's acquisition of Target's assets is a covered nonrecognition transaction. Under paragraph (c)(1)(i)(A) of this section, in computing AFSI resulting from the transaction, Target disregards any FSI reflected in its AFS resulting from the exchange of its assets for the Acquiror stock. Under paragraph (c)(3)(i)(A) of this section, Acquiror disregards any FSI reflected in its AFS resulting from the exchange of its stock for Target's assets, and instead applies section 1032(a) of the Code under paragraph (c)(3)(i)(B) of this section. Under paragraph (c)(3)(ii) of this section, Acquiror takes the Target assets with a CAMT basis of $15x. Under paragraph (c)(3)(iii) of this section, Acquiror adjusts its CAMT retained earnings to reflect Target's $10x CAMT retained earnings. Under paragraph (c)(7)(i) of this section, X disregards any FSI resulting from the exchange of its Target stock for Acquiror stock. Under paragraph (c)(7)(iii) of this section, X takes the Acquiror stock with a $40x CAMT basis.

(ii) *Example 2: Covered nonrecognition transaction with nonqualifying consideration*—(A) *Facts*. The facts are the same as in paragraph (c)(8)(i) of this section (*Example 1*), except that X receives as consideration in the merger $10x cash and Acquiror voting stock with a fair market value of $90x.

(B) *Analysis*. The analysis is the same as in paragraph (c)(8)(i)(B) of this section (*Example 1*), except as follows: Under paragraph (c)(7)(i)(B) of this section, X applies section 356 to the receipt of the $10x cash and includes $10x in AFSI. Under paragraph (c)(7)(iii) of this section, X takes the Acquiror stock at a $50x basis ($40x exchanged basis of Target stock + $10x gain recognized). Under paragraph (c)(7)(v) of this section, X adjusts its CAMT retained earnings to reflect the $10x AFSI recognized.

(d) *CAMT consequences of section 355 transactions*—(1) *Distributing corporation in covered nonrecognition transactions*—(i) *Controlled contribution*. If a distributing corporation transfers property to a controlled corporation in a transaction that qualifies the distributing corporation solely for nonrecognition treatment under sections 355 and 361 (that is, a covered nonrecognition transaction), the distributing corporation—

(A) Determines the distributing corporation's AFSI resulting from the one or more transfers by disregarding any resulting gain or loss reflected in its FSI and applying sections 355 and 361, respectively (that is, no AFSI is recognized by the distributing corporation);

(B) Determines the distributing corporation's CAMT basis in the property received from the controlled corporation by applying section 358 using the CAMT basis (in lieu of AFS basis) of the property transferred by the distributing corporation to the controlled corporation; and

(C) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(ii) *Section 361(c) distributions and transfers*. If a distributing corporation distributes or transfers solely qualified property to a distributing corporation shareholder or security holder, or to a creditor of the distributing corporation, that qualifies solely for nonrecognition treatment to the distributing corporation under section 361(c) (that is, a covered nonrecognition transaction), the distributing corporation determines the distributing corporation's AFSI resulting from the covered nonrecognition transaction by disregarding any resulting gain or loss reflected in the dis-

tributing corporation's FSI and applying section 361(c) (that is, no AFSI is recognized by the distributing corporation).

(iii) *Section 355(c) distributions*. If a distributing corporation distributes solely qualified property to a distributing corporation shareholder or security holder in a distribution that qualifies solely for nonrecognition treatment to the distributing corporation under section 355(c) (that is, a covered nonrecognition transaction), the distributing corporation—

(A) Determines the distributing corporation's AFSI resulting from the distribution by disregarding any resulting gain or loss reflected in the distributing corporation's FSI and applying section 355(c) (that is, no AFSI is recognized by the distributing corporation); and

(B) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312.

(2) *Distributing corporation in covered recognition transactions*—(i) *Controlled contribution*. If a distributing corporation transfers property to a controlled corporation in a section 355 transaction that results in any recognition treatment to the distributing corporation (that is, a covered recognition transaction), the distributing corporation—

(A) Determines the distributing corporation's AFSI resulting from the one or more transfers by redetermining any resulting gain or loss reflected in its FSI by using CAMT basis in lieu of AFS basis;

(B) Determines the distributing corporation's CAMT basis in the property received from the controlled corporation to be equal to the distributing corporation's AFS basis in that property; and

(C) Adjusts the distributing corporation's CAMT retained earnings (in lieu of AFS retained earnings) based on the distributing corporation's AFSI, as determined under paragraph (d)(2)(i)(A) of this section.

(ii) *Section 361(c) distribution*. If a distribution or transfer of property by a distributing corporation under section 361(c) results in any recognition treatment to the distributing corporation (that is, a covered recognition transaction), the distributing corporation—

(A) Determines the distributing corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the distributing corporation's FSI by reference to its CAMT basis in the distributed or transferred property (in lieu of AFS basis); and

(B) Adjusts the distributing corporation's CAMT earnings (in lieu of AFS retained earnings) based on the distributing corporation's AFSI, as determined under paragraph (d)(2)(ii)(A) of this section.

(3) *Distributing corporation shareholder or security holder*. A distributing corporation shareholder or security holder in a covered transaction described in paragraph (d)(1) or (2) of this section—

(i) Determines the distributing corporation shareholder's or security holder's AFSI resulting from the distribution by—

(A) Disregarding any resulting gain or loss reflected in the distributing corporation shareholder's or security holder's FSI;

(B) Applying the relevant section of the Code; and

(C) Using the distribution amount of the property other than distributing corporation stock reflected in the AFS of the distributing corporation shareholder or security holder, taking into account (for purposes of the relevant section of the Code) the CAMT basis of the distributing corporation shareholder or security holder in its distributing corporation stock;

(ii) Determines the characterization of the distribution of the property other than distributing corporation stock (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of earnings and profits) of the distributing corporation;

(iii) Determines the distributing corporation shareholder's or security holder's CAMT basis in the stock of the distributing corporation resulting from the distribution by applying the relevant section of the Code, using the CAMT basis of the distributing corporation shareholder or security holder in the stock (in lieu of basis for regular tax purposes);

(iv) Determines the distributing corporation shareholder's or security holder's CAMT basis in the property received from the distributing corporation by applying the relevant section of the Code, using CAMT basis (in lieu of AFS basis); and

(v) Adjusts the distributing corporation shareholder's or security holder's CAMT earnings (in lieu of AFS retained earnings) resulting from the distribution by applying section 312 based on its AFSI, as determined under paragraph (d)(3)(i) of this section.

(4) *Controlled corporation in covered nonrecognition transaction.* Subject to §1.56A-18(e), if a controlled corporation transfers solely its own stock to a distributing corporation that qualifies the controlled corporation for nonrecognition treatment under section 1032(a) (that is, a covered nonrecognition transaction), the controlled corporation—

(i) Determines the controlled corporation's AFSI resulting from the transfer by—

(A) Disregarding any resulting gain or loss reflected in the controlled corporation's FSI; and

(B) Applying section 1032(a) to the transfer (that is, no AFSI is recognized by the controlled corporation);

(ii) Determines the controlled corporation's CAMT basis in the property received by the controlled corporation from the distributing corporation by applying section 362 using the CAMT basis (in lieu of AFS basis) of that property; and

(iii) Adjusts the controlled corporation's CAMT current earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(5) *Controlled corporation in covered recognition transaction*—(i) *Qualification*—(A) *General rule*. Except as provided in paragraph (d)(5)(i)(B) of this section, if a controlled corporation transfers money or other property (in addition to stock) to a distributing corporation as part of a section 355 transaction that qualifies the controlled corporation for nonrecognition treatment under section 1032(a), the transfer is treated as a covered recognition transaction to the controlled corporation.

(B) *Exception for complete boot purges through covered nonrecognition transactions*. A transfer by a controlled corporation described in paragraph (d)(5)(i)(A) of this section is treated as a covered nonrecognition transaction if the distributing corporation distributes or transfers all of the money or other property received by the distributing corporation in that transfer

to a distributing corporation shareholder or security holder, or to a distributing corporation creditor, that qualifies solely for nonrecognition treatment to the distributing corporation under section 361(b) (that is, a covered nonrecognition transaction).

(ii) *CAMT consequences*. If a transfer by a controlled corporation described in paragraph (d)(5)(i) of this section is a covered recognition transaction, the controlled corporation—

(A) Determines the controlled corporation's AFSI resulting from the covered recognition transaction by redetermining any resulting gain or loss reflected in the controlled corporation's FSI by reference to the controlled corporation's CAMT basis (in lieu of AFS basis);

(B) Determines the controlled corporation's CAMT basis in the property received from the distributing corporation to be equal to the controlled corporation's AFS basis in that property; and

(C) Adjusts the controlled corporation's CAMT earnings (in lieu of AFS retained earnings) based on the controlled corporation's AFSI, as determined under paragraph (d)(5)(ii)(A) of this section.

(6) *Examples*. The following examples illustrate the application of the rules in this paragraph (d). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction to distributing corporation and controlled corporation*—(A) *Facts*. On February 1, Distributing contributes property with a fair market value of $190x and a CAMT basis of $20x to Controlled, a newly formed corporation, in exchange for Controlled stock with a fair market value of $175x and $15x of Controlled securities (collectively, the Contribution). Pursuant to a plan of reorganization that includes the Contribution, Distributing distributes all of the Controlled stock to Distributing's shareholders in exchange for their Distributing stock (Controlled Split-Off) in a transaction that qualifies for Distributing under sections 368(a)(1)(D), 355, 357, and 361 of the Code, and for Controlled under section 1032(a). Pursuant to the plan of reorganization, Distributing distributes the Controlled securities to creditors of Distributing in transactions that qualify under section 361(c)(3) (Debt-for-Debt Exchange). Immediately before the Contribution, Distributing has $600x of CAMT retained earnings. As part of the Controlled Split-Off, X, a CAMT entity that holds 10 shares of Distributing stock with a CAMT basis of $10x and a fair market value of $26x, exchanges 5 shares of Distributing stock for Controlled stock. As part of the Debt-for-Debt Exchange, Y, a CAMT entity that holds Distributing securities with a CAMT basis of $3x and a fair market value of $6x, exchanges its Distributing securities for $6x of Controlled securities.

(B) *Analysis*: *Contribution and distribution*. The Contribution and the Controlled Split-Off are covered nonrecognition transactions. Under paragraph (d)(1)(i)(A) of this section, Distributing disregards any FSI reflected in its AFS resulting from the Contribution and instead applies section 361 to determine AFSI; that is, Distributing has $0x AFSI on the Contribution. Under paragraph (d)(1)(i)(B) of this section, Distributing takes a CAMT basis of $20x in the Controlled stock and securities received in the Contribution. Under paragraph (d)(1)(i)(C) of this section, Distributing reduces its CAMT earnings by the amount of AFSI resulting from the Contribution, or $0x. Under paragraph (d)(4)(i) of this section, Controlled disregards any FSI reflected in its AFS resulting from the Contribution and applies section 1032(a) to determine AFSI, or $0x AFSI resulting from the Contribution. Under paragraph (d)(4)(ii) of this section, Controlled records a CAMT basis of $20x for the assets received in the Contribution.

(C) *Analysis*: *Distributing shareholders*. Under paragraph (d)(3)(i)(A) of this section, X disregards any FSI reflected in its AFS resulting from the exchange of Distributing stock for Controlled stock and instead applies section 355(a) to determine AFSI, or $0x AFSI. Under paragraph (d)(3)(iii) of this section, X takes a $5x CAMT basis in the Controlled stock received in the Controlled Split-Off. Under paragraph (d)(3)(v) of this section, X adjusts its CAMT retained earnings by the amount of AFSI resulting from the exchange, or $0x.

(D) *Analysis*: *Distributing security holders*. The analysis is similar to paragraph (d)(6)(i)(C) of this section (*Example 1*) for Y with respect to the Controlled securities exchanged for Distributing securities.

(ii) *Example 2: Distributing corporation boot-purge exception*—(A) *Facts*. The facts are the same as in paragraph (d)(6)(i)(A) of this section (*Example 1*), except that in the Contribution, the property contributed to Controlled has a fair market value of $200x, Controlled transfers $10x cash to Distributing, and Distributing distributes the $10x cash to its shareholders in a distribution that qualifies under section 361(b)(1)(A) (Cash Distribution). In the Cash Distribution, X receives $1x.

(B) *Analysis*. Because the Cash Distribution qualifies under section 361(b)(1)(A), under paragraph (d)(5)(i)(B) of this section, the receipt of nonqualifying consideration and the distribution of nonqualifying consideration is a covered nonrecognition transaction. As a result, the analysis is the same as paragraph (d)(6)(i)(B) of this section (*Example 1*). Additionally, under paragraph (d)(3)(i)(B) of this section, X includes $1x in AFSI. Under paragraph (d)(3)(v) of this section, X adjusts its CAMT earnings by the amount of AFSI resulting from the exchange, or $1x.

(iii) *Example 3: Covered recognition transaction to distributing corporation*—(A) *Facts*. The facts are the same as in paragraph (d)(6)(ii)(A) of this section (*Example 2*), except that in the Contribution, the fair market value of the property contributed to Controlled is $210x and Distributing receives Controlled non-security debt worth $25x and distributes all of the Controlled debt to Distributing creditors in exchange for Distributing securities. Additionally, in the Controlled Split-Off, Distributing distributes only 90% of the Controlled stock. On September 30th, Distributing distributes the remaining 10% of the Controlled stock pro rata to its shareholders.

(B) *Analysis: Contribution.* Because the Debt-for-Debt exchange results in gain to Distributing under section 361(b)(3), under paragraph (d)(2)(i) of this section, the Contribution is a covered recognition transaction. *See* paragraph (d)(6)(iii)(D) (*Example 3*) of this section. Under paragraph (d)(2)(i)(A) of this section, Distributing determines its AFSI resulting from the exchange using its CAMT basis, or $190x ($210x - $20x). Under paragraph (d)(2)(i)(B) of this section, Distributing's CAMT basis in the Controlled stock and Controlled securities is its AFS basis, or $170x and $25x, respectively. Under paragraph (d)(2)(i)(C) of this section, Distributing adjusts its CAMT retained earnings by the amount of AFSI resulting from the Contribution, or $190x.

(C) *Analysis*: *Controlled split-off*. The Controlled Split-Off is a covered nonrecognition transaction. As a result, the analysis of the CAMT consequences to X is similar to paragraph (d)(6)(i)(C) of this section (*Example 1*). Under §1.56A-18(c)(2)(i), Distributing disregards any FSI reflected in its AFS resulting from the Controlled Split-Off. Additionally, under §1.56A-18(c)(2)(i), Distributing disregards any FSI reflected in its AFS resulting from any mark-to-market of the fair value of the retained Controlled stock.

(D) *Analysis—Debt-for-debt exchange*. Because the fair market value of the Controlled debt distributed to Distributing creditors in exchange for Distributing securities exceeds the basis of the property transferred to Controlled, the Debt-for-Debt exchange is a covered recognition transaction under section 361(b)(3). As a result, Distributing recognizes $5x gain on the exchange ($25x - $20x).

(e) *CAMT consequences of recapitalizations*—(1) *Recapitalizing corporation in covered nonrecognition transaction*. If a recapitalizing corporation transfers solely stock to a recapitalizing corporation shareholder or creditor in an E reorganization or a section 1036 exchange that qualifies the recapitalizing corporation solely for nonrecognition treatment (that is, a covered nonrecognition transaction), the recapitalizing corporation—

(i) Determines the recapitalizing corporation's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in the recapitalizing corporation's FSI; and

(B) Applying section 1032(a) or 1036 of the Code, as appropriate (that is, no AFSI is recognized by the recapitalizing corporation); and

(ii) Adjusts the recapitalizing corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(2) *Component transactions consisting of covered nonrecognition transaction and corporate distributions*. If a transaction that qualifies as an E reorganization includes a transfer of money or other property (other than stock in the recapitalizing corporation) to a recapitalizing corporation shareholder or security holder, the recapitalizing corporation determines its aggregate resulting AFSI and CAMT earnings by treating each of the following component transactions separately—

(i) Each component transaction that qualifies as a covered nonrecognition transaction; and

(ii) Each component transaction that is treated as a distribution of property by the recapitalizing corporation to a recapitalizing corporation shareholder or security holder. *See* paragraph (d)(1)(ii) of this section for rules addressing non-liquidating corporate distributions.

(3) *Recapitalizing corporation shareholder or security holder*. A recapitalizing corporation shareholder or security holder in a covered transaction described in paragraph (e)(1) or (2) of this section—

(i) Determines the recapitalizing corporation shareholder's or security holder's AFSI resulting from the covered transaction by—

(A) Disregarding any resulting gain or loss reflected in its FSI;

(B) Applying the relevant section of the Code; and

(C) Using the distribution amount reflected on its AFS, taking into account (for purposes of the relevant section of the Code) the CAMT basis in its recapitalizing corporation stock;

(ii) Determines the characterization of any distribution (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of earnings and profits) of the recapitalizing corporation;

(iii) Determines its CAMT basis in the stock of the recapitalizing corporation resulting from the exchange by applying the relevant section of the Code using its CAMT basis in the stock (in lieu of basis for regular tax purposes);

(iv) Determines its CAMT basis in the property received from the recapitalizing corporation by applying the relevant section of the Code, using CAMT basis (in lieu of AFS basis); and

(v) Adjusts (to the extent applicable) its CAMT earnings (in lieu of AFS retained earnings) resulting from the exchange by applying section 312 based on its AFSI, as determined under paragraph (e)(3)(i) of this section.

(4) *Examples*. The following examples illustrate the application of the rules in this paragraph (e). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction*—(A) *Facts*. X has two classes of common stock, Class D and Class E. X also has issued $100x in securities that are held by unrelated parties. On its AFS, X carries the X securities at $90x. Y owns Class E common stock with a fair market value of $100x and a CAMT basis of $50x. Z holds $20x of X's securities with a CAMT basis of $10x. As part of an E reorganization, X recapitalizes its Class D and Class E stock into a single class of Class D common stock. X also recapitalizes the $100x securities into preferred stock with a fair market value of $100x.

(B) *Analysis*. The transaction is a covered nonrecognition transaction. Under paragraph (e)(1)(i) of this section, X disregards any FSI reflected in its AFS from the exchange of its Class D and Class E common stock for the Class D common stock and instead applies the appropriate Code section to determine its AFSI on the exchange, or $0x. Under paragraph (e)(1)(ii) of this section, X adjusts its CAMT retained earnings to reflect the AFSI resulting from the exchange, or by $0x. Under paragraph (e)(3)(i)(A) of this section, Y disregards any FSI reflected in its AFS resulting from the exchange of its Class E common stock for Class D common stock. Under paragraph (e)(3)(i)(B) of this section, Y determines its AFSI resulting from the exchange by applying section 354 of the Code, resulting in $0x AFSI. Under paragraph (e)(3)(iii) of this section, Y takes a CAMT basis in its Class D stock of $50x.

(ii) *Example 2: E reorganization and corporate distribution*—(A) *Facts*. X has two classes of common stock outstanding, held as follows: Y owns 99 shares of Class D common stock with a CAMT basis of $99x and a fair market value of $198x, and Z owns one share of Class E common stock with a CAMT basis of $1x and a fair market value of $2x. In order to simplify its capital structure and eliminate minority interests, Y engages in a transaction in which the Class D and Class E stock are recapitalized into a single class of common stock. In the exchange, Y exchanges its 99 shares of Class D X stock for 33 shares of X stock, and Z receives $2x cash in exchange for its one share in lieu of X issuing a fractional share of stock.

(B) *Analysis*. Y's exchange of Class D common stock for new X common stock is a covered nonrecognition transaction. Z's exchange of its share of Class E common stock for cash is a covered recognition transaction. Under paragraph (e)(2) of this section, X determines its aggregate AFSI and CAMT earnings by treating each component transaction separately. With respect to the covered nonrecognition transaction, the analysis is similar to paragraph (e)(4)(i)(B) of this section (*Example 1*), except that Y's CAMT basis in its 33 shares of X stock is $99x. *See* §1.56A-18(d) for rules relating to the computation of AFSI for Z and X with respect to the complete redemption of Z's interest in X for cash.

(f) *CAMT consequences of F reorganizations*—(1) *Transferor corporation in covered nonrecognition transaction*. If a transferor corporation transfers property to a resulting corporation in an F reorganization that qualifies the transferor corporation solely for nonrecognition treatment (that is, a covered nonrecognition transaction), the transferor corporation—

(i) Determines the transferor corporation's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in the transferor corporation's FSI; and

(B) Applying section 361 to the transfer (that is, no AFSI is recognized by the transferor corporation);

(ii) Determines the transferor corporation's CAMT basis in any property received from the resulting corporation by applying section 358 using the CAMT basis (in lieu of AFS basis) of the property transferred by the transferor corporation to the resulting corporation; and

(iii) Adjusts the transferor corporation's CAMT earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying section 312.

(2) *Component transactions consisting of covered nonrecognition transaction and corporate distributions*. If a transaction that qualifies as an F reorganization includes a transfer of money or other property (other than stock in the resulting corporation) to a transferor corporation shareholder or security holder, the transferor corporation determines its aggregate resulting AFSI and CAMT earnings by treating each of the following component transactions separately—

(i) Each component transaction that qualifies as a covered nonrecognition transaction; and

(ii) Each component transaction that is treated as a distribution of property by the transferor corporation to a transferor corporation shareholder or security holder. *See* §1.56A-18(d) for rules addressing non-liquidating corporate distributions.

(3) *Resulting corporation*. If a resulting corporation transfers solely stock, or stock and money or other property, to a transferor corporation as part of an F reorganization that qualifies the resulting corporation for nonrecognition treatment under section 1032(a) (that is, a covered nonrecognition transaction), the resulting corporation—

(i) Determines the resulting corporation's AFSI resulting from the covered nonrecognition transaction by—

(A) Disregarding any resulting gain or loss reflected in the resulting corporation's FSI; and

(B) Applying section 1032(a) to the transfer (that is, no AFSI is recognized by the resulting corporation);

(ii) Determines the resulting corporation's CAMT basis in the property received from the transferor corporation by applying section 362 using the CAMT basis (in lieu of AFS basis) of that property; and

(iii) Adjusts the resulting corporation's CAMT retained earnings (in lieu of AFS retained earnings) resulting from the covered nonrecognition transaction by applying sections 381(c)(2) and 312.

(4) *Transferor corporation shareholder or security holder*. A transferor corporation shareholder or security holder described in paragraph (f)(1) or (2) of this section—

(i) Determines the transferor corporation shareholder's or security holder's AFSI resulting from the covered transaction by—

(A) Disregarding any resulting gain or loss reflected in its FSI;

(B) Applying the relevant provision of the Code; and

(C) Using the distribution amount reflected on its AFS, taking into account (for purposes of the relevant section of the Code) the transferor corporation shareholder's or security holder's CAMT basis in its transferor corporation stock;

(ii) Determines the characterization of any distribution (to the extent applicable) by applying the relevant section of the Code based on the CAMT earnings (in lieu of AFS earnings and profits) of the transferor corporation;

(iii) Determines the transferor corporation shareholder's or security holder's CAMT basis in the stock of the resulting corporation resulting from the exchange by applying the relevant section of the Code using the transferor corporation shareholder's or security holder's CAMT basis in the stock (in lieu of basis for regular tax purposes);

(iv) Determines the transferor corporation shareholder's or security holder's CAMT basis in the property received by applying the relevant section of the Code, using CAMT basis in lieu of AFS basis; and

(v) Adjusts (to the extent applicable) its CAMT earnings (in lieu of AFS retained earnings) resulting from the exchange by applying section 312 based on its AFSI, as determined under paragraph (f)(4)(i) of this section.

(5) *Examples*. The following examples illustrate the application of the rules in this paragraph (f). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction*—(A) *Facts*. X is organized in State G. X has a single class of stock owned by Y, Z, and W as follows: Y owns 50 shares, with a fair market value of $100x and a CAMT basis of $50x; Z owns 45 shares, with a fair market value of $90 and a CAMT basis of $45; and W owns 5 shares with a fair market value of $10 and a CAMT basis of $5. X's assets have a fair market value of $200x and a CAMT basis of $75x. X has $350x CAMT retained earnings and $0x CAMT current earnings. In 2024, X organizes U as a State H corporation. Y, Z, and W contribute their X stock to U in exchange for U stock, and U converts X to a limited liability company under State H law.

(B) *Analysis.* The reorganization is a covered nonrecognition transaction. Under paragraph (f)(1)(i) of this section, X determines its AFSI by disregarding any FSI reflected in its AFS resulting from the transfer of its assets to U and instead applies section 361 to the exchange, resulting in $0x AFSI. Under paragraph (f)(1)(ii) of this section, X takes a $75x CAMT basis in the U stock it is deemed to receive. Under paragraph (f)(1)(iii) of this section, X adjusts its CAMT retained earnings by the amount of its AFSI, or $0x. Under paragraph (f)(3)(i) of this section, U disregards any FSI on its AFS resulting from the issuance of its stock in exchange for X's assets, and instead applies section 1032(a), resulting in $0x AFSI on the exchange. Under paragraph (f)(3)(ii) of this section, U takes the assets received from X at X's CAMT basis, or $75x. Under paragraph (f)(3)(iii) of this section, U adjusts its CAMT retained earnings by taking into account X's CAMT retained earnings, or $350x, plus the AFSI recognized on the exchange, or $0x. Under paragraph (f)(4)(i) of this section, each of Y, Z, and W, would disregard any FSI reflected in its AFS resulting from the exchange of X stock for U stock, and instead would apply section 354 to the exchange, resulting in $0x AFSI. Under paragraph (f)(4)(iv) of this section, each of Y, Z, and W would determine its basis in the U stock by applying section 358, resulting in Y taking a CAMT basis in the U stock of $50x, Z taking a CAMT basis in the U stock of $45x, and W taking a CAMT basis in the U stock of $5x. Under paragraph (f)(4)(v) of this section, each of Y, Z, and W would adjust CAMT retained earnings by the amount of AFSI recognized on the exchange, or $0x.

(ii) *Example 2: Component transactions*—(A) *Facts*. The facts are the same as in paragraph (f)(5)(i)(A) of this section (*Example 1*), except that as part of the transaction, U distributes $10x cash to W in complete redemption of W's stock.

(B) *Analysis*. The F reorganization involving Y and Z is a covered nonrecognition transaction. The redemption by U of all of W's stock is a covered recognition transaction. Under paragraph (f)(2) of this section, U determines its aggregate AFSI and CAMT earnings by treating each component transaction separately. With respect to the covered nonrecognition transaction, the analysis is similar to paragraph (f)(5)(i)(B) of this section (*Example 1*). With respect to the covered recognition transaction, *see* §1.56A-18(d).

(g) *CAMT consequences of section 351 exchanges*—(1) *Component transactions consisting of covered recognition and covered nonrecognition transactions*. If a section 351 exchange has more than one section 351 transferor, and if the section 351 transferee transfers solely stock to at least one section 351 transferor and transfers money or other property in addition to its stock to at least one other section 351 transferor, the section 351 transferee determines its aggregate resulting AFSI, CAMT basis, and CAMT earnings consequences by treating each of the following component transactions separately—

(i) Each component transaction in which the section 351 transferee transfers solely stock (including nonqualified preferred stock described in section 351(g)(2)) to a section 351 transferor (that is, a covered nonrecognition transaction with respect to the section 351 transferee); and

(ii) Each component transaction in which the section 351 transferee transfers money or other property in addition to its stock to a section 351 transferor (that is, a covered recognition transaction with respect to the section 351 transferee).

(2) *Section 351 transferor in covered nonrecognition transaction*. If a section 351 transferor transfers property to a section 351 transferee in a transaction to which section 351(a) applies to the section 351 transferor (that is, a covered nonrecognition transaction with respect to the

section 351 transferor), the section 351 transferor—

(i) Determines the section 351 transferor's AFSI resulting from the transfer by—

(A) Disregarding any resulting gain or loss reflected in the section 351 transferor's FSI; and

(B) Applying section 351 to the transfer (that is, no AFSI is recognized by the section 351 transferor); and

(ii) Determines the section 351 transferor's CAMT basis in the stock received from the section 351 transferee by applying section 358 using the CAMT basis (in lieu of AFS basis) of the property transferred by the section 351 transferor to the section 351 transferee.

(3) *Section 351 transferor in covered recognition transaction*. If a section 351 transferor transfers property to a section 351 transferee in a transaction in which section 351(b) applies (including by reason of section 351(g)) to the section 351 transferor (that is, a covered recognition transaction with respect to the section 351 transferor), the section 351 transferor—

(i) Determines the section 351 transferor's AFSI resulting from the transfer by redetermining any resulting gain or loss, if any, reflected in its FSI by reference to its CAMT basis in the transferred property (in lieu of AFS basis);

(ii) Determines the section 351 transferor's CAMT basis in the property received from the section 351 transferee to be equal to the section 351 transferor's AFS basis in that property; and

(iii) Adjusts the section 351 transferor's CAMT retained earnings (in lieu of AFS retained earnings) based on the section 351 transferor's AFSI, as determined under paragraph (g)(3)(i) of this section.

(4) *Section 351 transferee in covered nonrecognition transaction*. If a section 351 transferee transfers solely stock to a section 351 transferor in a transaction in which section 1032(a) applies to the section 351 transferee (that is, a covered nonrecognition transaction), the section 351 transferee determines its AFSI resulting from the covered nonrecognition transaction and its CAMT basis in the property received from the section 351 transferor under this paragraph (g)(4).

(i) *Section 351 transferee's AFSI*. The section 351 transferee determines the section 351 transferee's AFSI resulting from the transfer by—

(A) Disregarding any resulting gain or loss reflected in the section 351 transferee's FSI; and

(B) Applying section 1032(a) to the transfer (that is, no AFSI is recognized by the section 351 transferee).

(ii) *Section 351 transferee's CAMT basis in property.* Except as provided in paragraph (g)(3)(iii) of this section, the section 351 transferee determines the section 351 transferee's CAMT basis in the property received by the section 351 transferee from the section 351 transferor by applying section 362 using the CAMT basis (in lieu of AFS basis) of that property and any CAMT gain recognized by the section 351 transferor in the section 351 exchange.

(iii) *Special CAMT basis rule*. The section 351 transferee determines its CAMT basis under paragraph (g)(4)(ii) of this section in the property received from a section 351 transferor by redetermining the amount of any CAMT gain recognized by the section 351 transferor to include only the amount, if any, by which the fair market value of the portion of the property transferred by the section 351 transferor exceeds the section 351 transferor's CAMT basis in that portion of the transferred property if—

(A) The section 351 transferor is not an applicable corporation and its AFSI otherwise is not required to be taken into account under the section 56A regulations by any applicable corporation for the taxable year in which qualification of the component transaction as a covered recognition transaction with respect to the section 351 transferor otherwise would be determined under the section 56A regulations,

(B) The section 351 transferee solely transfers its stock to that section 351 transferor, and

(C) The fair market value of nonqualified preferred stock (as defined in section 351(g)(2)) described in paragraph (g)(4)(iii)(B) of this section is 10 percent or less of the aggregate fair market value of the stock described in paragraph (g)(4)(iii)(B) of this section transferred by the section 351 transferee to the section 351 transferor in the section 351 exchange.

(5) *Section 351 transferee in covered recognition transaction.* If a section 351 transferee transfers money or other property and stock to a section 351 transferor in a transaction to which section 1032(a) applies to the section 351 transferee (that is, a covered recognition transaction), the section 351 transferee determines its AFSI resulting from the transfer and its CAMT basis in the property received from the section 351 transferor, and CAMT retained earnings consequences under this paragraph (g)(5).

(i) *Section 351 transferee's AFSI*. The section 351 transferee determines the section 351 transferee's AFSI resulting from the transfer by redetermining any resulting gain or loss reflected in the section 351 transferee's FSI by reference to CAMT basis (in lieu of AFS basis).

(ii) *Section 351 transferee's CAMT basis in property.* Except as provided in paragraph (g)(5)(iii) of this section, the section 351 transferee determines the section 351 transferee's CAMT basis in the property received by the section 351 transferee to be equal to the section 351 transferee's AFS basis in that property.

(iii) *Special CAMT basis rule*. The section 351 transferee determines its CAMT basis under paragraph (g)(5)(ii) of this section in the property received from a section 351 transferor by redetermining the section 351 transferee's AFS basis in that property to not exceed the sum of the amount of the section 351 transferee's CAMT basis in the transferred property immediately before the section 351 exchange and the amount, if any, by which the fair market value of the portion of the property other than stock of the section 351 transferee transferred to the section 351 transferor exceeds the section 351 transferee's CAMT basis in that portion of the transferred property if—

(A) The section 351 transferor is not an applicable corporation and its AFSI otherwise is not required to be taken into account under the section 56A regulations by any applicable corporation for the taxable year in which qualification of the component transaction as a covered recognition transaction with respect to the section 351 transferee otherwise would be determined under the section 56A regulations,

(B) The section 351 transferee transfers its stock and money or other property to that section 351 transferor, and

(C) The amount of money and fair market value of other property described in paragraph (g)(5)(iii)(B) of this section is 10 percent or less of the sum of the money and the aggregate fair market value of the stock and other property described in paragraph (g)(5)(iii)(B) of this section transferred by the section 351 transferee to the section 351 transferor in the section 351 exchange.

(iv) *Section 351 transferee's CAMT retained earnings*. The section 351 transferee adjusts the section 351 transferee's CAMT retained earnings (in lieu of AFS retained earnings) based on the section 351 transferee's AFSI, as determined under paragraph (g)(5)(i) of this section.

(6) *Examples*. The following examples illustrate the application of the rules in this paragraph (g). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Covered nonrecognition transaction*—(A) *Facts*. Acquiror transfers assets with a CAMT basis of $40x and a fair market value of $90x to newly formed Target in a section 351 exchange (Exchange). On its AFS, Acquiror recognizes $50x of FSI on the Exchange ($90x - $40x).

(B) *Analysis*. The Exchange is a covered nonrecognition transaction to each of Acquiror and Target. Under paragraph (g)(2)(i) of this section, in computing AFSI, Acquiror disregards the FSI reflected in its AFS resulting from the Exchange. Under paragraph (g)(2)(ii) of this section, Acquiror records the Target stock received in the Exchange at the CAMT basis of the assets transferred to Target, or $40x. Under paragraph (g)(4)(i) of this section, Target disregards any FSI reflected in its AFS resulting from the Exchange. Under paragraph (g)(4)(ii) of this section, Target takes a $40x CAMT basis in the assets it receives from Acquiror in the Exchange.

(ii) *Example 2: Covered recognition transaction*—(A) *Facts*. The facts are the same as in paragraph (g)(6)(i)(A) of this section (*Example 1*), except that Acquiror receives $10x of cash in addition to $80x of Target stock in the Exchange.

(B) *Analysis*. The Exchange is a covered recognition transaction to each of Acquiror and Target. Under paragraph (g)(3)(i) of this section, Acquiror disregards any FSI resulting from the Exchange reflected in its AFS and instead redetermines its AFSI by computing any gain or loss using its CAMT basis in the assets transferred to Target, or $50x ($90x - $40x). Under paragraph (g)(3)(ii) of this section, Acquiror's CAMT basis in the Target stock received is its AFS basis, or $80x. Under paragraph (g)(3)(iii) of this section, Acquiror adjusts its CAMT retained earnings by the amount of AFSI resulting from the Exchange, or $50x. Under paragraph (g)(5)(i) of this section, Target disregards any FSI resulting from the Exchange and instead determines AFSI using CAMT basis, or $90x. Under paragraph (g)(5)(ii) of this section, Target determines its CAMT basis using its AFS basis in the property, or $90x. Paragraph (g)(5)(iii) of this section does not apply. Under paragraph (g)(5)(iv) of this section, Target adjusts its CAMT retained earnings by the amount of AFSI recognized on the Exchange, or $90x, reduced by the $10x cash distributed.

(iii) *Example 3: Component transactions*—(A) *Facts*. The facts are the same as in paragraph (g)(6)(ii)(A) of this section (*Example 2*), except that, as part of the same transaction, unrelated X transfers assets to Target with a CAMT basis of $25x and a fair market value of $120x in exchange for Target stock.

(B) *Analysis*. The transfer of assets by Acquiror to Target is a covered recognition transaction to each of Acquiror and Target. The transfer of assets by X to Target is a covered nonrecognition transaction to each of X and Target. Under paragraph (g)(1) of this section, Target determines its aggregate AFSI, CAMT basis, and CAMT retained earnings by treating each of the component transactions separately. With respect to the transfer of assets by Acquiror to Target, the analysis is similar to paragraph (g)(6)(ii)(B) of this section (*Example 2*). Under paragraph (g)(2)(i) of this section, in computing AFSI, X disregards the FSI reflected in its AFS resulting from the Exchange. Under paragraph (g)(2)(ii) of this section, X's CAMT basis of the Target stock received in the Exchange is the CAMT basis of the assets transferred to Target, or $25x. Under paragraph (g)(4)(i) of this section, Target disregards any FSI reflected in its AFS resulting from the Exchange. Under paragraph (g)(4)(ii) of this section, Target takes a $25x CAMT basis in the assets it receives from X in the Exchange.

(iv) *Example 4: Covered recognition transaction*—(A) *Facts*. The facts are the same as in paragraph (g)(6)(ii)(A) of this section (*Example 2*), except that Acquiror is not an applicable corporation and receives $5x of cash in addition to $85x of Target stock in the Exchange.

(B) *Analysis*. The amount of money transferred by Target to Acquiror in the Exchange is less than 10 percent of the amount of money and the fair market value of stock transferred by Target to Acquiror in the Exchange ($5x / ($5x + $85x) = 5.5%). Accordingly, under paragraph (g)(5)(iii) of this section, Target's CAMT basis in the assets received from Acquiror is equal to Acquiror's CAMT basis in the assets immediately before the Exchange ($40x) plus $0 of CAMT gain recognized by Target on the transfer of the $5x of cash in the Exchange.

(h) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-20 AFSI adjustments to apply certain subchapter K principles.

(a) *Overview*—(1) *In general*. This section provides rules under sections 56A(c)(15)(B) and (e) of the Code for determining AFSI adjustments for a CAMT entity that is a partner in a partnership, including the CAMT entity's distributive share of AFSI from a partnership investment under section 56A(c)(2)(D) of the Code, to take into account certain principles under subchapter K. Paragraph (b) of this section provides a general rule for FSI resulting from transactions between a CAMT entity and a partnership in which the CAMT entity is a partner. Paragraph (c) of this section provides special rules for contributions of property by a CAMT entity to a partnership. Paragraph (d) of this section provides special rules for distributions of property by a partnership if one or more of its partners is a CAMT entity. Paragraph (e) of this section provides rules regarding the treatment of partner and partnership liabilities for purposes of the section 56A regulations. Paragraph (f) of this section provides special rules for partial nonrecognition transactions under sections 721(a) and 731(b) of the Code. Paragraph (g) of this section provides rules regarding the maintenance of books and records and reporting requirements to comply with the rules of this section. Paragraph (h) of this section provides examples illustrating the application of the rules in this section. Paragraph (i) of this section provides the applicability date of this section.

(2) *Scope of rules*. This section applies to contributions to or distributions from a partnership. However, this section does not apply to contributions to or distributions from a partnership of stock of a foreign corporation except with respect to the effect on the CAMT basis of a partnership investment for a distribution of stock of a foreign corporation that is distributed in the same transaction as other property under paragraph (d)(2)(iii) of this section. *See* §1.56A-4(b) for rules that apply if stock of a foreign corporation is contributed to or distributed by a partnership.

(b) *General operating rules*. Except as otherwise provided in this section, in the case of a transaction between a CAMT entity and a partnership, each of the CAMT entity, any other partners in that partnership, and the partnership in which the CAMT entity is a partner includes in its AFSI any income, expense, gain, or loss reflected in its FSI as a result of the transaction.

(c) *Contributions of property*—(1) *In general*. Subject to paragraph (e) of this

section and except as provided in paragraph (f) of this section, if property is contributed by a CAMT entity (contributor) to a partnership in a transaction to which section 721(a) applies, any gain or loss reflected in the CAMT entity's FSI from the property transfer is included in the CAMT entity's AFSI in accordance with paragraphs (c)(2)(i) through (iv) of this section. As provided in paragraph (b) of this section, any other FSI amount resulting to the CAMT entity or the partnership from the transaction (for example, FSI gain or loss resulting from a deconsolidation or dilution, a revaluation to the fair market value of partnership assets for FSI purposes, or the application of paragraph (e) of this section) is not disregarded for AFSI purposes.

(2) *Contribution of property with financial accounting built-in gain or loss*—(i) *Deferred sale approach*. Subject to paragraph (e) of this section and except as provided in paragraphs (c)(2)(ii) through (iv) and (f) of this section, a contributor that contributes property to a partnership in a transaction described in paragraph (c)(1) of this section (deferred sale property) includes the amount of deferred sale gain or loss (as determined under paragraph (c)(2)(i)(A) of this section) in its AFSI ratably, on a monthly basis, over the applicable recovery period (as determined under paragraphs (c)(2)(i)(B) through (F) of this section) beginning on the first day of the month the deferred sale property is contributed to the partnership (in the case of deferred sale property described in paragraph (c)(2)(i)(B), (C), (D), or (F) of this section) or the first day of the month described in paragraph (c)(2)(i)(E) of this section (in the case of deferred sale property described in paragraph (c)(2)(i)(E) of this section). For purposes of the preceding sentence—

(A) The amount of *deferred sale gain or loss* is the amount of gain or loss reflected in the contributor's FSI resulting from the contribution of deferred sale property, and if the contribution is treated as a sale or exchange for AFS purposes, such gain or loss is redetermined by reference to the contributor's CAMT basis in the deferred sale property at the time of contribution rather than the contributor's AFS basis;

(B) The applicable recovery period for deferred sale property that is section 168 property (as defined in §1.56A-15(b)(6)) or qualified wireless spectrum (as defined in §1.56A-16(b)(4)) and that is placed in service by the contributor in a taxable year prior to the taxable year in which the property becomes deferred sale property is the full recovery period that was assigned to the property by the contributor in the taxable year such property was placed in service for purposes of depreciating or amortizing the property for regular tax purposes;

(C) The applicable recovery period for deferred sale property that is section 168 property or qualified wireless spectrum and that is either placed in service and contributed to a partnership in the same taxable year or is contributed and placed in service by the partnership in the same taxable year as the contribution, is the recovery period used by the partnership to depreciate or amortize the deferred sale property for regular tax purposes;

(D) The applicable recovery period for deferred sale property subject to depreciation or amortization for AFS purposes that is not section 168 property or qualified wireless spectrum in the hands of the contributor or the partnership is the recovery period used by the partnership to depreciate or amortize the deferred sale property for AFS purposes;

(E) If the deferred sale property that is section 168 property or qualified wireless spectrum has not been placed in service in the same taxable year it is contributed to the partnership, but is placed in service by the partnership in the immediately subsequent taxable year and thus subject to depreciation or amortization in that subsequent taxable year, the applicable recovery period is the recovery period for regular tax purposes that is used by the partnership for the deferred sale property in the immediately subsequent taxable year, and the inclusion of the deferred sale gain or loss by the contributor begins on the first day of the first month of that subsequent taxable year; and

(F) The applicable recovery period for deferred sale property that is not described in paragraphs (c)(2)(i)(B) through (E) of this section is 15 years.

(ii) *Inclusion of deferred sale gain or loss upon a decrease in contributor's distributive share percentage*—(A) *In general*. If the contributor's distributive share percentage (as determined under §1.56A-5(e)(2)) in the partnership decreases by more than one-third following its contribution of deferred sale property (whether by sale or exchange, liquidation of all or part of the contributor's interest in the partnership, dilution or deconsolidation, or otherwise), then the contributor includes in its AFSI for the taxable year in which the decrease occurs an amount of the deferred sale gain equal to the product of the amount described in paragraph (c)(2)(ii)(B) of this section and the percentage described in paragraph (c)(2)(ii)(C) of this section. Any amount of deferred sale gain remaining after application of this paragraph is included in the contributor's AFSI as provided in paragraph (c)(2)(ii)(D) of this section. Deferred sale loss, if any, is not accelerated under this paragraph (c)(2)(ii) as a result of a decrease in the contributor's distributive share percentage unless the decrease is the result of the contributor disposing of its entire investment in the partnership.

(B) *The amount*. The *amount* referenced in paragraph (c)(2)(ii)(A) of this section is the amount of deferred sale gain with respect to the deferred sale property that has not yet been included in the contributor's AFSI as of the date immediately before the transaction resulting in the decrease in the contributor's distributive share percentage.

(C) *The percentage*. The *percentage* referenced in paragraph (c)(2)(ii)(A) of this section is the percentage change in the contributor's distributive share percentage resulting from the transaction.

(D) *Continued ratable inclusion of remaining deferred sale gain or loss*. The amount (if any) of deferred sale gain or loss with respect to deferred sale property remaining after application of paragraph (c)(2)(ii)(A) of this section will continue to be included in the contributor's AFSI ratably on a monthly basis over the remaining applicable recovery period of the deferred sale property.

(iii) *Inclusion of deferred sale gain or loss upon disposition of deferred sale property*. If the partnership sells, distributes, or otherwise disposes of deferred sale property (including by distribution to the contributor or the partnership's contribution of the deferred sale property to another CAMT entity in a recognition or

nonrecognition transaction), then the contributor includes in its AFSI in the taxable year of the disposition, the amount of any deferred sale gain or loss with respect to the deferred sale property that has yet to be included in the contributor's AFSI as of the date of the disposition. For rules regarding the effects of property distributions on the AFSI of a partnership and its CAMT entity partner, *see* paragraphs (d)(1) and (2) of this section.

(iv) *Inclusion of deferred sale gain upon an acceleration or partial acceleration event described in §1.721(c)-4(b) or §1.721(c)-5(d).* If section 721(a) applies to a contribution of deferred sale property due to the application of the gain deferral method described in §1.721(c)-3 and an acceleration event described in §1.721(c)-4(b) occurs, then the contributor includes in its AFSI for the contributor's taxable year of the event, the amount of any deferred sale gain with respect to the deferred sale property that has yet to be included in the contributor's AFSI as of the date of the acceleration event. If a partial acceleration event described in §1.721(c)-5(d) occurs, then the contributor includes in its AFSI in the taxable year of the event an amount of deferred sale gain that bears the same ratio to the total amount of any deferred sale gain that has yet to be included in the contributor's AFSI immediately before the event, that the taxable gain required to be recognized under §1.721(c)-5(d)(2) or (3) bears to the total amount of remaining built-in gain (as defined in §1.721(c)-1(b)(13)) with respect to section 721(c) property, as computed for regular tax purposes. The amount (if any) of deferred sale gain with respect to deferred sale property remaining after application of this paragraph (c)(2)(iv) will continue to be included in the contributor's AFSI ratably on a monthly basis over the remaining applicable recovery period of the deferred sale property. These acceleration events are in addition to the acceleration events under paragraphs (c)(2)(ii) and (iii) of this section.

(v) *Tiered partnerships*. If the contributor is a partnership, the deferred sale gain or loss included in the contributor partnership's AFSI for a taxable year in accordance with this paragraph (c)(2) is included in the distributive share amounts of the partners of the contributor partnership (whether or not the partners were partners of the contributor at the time of contribution) in proportion to their distributive share percentages for the taxable year, as determined under §1.56A-5(e)(2). Similar rules apply to any partner in the chain of partnerships that owns an interest directly or indirectly in the contributor.

(3) *Basis rules*—(i) *Basis of property contributed to partnership*. The partnership's initial CAMT basis in property contributed to a partnership by a CAMT entity at the time of the contribution is the partnership's initial AFS basis in the contributed property at the time of the contribution, regardless of whether section 721(a) applies, in whole or in part, to the contribution.

(ii) *Basis of partnership investment for contributed property*. The initial CAMT basis of an interest in a partnership investment acquired by a contributor upon a contribution of property to the partnership to which section 721(a) applies is the contributor's AFS basis in the acquired partnership investment, decreased by any deferred sale gain or increased by any deferred sale loss that is required to be included in the contributor's AFSI in accordance with paragraph (c)(2) of this section. *See* §1.56A-5(j) for rules that apply to adjustments to CAMT basis of a partnership investment for contributions of stock of a foreign corporation. The contributor's initial CAMT basis in the acquired partnership investment is subsequently increased or decreased—

(A) On the last day of each taxable year during the applicable recovery period by an amount equal to the deferred sale gain or loss, respectively, required to be included in AFSI in each taxable year in accordance with paragraph (c)(2)(i) of this section (without duplication of any increases or decreases to CAMT basis under paragraph (c)(3)(ii)(B) of this section); or

(B) Immediately prior to an event causing all or a portion of the deferred sale gain or loss to be accelerated into AFSI in accordance with paragraph (c)(2)(ii) of this section, by an amount equal to the sum of the deferred sale gain or loss that accrued in accordance with paragraph (c)(2)(i) of this section prior to the event and the amount required to be included in AFSI under paragraph (c)(2)(ii) of this section.

(d) *Distributions of property*—(1) *Gain or loss recognized by partnership*—(i) *In general*. Except as provided in paragraph (f) of this section, if a partnership distributes property to a partner in a transaction to which section 731(b) applies, any gain or loss reflected in the partnership's FSI with respect to the property transferred is disregarded for purposes of determining the partnership's modified FSI and instead is included in the CAMT entity partners' distributive share amounts (as provided in §1.56A-5(e)(1)(iv)) in accordance with paragraphs (d)(1)(ii) and (iii) and (d)(2) of this section. As provided in paragraph (b) of this section, any other FSI amount resulting from the transaction (for example, FSI gain or loss to a partner resulting from a deconsolidation or dilution, or a revaluation to fair market value of other partnership assets for FSI purposes) is not disregarded for purposes of determining the AFSI of the partner or the modified FSI of the partnership.

(ii) *Deferred distribution gain or loss approach*. Subject to paragraph (e) of this section and except as provided in paragraphs (d)(1)(iii), (d)(2)(ii), and (f) of this section, if a partnership distributes property to a partner in a transaction to which section 731(b) applies (deferred distribution property), the amount of deferred distribution gain or loss (as determined under paragraph (d)(1)(ii)(A) of this section) is included in each CAMT entity partner's distributive share amount (in accordance with their allocable shares as provided in paragraph (d)(2) of this section) ratably, on a monthly basis, over the applicable recovery period (as determined under paragraphs (d)(1)(ii)(B) through (F) of this section) beginning on the first day of the month in which the distribution occurs (in the case of deferred distribution property described in paragraph (d)(1)(ii)(B), (C), (D), or (F) of this section), or the first day of the month described in paragraph (d)(1)(ii)(E) of this section (in the case of deferred distribution property described in paragraph (d)(1)(ii)(E) of this section). For purposes of the preceding sentence—

(A) The amount of *deferred distribution gain or loss* is the amount of gain or loss reflected in the partnership's FSI resulting from the distribution of deferred distribution property, and if the distribu-

tion is treated as a sale or exchange for AFS purposes, such gain or loss is redetermined by reference to the partnership's CAMT basis in the deferred distribution property at the time of distribution rather than the partnership's AFS basis;

(B) The applicable recovery period for deferred distribution property that is section 168 property (as defined in §1.56A-15(b)(6)) or qualified wireless spectrum (as defined in §1.56A-16(b)(4)) and that is placed in service by the partnership in a taxable year prior to the taxable year in which the property becomes deferred distribution property is the full recovery period that was assigned to the property by the partnership in the taxable year such property was placed in service for purposes of depreciating or amortizing the property for regular tax purposes;

(C) The applicable recovery period for deferred distribution property that is section 168 property or qualified wireless spectrum and that is either placed in service by a partnership and distributed by the partnership to a partner in the same taxable year or is distributed by the partnership to a partner and placed in service by the partner in the same taxable year as the distribution is the recovery period used by the partner to depreciate or amortize the deferred distribution property for the taxable year of the distribution for regular tax purposes;

(D) The applicable recovery period for deferred distribution property subject to depreciation or amortization for AFS purposes that is not section 168 property or qualified wireless spectrum is the recovery period that was used by the partnership to depreciate or amortize the deferred distribution property for AFS purposes;

(E) If the deferred distribution property that is section 168 property or qualified wireless spectrum has not been placed in service in the same taxable year it is distributed to the partner, but is placed in service by the partner in the immediately subsequent taxable year and thus subject to depreciation in that subsequent taxable year, the applicable recovery period is the recovery period for regular tax purposes that is used by the partner for the deferred distribution property in the immediately subsequent taxable year, and the inclusion of the deferred distribution gain or loss by the partnership begins on the first day of the first month of that subsequent taxable year; and

(F) The applicable recovery period for deferred distribution property that is not described in paragraphs (d)(1)(ii)(B) through (E) of this section is 15 years.

(iii) *Acceleration of deferred distribution gain or loss*. If a partnership described in paragraph (d)(1)(ii) of this section engages in an acceleration transaction, then the partners of the partnership that are CAMT entities include in their distributive share amounts, in the manner provided in paragraph (d)(2) of this section, the amount of any deferred distribution gain or loss with respect to the deferred distribution property that has yet to be included in such partners' distributive share amounts as of the date immediately before the acceleration transaction for the partnership's taxable year in which the acceleration transaction occurs. For purposes of this paragraph (d)(1)(iii), the term *acceleration transaction* means, with respect to a partnership described in paragraph (d)(1)(ii) of this section—

(A) A termination of the partnership under section 708(b)(1) of the Code as a result of a dissolution or liquidation;

(B) A sale or exchange of all or substantially all of the partnership's assets; or

(C) A merger or consolidation of the partnership with one or more partnerships in which the partnership is not the resulting partnership for regular tax purposes (as determined under §1.708-1(c)).

(2) *Partner inclusions of deferred distribution gain or loss*—(i) *Partners' allocable shares of deferred distribution gain or loss*. Deferred distribution gain or loss is allocated among the CAMT entity partners in proportion to their distributive share percentages for the taxable year of the distribution, as determined under §1.56A-5(e)(2).

(ii) *Acceleration of a partner's allocable share of deferred distribution gain or loss*. If a CAMT entity partner disposes of its entire investment in the partnership, including through a liquidating distribution by the partnership, the partner includes in its distributive share amount for the partner's taxable year in which the disposition occurs its allocable share of any deferred distribution gain or loss that has not yet been included in the partner's distributive share amount as of the disposition date.

(iii) *FSI resulting to a partner from a distribution of property or money*. If a distribution of property or money from a partnership to a CAMT entity partner results in any gain, loss, or other amount being reflected in the FSI of the partner, then such gain, loss or other amount is redetermined using the relevant CAMT basis, if applicable, and included in the partner's AFSI in the taxable year in which the property or money is distributed to the partner. For purposes of this paragraph (d)(2)(iii), if the relevant CAMT basis is the partner's CAMT basis in its partnership investment—

(A) Money distributed in the same transaction as property is treated as reducing CAMT basis, if applicable under §1.56A-5(j)(3)(i), prior to any distribution of property;

(B) Stock in a foreign corporation distributed in the same transaction is treated as reducing CAMT basis under §1.56A-5(j)(3)(xii) prior to any distribution of property other than stock in a foreign corporation; and

(C) Principles similar to §1.731-1(a)(1)(ii) apply for purposes of calculating the effect of the distribution on AFSI.

(iv) *Tiered partnerships*. If any partner of the distributing partnership is a partnership for Federal tax purposes, the deferred distribution gain or loss included in the partner's distributive share amount for a taxable year in accordance with paragraph (d)(2)(i) of this section is included in its CAMT entity partners' distributive share amounts (whether or not the partners were partners in the partnership at the time of the distribution) in proportion to their distributive share percentages for the taxable year, as determined under §1.56A-5(e)(2). Similar rules apply to any CAMT entity partner in the chain of partnerships that owns an interest, directly or indirectly, in the partnership that is a partner in the distributing partnership.

(3) *Basis rules*—(i) *Basis of distributed property*. A CAMT entity partner's initial CAMT basis in property distributed by a partnership is the partner's initial basis in the property for AFS purposes, determined immediately after the distribution.

(ii) *Basis of partner's investment in partnership*. The CAMT basis of a CAMT

entity partner's investment in a partnership following the partnership's distribution of property is increased or decreased—

(A) At the end of each taxable year during the applicable recovery period by the amount required to be included in the partner's distributive share amount in each taxable year in accordance with paragraph (d)(1)(ii) of this section; and

(B) Immediately prior to an acceleration event specified in paragraph (d)(1)(iii) or (d)(2)(ii) of this section by the amount of deferred distribution gain or loss not previously included in the partner's distributive share amount in accordance with paragraph (d)(1)(ii) of this section.

(e) *Liability allocation rules*—(1) *General rule.* The treatment of partner and partnership liabilities for purposes of determining a CAMT entity partner's or partnership's AFSI is based on the applicable liability treatment for AFS purposes and not under section 752 of the Code.

(2) *Application of rules to contributions and distributions*. For purposes of determining whether section 721(a) or 731(b) applies to a transaction, section 752 is inapplicable. As a result, any rules relating to liabilities for regular tax purposes, such as the rules relating to liabilities under §§1.707-5 and 1.707-6, do not apply.

(f) *Proportionate deferred sale approach for partial nonrecognition transactions under sections 721(a) and 731(b)*. This paragraph (f) applies if a transfer of property by a partner to a partnership does not constitute a nonrecognition transaction under section 721(a) for regular tax purposes (or would not constitute a nonrecognition transaction under section 721(a) for regular tax purposes considering the application of paragraph (e) of this section), in whole or in part, or if a transfer of property by a partnership to a partner would not constitute a nonrecognition transaction under section 731(b) for regular tax purposes (or would not constitute a nonrecognition transaction under section 731(b) for regular tax purposes considering the application of paragraph (e) of this section), in whole or in part. If this paragraph (f) applies, then the CAMT entity partner or partnership includes in its AFSI or modified FSI, as applicable, for the taxable year of the transfer an amount (if any) of the FSI reflected on the partner's or the partnership's AFS resulting from the transaction that bears the same ratio to the total amount of gain or loss reflected in the partner's or partnership's FSI resulting from the transaction (with the amount of such gain or loss being redetermined using the CAMT basis of the property) that the taxable gain or loss that would be recognized without application of section 752 and the exceptions relating to liabilities in §§1.707-5 and 1.707-6 bears to the taxable gain or loss realized on the transfer as determined for regular tax purposes. Any FSI resulting from the transaction but not included in a CAMT entity partner's or partnership's AFSI or modified FSI, as applicable, because of the rules in paragraph (c) or (d) of this section is deferred and included in the partner's AFSI or the partners' distributive share amounts, as appropriate, in accordance with paragraph (c) or (d) of this section.

(g) *Maintenance of books and records and reporting requirements*—(1) *Information to be included in books and records*. A partnership and each CAMT entity that is a partner in the partnership must include in its respective books and records the information necessary for the partnership and each CAMT entity to comply with the rules of this section and §1.56A-5. As applicable for a partnership or partner to comply with the rules of this section and §1.56A-5, the information to be maintained in its respective books and records includes, without limitation—

(i) The recovery periods used to depreciate deferred sale property and deferred distribution property for regular tax purposes;

(ii) The properties contributed to the partnership that had a built-in gain or loss at the time of contribution and the amount of the built-in gain or loss with respect to each property for AFSI purposes;

(iii) The CAMT basis of any property contributed to or distributed from the partnership; and

(iv) The amount of deferred distribution gain or loss to be allocated among, and included in the distributive share amounts of, the partners of the partnership.

(2) *Reporting requirements*—(i) *In general*. Subject to the notice requirement in §1.56A-5(i)(3)(iii), a partnership must report to a CAMT entity partner the information required for the CAMT entity partner to comply with the rules of this section and §1.56A-5, including, without limitation—

(A) The recovery periods used to depreciate deferred sale property;

(B) The date on which the partnership sold, distributed, or otherwise disposed of deferred sale property;

(C) The date on which an acceleration event or partial acceleration event described in §1.721(c)-4(b) or §1.721(c)-5(d), respectively, occurred; and

(D) The amount of deferred distribution gain or loss resulting from a distribution of property that is included in the CAMT entity partner's distributive share amount under paragraph (d) of this section.

(ii) *Form of reporting*. A partnership may report information to a CAMT entity partner in any reasonable manner sufficient for a CAMT entity partner to comply with the rules of this section, provided, that if any information relates to the determination of a CAMT entity partner's distributive share amount with respect to its investment in the partnership, the partnership must report the information consistently with the reporting requirements described in §1.56A-5(h).

(h) *Examples*. The following examples illustrate the application of the rules in this section.

(1) *Example 1: Contribution of property to an existing partnership with no deferred sale gain or loss*—(i) *Facts*. On July 1, 2024, X, a domestic corporation, contributes land with an AFS basis of $20,000x and a fair market value of $20,000x to PRS, a partnership, in exchange for a 20% interest in the capital and profits of PRS in a transaction to which section 721(a) applies. No gain or loss is reflected in X's FSI as a result of the property transfer. Following the transfer, X's AFS basis in its investment in PRS is $20,000x. PRS's initial AFS basis in the land is $20,000x. At the time of contribution, Y, a domestic corporation, held a 55% interest in the capital and profits of PRS, and various individuals owned the remaining 45%.

(ii) *Analysis*. Although this is a contribution of property to which paragraph (c)(1) of this section would apply, because no gain or loss is reflected in X's FSI as a result of the property transfer, there is no deferred sale gain or loss. Under paragraph (c)(3)(ii) of this section, X's initial CAMT basis in its partnership investment is equal to $20,000x ($20,000x AFS basis of X's partnership investment following the transfer - $0 deferred sale gain or loss). Under paragraph (c)(3)(i) of this section, PRS has an initial CAMT basis in the land equal to its initial AFS basis of the land, which is also $20,000x. If X's receipt of the 20% interest in capital and profits of PRS causes PRS to become deconsolidated from Y for AFS purposes, then, under paragraph (b)(2) of this section,

any gain or loss included in Y's FSI because of the deconsolidation for AFS purposes would not be excluded from Y's AFSI under this section.

(2) *Example 2: Contribution of property to a new partnership with deferred sale gain*—(i) *Facts*. X and Y, each a domestic corporation that uses the calendar year as its taxable year, form partnership PRS on July 1, 2024. X contributes Asset 1, which is section 168 property, in exchange for a 40% interest in the capital and profits of PRS in a transaction to which section 721(a) applies. Immediately before the contribution, Asset 1 had an AFS basis of $4,000x, a CAMT basis of $3,000x, and a fair market value of $10,000x. The property transfer results in $6,000x of FSI being reflected in X's AFS for 2024, which is calculated for AFS purposes by subtracting the AFS basis of Asset 1 from the fair market value ($10,000x - $4,000x). For regular tax purposes, X uses a 5-year recovery period for Asset 1. Following the transfer, X's initial AFS basis in its investment in PRS is $10,000x. PRS's initial AFS basis in Asset 1 is $10,000x.

(ii) *Analysis*. The FSI resulting from the transfer is included in X's AFSI in accordance with paragraph (c)(2) of this section under the deferred sale approach. First, the amount of FSI resulting from the transfer must be redetermined using the CAMT basis of the property instead of the AFS basis of the property, which results in a redetermined FSI amount of $7,000x ($10,000x - $3,000x). This redetermined FSI amount is included in X's AFSI ratably over the applicable recovery period. Because Asset 1 is section 168 property, under paragraph (c)(2)(i)(B) of this section, the recovery period is the recovery period used by X to depreciate the deferred sale property for regular tax purposes, or 5 years. Accordingly, X includes $700x in AFSI in 2024 (($7,000x deferred sale gain) / (60 months (the 5-year recovery period determined on a monthly basis)) x 6 months (the number of months, including partial months, remaining in X's taxable year from the date of the contribution)). X will include the remaining $6,300x of deferred sale gain in AFSI in 2025 through 2029. Under paragraph (c)(3)(i) of this section, PRS's initial CAMT basis in Asset 1 equals its AFS basis of Asset 1 following the transfer, or $10,000x. Under paragraph (c)(3)(ii) of this section, X's initial CAMT basis in its investment in PRS is $3,000x (the $10,000x initial AFS basis of the partnership investment - the $7,000x of deferred sale gain). X's CAMT basis in its partnership investment is increased by the amount of deferred sale gain included in its AFSI in accordance with paragraph (c)(3)(ii) of this section and §1.56A-5(j)(3).

(3) *Example 3*: *Acceleration of deferred sale gain upon disposition of a portion of CAMT entity's partnership investment*—(i) *Facts*. The facts are the same as in paragraph (h)(2)(i) of this section (*Example 2*), except that, effective July 1, 2026, X sold a portion of its investment in PRS and, after the sale, X's distributive share percentage under §1.56A-5(c)(2) is reduced from 40% to 25%.

(ii) *Analysis*—(A) *Determine the amount of deferred gain accelerated.* Under paragraph (c)(2)(ii) of this section, X includes $1,575x in AFSI in 2026 because of the sale, determined as follows:

Table 1 to Paragraph (h)(3)(ii)(A)

Deferred gain under paragraph (c)(2)(i) of this section	$7,000x
Less deferred gain previously included in AFSI	($2,800x)
Remaining deferred gain under paragraph (b)(2)(i) of this section	$4,200x
Distributive share percentage prior to sale	40%
Distributive share percentage after sale	25%
Percentage change in ownership ((40%-25%)/40%)	37.5%
Amount included in AFSI under paragraph (c)(2)(ii) of this section ($4,200x x 0.375)	$1,575x

(B) *Calculation of CAMT basis upon disposition of a portion of a CAMT entity's partnership investment.* In addition to the $1,575x that X includes in AFSI in 2026 because of the sale, X must also include in AFSI in 2026 the portion of the deferred sale gain that accrued from January 1 through June 30 of 2026, and a portion of the remaining deferred sale gain required to be included at the end of 2026 based on the remaining recovery period of Asset 1. Per the preceding calculation, there is $2,625x deferred sale gain remaining ($4,200x less $1,575x). Accordingly, X includes in AFSI $1,137.5x ($700x deferred sale gain that accrued from January 1 through June 30, 2026, plus $437.5x (($2,625x deferred sale gain remaining after the sale) / (36 months (the 3-year remaining recovery period determined on a monthly basis)) x 6 months (the number of months, including partial months, remaining in X's taxable year from the date of sale))). For purposes of determining the amount of gain or loss to be included in X's AFSI as a result of a sale of its partnership investment, X must, under paragraph (c)(3)(ii) of this section, increase its CAMT basis immediately prior to the sale of the partnership investment by the sum of $2,275x ($700x deferred sale gain required to be ratably included in AFSI through June 30, 2026 + $1,575x deferred sale gain required to be included in AFSI in 2026 as a result of the sale).

(4) *Example 4: Partnership disposition of deferred sale property*—(i) *Facts*. The facts are the same as in paragraph (h)(2)(i) of this section (*Example 2*), except that PRS sells Asset 1 to an unrelated third party at the end of 2026.

(ii) *Analysis*. Under paragraph (c)(2)(iii) of this section, X includes in AFSI in 2026 all of the $3,500x of remaining deferred sale gain with respect to Asset 1 as of the end of 2026. Under paragraph (c)(3)(ii) of this section and §1.56A-5(k)(3), X's CAMT basis in its partnership investment will increase by the amount of deferred sale gain required to be included in AFSI, or $3,500x.

(5) *Example 5: Part disguised sale of property to partnership and part deferred sale gain*—(i) *Facts*. The facts are the same as in paragraph (h)(2)(i) of this section (*Example 2*), except that, immediately after the contribution, PRS transfers $5,000x cash to X, and X's initial AFS basis in its investment in PRS is $5,000x. Assume that, under section 707(a)(2)(B) of the Code and §1.707-3, PRS's transfer of cash to X is treated as part of a sale of Asset 1 by X to PRS. X's adjusted tax basis in Asset 1 is $0x at the time of the transfer.

(ii) *Analysis: Treatment of transaction for regular tax purposes*. Under section 707(a)(2)(B) and §1.707-3, X is treated as having sold a portion of Asset 1 with a value of $5,000x to PRS in exchange for $5,000x of cash. Accordingly, X recognizes $5,000x of taxable gain for regular tax purposes ($5,000x amount realized - $0x adjusted tax basis ($0x x $5,000x/$10,000x)), and X is considered to have contributed to PRS in a transaction to which section 721(a) applies, a portion of Asset 1 with a $5,000x fair market value and an adjusted tax basis of $0x.

(iii) *Analysis: Proportionate deferred sale approach*—(A) *Determine X's AFSI inclusion amount.* Under paragraph (f) of this section, X is required to include in AFSI an amount of gain or loss that bears the same ratio to the total amount of gain or loss reflected in X's FSI (but redetermined using the CAMT basis of the property) that taxable gain or loss recognized on the transfer bears to the taxable gain or loss realized on the transfer, as determined for regular tax purposes. Accordingly, X includes $3,500x in AFSI in 2024 ($7,000x of gain resulting from the transfer, redetermined using the CAMT basis of the property ($10,000x - $3,000x) x ($5,000x taxable gain recognized / $10,000x taxable gain realized)).

(B) *Determine X's deferred sale gain amount*. X is considered to have contributed to PRS in a transaction to which section 721(a) applies, $5,000x of the fair market value of Asset 1 with an AFS basis of $2,000x ($4,000x x ($5,000x/$10,000x)) and a CAMT basis of $1,500x ($3,000x x ($5,000x/$10,000x)). Under paragraph (c)(2) of this section, the CAMT gain resulting from the transfer is included in X's AFSI in accordance with paragraph (c)(2)(i) of this section under the deferred sale approach. To do this, X first determines the amount of deferred sale gain using the CAMT basis of the property considered contributed in a deferred sale ($5,000x - $1,500x) and includes this gain, or $3,500x, in its AFSI ratably

over the applicable recovery period. Because Asset 1 is section 168 property, under paragraph (c)(2)(i)(B) of this section, the applicable recovery period is the recovery period used by X to depreciate the deferred sale property for regular tax purposes, or 5 years.

(C) *Determine X's initial CAMT basis in its partnership investment and PRS's initial CAMT basis in Asset 1*. Under paragraph (c)(3)(ii) of this section, X's initial CAMT basis in its partnership investment is $1,500x ($5,000x AFS basis of the partnership investment to X following the transfer - $3,500x deferred sale gain determined under paragraph (c)(2)(i) of this section). Under paragraph (c)(3)(i) of this section, PRS's initial CAMT basis in Asset 1 is equal to the AFS basis of the property, or $10,000x.

(6) *Example 6: Contribution of encumbered property*—(i) *Facts*. The facts are the same as in paragraph (h)(2)(i) of this section (*Example 2*), except that Asset 1 was subject to a $5,000x nonrecourse liability that would be a qualified liability under §1.707-5, and that PRS took the property subject to such liability. Other than PRS's taking of Asset 1 subject to the liability, X received no other consideration as part of a transfer and would not be deemed to have sold any portion of Asset 1 under §§1.707-3 and 1.707-5. X's adjusted tax basis in Asset 1 at the time of contribution is $0x. For AFS purposes, X is required to recognize gain equal to the excess of the nonrecourse liability on Asset 1 upon contribution, and its AFS basis in the property contributed and X's initial AFS basis in its investment in PRS is $5,000x.

(ii) *Analysis*—(A) *Proportionate deferred sale approach with application of paragraph (e) of this section*. Even though X is not considered to have sold any portion of Asset 1 to PRS for which taxable gain would be required to be recognized for regular tax purposes under §§1.707-3 and 1.707-5 because the nonrecourse liability is a qualified liability, paragraph (e)(2) of this section applies. Paragraph (e)(2) of this section provides that section 752 and the exceptions in §1.707-5 concerning liabilities assumed or taken subject to property by a partnership do not apply for purposes of determining the portion of Asset 1 deemed contributed or sold under paragraphs (c) and (f) of this section. Accordingly, for purposes of determining the amount of the gain or loss to be included in AFSI in the taxable year of transfer under paragraph (f) of this section and the amount to be deferred under paragraph (c) of this section, X calculates the amount of taxable gain that would be recognized on the transfer under §§1.1001-2(a)(1) and 1.707-3, without application of section 752 and §1.707-5.

(B) *Determine X's proportionate amount of AFSI inclusion and deferred sale gain*. Under §1.1001-2(a)(1), X would have been treated as receiving consideration of $5,000x on the transfer of Asset 1 to PRS because of PRS's taking Asset 1 subject to the $5,000x nonrecourse liability. Applying §1.707-3 to determine the portion of Asset 1 that is sold to PRS and the portion that is contributed under section 721(a), X would have been treated as having sold a portion of Asset 1 and recognized $5,000x of gain for regular tax purposes ($5,000x amount realized - $0x adjusted tax basis ($0x x $5,000x/$10,000x)). X also would have been considered to have contributed to PRS under section 721(a) $5,000x of the fair market value of Asset 1 with an adjusted tax basis of $0x.

(C) *Remaining analysis*. The remaining analysis is the same as in paragraphs (h)(5)(iii)(A) through (C) of this section (*Example 5)*.

(7) *Example 7: Current distribution of section 168 property to partner*—(i) *Facts*. Each of X and Y is a corporation and a partner in PRS. Each of X, Y and PRS uses the calendar year as its taxable year. On July 1, 2024, PRS transfers Asset 1 to X, which is not an asset contributed to PRS by either X or Y. The distribution is not in liquidation of any part of X's financial interest in PRS. At the time of the distribution, Asset 1, which is section 168 property, had a fair market value of $200,000x, an AFS basis of $120,000x, and a CAMT basis of $100,000x, and was being depreciated over a 5-year recovery period under the general depreciation system of section 168. For AFS purposes, PRS recognizes $80,000x of FSI on the distribution, which is calculated by subtracting the AFS basis of Asset 1 from the fair market value of Asset 1. At the time of the distribution, X had an AFS basis in its partnership investment of $125,000x, and a distributive share percentage of 40%, as determined under §1.56A-5(e)(2).

(ii) *Analysis: Treatment of partnership-level gain*. Under paragraph (d)(1)(i) of this section, no part of the $80,000x of FSI is included in PRS's modified FSI. Rather, under paragraph (d)(1)(ii) of this section, X and Y include their allocable portion (as determined under paragraph (d)(2)(i) of this section) of the deferred distribution gain (but redetermined using the CAMT basis of Asset 1) in their respective distributive share amounts over a period of 5 years (the applicable recovery period used by the partnership to depreciate the property for regular tax purposes), commencing on July 1, 2024. Accordingly, under paragraphs (d)(1)(ii) and (d)(2)(i) of this section, X and Y would include in their distributive share amounts in 2024 the sum of $4,000x and $6,000x, respectively (the $100,000x of deferred distribution gain (as redetermined using the CAMT basis of Property) multiplied by X's or Y's distributive share percentage (40% or 60%, respectively), divided by 60 months (the 5 year recovery period determined on a monthly basis), and further multiplied by 6 (the number of months, including partial months, remaining in PRS's taxable year following the distribution of Asset 1)). In each of 2025 through 2028, X and Y would include in their respective distributive share amounts the sums of $8,000x and $12,000x, respectively, and in 2029, the sums of $4,000x and $6,000x, respectively.

(iii) *Analysis: Treatment of partner-level gain*. If, as a result of the distribution, X would be required to include $75,000x of gain in FSI (calculated by the $200,000x AFS value of Asset 1 over X's $125,000x AFS basis in its partnership investment), then, under paragraph (d)(2)(iii) of this section, X must redetermine the FSI amount using the CAMT basis it is partnership investment as of the last day of the taxable year under principles similar to §1.731-1(a)(1)(ii) and include this amount in its AFSI. Under paragraph (d)(3)(i) of this section, X's initial CAMT basis in Asset 1 would be X's initial basis in the property for AFS purposes, determined immediately after the distribution.

(8) *Example 8: Acceleration of gain due to partnership dissolution*—(i) *Facts*. The facts are the same as in paragraph (h)(7)(i) of this section (*Example 7*), except that at the beginning of 2026, Partnership XY dissolves and liquidates.

(ii) *Analysis*. Under paragraph (d)(1)(iii) of this section, PRS includes in X's and Y's distributive share amounts in 2026 the sums of $28,000x ($40,000x deferred distribution gain allocated to X - $12,000x previously included in X's distributive share amount in 2024 and 2025), and $42,000x (the $60,000x of the deferred distribution gain allocated to Y - $18,000x previously included in Y's distributive share amount in 2024 and 2025), respectively. Under paragraph (d)(3)(ii) of this section, X and Y would increase their CAMT bases in their partnership investments by the $28,000x and $42,000x, respectively, immediately prior to the dissolution and liquidation.

(9) *Example 9: Acceleration of gain due to liquidation of partner's interest*—(i) *Facts*. The facts are the same as in paragraph (h)(7)(i) of this section (*Example 7*), except that at the beginning of 2027, Y sells its partnership investment to Z, an unrelated corporation.

(ii) *Analysis*. Under paragraph (d)(2)(ii) of this section, Y includes in its distributive share amount for 2027 the sum of $30,000x, the remaining amount of deferred distribution gain allocated to it under paragraph (d)(2)(i) of this section ($60,000x initial allocation - $6,000x previously included in its distributive share amount in 2024 - $12,000x previously included in its distributive share amount in each of 2025 and 2026). Under paragraph (d)(3)(ii) of this section, Y would increase its CAMT basis immediately prior to its sale of its partnership investment to Z by the $30,000x of remaining deferred distribution gain required to be included in its AFSI under paragraph (d)(2)(ii) of this section. Under paragraph (d)(1)(ii) of this section, X would continue to include in its distributive share amount its proportionate amount of the deferred distribution gain allocated to it under paragraph (d)(2)(i) of this section. Accordingly, X would include $8,000x in its distributive share amount in 2027.

(i) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-21 AFSI adjustments for troubled companies.

(a) *Overview*—(1) *Scope*. This section provides rules under section 56A of the Code for determining the CAMT consequences resulting from an insolvency or bankruptcy of a CAMT entity, including rules for determining any resulting AFSI and adjustments to CAMT basis or other CAMT attributes. This section also provides rules under section 56A for determining the CAMT consequences resulting from the receipt of Federal financial assistance. This section incorporates the definitions and rules regarding covered transactions in §§1.56A-18 and 1.56A-

19. Paragraph (b) of this section provides additional definitions for purposes of this section. Paragraph (c) of this section provides rules regarding discharge of indebtedness income. Paragraph (d) of this section provides rules regarding fresh start accounting for the emergence from bankruptcy. Paragraph (e) of this section provides rules regarding investments in partnerships that realize discharge of indebtedness income. Paragraph (f) of this section provides rules regarding Federal financial assistance. Paragraph (g) of this section provides the applicability date of this section.

(2) *AFS consequences resulting from disposition of property*. For rules for determining the CAMT consequences resulting from the disposition of any property by a CAMT entity in connection with a title 11 case or an insolvency, *see* §1.56A-18(g) and (h), which address covered recognition transactions consisting of a sale of property by a CAMT entity.

(3) *AFS consequences resulting from certain covered nonrecognition transactions*. For rules for determining the CAMT consequences of acquisitive reorganizations and section 355 transactions, *see* §1.56A-19(c) and (d), respectively.

(4) *Disregarded entities*. For rules regarding the application of paragraphs (c) and (d) of this section to disregarded entities, *see* paragraphs (c)(3) and (d)(5) of this section.

(b) *Definitions*. For purposes of this section:

(1) *CAMT attribute*. The term *CAMT attribute* means—

(i) CAMT basis;

(ii) CAMT foreign tax credits;

(iii) CFC adjustment carryovers (as defined in §1.56A-6(b)(6)); and

(iv) FSNOLs.

(2) *Covered property*. The term *covered property* means section 168 property, qualified wireless spectrum, and ANCSA property (as defined in §1.56A-11(b)(2)).

(3) *Discharge of indebtedness*—(i) *In general*. With respect to a CAMT entity, the term *discharge of indebtedness*, and any similar term, means any discharge of indebtedness of the CAMT entity reflected in its AFS.

(ii) *Adjustments to AFS basis.* For purposes of this paragraph (b)(3), the term *discharge of indebtedness*, and any similar term, includes income resulting from adjustments to the AFS basis of the indebtedness during the pendency of a title 11 case.

(iii) *Scope of discharge of indebtedness*. With respect to a CAMT entity, the term *discharge of indebtedness*, and any similar term, does not include the discharge of any indebtedness of the CAMT entity—

(A) To the extent incurring that indebtedness previously has resulted in a reduction in the FSI of the CAMT entity;

(B) That results from the satisfaction of a nonrecourse debt of the CAMT entity with the property that secures that debt; or

(C) That results from the satisfaction of recourse debt of the CAMT entity with property to the extent the aggregate fair market value of the property exceeds the aggregate CAMT basis of that property.

(4) *Federal financial assistance*. The term *Federal financial assistance* (FFA) has the meaning provided in section 597(c) of the Code and §1.597-1(b).

(5) *Indebtedness*. With respect to a CAMT entity, the term *indebtedness*, and any similar term, means any indebtedness reflected on the AFS of the CAMT entity—

(i) For which the CAMT entity is liable; or

(ii) Subject to which the CAMT entity holds property (*see* section 108(d)(1) of the Code).

(6) *Insolvent*—(i) *In general*. The term *insolvent* has the meaning given the term in section 108(d)(3).

(ii) *Timing of determination*. With respect to any discharge of indebtedness of a CAMT entity, whether or not the CAMT entity is insolvent, and the amount by which the CAMT entity is insolvent, is determined on the basis of the CAMT entity's assets and liabilities (for regular tax purposes) immediately before the discharge of indebtedness. *See* section 108(d)(3).

(7) *Title 11 case*. The term *title 11 case* has the meaning given the term in section 108(d)(2).

(c) *Discharge of indebtedness income*—(1) *AFSI in title 11 cases*. If a CAMT entity that is under the jurisdiction of a court in a title 11 case realizes any discharge of indebtedness income, and if the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court—

(i) For purposes of determining the AFSI of the CAMT entity, the CAMT entity disregards the total amount of income that is reflected in the FSI of the CAMT entity resulting solely from the discharge of indebtedness of the CAMT entity; and

(ii) The CAMT entity applies the attribute reduction rules described in paragraphs (c)(4) and (5) of this section to the CAMT entity's CAMT attributes.

(2) *AFSI in cases of insolvency*. If a CAMT entity is insolvent and realizes any discharge of indebtedness income, and if paragraph (c)(1) of this section does not apply to the CAMT entity—

(i) For purposes of determining the AFSI of the CAMT entity, the CAMT entity disregards the income reflected in the FSI of the CAMT entity resulting solely from the discharge of indebtedness by an amount equal to the lesser of the amount of the discharge of indebtedness and the amount by which the CAMT entity is insolvent; and

(ii) The CAMT entity applies the attribute reduction rules in paragraph (c)(4) of this section to the CAMT entity's CAMT attributes.

(3) *Disregarded entities*—(i) *In general*. For purposes of applying paragraphs (c)(1) and (2) of this section to discharge of indebtedness of a disregarded entity, the disregarded entity is not considered to be the *taxpayer*, as that term is used in section 108. Instead, for purposes of paragraphs (c)(1) and (2) of this section, the CAMT entity owner of the disregarded entity is the *taxpayer*. *See* §1.108-9.

(ii) *Title 11 cases*. If indebtedness of a disregarded entity is discharged in a title 11 case, paragraph (c)(1) of this section applies to that discharged indebtedness only if the CAMT entity owner of the disregarded entity is under the jurisdiction of the court in a title 11 case as the title 11 debtor.

(iii) *Insolvency*. If indebtedness of an insolvent disregarded entity is discharged, paragraph (c)(2) of this section applies to that discharged indebtedness only to the extent the CAMT entity owner of the disregarded entity is insolvent.

(4) *Attribute reduction*—(i) *Overview*. If income reflected in the FSI of a CAMT

entity is disregarded for AFSI purposes under paragraph (c)(1)(i) or (c)(2)(i) of this section (that is, with regard to a discharge of indebtedness resulting from a title 11 case or an insolvency), the CAMT entity reduces the CAMT attributes of the CAMT entity described in, and in the manner required by, this paragraph (c)(4) and paragraph (c)(5) of this section.

(ii) *Required attribute reduction amount*—(A) *In general*. Subject to paragraph (c)(4)(ii)(B) of this section, a CAMT entity described in paragraph (c)(4)(i) of this section reduces its CAMT attributes by an amount that corresponds to the amount of discharge of indebtedness of the CAMT entity excluded from AFSI under paragraph (c)(1) or (2) of this section. For rules that provide the amount of CAMT attributes that is reduced for each dollar of discharge of indebtedness excluded from AFSI, *see* paragraph (c)(5) of this section.

(B) *Maximum amount of attribute reduction*. The amount of CAMT attributes required to be reduced by a CAMT entity under paragraph (c)(4)(iii) of this section cannot exceed the aggregate amount of the CAMT entity's CAMT attributes, determined as of the time of the reduction under paragraphs (c)(4)(iv) and (v) of this section.

(iii) *Attribute reduction*. A CAMT entity described in paragraph (c)(4)(i) of this section reduces the following CAMT attributes of the CAMT entity in the following order:

(A) CAMT basis of covered property, but only to the extent the basis of the covered property is reduced by the CAMT entity under section 108 for regular tax purposes.

(B) FSNOLs.

(C) CFC adjustment carryovers.

(D) CAMT basis of property (other than covered property) that is depreciated or amortized for AFS purposes.

(E) CAMT basis of property (other than covered property) that is not depreciated or amortized for AFS purposes.

(F) CAMT foreign tax credits.

(G) Any remaining CAMT basis of covered property.

(iv) *Timing and allocation of reductions*—(A) *Reductions generally made after determination of CAMT liability for taxable year*. The reductions described in paragraph (c)(4)(iii) of this section are made after the determination of the tentative minimum tax under section 55(b)(2)(A) of the Code for the taxable year of the discharge of indebtedness of the CAMT entity. For taxable years beginning after December 31, 2019, and before January 1, 2023, the reductions described in paragraph (c)(4)(iii) of this section are made after the determination of AFSI for the taxable year of the discharge of indebtedness of the CAMT entity. For any discharge of indebtedness of a CAMT entity that occurs in a taxable year beginning on or before December 31, 2019, the reductions described in paragraph (c)(4)(iii) of this section do not apply. *See* §1.56A-1(d)(3).

(B) *CAMT basis of property*. The reductions of basis described in paragraphs (c)(4)(iii)(A), (D), (E), and (G) of this section apply solely to property of the CAMT entity that the CAMT entity holds on the first day of the taxable year following the taxable year in which the CAMT entity excludes discharge of indebtedness income from its AFSI. For additional rules that address covered nonrecognition transactions, *see* paragraph (d)(3)(ii) of this section.

(C) *Allocation of basis reductions*. The CAMT entity must reduce CAMT basis under paragraph (c)(4)(iii)(A) of this section for each individual item of property under section 108 for regular tax purposes. For basis reductions to property described in paragraph (c)(4)(iii)(D), (E), or (G) of this section, the CAMT entity applies §1.1017-1(a) to determine the allocation of CAMT basis reductions to individual items of property. A CAMT entity that properly makes an election under section 108(b)(5) for regular tax purposes must apply the modifications of §1.1017-1(c) to determine the allocation of CAMT basis reductions to individual items of property.

(v) *Order of reductions*—(A) *FSNOL carryovers*. The reductions described in paragraph (c)(4)(iii)(B) or (C) of this section, respectively, are made first to any FSNOL or CFC adjustment carryover arising for the taxable year of the discharge of indebtedness of the CAMT entity, and then to the FSNOL carryover or CFC adjustment carryover to that taxable year, in the order of the taxable years from which each FSNOL or CFC adjustment carryover arose, beginning with the earliest such taxable year.

(B) *CAMT foreign tax credits*. The reduction described in paragraph (c)(4)(iii)(F) of this section is made in the order in which the CAMT foreign tax credits are taken into account for the taxable year of the discharge of indebtedness of the CAMT entity.

(5) *Amount of attribute reduction*—(i) *CAMT basis, FSNOLs, and CFC adjustment carryovers*. For each dollar of AFSI that a CAMT entity excludes under paragraphs (c)(1) and (2) of this section, the CAMT entity reduces, as appropriate—

(A) A dollar of CAMT basis;

(B) A dollar of FSNOL; or

(C) A dollar of CFC adjustment carryover.

(ii) *CAMT basis reduction limitation*. Except as otherwise provided in paragraph (c)(5)(iii) of this section, the combined amount of CAMT basis reduced under paragraphs (c)(4)(iii)(D), (E), and (G) of this section cannot exceed the excess of—

(A) The aggregate CAMT basis and money of the CAMT entity immediately after the discharge of indebtedness of the CAMT entity, less the amount of basis reduced under paragraph (c)(4)(iii)(A) of this section; over

(B) The aggregate amount of liabilities reflected on the AFS of the CAMT entity immediately after the discharge of indebtedness of the CAMT entity.

(iii) *Election under section 108(b)(5)*. The limitation in paragraph (c)(5)(ii) of this section does not apply if the CAMT entity has made an election under section 108(b)(5).

(iv) *CAMT foreign tax credits*. For each dollar of AFSI that a CAMT entity excludes under this paragraph (c), the CAMT entity reduces each dollar of the CAMT entity's CAMT foreign tax credits by an amount equal to—

(A) One dollar of the CAMT foreign tax credit; multiplied by

(B) The percentage specified in section 55(b)(2)(A)(i).

(6) *Examples*. The following examples illustrate the application of the rules in this paragraph (c). For purposes of these examples, each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group.

(i) *Example 1: Bankruptcy emergence in a covered nonrecognition transaction*—(A) *Facts*. During its 2024 taxable year, X emerges from bankruptcy in a title 11 case by transferring all of its assets with a CAMT basis of $60x and a fair value of $160x to Y in a transaction that qualifies as a reorganization under section 368(a)(1)(G) of the Code (G Reorganization). In connection with the transaction, $40x of X's $200x indebtedness is discharged. On its AFS, X reports $100x of gain from the G Reorganization and $40x of income from the discharge of indebtedness, and Y reports the AFS basis of the assets it receives as $160x on its AFS.

(B) *Analysis*. The G Reorganization is a covered nonrecognition transaction. *See* §1.56A-18(b)(9). For purposes of determining X's AFSI for the 2024 taxable year, X disregards the $100x of FSI resulting from the G Reorganization and the $40x of income from the discharge of indebtedness. *See* §1.56A-19(c)(1)(i)(A). Y disregards any increase in the AFS basis of the assets it receives from X and takes a CAMT basis in those assets equal to X's $60x CAMT basis. *See* §1.56A-19(c)(3)(ii).

(ii) *Example 2: Bankruptcy emergence in a covered recognition transaction*—(A) *Facts*. The facts are the same as in paragraph (c)(6)(i)(A) of this section (*Example 1*), except that, after the discharge of its indebtedness in a title 11 case, X sells all of its assets to Y for cash in a transaction that does not qualify for nonrecognition treatment under any provision of the Code. X then distributes the cash to its creditors and dissolves. On its AFS, X reports $40x from the discharge of indebtedness and $100x of gain from the sale.

(B) *Analysis*. X disregards any FSI that otherwise would result from the discharge of $40x of X's indebtedness. *See* paragraph (c)(1)(i) of this section. X's AFSI for the 2024 taxable year includes the $100x gain from the sale of its assets in a covered recognition transaction. *See* §1.56A-18(h)(1). Y has a CAMT basis of $160x in the assets it receives from X in the covered recognition transaction. *See* §1.56A-18(h)(2)(ii).

(iii) *Example 3: Attribute reduction*—(A) *Facts*. During its 2024 taxable year, X emerges from bankruptcy in a title 11 case. As a result of the bankruptcy reorganization, some of X's indebtedness is discharged. X has $850x of discharge of indebtedness income for regular tax purposes prior to the application of section 108(b). On X's AFS, X reports $1,000x from the discharge of indebtedness. At the time of the discharge, X has $300x of net operating losses (NOLs), $700x of FSNOLs, and $800x of basis in its assets for both regular tax and CAMT purposes (including $400x of basis in covered property). X does not make an election under section 108(b)(5).

(B) *Application of section 108*. For purposes of determining its income for regular tax purposes for the 2024 taxable year, X excludes $850x of income from the discharge of indebtedness under section 108(a)(1)(A). Under section 108(b), X reduces its NOLs by $300x and the basis of its assets by $550x, of which $275x is basis in covered property.

(C) *AFSI analysis*. For purposes of determining X's AFSI for the 2024 taxable year, X disregards any FSI that otherwise would result from the discharge of X's indebtedness. *See* paragraph (c)(1)(i) of this section. X's CAMT attributes are reduced by an amount equal to the amount of the exclusion of FSI from X's AFSI (that is, $1,000x). *See* paragraphs (c)(1)(ii) and (c)(4)(ii) of this section. X first reduces its CAMT basis of covered property to the extent its basis is reduced under section 108(b) for regular tax purposes, or $275x. *See* paragraphs (c)(4)(iii)(A) and (c)(5)(i)(A) of this section. X then reduces X's FSNOLs by $700x. Finally, X reduces X's CAMT basis in property other than covered property by $25x. *See* paragraphs (c)(4)(iii)(B) and (D), (c)(5)(i)(A) and (B), and (c)(5)(ii) of this section. X does not further reduce its basis in covered property because X already has reduced $1,000x of attributes for the $1,000x of income from the discharge of indebtedness it has excluded. *See* paragraph (c)(4)(ii)(A) of this section.

(iv) *Example 4: Excluded income from the discharge of indebtedness of insolvent taxpayer*—(A) *Facts*. The facts are the same as in paragraph (c)(6)(iii)(A) of this section (*Example 3*), except that X does not emerge from bankruptcy in a title 11 case; instead, some of X's indebtedness is discharged during the 2024 taxable year. Immediately before the discharge, X is insolvent by $850x. Under section 108(b), X reduces its NOLs by $300x and the basis of its assets by $550x, of which $275x is basis in covered property.

(B) *AFSI analysis*. For purposes of determining its AFSI for the 2024 taxable year, X disregards $850x of its $1,000x of FSI that otherwise would result from the discharge of its indebtedness. *See* paragraph (c)(2)(i) of this section. X takes the remaining $150x of FSI from the discharge of its indebtedness into account for purposes of computing its AFSI. *See id*. X's CAMT attributes are reduced by an amount equal to the amount of the exclusion of financial accounting gain from X's AFSI (that is, $850x). *See* paragraphs (c)(2)(ii) and (c)(4)(ii) of this section. X first reduces its CAMT basis of covered property to the extent its basis is reduced under section 108(b) for regular tax purposes, or $275x. *See* paragraphs (c)(4)(iii)(A) and (c)(5)(i)(A) of this section. X then reduces its FSNOLs by $575x. *See* paragraphs (c)(4)(iii)(B) and (c)(5)(i)(B) of this section.

(d) *Fresh start accounting for emergence from bankruptcy*—(1) *Scope*. This paragraph (d) provides rules for determining the CAMT consequences to a CAMT entity resulting from an emergence from bankruptcy of the CAMT entity.

(2) *AFSI consequences resulting from emergence from bankruptcy*—(i) *General rule*. Except to the extent provided in paragraphs (d)(2)(ii) and (iii) of this section, a CAMT entity determines its CAMT consequences resulting from its emergence from bankruptcy by—

(A) Disregarding any resulting gain or loss that is reflected in the FSI of the CAMT entity;

(B) Determining the CAMT basis of any assets of the CAMT entity by disregarding any adjustment to the AFS basis of those assets resulting from the emergence from bankruptcy; and

(C) Adjusting the CAMT entity's CAMT earnings (in lieu of AFS retained earnings) resulting from the CAMT entity's emergence from bankruptcy by applying section 312 of the Code.

(ii) *Discharge of indebtedness*. A CAMT entity described in paragraph (d)(2)(i) of this section determines the CAMT consequences of any discharge of indebtedness of the CAMT entity resulting from the CAMT entity's emergence from bankruptcy in accordance with paragraph (c) of this section.

(iii) *Covered transactions*. A CAMT entity described in paragraph (d)(2)(i) of this section determines the CAMT consequences of any covered transaction in connection with the CAMT entity's emergence from bankruptcy in accordance with paragraph (d)(3) of this section.

(3) *AFSI consequences of title 11 cases*—(i) *Covered recognition transactions*. If a CAMT entity disposes of assets in a covered recognition transaction (solely with regard to the CAMT entity) as part of its title 11 case, the CAMT entity determines the CAMT consequences of the covered recognition transaction with regard to the CAMT entity by applying §1.56A-18(g) and (h).

(ii) *Covered nonrecognition transactions*—(A) *In general*. If a CAMT entity disposes of assets in a covered nonrecognition transaction (solely with regard to the CAMT entity) as part of its title 11 case, the CAMT entity determines the CAMT consequences of the covered nonrecognition transaction with regard to the CAMT entity by applying §1.56A-19(c) and (d), which provide rules for determining the CAMT consequences of acquisitive reorganizations and section 355 transactions, respectively.

(B) *CAMT attribute adjustments resulting from covered nonrecognition transactions*. If a CAMT entity described in paragraph (d)(2)(i) of this section is a target corporation in an acquisitive reorganization that qualifies as a covered nonrecognition transaction with regard to the CAMT entity (that is, the target corporation), the CAMT entity is treated as reducing all CAMT attributes required by paragraphs (c)(5) and (6) of this section before the acquiror corporation would be treated

as receiving those CAMT attributes under §1.56A-19(c).

(4) *Discharge of indebtedness*. A CAMT entity described in paragraph (d)(3)(i) or (d)(3)(ii)(A) of this section determines the CAMT consequences of any discharge of indebtedness of the CAMT entity resulting from the CAMT entity's emergence from bankruptcy in accordance with paragraph (c) of this section.

(5) *Disregarded entities*. For purposes of applying this paragraph (d) to a disregarded entity, the disregarded entity is not considered to be the *taxpayer*, as that term is used in section 108. Instead, for purposes of this paragraph (d), the CAMT entity owner of the disregarded entity is the *taxpayer*. *See* paragraph (c)(1) of this section and §1.108-9.

(6) *Example*. The following example illustrates the application of the rules in this paragraph (d).

(i) *Facts*. X is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group. During its 2024 taxable year, X emerges from bankruptcy without being a party to a covered transaction. In connection with the transfer of ownership, X reports $90x of gain on its AFS when it increases the AFS basis of its assets from $40x to their fair value of $130x at the time it emerges from bankruptcy.

(ii) *Analysis*. For purposes of determining its AFSI for the 2024 taxable year, X does not take into account the $90x of FSI resulting from the increase in the AFS basis of its assets. *See* paragraph (d)(2)(i)(A) of this section. X does not make any adjustments to the CAMT basis of its assets resulting from X's emergence from bankruptcy. Accordingly, X's CAMT basis in its assets remains at $40x. *See* paragraph (d)(2)(i)(B) of this section.

(e) *Application to investments in partnerships*—(1) *Scope*. This paragraph (e) provides rules for applying this section to a CAMT entity that is a partner in a partnership if the partnership realizes discharge of indebtedness income.

(2) *Discharge of indebtedness income of a partnership*—(i) *Calculation of partnership's AFSI.* Any discharge of indebtedness income reflected in a partnership's FSI is disregarded for purposes of determining the partnership's AFSI, and is instead taken into account by the CAMT entities that are partners in the partnership in accordance with paragraphs (e)(2)(ii) and (iii) of this section.

(ii) *Exclusion from AFSI and attribute reduction at the partner level*—(A) *In general.* Subject to paragraph (e)(3) of this section, the AFSI exclusions provided in paragraphs (c)(1) and (2) of this section, and any resulting CAMT attribute reductions (as provided in paragraphs (c)(4) and (5) of this section), are applied at the partner level in the same manner as the rules in section 108(a) and section 108(b) are applied at the partner level for regular tax purposes. *See* section 108(d)(6) and §1.108-9(b).

(B) *Special rules for covered property*. For purposes of applying the CAMT attribute reduction rules under paragraphs (c)(4) and (5) of this section at the partner level, a CAMT entity partner treats its partnership investment as covered property to the extent the basis of covered property held by the partnership is reduced by the partnership for regular tax purposes under §1.1017-1(g)(2). In addition, if a CAMT entity partner treats its partnership investment as covered property under the immediately preceding sentence, the basis adjustment rules under §1.1017-1(g)(2) with respect to covered property held by the partnership apply for purposes of determining the CAMT entity's distributive share amount under §1.56A-5.

(iii) *Discharge of indebtedness income separately stated to partners.* Discharge of indebtedness income reflected in a partnership's FSI is separately stated to the partners in accordance with their distributive share percentages for the taxable year in which the income is reflected in the partnership's FSI. *See also* §1.56A-5(e)(4)(iii).

(3) *Inclusion of partnership liabilities for purposes of determining insolvency*. In applying paragraph (e)(2) of this section, a CAMT entity that is a partner in a partnership includes its share of partnership's liabilities under section 752 of the Code in determining whether it is insolvent in the same manner as its share of partnership liabilities would be included for regular tax purposes.

(f) *Federal financial assistance*—(1) *In general*. AFSI does not include any financial accounting gain attributable to FFA any earlier than when the gain is included in gross income for purposes of section 597 and the regulations under section 597.

(2) *Example*. The following example illustrates the application of the rules in this paragraph (f).

(i) *Facts*. X is an Institution, as defined in §1.597-1(b), that uses the calendar year as its taxable year. On July 1, 2024, X acquires assets and assumes liabilities of an unrelated Institution under Agency Receivership, as defined in §1.597-1(b), in a Taxable Transfer, as defined in §1.597-5(a)(1)(i)(A), in exchange for an up-front payment from an Agency, as defined in §1.597-1(b). The contractual terms of the acquisition by X involve a transfer of assets to X that gives rise to $10,000x of FSI that is attributable to FFA. Applicable financial accounting principles require X to include this $10,000x in FSI in 2024. Pursuant to section 597 and the regulations under section 597, the gain is not recognized in 2024. As a result of subsequent events, X includes $2,000x of gain attributable to that FFA in gross income for regular tax purposes in 2025.

(ii) *Analysis*. Under paragraph (f)(1) of this section, X does not include the $10,000x of FSI in AFSI in 2024. Under paragraph (f)(1) of this section, X includes FSI of $2,000x in AFSI in 2025.

(g) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-22 AFSI adjustments for certain insurance companies and other specified industries.

(a) *Overview*. This section provides rules under section 56A of the Code for determining AFSI for certain insurance companies and other specified industries. Paragraph (b) of this section provides additional definitions that apply to this section. Paragraph (c) of this section provides rules for determining AFSI as it relates to certain types of life insurance and annuity contracts. Paragraph (d) of this section provides rules for determining AFSI as it relates to funds withheld reinsurance or modified coinsurance agreements. Paragraph (e) of this section provides rules for determining AFSI as it relates to assets held by any one of several identified entities since the entity became

fully subject to Federal income tax by an act of Congress. Paragraph (f) of this section provides the applicability date of this section.

(b) *Definitions*. For purposes of this section:

(1) *Covered insurance company*. The term *covered insurance company* means—

(i) A company subject to tax under subchapter L of the Code; or

(ii) A foreign company that is subject to regulation as an insurance (or reinsurance) company by its home country and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts.

(2) *Covered investment pool*. The term *covered investment pool* means a pool of investment assets that are designated to support one or more covered variable contracts and that are taken into account in determining FSI.

(3) *Covered obligations*. The term *covered obligations* means the AFS liabilities, including contract reserves and claims or benefits payable, that reflect a covered insurance company's obligations with respect to one or more covered variable contracts and that are taken into account in determining FSI.

(4) *Covered reinsurance agreement*. The term *covered reinsurance agreement* means a funds withheld reinsurance or modified coinsurance agreement and any retrocession of all or part of the risk under either such agreement. Under these agreements, the reinsurance operates like conventional reinsurance, but from a legal title and financial accounting perspective, the ceding company retains the investment assets supporting the obligations to the holders of the underlying contracts (and for modified coinsurance, the ceding company also retains the reserves). The ceding company records a liability to the reinsurer to reflect the assets it has retained.

(5) *Covered variable contract*. The term *covered variable contract* means a contract—

(i) That is issued by a covered insurance company;

(ii) That is regulated as a life insurance or annuity contract in the jurisdiction in which it is issued; and

(iii) For which the amount of the covered insurance company's obligations to the contract holder depends in whole or in part (by law, regulation, or the terms of the contract) on the value of the assets that are designated to support the contract.

(6) *Withheld assets*. The term *withheld assets* means the assets held by a ceding company to support the risk reinsured under a covered reinsurance agreement.

(7) *Withheld assets payable*. The term *withheld assets payable* means a liability on the ceding company's AFS that reflects—

(i) The ceding company's obligation to the reinsurer under a covered reinsurance agreement with respect to the withheld assets; and

(ii) Changes in the value of the withheld assets.

(8) *Withheld assets receivable*. The term *withheld assets receivable* means an asset on the reinsurer's AFS that reflects—

(i) The reinsurer's right against the ceding company under a covered reinsurance agreement with respect to the withheld assets; and

(ii) Changes in the value of the withheld assets.

(c) *AFSI adjustments for covered variable contracts*—(1) *Non-application of certain provisions*—(i) *In general*. If the requirements in paragraph (c)(1)(ii) of this section are satisfied, the AFSI adjustments (and corresponding adjustments to CAMT basis) provided in §§1.56A-4, 1.56A-5, and 1.56A-18 through 1.56A-20 do not apply to determine the AFSI of a covered insurance company with respect to the covered investment pool assets referenced in paragraph (c)(1)(ii)(B) of this section that are otherwise within the scope of such regulations. Thus, amounts reflected in the FSI of the covered insurance company with respect to the covered investment pool assets, including unrealized gains and losses, are included in AFSI without adjustment if the requirements of paragraph (c)(1)(ii) of this section are met.

(ii) *Requirements*. Paragraph (c)(1)(i) of this section applies if—

(A) A covered insurance company issues or reinsures covered variable contracts;

(B) Amounts reflected in the FSI of the covered insurance company with respect to covered investment pool assets result in a change in the amount of the obligations to the holders of the related covered variable contracts by reason of law, regulation, or the terms of one or more such covered variable contracts; and

(C) The change in the amount of the obligations results in a change in the amount of the covered obligations of the covered insurance company.

(2) *Example*. The following example illustrates the application of paragraph (c)(1) of this section.

(i) *Facts*. X is a life insurance company subject to tax under subchapter L of the Code. X uses the calendar year as its taxable year and has a calendar-year financial accounting period. X uses GAAP to prepare its AFS. On January 1, 2024, X issues a life insurance contract that is a variable contract, as described in section 817, to an individual, A. The contract is regulated as a life insurance contract in the jurisdiction in which it is issued. X owns assets that are designated to support X's contractual obligation to A and holds those assets in a separate account that is segregated from the general asset accounts of X. X accounts for these assets and its contractual obligations to A in its FSI. The separate account assets are stock in unrelated domestic corporations. At the end of 2024, no assets that support A's variable contract have been sold, and the fair market value of the assets has increased by $10x. Under the terms of the variable contract, the increase in the value of the assets supporting A's variable contract caused X's contractual obligation to A to increase by $10x. On X's AFS, the $10x increase in the value of the assets supporting the variable contract is included in FSI and offsets the $10x increase in X's contractual obligation to A (which reduces X's FSI).

(ii) *Analysis*. X is a covered insurance company, and the variable contract that X issued to A is a covered variable contract. The assets in the separate account that X holds to support its contractual obligations to A constitute a covered investment pool, and X's contractual obligations to A are reflected in X's AFS liabilities, which constitute covered obligations. Paragraph (c)(1) of this section provides that §1.56A-18 does not apply to exclude from a covered insurance company's AFSI or otherwise adjust any gain or loss in a covered investment pool that is reflected in the FSI of the covered insurance company if the requirements in paragraph (c)(1)(ii)

of this section are satisfied. In this case, the requirement in paragraph (c)(1)(ii)(A) of this section is satisfied because X is a covered insurance company that issues covered variable contracts. The requirement in paragraph (c)(1)(ii)(B) of this section is satisfied because the $10x increase in value in the covered investment pool results in a change in X's obligation to A under the terms of the variable contract. The requirement in paragraph (c)(1)(ii)(C) of this section is satisfied because the change in the amount of the obligation results in a change in the amount of X's covered obligations. Accordingly, §1.56A-18 does not apply to exclude any of the $10x unrealized gain from X's AFSI or otherwise adjust the amount. Thus, both the unrealized gain and the offsetting change in the covered obligations are taken into account for purposes of determining X's AFSI, which eliminates what would otherwise be a difference between X's AFSI and A's life insurance company taxable income.

(d) *AFSI adjustments for covered reinsurance agreements*—(1) *In general*. For a covered insurance company that is a party to a covered reinsurance agreement, the changes described in paragraphs (d)(1)(i) and (ii) of this section that are accounted for separately in the covered insurance company's AFS with respect to each agreement are excluded from the covered insurance company's AFSI.

(i) *Ceding company*. For the ceding company holding the withheld assets, changes in FSI of the ceding company as a result of changes in the amount of the withheld assets payable to the extent that—

(A) The changes in the amount of the withheld assets payable correspond to the ceding company's unrealized gains and losses in the withheld assets; and

(B) The unrealized gains and losses in the withheld assets are not included in the ceding company's AFSI (determined without regard to this section but after giving effect to all other sections in the section 56A regulations except for §1.56A-23).

(ii) *Reinsurer*. For the reinsurer, changes in FSI of the reinsurer as a result of changes in the amount of the withheld assets receivable, provided that the changes in the amount of the withheld assets receivable correspond to the unrealized gains and losses in the withheld assets.

(2) *Effect of retrocession agreement*. The exclusion provided in paragraph (d)(1)(ii) of this section is reduced to the extent that the accounting for a retrocession of the reinsured risk results in the withheld assets receivable being offset on the AFS of the reinsurer by a withheld asset payable with respect to the retrocessionaire in the retrocession.

(3) *Fair value accounting*. The exclusions provided in paragraph (d)(1) of this section will not apply to a covered insurance company with respect to a covered reinsurance agreement if—

(i) The covered insurance company elects for AFS purposes to account for the covered reinsurance agreement at fair value in its FSI; or

(ii) The covered insurance company accounts for both of the following items at fair value in its FSI—

(A) The changes in the withheld assets payable that correspond to the unrealized gains and losses in the withheld assets (for the ceding company) or the withheld assets receivable that correspond to the unrealized gains and losses in the withheld assets (for the reinsurer); and

(B) The covered reinsurance agreement.

(4) *Examples*. The following examples illustrate the application of paragraphs (d)(1) and (3) of this section.

(i) *Example 1: Covered reinsurance transaction*—(A) *Facts*. X and Y are life insurance companies subject to tax under subchapter L of the Code. Each of X and Y uses the calendar year as its taxable year, has a calendar-year financial accounting period, and uses GAAP for purposes of preparing its AFS. On January 1, 2024, X, the ceding company, enters into a funds withheld reinsurance agreement with Y, the reinsurer. Y does not retrocede any risk covered by the funds withheld reinsurance agreement. Under the terms of the agreement, from a legal title and financial accounting perspective, X retains the assets supporting the obligations to the holders of the reinsured contracts (the withheld assets) as security for the reinsurer's obligations under the reinsurance agreement. X has a liability to Y with respect to the withheld assets (the withheld assets payable). X reflects all unrealized gains and losses on the withheld assets in OCI on its AFS, and X accounts for the corresponding changes in the withheld assets payable in its FSI. Y records an asset that corresponds to X's withheld assets payable (the withheld assets receivable) on its AFS, and Y accounts for changes in the withheld assets receivable in its FSI. At the end of 2024, no withheld assets have been sold, and the fair market value of the withheld assets has increased by $10x. On its AFS, X includes the $10x unrealized gain in OCI and records the effect of the $10x increase in its withheld assets payable in FSI. Y records the effect of a corresponding $10x increase in its withheld assets receivable in its FSI.

(B) *Analysis.* Each of X and Y is a covered insurance company, and the funds withheld reinsurance agreement is a covered reinsurance agreement. The $10x of unrealized gain in the withheld assets is included in OCI on X's AFS and thus is excluded from X's AFSI under the definition of FSI in §1.56A-1(b)(20). Under paragraph (d)(1)(i) of this section, because the $10x of unrealized gain is not included in X's AFSI, the $10x increase in the withheld assets payable is also excluded from X's AFSI. The amount included in Y's FSI as a result of the $10x increase in Y's withheld assets receivable corresponds to the unrealized gain in the withheld assets. Under paragraph (d)(1)(ii) of this section, this $10x increase is excluded from Y's AFSI.

(ii) *Example 2: Fair value accounting*—(A) *Facts*. The facts are the same as in paragraph (d)(4)(i)(A) of this section (*Example 1*), except that Y had made an election to account for the covered reinsurance agreement at fair value on its AFS. In 2024, the value of Y's liability under the reinsurance agreement on its AFS increased by $8x (determined in accordance with the relevant accounting valuation rules).

(B) *Analysis.* As a result of Y's election, Y accounts for both the $10x increase in its withheld assets receivable and the $8x increase in its reinsurance agreement liability at fair value in FSI. Under paragraph (d)(3) of this section, the exclusion provided in paragraph (d)(1)(ii) of this section does not apply. Accordingly, Y includes both the $10x increase in its withheld assets receivable and the $8x increase in its reinsurance agreement liability in AFSI.

(e) *Use of fresh start basis*. For purposes of determining AFSI, the following rules apply.

(1) *Federal Home Loan Mortgage Corporation*. The adjusted basis rules provided in section 177(d)(2) of the Deficit Reduction Act of 1984, Public Law 98-369, 98 Stat. 494 (1984), apply to determine the CAMT basis of any asset held by the Federal Home Loan Mortgage Corporation (and any successor(s) under section 381) since January 1, 1985.

(2) *Existing Blue Cross or Blue Shield organizations.* The AFSI gain or loss (but not depreciation, amortization, or other amounts) for any asset held by an existing Blue Cross or Blue Shield organization, as defined in section 833(c)(2), as added by section 1012 of the Tax Reform Act of 1986, Public Law 99–514, 100 Stat. 2085 (1986) (and any successor(s) under section 381), since the first day of the entity's first taxable year beginning after December 31, 1986, is determined using the entity's adjusted basis for regular tax purposes for the asset.

(3) *Certain pension business entities.* The AFSI gain or loss (but not depreciation, amortization, or other amounts) for any asset held by Mutual of America or Teachers Insurance Annuity Association-College Retirement Equities Fund, as referenced in sections 1012(c)(4)(A) and (B) of the Tax Reform Act of 1986 (and any successor(s) under section 381) since the first day of the entity's first

taxable year beginning after December 31, 1997, is determined using the entity's adjusted basis for regular tax purposes for the asset.

(f) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-23 AFSI adjustments for financial statement net operating losses and other attributes.

(a) *Overview*. This section provides rules under section 56A(d) of the Code for determining the AFSI adjustment for FSNOL carryovers, built-in losses, and other attributes. Paragraph (b) of this section defines the term financial statement net operating loss (FSNOL). Paragraph (c) of this section provides general rules regarding the adjustment to AFSI for the utilization of an FSNOL carryover. Paragraph (d) of this section provides rules regarding the amount of an FSNOL that can be carried forward. Paragraph (e) of this section provides limitations on the utilization of certain FSNOL carryovers. Paragraph (f) of this section provides rules regarding the utilization of built-in losses. Paragraph (g) of this section provides the applicability date of this section.

(b) *Definition of financial statement net operating loss.* The term *financial statement net operating loss* (FSNOL) means, with respect to a corporation for any taxable year ending after December 31, 2019, the amount of the corporation's negative AFSI for the taxable year (determined after application of the section 56A regulations and without regard to this section).

(c) *AFSI adjustments for the utilization of an FSNOL*. Subject to the limitation in paragraph (e) of this section, if a corporation's AFSI for a taxable year is positive (determined after application of the section 56A regulations and without regard to this section), the corporation's AFSI is reduced by an amount equal to the lesser of—

(1) The aggregate amount of FSNOL carryovers to the taxable year (as determined under paragraph (d) of this section); or

(2) 80 percent of the AFSI of the corporation for the taxable year (determined after application of the section 56A regulations and without regard to this section).

(d) *FSNOL carryovers*—(1) *In general*. An FSNOL for any taxable year (including a taxable year in which the corporation is not an applicable corporation) is carried forward to each taxable year following the taxable year of the loss. The amount of an FSNOL carried forward to a taxable year is the amount of the FSNOL remaining (if any) after the application of paragraphs (c), (e), and (f) of this section. FSNOL carryovers used to reduce a corporation's AFSI under paragraph (c) of this section are used in the order of the taxable years in which the FSNOLs arose. For purposes of determining the amount of an FSNOL carried forward to the first taxable year a corporation is an applicable corporation (and any subsequent taxable year), paragraphs (c), (e), and (f) of this section apply to reduce the FSNOL in taxable years beginning after the taxable year of the loss and before the first taxable year in which the corporation is an applicable corporation.

(2) *Example*. The following example illustrates the application of paragraph (d)(1) of this section.

(i) *Facts*. X is a corporation that uses the calendar year as its taxable year. For 2020, X generated an FSNOL of $3,000x. For 2021, 2022, and 2023, X's AFSI (determined without regard to this section) is $900x, $1,100x, and $1,200x, respectively. X first becomes an applicable corporation for 2024. X's FSNOL is not subject to the limitations in paragraph (e) of this section.

(ii) *Analysis*. X calculates its FSNOL carryover to 2024 by first determining how much of the 2020 FSNOL is absorbed in 2021 through 2023. In 2021, $720x (80% of $900x) of the FSNOL carryover is absorbed, resulting in an FSNOL carryover to 2022 of $2,280x ($3,000x - $720x). In 2022, $880x (80% of $1,100x) of the FSNOL carryover is absorbed, resulting in an FSNOL carryover to 2023 of $1,400x ($2,280x - $880x). In 2023, $960x (80% of $1,200x) of the FSNOL carryover is absorbed, resulting in an FSNOL carryover to 2024 of $440x ($1,400x - $960x).

(e) *Limitation on use of FSNOL carryovers following acquisitions*—(1) *In general.* If a corporation or a tax consolidated group (successor) succeeds to the FSNOL carryovers (acquired FSNOLs) of another corporation (predecessor corporation) in a successor transaction, as defined in paragraph (e)(2) of this section, the use of the acquired FSNOLs by the successor is subject to the limitation described in paragraph (e)(3) of this section.

(i) *Successor after stock acquisitions*. For purposes of this paragraph (e), the acquired corporation in a transaction described in paragraph (e)(2)(ii) of this section is treated as the successor to the acquired corporation after the acquisition.

(ii) *Tax consolidated groups*. If the consolidated group continues under §1.1502-75(d)(1), this paragraph (e) applies to the tax consolidated group as if it were a single corporation.

(2) *Successor transaction*. For purposes of this paragraph (e), with respect to a particular acquired FSNOL, the term *successor transaction* means—

(i) A transaction described in section 381(a) of the Code; or

(ii) The acquisition of stock of a corporation in a transaction—

(A) That constitutes an ownership change within the meaning of §1.59-2(f); or

(B) In which the predecessor corporation joins a tax consolidated group.

(3) *Limitation*—(i) *In general*. Acquired FSNOLs generated by an acquired business of a predecessor corporation can be used to reduce the AFSI of a successor under paragraph (c) of this section—

(A) Only if the business that generated the acquired FSNOLs (predecessor business) is separately tracked in the successor's books and records (separately tracked business); and

(B) Only to the extent of the amount of AFSI generated by the separately tracked business after the successor transaction (separately tracked income), subject to the limitation in section 56A(d) and paragraph (e)(3)(ii)(E) of this section.

(ii) *Separately tracked income*. For purposes of paragraph (e)(3)(i) of this section, the separately tracked income of a business is determined as provided in this paragraph (e)(3)(ii).

(A) *Tracked register*. The aggregate of the acquired FSNOLs of a predecessor corporation that are utilized to reduce a successor's AFSI for all taxable years under this paragraph (e) may not exceed the aggregate AFSI for all separately

tracked businesses (tracked register) for all taxable years computed under this paragraph (e)(3).

(B) *Taxable periods*. The tracked register applicable to a taxable year to which an FSNOL is carried includes items taken into account in AFSI solely in taxable periods following the successor transaction, but excludes items taken into account in AFSI in any taxable years ending after the taxable year to which the loss is carried. If the successor transaction does not occur at the close of the predecessor corporation's taxable year, separately tracked income is allocated to the portions of the taxable year before and after the successor transaction as if the predecessor corporation's books were closed on the acquisition date.

(C) *Computation of tracked register generally*. Except as provided in paragraph (e)(3)(ii)(D) of this section, the tracked register is computed by reference to only the items taken into account in AFSI that are generated by the separately tracked business without regard to FSNOLs that reduce that AFSI.

(D) *FSNOL reductions*. The tracked register takes into account the expenses, FSNOLs, and other losses of the separately tracked business actually absorbed by the successor corporation or the successor group in the taxable periods included in the tracked register (whether or not absorbed against income of the separately tracked business).

(E) *80-percent limitation*. The amount of acquired FSNOL that may be used in a taxable year is subject to limitation under paragraph (c)(2) of this section. The tracked register is decreased in a taxable year by the full amount of AFSI required to support the amount of FSNOL absorption in such taxable year.

(F) *Built-in losses*. The treatment under paragraph (f) of this section of a built-in loss as a hypothetical FSNOL in the taxable year recognized for AFSI purposes applies solely for purposes of determining the limitation under this paragraph (e)(3) with respect to the loss in that taxable year.

(iii) *Separation of predecessor business from related FSNOLs*—(A) *In general*. If, following a successor transaction, the assets constituting a predecessor business are transferred to a corporation that is not a member of the same tax consolidated group as the transferor in exchange for stock of the transferee corporation, and if the exchange is not described in paragraph (e)(2)(i)(A) of this section, the amount of separately tracked income derived from those assets after the exchange for purposes of paragraph (e)(3)(ii) of this section is limited to the amount of AFSI resulting from the ownership of the stock received in the exchange (for example, dividends received with respect to the stock, or gain on the sale or exchange of the stock).

(B) *Transfer to member of same tax consolidated group*. If, following a successor transaction, the assets constituting a predecessor business are transferred from one member of the successor group to another member, this paragraph (e) applies as if all members of the successor group were a single corporation. *See* §1.1502-56A(a)(2).

(iv) *Integration of predecessor and acquiror businesses*. If, following a successor transaction, a predecessor business is integrated with a business that previously had been separately tracked and reported on the successor's books and records, the acquired FSNOLs may be used—

(A) Only to the extent of the AFSI of the predecessor business that would have been separately tracked under paragraph (e)(3)(ii) of this section if the predecessor business had remained a separately tracked business; and

(B) Only if the successor generates and maintains pro forma income statements supporting any use of the acquired FSNOLs under this paragraph (e)(3)(iv).

(v) *Successor transaction involving multiple separately tracked businesses*—(A) *In general.* If a predecessor has more than one separately tracked business before the successor transaction, the acquired FSNOLs may be used to the extent of the combined AFSI from all separately tracked businesses of the predecessor corporation.

(B) *Subgroup acquisition*. If multiple members of the same tax consolidated group are acquired in a successor transaction and are members of a consolidated group immediately after the acquisition (limitation subgroup), paragraph (e)(3)(v)(A) of this section applies to the limitation subgroup (during its period of consolidation immediately following the successor transaction) as if the subgroup's members were a single predecessor corporation.

(4) *Examples*. The following examples illustrate the application of the rules in this paragraph (e). Except as otherwise provided: each entity is a domestic corporation that uses the calendar year as its taxable year and is not a member of a tax consolidated group; Target and Acquiror are unrelated before the transaction; and the successor in the transaction has available AFSI in each year in excess of the amount of FSNOL available for use under this section.

(i) *Example 1: Acquisition of Target stock followed by contribution of assets*—(A) *Facts*. Acquiror purchases all of Target's stock for cash (Acquisition) on December 31, 2023. At the time of the Acquisition, Target operates Business X, and Target has a $200x FSNOL. Target has no other separately tracked businesses. Following the Acquisition, Acquiror contributes assets to Target to expand Business X (Expansion). Following the Expansion, Business X (including the contributed assets) is separately tracked in Target's books and records. In 2024, Business X has separately tracked income of $25x.

(B) *Analysis*. The Acquisition is a successor transaction. *See* paragraph (e)(2)(ii)(A) of this section. Target is treated as the successor after the Acquisition. *See* paragraph (e)(1)(ii) of this section. Because Business X is a separately tracked business, the tracked register at the end of 2024 is $25x. *See* paragraph (e)(3)(i) of this section. Accordingly, $25x of the $200x FSNOL can be applied against the $25x of tracked income for the year, subject to the 80-percent limitation in paragraph (c)(2) of this section. *See* paragraph (e)(3)(ii) of this section. As a result, Target may deduct $20x (80% of $25x) of the acquired FSNOL in 2024, and the tracked register is reduced to $0x. *See* paragraph (e)(3)(ii)(E) of this section. The remaining $180x of acquired FSNOL ($200x - $20x) is carried forward to 2025.

(ii) *Example 2: Acquisition of Target assets*—(A) *Facts*. On January 1, 2024, Target merges with and into Acquiror in a transaction described under section 381(a) (Merger). At the time of the Merger, Target operates Business X, and Target has a $400x FSNOL. Acquiror also operates Business X. Following the Merger, Acquiror integrates Target's Business X operations with Acquiror's historic Business X operations and separately tracks the combined Business X operations on Acquiror's books and records. In 2024, Business X generates AFSI of $40x, with $15x attributable to the Business X operations acquired from Target in the Merger, and $25x attributable to Acquiror's historic Business X operations, as reflected in pro forma income statements generated and maintained by Acquiror.

(B) *Analysis: In general*. The Merger is a successor transaction. *See* paragraph (e)(2)(i) of this section. An acquired FSNOL may be used only to the extent the business that generated that FSNOL is separately tracked, and only to the extent of the separately tracked income of that business (as determined under paragraph (e)(3)(ii) of this section). *See* paragraph (e)(3)(i) of this section. Although Target's

Business X is integrated with Acquiror's Business X after the Merger, the acquired FSNOL may be used to the extent of the income that would have been separately tracked under paragraph (e)(3)(ii) of this section if Target's Business X had remained a separately tracked business, provided that the successor generates and maintains pro forma income statements. *See* paragraph (e)(3)(iv) of this section.

(C) *Analysis: Computation of limitation.* Because Acquiror generates and maintains pro forma income statements for Target's Business X, the tracked register for 2024 is $15x. Accordingly, $15x of the $400x FSNOL can be applied against the $15x of tracked income for the year, subject to the 80-percent limitation in paragraph (c)(2) of this section. *See* paragraph (e)(3)(ii) of this section. As a result, Acquiror may include $12x (80% of $15x) of the acquired FSNOL in its aggregate FSNOL deduction for 2024, and the tracked register is reduced to $0x. *See* paragraph (e)(3)(ii)(E) of this section. The remaining $388x of acquired FSNOL ($400x - $12x) is carried forward to 2025.

(iii) *Example 3: Acquisition of multiple lines of business*—(A) *Facts*. Acquiror is the common parent of a tax consolidated group (Acquiror group). Acquiror purchases all the stock of Target for cash (Acquisition) on December 31, 2023. As a result, Target becomes a member of the Acquiror group. At the time of the Acquisition, Target operates two lines of business (Business X and Business Y), and Target has a $400x FSNOL, all of which is allocable to Business X. Following the Acquisition, each of Business X and Business Y is separately tracked in the Acquiror group's books and records. In 2024, Business X generates AFSI of $25x, and Business Y generates AFSI of $20x.

(B) *Analysis*. The Acquisition is a successor transaction. *See* paragraph (e)(2)(ii)(B) of this section. Target is treated as the successor after the Acquisition. *See* paragraph (e)(1)(ii) of this section. Because each of Business X and Business Y is a separately tracked business, the tracked register at the end of 2024 is $45x ($25x + $20x)). *See* paragraphs (e)(3)(i) and (v) of this section. Accordingly, $45x of the $400x FSNOL can be applied against the $45x of tracked income for the year, subject to the 80-percent limitation in paragraph (c)(2) of this section. *See* paragraph (e)(3)(ii) of this section. As a result, the Acquiror group may include $36x (80% of $45x) of the acquired FSNOL in its aggregate FSNOL deduction for 2024, and the tracked register is reduced to $0. *See* paragraph (e)(3)(ii)(E) of this section. The remaining $364x of acquired FSNOL ($400x - $36x) is carried forward to 2025.

(iv) *Example 4: Negative tracked register*. The facts are the same as in paragraph (e)(4)(iii)(A) of this section (*Example 3*), except that, in 2024, Business Y generates AFSI of -$30x. The tracked register at the end of 2024 is -$5x ($25x + -$30x). *See* paragraphs (e)(3)(i) and (v) of this section. Because the tracked register is not a positive number, the Acquiror group may include none of the $400x acquired FSNOL in its aggregate FSNOL deduction in 2024. *See* paragraph (c)(2) of this section. The entire $400x of acquired FSNOL is carried forward to 2025.

(v) *Example 5: Acquisition of subgroup*. The facts are the same as in paragraph (e)(4)(iii)(A) of this section (*Example 3*), except that, at the time of the Acquisition, Target is the comment parent of a tax consolidated group that includes subsidiary member T1. Target operates Business X, and T1 operates Business Y. The results are the same as in paragraph (e)(4)(iii)(B) of this section. *See* paragraph (e)(3)(v)(B) of this section.

(vi) *Example 6: Asset transfer to affiliate that is not a member of the transferor's tax consolidated group*—(A) *Facts*. Acquiror is the common parent of a tax consolidated group (Acquiror group). Acquiror also owns 70 percent of the stock of Affiliate, which is engaged in Business X. Acquiror is not engaged in Business X or Business Y. On January 1, 2024, Target merges with and into Acquiror in a transaction described in section 381(a) (Merger). At the time of the Merger, Target operates Business X and Business Y, and Target has a $400x FSNOL, all of which is allocable to Business Y. Following the Merger, Acquiror operates and separately tracks Business Y, which generates AFSI of $12x in 2024. Acquiror contributes Business X to Affiliate in exchange for an additional five percent of Affiliate stock. Business X generates AFSI of $45x in 2024. On December 31, 2024, Affiliate pays a dividend to Acquiror, $8x of which (net of DRD) is attributable to the stock issued to Acquiror in exchange for Target's Business X assets.

(B) *Analysis*. The Merger is a successor transaction. *See* paragraph (e)(2)(i) of this section. Because Acquiror transferred Target's Business X assets to a corporation that is not a member of Acquiror's tax consolidated group, the tracked register at the end of 2024 with respect to Business X includes only AFSI attributable to stock received in the exchange, or $8x. *See* paragraph (e)(3)(iii)(A) of this section. Because Business Y is a separately tracked business, the tracked register at the end of 2024 with respect to Business Y is $12x. *See* paragraph (e)(3)(i) of this section. Accordingly, the tracked register at the end of 2024 is $20x ($8x + $12x). As a result, $20x of the $400x FSNOL can be applied against the $20x of tracked income for the year, subject to the 80-percent limitation in paragraph (c)(2) of this section. *See* paragraph (e)(3)(ii) of this section. The Acquiror group may include $16x (80% of $20x) of the acquired FSNOL in its aggregate FSNOL deduction for 2024, and the tracked register is reduced to $0x. *See* paragraph (e)(3)(ii)(E) of this section. The remaining $384x of the acquired FSNOL ($400x - 16x) is carried forward to 2025.

(f) *Limitation on use of built-in losses following acquisitions*—(1) *Scope*. This paragraph (f) applies if a predecessor corporation (as defined in paragraph (e)(1)(i) of this section) has a CAMT net unrealized built-in loss (as defined in paragraph (f)(4) of this section) immediately before a successor transaction (as defined in paragraph (e)(2) of this section). Under this paragraph (f), the limitation in paragraph (e) of this section applies to the use of the built-in losses (as defined in paragraph (f)(3) of this section) recognized for AFSI purposes following the successor transaction.

(2) *Operating rules*—(i) *General rule*. For purposes of applying the limitation in paragraph (e) of this section, all built-in losses are treated as if they were acquired FSNOLs.

(ii) *Asset acquisition*. For purposes of applying this paragraph (f), assets and liabilities acquired directly from the same transferor (whether corporate or non-corporate, and whether foreign or domestic) pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the consolidated group on the date of the acquisition. *See* paragraph (e)(2)(ii)(B) of this section.

(iii) *Association of built-in loss with separately tracked acquired business*. Every built-in loss is treated as allocable to the separately tracked acquired business with which it was associated immediately before the successor transaction, regardless of whether the built-in loss is associated with that separately tracked acquired business when the built-in loss is recognized for AFSI purposes.

(iv) *Ordering rule*. To the extent that a built-in loss is allowed to reduce AFSI of the successor under paragraph (e) of this section in the taxable year the built-in loss is recognized for AFSI purposes, the built-in loss reduces AFSI for the taxable year before any acquired FSNOLs are allowed to reduce AFSI for the taxable year.

(v) *Carryover of built-in loss not allowed in year of recognition*. To the extent that a built-in loss is not allowed to reduce AFSI under paragraph (e) of this section in the taxable year the built-in loss is recognized for AFSI purposes, the built-in loss is treated for purposes of paragraph (e) of this section as a separate FSNOL carryover arising in a taxable period immediately preceding the successor transaction.

(3) *Built-in losses*—(i) *Definition.* All losses of a separately tracked business that are recognized for AFSI purposes during the five-year period beginning on the date of the successor transaction are built-in losses subject to limitation under this paragraph (f), except to the extent the successor establishes that—

(A) The asset at issue was not held by the predecessor corporation immediately before the successor transaction; or

(B) The loss exceeds the built-in loss in the asset, measured as of the date of the successor transaction, taking into account the CAMT basis of any relevant property.

(ii) *Timing rule*. A loss that is recognized but disallowed or deferred for AFSI purposes (*see*, for example, §1.56A-26(b)) is not treated as a built-in loss unless and until the loss would be allowed to be taken into AFSI without regard to the application of this paragraph (f).

(4) *CAMT net unrealized built-in loss*—(i) *Successor transaction results in a section 382 ownership change*. If a successor transaction results in an ownership change, as defined in section 382(g) of the Code or §1.1502-92, then the predecessor corporation in the successor transaction is treated as having a CAMT net unrealized built-in loss (CAMT NUBIL) if the predecessor corporation has a net unrealized built-in loss (NUBIL), as defined in section 382(h)(3), based on CAMT basis.

(ii) *Successor transaction does not result in a section 382 ownership change*. This paragraph (f)(4)(ii) applies if a successor transaction does not result in an ownership change. Under this paragraph (f)(4)(ii), a predecessor corporation has a CAMT NUBIL if that predecessor corporation would have a NUBIL under section 382(h)(3) on the day of the successor transaction, taking into account—

(A) The CAMT basis of property; and

(B) Income, expenses, gains, and losses for AFSI purposes that are attributable to periods before the successor transaction.

(iii) *Inapplicability of NUBIL limitation*. For purposes of paragraphs (f)(4)(i) and (ii) of this section, section 382(h)(1)(B)(ii) does not apply to the extent it limits the amount of recognized built-in loss that may be treated as a pre-change loss to the amount of the NUBIL.

(iv) *Successor transaction treated as ownership change*. In applying section 382(h) to identify a NUBIL for purposes of paragraph (f)(4)(ii) of this section, every successor transaction is treated as if it were an ownership change under section 382(g).

(v) *No consideration in excess of fair market value*. For purposes of determining CAMT NUBIL under this paragraph (f)(4), no consideration or deemed consideration in excess of fair market value is taken into account.

(5) *Example: Determination of recognized built-in loss*. The following example illustrates the application of the rules in this paragraph (f).

(i) *Facts*. Target and Acquiror are unrelated domestic corporations, each of which uses the calendar year as its taxable year. Target merges with and into Acquiror in a successor transaction described in paragraph (e)(2)(i) of this section (Merger). At the time of the Merger, Target holds two assets that are used in the same business. Asset 1 has a built-in loss for AFSI purposes of $55x (CAMT basis $75x, value $20x), and Asset 2 has a built-in gain for AFSI purposes of $20x (CAMT basis $30x, value $50x). Target has no other income or expense items that would be treated as built-in items under section 382(h)(6).

(ii) *Analysis: Computation of NUBIL*. The Merger results in an ownership change under section 382(g). Under section 382(h)(3)(A), computed using CAMT basis, Target has a $35x NUBIL at the time of the Merger (-$55x + $20x = -$35x). Under paragraph (f)(4)(i) of this section, Target has a CAMT NUBIL. Assume that $35x exceeds the threshold requirement in section 382(h)(3)(B).

(iii) *Analysis: Imposition of limitation*. Under paragraph (f)(4)(iii) of this section, the restriction under section 382(h)(1)(B)(ii), which limits the amount of recognized built-in loss that is treated as pre-change loss to the amount of the NUBIL, does not apply for purposes of this paragraph (f). As a result, the entire $55x of unrealized loss (and not just the $35x net unrealized loss) is treated under paragraphs (f)(2) and (3) of this section as a built-in loss to the extent it is recognized within 5 years of the Merger. Under paragraph (e)(1) of this section, this $55x built-in loss is subject to limitation under paragraph (e)(3) of this section. The use of the $55x built-in loss is not limited by section 382.

(g) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-24 AFSI adjustments for hedging transactions and hedged items.

(a) *Overview*. This section provides rules under section 56A of the Code for determining AFSI for certain hedging transactions and hedged items. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides general rules that may apply to disregard a fair value measurement adjustment for purposes of determining AFSI of a CAMT entity for a taxable year. Paragraph (d) of this section provides a rule for determining AFSI if a CAMT entity marks to market a net investment hedge for regular tax purposes. Paragraph (e) of this section provides operative rules for the application of paragraphs (c) and (d) of this section. Paragraph (f) of this section provides examples illustrating the application of the rules in this section. Paragraph (g) of this section provides the applicability date of this section.

(b) *Definitions*. For purposes of this section:

(1) *AFSI hedge*—(i) *In general*. Except as provided in paragraph (b)(1)(ii) of this section, the term *AFSI hedge* means an asset or a liability of a CAMT entity for which there are fair value measurement adjustments and that—

(A) Is entered into as a hedging transaction, as defined in §1.1221-2(b) (whether or not the character of gain or loss from the transaction is determined under §1.1221-2), a §1.1275-6 hedge that is part of an integrated transaction subject to §1.1275-6, a section 1256(e) hedging transaction, a section 988(d) hedging transaction that is part of a transaction that is integrated under §1.988-5 or other regulations issued under section 988(d) of the Code (or an advance ruling described in §1.988-5(e)) that govern the character or timing of gain or loss from the transaction, or a position that is a hedge under section 475(c)(2)(F) of the Code;

(B) Is a hedge that qualifies for, and is properly treated by the CAMT entity as subject to, hedge accounting (for example, under Accounting Standards Codification paragraph 815-20-25-1 or IFRS 9 Chapter 6) and reported on a CAMT entity's AFS; or

(C) Is described in both paragraphs (b)(1)(i)(A) and (B) of this section.

(ii) *Exception for certain insurance hedges*. The term *AFSI hedge* does not include an asset or a liability that is entered into as a hedging transaction, as

defined in §1.1221-2(b) (whether or not the character of gain or loss from the transaction is determined under §1.1221-2), by a covered insurance company, as defined in §1.56A-22(b)(1), to manage risk of fluctuations in the value of one or more assets or indices that are taken into account in determining—

(A) The obligations of the covered insurance company to holders of life insurance or annuity contracts; or

(B) The obligations of the covered insurance company to another covered insurance company with respect to obligations to holders of life insurance or annuity contracts.

(2) *AFSI subsequent adjustment date*—(i) *In general*. Except as provided in paragraph (b)(2)(ii) of this section, the term *AFSI subsequent adjustment date* means the earliest day on which any of the following events occur—

(A) An AFSI hedge or a hedged item (as applicable) subject to paragraph (c)(2) of this section matures or is sold, disposed of, or otherwise terminated;

(B) An AFSI hedge or a hedged item (as applicable) that corresponds to the hedged item or the AFSI hedge subject to paragraph (c)(2) of this section matures or is sold, disposed of, or otherwise terminated; or

(C) An asset or liability ceases to constitute an AFSI hedge or hedged item (as applicable) subject to paragraph (c)(2) of this section.

(ii) *Certain corporate and partnership transactions*—(A) *Covered nonrecognition transactions.* The acquisition of an AFSI hedge and the corresponding hedged item subject to paragraph (c)(2) of this section by a CAMT entity in a covered nonrecognition transaction (as defined in §1.56A-18(b)(9)) is not an AFSI subsequent adjustment date. As a result, this section continues to apply to the AFSI hedge and hedged item that were acquired by the CAMT entity. The acquisition of an AFSI hedge or hedged item subject to paragraph (c)(2) of this section without the corresponding hedged item or AFSI hedge (as applicable) by a CAMT entity in a covered nonrecognition transaction (as defined in §1.56A-18(b)(9)) is an AFSI subsequent adjustment date.

(B) *Covered recognition transactions and certain partnership transactions.* The acquisition of an AFSI hedge or hedged item (as applicable) subject to paragraph (c)(2) of this section with or without the corresponding hedged item or AFSI hedge (as applicable) by a CAMT entity in a covered recognition transaction (as defined in §1.56A-18(b)(10)), a contribution of an AFSI hedge or hedged item (as applicable) subject to paragraph (c)(2) of this section with or without the corresponding hedged item or AFSI hedge (as applicable) to a partnership in a transaction to which section 721(a) applies, or a distribution of an AFSI hedge or hedged item (as applicable) subject to paragraph (c)(2) of this section with or without the corresponding hedged item or AFSI hedge (as applicable) from a partnership to a partner in a transaction to which section 731(b) applies is an AFSI subsequent adjustment date.

(3) *Fair value measurement adjustment*. The term *fair value measurement adjustment* means a change in the value of an asset or a liability due to required periodic determinations at least annually of the increases or decreases in fair value of that asset or liability included in a CAMT entity's FSI, regardless of whether the determinations are required due to the type of asset or liability or due to an election by the CAMT entity. The term fair value measurement adjustment does not include an impairment loss or impairment loss reversal.

(4) *Hedged item*. The term *hedged item* means an asset or a liability that is reported on a CAMT entity's AFS and for which there are one or more AFSI hedges managing a risk of interest rate or price changes, a risk of currency fluctuations, or another risk that is eligible to be managed by an AFSI hedge.

(5) *Net investment hedge*. The term *net investment hedge* means an asset or a liability entered into by a CAMT entity to manage the foreign currency exposure of a net investment in a foreign operation (including under Accounting Standards Codification paragraph 815-20-25-66 or IFRS 9 Chapter 6.5.13) for which there are changes in the value of the asset or liability due to required periodic determinations (at least annually) of the increases or decreases in fair value of that asset or liability that are included in the CAMT entity's equity accounts on the CAMT entity's AFS, such as retained earnings or OCI.

(c) *Fair value measurement adjustments for an AFSI hedge or a hedged item*—(1) *Scope.* For purposes of determining AFSI of a CAMT entity for a taxable year, paragraph (c)(2) of this section applies to a fair value measurement adjustment for an AFSI hedge or a hedged item if the fair value measurement adjustment would otherwise be included in the CAMT entity's AFSI (determined without regard to this section but after giving effect to all other sections in the section 56A regulations except for §1.56A-23). Paragraph (c)(2) of this section provides the exclusive rules for the treatment of such a fair value measurement adjustment for purposes of determining AFSI.

(2) *Treatment of fair value measurement adjustment for certain AFSI hedges or hedged items*. A fair value measurement adjustment for an AFSI hedge or a hedged item for a taxable year is disregarded by a CAMT entity for purposes of determining the CAMT entity's AFSI if the CAMT entity either—

(i) Has a fair value measurement adjustment described in paragraph (c)(1) of this section with respect to an AFSI hedge but not the hedged item, and marks to market neither the AFSI hedge nor the hedged item for regular tax purposes; or

(ii) Has a fair value measurement adjustment described in paragraph (c)(1) of this section with respect to a hedged item but not the AFSI hedge, and marks to market neither the hedged item nor the AFSI hedge for regular tax purposes.

(3) *Application to prior taxable years*. Adjustments to AFSI under paragraph (c)(2) of this section are required to be made for all taxable years prior to the taxable year in which the AFSI hedge or hedged item matures or is sold, disposed of, or otherwise terminated, including taxable years that end on or before December 31, 2019.

(d) *Net investment hedge adjustments*. To the extent a CAMT entity marks to market a net investment hedge for regular tax purposes for a taxable year, the CAMT entity includes in AFSI for the taxable year the gain or loss resulting from marking to market the net investment hedge for regular tax purposes.

(e) *Operative rules*—(1) *Inclusion of certain taxable amounts in AFSI*. If a fair value measurement adjustment that is dis-

regarded under paragraph (c)(2) of this section in a taxable year includes amounts corresponding to items of income, gain, deduction, or loss under chapter 1 in that taxable year, the CAMT entity includes such amounts in AFSI in that taxable year. *See* paragraph (f)(5) of this section *(Example 5)*.

(2) *Subsequent adjustments for AFSI hedges and hedged items*. Paragraphs (e)(2)(i) and (ii) of this section apply in the taxable year in which there is an AFSI subsequent adjustment date.

(i) In the taxable year of an AFSI subsequent adjustment date, the CAMT entity includes in AFSI the cumulative fair value measurement adjustments previously disregarded in determining AFSI under paragraph (c)(2) of this section, net of any amounts included in AFSI under paragraph (e)(1) of this section. In the case of multiple AFSI hedges with respect to a single hedged item, the preceding sentence applies only to the AFSI hedge for which there was an AFSI subsequent adjustment date.

(ii) Following an event described in paragraph (b)(2)(i)(B) or (C) of this section, the CAMT entity uses the AFS basis of the AFSI hedge or hedged item that was subject to paragraph (c)(2) of this section immediately following the AFSI subsequent adjustment date as the CAMT basis in order to determine any further recognized gain or loss included in AFSI with respect to the AFSI hedge or hedged item.

(3) *Subsequent adjustments for net investment hedges.* In the taxable year in which the net investment hedge subject to paragraph (d) of this section matures or is sold, disposed of, or otherwise terminated, or in which the asset or liability that was a net investment hedge subject to paragraph (d) of this section ceases to constitute a net investment hedge, the CAMT entity adjusts the amount included in AFSI by the cumulative mark-to-market gain or loss for regular tax purposes included in AFSI under paragraph (d) of this section. If the asset or liability that was a net investment hedge subject to paragraph (d) of this section ceases to constitute a net investment hedge but does not mature or is not sold, disposed of, or otherwise terminated, as of the date it ceases to constitute a net investment hedge, the CAMT entity redetermines the CAMT basis of the net investment hedge that was subject to paragraph (d) of this section in accordance with §1.56A-1(d)(4). For purposes of the preceding sentence, the CAMT basis of the net investment hedge is the initial AFS basis of the net investment hedge (that is, the AFS basis as of the date the CAMT entity enters into the net investment hedge), adjusted to take into account the cumulative mark-to-market gain or loss for regular tax purposes included in AFSI under paragraph (d) of this section (and disregarding for this purpose any changes in AFS basis resulting from items with respect to the net investment hedge not included in AFSI).

(f) *Examples*. The following examples illustrate the application of the rules in this section. For purposes of these examples, X is a corporation and, except as otherwise provided, the AFSI hedge and hedged item do not mature and are not sold, disposed of, or otherwise terminated during the taxable years involved, and the gain and loss occur in the same taxable year.

(1) *Example 1: Fair value measurement adjustment for an AFSI hedge*—(i) *Facts*. X has an outstanding forward contract constituting an AFSI hedge with respect to a commodity delivery obligation constituting a hedged item. X has a fair value measurement adjustment described in paragraph (c)(1) of this section on the AFSI hedge of $20x of gain. There is no fair value measurement adjustment described in paragraph (c)(1) of this section on the hedged item. X does not mark to market the AFSI hedge or the hedged item for regular tax purposes.

(ii) *Analysis*. For purposes of determining AFSI of X, X will disregard the fair value measurement adjustment of $20x of gain under paragraph (c)(2)(i) of this section because the forward contract is an AFSI hedge, there is no fair value measurement adjustment described in paragraph (c)(1) of this section on the hedged item, and X does not mark to market the AFSI hedge or the hedged item for regular tax purposes.

(2) *Example 2: AFSI hedge marked to market for regular tax purposes*—(i) *Facts*. X has an outstanding futures contract constituting an AFSI hedge with respect to a purchased debt instrument constituting a hedged item. X has a fair value measurement adjustment described in paragraph (c)(1) of this section on the AFSI hedge of $15x of gain. There is no fair value measurement adjustment described in paragraph (c)(1) of this section on the hedged item. For regular tax purposes, the AFSI hedge is marked to market, resulting in X including $15x of gain on the AFSI hedge in X's taxable income.

(ii) *Analysis*. For purposes of determining AFSI of X, X will not disregard the fair value measurement adjustment on the AFSI hedge of $15x of gain because the AFSI hedge is marked to market for regular tax purposes, and therefore paragraph (c)(2)(i) of this section does not apply.

(3) *Example 3: Fair value measurement adjustment for AFSI hedge and hedged item*—(i) *Facts*. X has an outstanding futures contract constituting an AFSI hedge with respect to a fixed-rate obligation constituting a hedged item. X has a fair value measurement adjustment described in paragraph (c)(1) of this section on the AFSI hedge of $10x of gain, and a fair value measurement adjustment described in paragraph (c)(1) of this section on the hedged item of $10x of loss. For regular tax purposes, neither the AFSI hedge nor the hedged item is marked to market.

(ii) *Analysis*. For purposes of determining the AFSI of X, X will not disregard either the fair value measurement adjustment of $10x of gain or the fair value measurement adjustment of $10x of loss because there are fair value measurement adjustments described in paragraph (c)(1) of this section for both the AFSI hedge and the hedged item, and therefore paragraphs (c)(2)(i) and (ii) of this section do not apply.

(4) *Example 4: Net investment hedge marked to market*—(i) *Facts*. X has an outstanding futures contract constituting a net investment hedge. For regular tax purposes, the futures contract is marked to market, resulting in X including $10x of unrealized loss on the net investment hedge in X's taxable income. X includes $8x of unrealized loss on the net investment hedge in OCI.

(ii) *Analysis*. Because the futures contract is a net investment hedge, X will include the mark-to-market loss of $10x for regular tax purposes on the futures contract in AFSI under paragraph (d) of this section, rather than the $8x of unrealized loss included in OCI.

(5) *Example 5: Inclusion of original issue discount (OID) in AFSI*—(i) *Facts*. X holds a debt instrument with OID subject to section 1272 of the Code that is a hedged item and that has a fair value measurement adjustment described in paragraph (c)(1) of this section. X also holds an AFSI hedge that does not have a fair value measurement adjustment described in paragraph (c)(1) of this section. The fair value measurement adjustment includes amounts corresponding to the OID on the debt instrument. For regular tax purposes, neither the AFSI hedge nor the hedged item is marked to market. The fair value measurement adjustment is disregarded under paragraph (c)(2)(ii) of this section.

(ii) *Analysis*. Under paragraph (c)(2)(ii) of this section, X disregards the fair value measurement adjustment on the debt instrument in determining AFSI. Instead, X will include the taxable income from the OID on the debt instrument in determining AFSI under paragraph (e)(1) of this section.

(6) *Example 6: Subsequent adjustments for AFSI hedge*—(i) *Facts*. X has an AFSI hedge with an initial AFS basis of $100x. There are fair value measurement adjustments described in paragraph (c)(1) of this section for the AFSI hedge of $10x of gain in 2024 and $2x of loss in 2025 that were disregarded under paragraph (c)(2) of this section. There is no fair value measurement adjustment for the hedged item, and X does not mark to market the AFSI hedge or the hedged item for regular tax purposes. This gain and loss results in an increase in the AFS basis to $110x in 2024 and a decrease in the AFS basis to $108x in 2025. In 2026, the AFSI hedge is sold for

$115x when the AFS basis is still $108x, giving rise to an FSI gain of $7x.

(ii) *Analysis*. Under paragraph (e)(2)(i) of this section, X includes in AFSI the cumulative fair value measurement adjustments of $8x previously disregarded in determining AFSI under paragraph (c)(2) of this section. X also includes in AFSI the FSI gain of $7x from the taxable year that includes the AFSI subsequent adjustment date to take into account the net difference between the $115x received in the sale and the AFS basis as of the AFSI subsequent adjustment date of $108x. As a result, the sale of the AFSI hedge gives rise to $15x of gain in 2026 for purposes of determining AFSI for that taxable year.

(7) *Example 7: Subsequent adjustments for AFSI hedge with negative carrying value*—(i) *Facts*. In 2024, X enters into a forward contract constituting an AFSI hedge with respect to a purchase obligation constituting a hedged item. The forward contract has a three-year term and an initial carrying value (AFS basis) of $0. At the end of 2024, there is a fair value measurement adjustment described in paragraph (c)(1) of this section for the forward contract of $15x of loss that is included in X's FSI for that year and was disregarded under paragraph (c)(2) of this section. There is no fair value measurement adjustment for the purchase obligation, and X does not mark to market the forward contract or the purchase obligation for regular tax purposes. Applicable financial accounting principles treat the forward contract as a liability with a negative carrying value (AFS basis) at the end of 2024 of $15x. In 2025 and at a time when the forward contract still has a negative carrying value (AFS basis) of $15x, the purchase obligation is sold, which sale gives rise to an AFSI subsequent adjustment date. Because the forward contract has not yet matured or been sold, disposed of, or otherwise terminated, there is no gain or loss included in X's FSI as of the AFSI subsequent adjustment date.

(ii) *Analysis*. Under paragraph (e)(2)(i) of this section, X includes in AFSI in 2025 the $15x of loss to take into account the fair value measurement adjustment for the forward contract that was previously disregarded under paragraph (c)(2) of this section. Under paragraph (e)(2)(ii) of this section, for purposes of determining any future gain or loss included in the AFS basis (and the CAMT basis) of the forward contract immediately following the AFSI subsequent adjustment date is -$15x.

(g) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-25 AFSI adjustments for mortgage servicing income.

(a) *Overview*. This section provides rules under section 56A(c)(10) of the Code for adjusting AFSI with respect to mortgage servicing income.

(b) *In general*. AFSI is adjusted so as not to include any item of income in connection with a mortgage servicing contract any earlier than the date such income is included in gross income under chapter 1.

(c) *Applicability date*. This section applies to taxable years ending after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.56A-26 AFSI adjustments for certain related party transactions and CAMT avoidance transactions.

(a) *Overview*. This section provides rules under section 56A of the Code for adjusting AFSI for losses that arise in certain related party transactions and for CAMT avoidance transactions. Paragraph (b) of this section provides rules for adjusting AFSI for losses that arise from the sale or exchange of property between CAMT entities that are related. Paragraph (c) of this section provides an anti-abuse rule to adjust AFSI for transactions undertaken with a principal purpose of avoiding applicable corporation status or reducing or avoiding a CAMT liability under section 55 of the Code. Paragraph (d) of this section provides for the clear reflection of income under the principles of section 482 of the Code. Paragraph (e) of this section provides the applicability date of this section.

(b) *Deferral of loss from disposition between or among certain related entities*—(1) *CAMT-related group*. For purposes of this paragraph (b), the term *CAMT-related group* means any two or more CAMT entities that are treated as a single employer under section 52(a) and (b) of the Code. *See* §1.59-2(e).

(2) *Required deferral*. If the AFSI of a CAMT entity (as determined after the application of all other sections of the section 56A regulations other than §1.56A-23) reflects a loss resulting from a sale, exchange, or any other disposition of property (including stock) between that CAMT entity and one or more CAMT entities that are part of that CAMT entity's CAMT-related group (including after application of paragraph (d) of this section), that loss is deferred for AFSI purposes until no member of that CAMT entity's CAMT-related group holds that property (in whole or in part).

(c) *General anti-abuse rule*. Arrangements entered into with a principal purpose of avoiding the application of the corporate alternative minimum tax rules under sections 55 through 59 of the Code, the section 56A regulations, or §§1.59-2 through 1.59-4, including avoiding treatment as an applicable corporation or reducing or otherwise avoiding a liability under section 55(a), may be disregarded or recharacterized by the Commissioner to the extent necessary to carry out the purposes of the corporate alternative minimum tax, the section 56A regulations, and §§1.59-2 through 1.59-4 .

(d) *Clear reflection of income requirement*—(1) *In general*. For purposes of determining AFSI, if any item of income, expense, gain, or loss reflected in the FSI of the CAMT entity with respect to a controlled transaction or controlled transfer (as defined in §1.482-1(i)(8)) between two or more CAMT entities does not reflect the principles of section 482 and the regulations under section 482, then the CAMT entity must adjust its AFSI with respect to that transaction to reflect these principles (regardless of whether section 482 is otherwise considered to apply).

(2) *Appropriate adjustments*. For purposes of calculating AFSI following a transaction described in paragraph (d)(1) of this section that does not reflect the principles of section 482 and the regulations under section 482, the CAMT entity must make appropriate adjustments to CAMT basis to reflect the adjustments required by paragraph (d)(1) of this section.

(3) *Example: Transfer accounted for at historical cost for accounting purposes.* The following example illustrates the application of paragraphs (d)(1) and (2) of this section.

(i) *Facts*. X is a domestic corporation that owns all the stock of FC, a controlled foreign corporation. FC's functional currency is the U.S. dollar. X's and FC's financial results are consolidated in the financial statement included with X's Form 10-K, filed with the SEC and prepared using GAAP, and which serves as both X's and FC's AFS. On July 1, FC sells to X self-created intangible property with a zero AFS basis in the financial accounts of FC, a zero CAMT basis and a zero basis for regular tax purposes on the date of transfer. GAAP measures the transferred intangible property at the carrying value of the intangible property in the accounts of FC on the date of the trans-

fer. No gain is reflected in the AFS for the transfer of the intangible property. Under the arm's length standard in the regulations under section 482, the arm's length sale price of the intangible property at the time of transfer is $10x.

(ii) *Analysis*. The sale of the self-created intangible property by FC to X is a controlled transaction or controlled transfer under §1.482-1(i)(8). Under paragraph (d)(1) of this section, X's AFSI with respect to the sale is adjusted to reflect the arm's length price at the time of the sale, or $10x, rather than the $0 properly shown for financial accounting purposes. Accordingly, FC recognizes a gain of $10x, and X's AFSI is increased by its pro rata share, or 100%, of the additional FC income. Going forward, under paragraph (d)(2) of this section, X's CAMT basis in the intangible property is appropriately adjusted to reflect the $10x that X is treated as paying for the intangible property.

(e) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

§1.56A-27 AFSI adjustments for foreign governments.

(a) *Overview*. This section provides rules under section 56A of the Code for adjusting AFSI with respect to income of foreign governments.

(b) *In general*. AFSI of a foreign government is adjusted so as not to take into account any amount of FSI that, if it were properly treated as gross income for regular tax purposes, would be excluded from gross income and exempt from taxation under subtitle A pursuant to section 892 of the Code.

(c) *Applicability date*. This section applies to taxable years ending after September 13, 2024.

Par. 10. Sections 1.59-2 through 1.59-4 are added to read as follows:

* * * * *

Sec.

1.59-2 General rules for determining applicable corporation status.

1.59-3 Foreign-parented multinational group.

1.59-4 CAMT foreign tax credit.

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§1.59-2 General rules for determining applicable corporation status.

(a) *Overview*. This section provides rules under section 59(k) of the Code for determining whether a corporation is an applicable corporation for purposes of sections 53 and 55 through 59 of the Code and §§1.56A-1 through 1.56A-27, this section, and §§1.59-3, 1.59-4, 1.1502-53, and 1.1502-56A. Paragraph (b) of this section provides defined terms, including the definition of an applicable corporation, that apply for purposes of this section. Paragraph (c) of this section provides general rules regarding the average annual AFSI test under section 59(k)(1)(B) and the determination of AFSI for purposes of the test, including rules to implement section 59(k)(1)(D) and (k)(2)(A). Paragraph (d) of this section provides special rules pursuant to section 59(k)(1)(E) that apply for purposes of the average annual AFSI test. Paragraph (e) of this section provides special rules pursuant to section 59(k)(1)(D) for determining whether a person and a corporation are treated as a single employer under section 52(a) or (b) of the Code. Paragraph (f) of this section provides special rules for determining the AFSI history of a corporation that joins or leaves a test group. Paragraph (g) of this section provides a safe harbor for purposes of determining whether a corporation is an applicable corporation. Paragraph (h) of this section provides rules under section 59(k)(1)(C) regarding the termination of applicable corporation status. Paragraph (i) of this section provides a substantiation requirement. Paragraph (j) of this section provides a reporting requirement. Paragraph (k) of this section provides the applicability date of this section.

(b) *Defined terms*. The following definitions apply for purposes of this section. Terms used in this section that are not defined in this section have the meanings provided in the section 56A regulations.

(1) *Applicable corporation*. Except as provided in paragraph (h) of this section, the term *applicable corporation* means, with respect to any taxable year, any corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) that meets the average annual AFSI test (as described in paragraph (c) of this section) for one or more taxable years that—

(i) Are prior to such taxable year; and

(ii) End after December 31, 2021.

(2) *FPMG corporation*. The term *FPMG corporation* means a corporation being tested for applicable corporation status if that corporation is a member of an FPMG (as determined under §1.59-3) on the first or last day of its taxable year.

(3) *Relevant aggregation entity*. The term *relevant aggregation entity* has the meaning provided in paragraph (c)(2)(ii)(A) of this section.

(4) *Relevant relationship criteria*. The term *relevant relationship criteria* means the relationship criteria set forth in paragraph (c)(1)(ii)(A), (c)(2)(ii)(A), or (c)(2)(iii)(A) of this section, as applicable.

(5) *Section 56A regulations*. The term *section 56A regulations* means §§1.56A-1 through 1.56A-27 and 1.1502-56A.

(6) *Test group*. The term *test group* means, with respect to a corporation, the corporation and all persons that are treated as related to such corporation under the relevant relationship criteria.

(7) *Test group parent.* The term *test group parent* means—

(i) In the case of a parent-subsidiary controlled group (as defined in paragraph (e)(1)(ii) of this section), the common parent of such group as described in paragraph (e)(1)(ii) of this section;

(ii) In the case of a brother-sister controlled group (as defined in paragraph (e)(1)(iii) of this section), the collective group of persons described in paragraph (e)(1)(iii) of this section that satisfy the ownership requirements under paragraphs (e)(1)(iii)(A) and (B) of this section with respect to each corporation that is a member of the brother-sister controlled group;

(iii) In the case of a combined group, as defined in paragraph (e)(1)(iv) of this section, either the common parent of the relevant parent-subsidiary controlled group or the collective group of persons described in paragraph (b)(7)(ii) of this section with respect to the relevant brother-sister controlled group, as applicable;

(iv) In the case of parent-subsidiary group under common control, as defined in §1.52-1(c), the common parent organization of such group as described in §1.52-1(c);

(v) In the case of a brother-sister group under common control, as defined in §1.52-1(d), the collective group of persons described in §1.52-1(d) that satisfy the ownership requirements under §1.52-1(d)(1) with respect to each organization, as defined in §1.52-1(b), that is a member of the brother-sister controlled group;

(vi) In the case of a combined group under common control, as defined in §1.52-1(e), either the common parent organization of the relevant parent-subsidiary group under common control or the collective group of persons described in paragraph (b)(7)(v) of this section with respect to the relevant brother-sister group under common control, as applicable; or

(vii) In the case of an FPMG, the FPMG common parent, as defined in §1.59-3(b)(9).

(c) *Average annual AFSI test*—(1) *Corporations other than FPMG corporations*--(i) *In general*. A corporation that is not an FPMG corporation meets the average annual AFSI test for a taxable year if the average annual AFSI of the corporation (as determined under paragraph (c)(1)(ii) of this section) for the 3-taxable-year period ending with such taxable year exceeds $1,000,000,000.

(ii) *Aggregation required to determine AFSI for purposes of the average annual AFSI test*—(A) *In general*. For purposes of applying the average annual AFSI test described in paragraph (c)(1)(i) of this section to a corporation described in paragraph (c)(1)(i) of this section, the AFSI of the corporation and all persons treated as a single employer with the corporation under section 52(a) or (b) is treated as the AFSI of the corporation. For purposes of this paragraph (c)(1)(ii)(A), if a person treated as a single employer with a corporation described in paragraph (c)(1)(i) of this section has a taxable year that differs from the taxable year of the corporation, then the corporation's AFSI includes such person's AFSI for the taxable year of such person that ends with or within the taxable year of the corporation. *See* paragraph (e) of this section for rules that apply to determine whether persons are treated as a single employer with the corporation under section 52(a) or (b). *See* paragraph (f) of this section for rules that apply to determine AFSI of the corporation if a person joins or leaves the corporation's test group.

(B) *Certain AFSI adjustments disregarded*. For purposes of applying the average annual AFSI test described in paragraph (c)(1)(i) of this section to a corporation described in paragraph (c)(1)(i) of this section, the AFSI of the corporation and the AFSI of any person treated as a single employer with the corporation under section 52(a) or (b) is determined without regard to the AFSI adjustments provided in §§1.56A-5, 1.56A-6(b)(2), 1.56A-8(c), 1.56A-13, 1.56A-20, 1.56A-23, and 1.56A-27. Because the AFSI adjustments provided in §§1.56A-5, 1.56A-13, 1.56A-20, and 1.56A-27 disregard, disregard and replace, or otherwise adjust amounts reflected in FSI, determining AFSI without regard to those AFSI adjustments means that such FSI amounts are included in AFSI without adjustment. *See* §1.56A-1(c) for rules that apply to determine FSI.

(C) *Adjustments to prevent duplications with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(1)(i) of this section to a corporation described in paragraph (c)(1)(i) of this section, and to prevent the duplication of income or loss from a partnership investment, if a partnership is treated as a single employer with the corporation under section 52(a) or (b), the AFSI of any partner in the partnership that is either that corporation, or treated as a single employer with that corporation, is determined without regard to any amount reflected in that partner's FSI that is derived from, and included in, the FSI of the partnership. *See* §1.56A-5(d) for a description of FSI amounts that are not treated as derived from, or included in, the FSI of the partnership.

(D) *Adjustments to account for discharge of indebtedness income with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(1)(i) of this section to a corporation described in paragraph (c)(1)(i) of this section, if a partnership is treated as a single employer with the corporation under section 52(a) or (b), the exclusions from AFSI for discharge of indebtedness income pursuant to §1.56A-21(c) apply to the partnership's AFSI, but are based on a determination of whether the relevant partner meets any of the exclusions provided in §1.56A-21(c)(1) and (2), including the application of any resulting CAMT attribute reductions provided in §1.56A-21(c)(5) and (6).

(2) *FPMG corporations*—(i) *In general*. An FPMG corporation meets the average annual AFSI test for a taxable year if—

(A) The average annual AFSI of the FPMG corporation (as determined under paragraph (c)(2)(ii) of this section) for the 3-taxable-year period ending with such taxable year exceeds $1,000,000,000; and

(B) The average annual AFSI of the FPMG corporation (as determined under paragraph (c)(2)(iii) of this section) for the 3-taxable-year period ending with such taxable year is $100,000,000 or more.

(ii) *Aggregation required to determine AFSI for purposes of the average annual AFSI test in paragraph (c)(2)(i)(A) of this section ($1,000,000,000 test for FPMG corporations)*—(A) *In general*. For purposes of applying the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section to an FPMG corporation, the AFSI of the FPMG corporation and all other members of its FPMG and persons (other than persons that are members of the FPMG) treated as a single employer with the FPMG corporation under section 52(a) or (b) (each such member or person other than the FPMG corporation, a relevant aggregation entity) is treated as AFSI of the FPMG corporation. For purposes of this paragraph (c)(2)(ii)(A), if a relevant aggregation entity has a taxable year that differs from the taxable year of the FPMG corporation, then the FPMG corporation's AFSI includes the relevant aggregation entity's AFSI for the taxable year of the relevant aggregation entity that ends with or within the taxable year of the FPMG corporation. Additionally, for purposes of this paragraph (c)(2)(ii)(A), if a relevant aggregation entity does not have a taxable year for regular tax purposes, the relevant aggregation entity treats its AFS reporting year as its taxable year. *See* paragraph (e) of this section for rules that apply to determine whether persons are treated as a single employer with the FPMG corporation under section 52(a) or (b). *See* §1.59-3 for rules that apply to determine the members of the FPMG corporation's FPMG. *See* paragraph (f) of this section for rules that

apply to determine AFSI of the FPMG corporation if a person joins or leaves the FPMG corporation's test group.

(B) *Certain AFSI adjustments disregarded*. For purposes of applying the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section to an FPMG corporation, and subject to paragraph (c)(2)(i)(C) of this section, the AFSI of the FPMG corporation and each relevant aggregation entity with respect to the FPMG corporation is determined without regard to the AFSI adjustments provided in §§1.56A-5 through 1.56A-7, 1.56A-8(c), 1.56A-13, 1.56A-20, 1.56A-23, and 1.56A-27. Because the AFSI adjustments provided in §§1.56A-5, 1.56A-7, 1.56A-13, 1.56A-20, and 1.56A-27 disregard, disregard and replace, or otherwise adjust amounts reflected in FSI, determining AFSI without regard to those AFSI adjustments means that such FSI amounts are included in AFSI without adjustment. *See* §1.56A-1(c) for rules that apply to determine FSI.

(C) *Special rule for foreign persons with items that are not taken into account for regular tax purposes*. For purposes of the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section, an FPMG corporation that is a foreign corporation or any relevant aggregation entity with respect to the FPMG corporation that is not a United States person (as defined in section 7701(a)(30) of the Code) does not make any AFSI adjustment described in the section 56A regulations that is dependent on the treatment of an item for regular tax purposes if the FPMG corporation or relevant aggregation entity, as applicable, does not take that item into account for regular tax purposes. If an AFSI adjustment provides for disregarding an item reflected in FSI and replacing that item with an amount that is taken into account for regular tax purposes, and the FPMG corporation or relevant aggregation entity, as applicable, does not take that item into account for regular tax purposes, then the item reflected in the FPMG corporation's or relevant aggregation entity's FSI is not disregarded or replaced with any other amount. Further, for purposes of this paragraph (c)(2)(ii)(C), any adjustment described in §1.56A-26 is not an adjustment that is dependent on the treatment of an item for regular tax purposes.

(D) *Adjustments to prevent duplications with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section to an FPMG corporation and preventing the duplication of income or loss from a partnership investment, if a partnership is a relevant aggregation entity (as described in paragraph (c)(2)(ii)(A) of this section) with respect to the FPMG corporation, then the AFSI of any partner in the partnership that is either the FPMG corporation or a relevant aggregation entity with respect to the FPMG corporation is determined without regard to any amount reflected in the partner's FSI that is derived from, and included in, the FSI of the partnership. *See* §1.56A-5(d) for a description of FSI amounts that are not treated as derived from, or included in, the FSI of the partnership.

(E) *Adjustments to account for discharge of indebtedness income with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section to an FPMG corporation, if a partnership is a relevant aggregation entity with respect to the FPMG corporation, the exclusions from AFSI for discharge of indebtedness income pursuant to §1.56A-21(c) apply to the partnership's AFSI, but are based on a determination of whether the relevant partner meets any of the exclusions provided in §1.56A-21(c)(1) and (2), including the application of any resulting CAMT attribute reductions provided in §1.56A-21(c)(5) and (6).

(F) *Adjustments to prevent duplications with respect to ownership of certain stock*. For purposes of applying the average annual AFSI test described in paragraph (c)(2)(i)(A) of this section, the AFSI of a shareholder of a foreign corporation that is the FPMG corporation or a relevant aggregation entity with respect to the FPMG corporation (corporate aggregation entity) is determined without regard to any item reflected in the FSI of the shareholder that is attributable to FSI of the FPMG corporation or corporate aggregation entity and that, under paragraph (c)(2)(ii)(C) of this section, is not disregarded, if either—

(*1*) The shareholder is the FPMG corporation and is a foreign corporation; or

(*2*) The shareholder is a relevant aggregation entity with respect to the FPMG corporation and is not a United States person (as defined in section 7701(a)(30) of the Code).

(iii) *Aggregation required to determine AFSI for purposes of the average annual AFSI test in paragraph (c)(2)(i)(B) of this section ($100,000,000 test for FPMG corporations)*—(A) *In general*. For purposes of the average annual AFSI test described in paragraph (c)(2)(i)(B) of this section to an FPMG corporation, the AFSI of the FPMG corporation and all persons treated as a single employer with the FPMG corporation under section 52(a) or (b) is treated as the AFSI of the FPMG corporation. For purposes of this paragraph (c)(2)(iii)(A), if a person treated as a single employer with an FPMG corporation has a taxable year that differs from the taxable year of the corporation, then the FPMG corporation's AFSI includes the person's AFSI for the taxable year of the person that ends with or within the taxable year of the FPMG corporation. *See* paragraph (e) of this section for rules that apply to determine whether persons are treated as a single employer with the FPMG corporation under section 52(a) or (b). *See* paragraph (f) of this section for rules that apply to determine AFSI of the FPMG corporation if a person joins or leaves the FPMG corporation's test group.

(B) *Certain AFSI adjustments disregarded*. For purposes of applying the average annual AFSI test described in paragraph (c)(2)(i)(B) of this section to an FPMG corporation, the AFSI of the FPMG corporation and the AFSI of any person treated as a single employer with the FPMG corporation under section 52(a) or (b) is determined without regard to the AFSI adjustments provided in §§1.56A-5, 1.56A-6(b)(2), 1.56A-8(c), 1.56A-13, 1.56A-20, 1.56A-23, and 1.56A-27. Because the AFSI adjustments provided in §§1.56A-5, 1.56A-13, 1.56A-20, and 1.56A-27 disregard, disregard and replace, or otherwise adjust amounts reflected in FSI, determining AFSI without regard to those AFSI adjustments means that such FSI amounts are included in AFSI without adjustment. *See* §1.56A-1(c) for rules that apply to determine FSI.

(C) *Adjustments to prevent duplications with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(2)

(i)(B) of this section to an FPMG corporation and preventing the duplication of income or loss from a partnership investment, if a partnership is treated as a single employer with the FPMG corporation under section 52(a) or (b), then the AFSI of any partner in the partnership that is either that FPMG corporation or treated as a single employer with that FPMG corporation is determined without regard to any amount reflected in the partner's FSI that is derived from, and included in, the FSI of the partnership. *See* §1.56A-5(d) for a description of FSI amounts that are not treated as derived from, or included in, the FSI of the partnership.

(D) *Adjustments to account for discharge of indebtedness income with respect to partnership investments*. For purposes of the average annual AFSI test described in paragraph (c)(2)(i)(B) of this section to an FPMG corporation, if a partnership is treated as a single employer with the FPMG corporation under section 52(a) or (b), the exclusions from AFSI for discharge of indebtedness income pursuant to §1.56A-21(c) apply to the partnership's AFSI, but are based on a determination of whether the relevant partner meets any of the exclusions provided in §1.56A-21(c)(1) and (2), including the application of any resulting CAMT attribute reductions provided in §1.56A-21(c)(5) and (6).

(d) *Special rules for applying the average annual AFSI test*—(1) *Corporations in existence for less than three taxable years.* If a corporation has been in existence for less than three taxable years, the average annual AFSI tests described in paragraphs (c)(1)(i) and (c)(2)(i) of this section, as applicable, are applied on the basis of the period during which the corporation was in existence. For purposes of the immediately preceding sentence, the period during which a corporation has been in existence includes the period during which any predecessor of the corporation has been in existence. *See* paragraph (d)(3) of this section.

(2) *Short taxable years*—(i) *In general*. For purposes of the average annual AFSI tests described in paragraphs (c)(1)(i) and (c)(2)(i) of this section and determining AFSI under paragraphs (c)(1)(ii) and (c)(2)(ii) and (iii) of this section, as applicable, the AFSI for any taxable year of less than 12 months is annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months in the short period.

(ii) *Nonrecurring items in short taxable years*. For purposes of paragraph (d)(2)(i) of this section, AFSI for the short period to be annualized does not include those items described as extraordinary items in §1.6655-2(f)(3)(ii)(A) to the extent that the items are not otherwise disregarded in determining AFSI, either because of an AFSI adjustment or because the items are not included in FSI. However, the items are included in AFSI for the annualized 12-month period after the AFSI for the short period is annualized under paragraph (d)(2)(i) of this section.

(3) *Treatment of predecessors*. For purposes of this section, any reference to a corporation includes a reference to any predecessor of the corporation.

(e) *Special rules for applying section 52(a) and (b) in determining applicable corporation status under paragraph (c) of this section.* This paragraph (e) provides rules for determining whether a corporation and another person are treated as a single employer under section 52(a) or (b) for purposes of determining the AFSI of the corporation under paragraphs (c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(2)(iii)(A) of this section, as applicable.

(1) *Persons treated as a single employer under section 52(a)*—(i) *In general*. Persons are treated as a single employer under section 52(a) if those persons are members of a controlled group of corporations. The term *controlled group of corporations* has the same meaning as under section 1563(a) of the Code, determined without regard to section 1563(a)(4) and (e)(3)(C), except that *more than 50 percent* is substituted for *at least 80 percent* each place it appears in section 1563(a)(1), and is any group of corporations that is—

(A) A parent-subsidiary controlled group, as defined in paragraph (e)(1)(ii) of this section;

(B) A brother-sister controlled group, as defined in paragraph (e)(1)(iii) of this section; or

(C) A combined group, as defined in paragraph (e)(1)(iv) of this section.

(ii) *Parent-subsidiary controlled group*. The term *parent-subsidiary controlled group* means one or more chains of corporations connected through stock ownership with a common parent if the ownership of each corporation satisfies the following ownership requirements—

(A) Stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each of the corporations, except the parent corporation, is owned (directly and with the application of section 1563(e)(1), (2), and (3), relating to options, partnerships, and estates or trusts, respectively) by one or more of the other corporations; and

(B) The common parent owns (directly and with the application of section 1563(e)(1), (2), and (3)) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing the voting power or value, stock owned directly by the other corporations.

(iii) *Brother-sister controlled group*. The term *brother-sister controlled group* means two or more corporations if the ownership of each corporation satisfies the controlling interest requirement of paragraph (e)(1)(iii)(A) of this section and the effective control requirement of paragraph (e)(1)(iii)(B) of this section.

(A) *Controlling interest requirement*. The same five or fewer persons who are individuals, estates, or trusts own (directly and with the application of section 1563(e)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of the shares of all classes of stock in each corporation.

(B) *Effective control requirement.* Taking into account the ownership of each of the same five or fewer persons whose ownership is considered for purposes of paragraph (e)(1)(iii)(A) of this section only to the extent that each person's ownership is identical with respect to each corporation, those persons own stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of the shares of all classes of stock of each corporation.

(iv) *Combined group.* The term *combined group* means a group of three or more corporations, if—

(A) Each corporation is a member of either a parent-subsidiary controlled group of corporations or brother-sister controlled group of corporations; and

(B) At least one corporation is the common parent of a parent-subsidiary controlled group and also a member of a brother-sister controlled group.

(2) *Persons treated as a single employer under section 52(b)*—(i) *In general*. Similar to the rules that apply under sections 52(a) and 1563(a), persons are treated as a single employer under section 52(b) if those persons are members of a group of trades or businesses that are under common control.

(ii) *Trades or businesses that are under common control*. The term *trades or businesses that are under common control* means any group of trades or businesses that is either—

(A) A parent-subsidiary group under common control, as defined in §1.52-1(c);

(B) A brother-sister group under common control, as defined in §1.52-1(d); or

(C) A combined group under common control, as defined in §1.52-1(e).

(3) *Component members*. In determining whether a corporation is included in a controlled group of corporations under sections 52(a) and 1563(a) and whether a group of trades or businesses are under common control under sections 52(b), 1563(b) and §1.1563-1(b) (relating to component members of a controlled group of corporations) are not taken into account. For example, a foreign corporation subject to income tax under section 881 of the Code may be a member of a controlled group of corporations or group of trades or businesses that are under common control and treated as a single employer for purposes of paragraphs (c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(2)(iii)(A) of this section, as applicable. *See* §1.1563-1(a)(1)(ii).

(4) *Application of section 52 to an S corporation, a regulated investment company, or a real estate investment trust*. Although an S corporation, a regulated investment company, or a real estate investment trust cannot be an applicable corporation, an S corporation, a regulated investment company, or a real estate investment trust can be a member of a controlled group under section 52(a) or (b) and treated as a single employer for purposes of paragraphs (c)(1)(ii)(A), (c)(2)(ii)(A), and (c)(2)(iii)(A) of this section, as applicable.

(5) *Example*. The following example illustrates the application of the rules in this paragraph (e).

(i) *Facts*. X is a corporation that owns 80% of the capital and profits interest in PRS, a partnership. PRS owns 80% of the total combined voting power of all classes of stock entitled to vote of Y, a corporation.

(ii) *Analysis*. In accordance with section 1563(e)(2), X is deemed to own stock owned, directly or indirectly, by or for PRS in proportion to its interest in the capital or profits of PRS. X is deemed to own 64% of the total combined voting power of all classes of stock entitled to vote of Y (80% of PRS x 80% of Y). X is the common parent of a parent-subsidiary controlled group consisting of X and Y. Because PRS is not a corporation, it is not a member of the controlled group under section 52(a). However, under paragraph (e)(2) of this section, if PRS is engaged in a trade or business, it may be a member of a group of trades or businesses under common control under section 52(b) that includes X and Y.

(f) *Special rules for applying the average annual AFSI test if persons join or leave a corporation's test group*—(1) *In general*. Except as provided in paragraph (f)(2) of this section, under paragraph (c)(1)(ii)(A), (c)(2)(ii)(A), or (c)(2)(iii)(A) of this section, as applicable, a corporation includes in its AFSI for a taxable year of the corporation the AFSI of all persons treated as related to the corporation (determined by applying the relevant relationship criteria) at any point during the taxable year. For purposes of the immediately preceding sentence, if a person is treated as related to the corporation under the relevant relationship criteria for a portion of the corporation's taxable year, the corporation includes in its AFSI for that taxable year the AFSI of the person for the portion of the taxable year in which the relevant relationship criteria are satisfied. For purposes of computing the AFSI of such person for the relevant portion of the taxable year under this paragraph (f)(1), the person performs an interim closing of its books as of the end of the day before a change in status (that is, the relevant relationship criteria are newly satisfied or are no longer satisfied).

(2) *Exceptions for ownership changes*—(i) *In general.* For purposes of paragraph (f)(1) of this section, if a corporation experiences a change in ownership during a taxable year that results in the corporation and a person no longer being treated as related under the relevant relationship criteria, then following the change in ownership the corporation does not include that person's AFSI in the corporation's AFSI for any period prior to the change in ownership (notwithstanding that the corporation and the person were treated as related under the relevant relationship criteria during some, or all, of that period) to determine whether the corporation meets the average annual AFSI test (as described in paragraph (c) of this section) for the taxable year in which the change in ownership occurs or for any subsequent taxable year in which the corporation and the person are not treated as related under the relevant relationship criteria. For purposes of the immediately preceding sentence, a corporation experiences a change in ownership during a taxable year of the corporation if—

(A) The corporation is not a test group parent (as defined in paragraph (b)(6) of this section);

(B) The corporation is treated as related to a test group parent under the relevant relationship criteria as of the first day of the taxable year; and

(C) As a result of a transaction (or series of related transactions) the corporation and the test group parent no longer satisfy the relevant relationship criteria as of the last day of the taxable year.

(ii) *Corporation joins a new tax consolidated group.* If a corporation experiences a change in ownership during a taxable year, as described in paragraph (f)(2)(i) of this section, that results in the corporation joining a tax consolidated group, as defined in §1.56A-1(b)(43), that is an applicable corporation for the taxable year that includes the corporation's first taxable year in which it is a member of the tax consolidated group, then the corporation is treated as an applicable corporation beginning with the first taxable year in which it is a member of the tax con-

solidated group. For the taxable years in which the corporation is a member of the tax consolidated group, the corporation's AFSI is included in the tax consolidated group's AFSI under §1.1502-56A.

(iii) *Multiple test group parents*. If a corporation is treated as related to multiple test group parents under the relevant relationship criteria as of the first day of the taxable year, then the determination of whether the corporation has a change in ownership (but not whether the corporation and a person are related under the relevant relationship criteria) during the taxable year is made under this paragraph (f)(2) separately with respect to each test group parent.

(iv) *Treatment of successors.* For purposes of this paragraph (f)(2), any reference to a test group parent includes a reference to any successor of that test group parent.

(3) *Examples*. The following examples illustrate the application of the rules in this paragraph (f). For purposes of these examples, the relevant CAMT entities are X, Y, PRS1, PRS2, PRS3 and PRS4. For regular tax purposes, X and Y are domestic corporations and PRS1, PRS2, PRS3, and PRS4 are partnerships engaged in trades or businesses. X, Y, PRS1, PRS2, PRS3, and PRS4 use a calendar year for both regular tax purposes and financial accounting purposes. X and Y each file stand-alone Federal income tax returns on Form 1120 and PRS1, PRS2, PRS3, and PRS4 each file a Federal income tax return on Form 1065.

(i) *Example 1: No change in ownership* —(A) *General facts.* X and Y were not applicable corporations for their 2023 taxable years and are determining whether they are applicable corporations for their 2024 taxable years. X and Y are not members of an FPMG (as defined in §1.59-3(c)) for their 2024 taxable years. At all times during taxable years 2021 and 2022, X and Y were members of a group of trades or business under common control under paragraph (e)(2)(ii)(A) of this section as they were members of a parent-subsidiary group under common control (as defined in §1.52-1(c)) of which PRS1 was the common parent (PRS1 group). Specifically, at all times during 2021 and 2022, PRS1 directly owned 80% of the total value of the shares of all classes of stock of X, X owned 60% the total value of the shares of all classes of stock of Y, and Y owned 75% of the capital and profits interests of PRS2. X, Y, PRS1, and PRS2 comprise a financial statement group that issues a consolidated AFS, as defined in §1.56A-1(c)(3) (PRS1 financial statement group).

(B) *Facts: Taxable year 2023.* On April 1, 2023, Y sold its 75% interest in the capital and profits of PRS2 to PRS4, a common parent of a different parent-subsidiary group under common control (PRS4 group) that also comprises a financial statement group that issues a consolidated AFS (PRS4 financial statement group). On July 1, 2023, PRS1 acquired 60% of the capital and profits interests of PRS3 in a taxable transaction. Accordingly, during 2023, PRS2 leaves the PRS1 group and PRS3 joins the PRS1 group. X and Y remain in the PRS1 group at all times during 2023.

(C) *Analysis: Relevant relationship criteria for X and Y's applicable corporation status test.* Because X and Y are not members of a FPMG for 2024, X and Y each apply the average annual AFSI test under paragraph (c)(1) of this section to determine whether they are applicable corporations for 2024 (using the 2021 through 2023 three-taxable-year period). Accordingly, the relevant relationship criteria for determining whether X and Y are applicable corporations for 2024 are the rules provided under paragraph (c)(1)(ii)(A) of this section and the special rules for determining whether persons are treated as a single employer under paragraph (e) of this section. Therefore, under paragraph (c)(1)(ii)(A) of this section, X includes in its AFSI the AFSI of all persons treated as a single employer with X under section 52(a) or (b) for purposes of its applicable corporation status test, and Y includes in its AFSI the AFSI of all persons treated as a single employer with Y under section 52(a) or (b) for its applicable corporation status test. Specifically, as PRS1 group includes both domestic corporations and partnerships, X and Y each apply the special rules in paragraph (e)(2) of this section for persons treated a single employer under section 52(b) and include in AFSI the persons that are members of a group of trades or businesses that are under common control with X and Y, respectively, for purposes of each of X and Y's applicable corporation status test.

(D) *Analysis: X's test group for taxable years 2021 through 2023.* Because X remained in the PRS1 group at all times during 2023, such that X's test group parent, as defined in paragraph (b)(6) of this section, was the same as the beginning and end 2023, X did not experience a change in ownership under paragraph (f)(2) of this section in 2023 notwithstanding that PRS2 left the PRS1 group and PRS3 joined the PRS1 group during 2023. Therefore, under paragraph (f)(1) of this section, for each taxable year in X's three-taxable-year test period, X's AFSI includes the AFSI of any person related to it under the relevant relationship criteria (the rules under paragraphs (c)(1)(ii)(A) and (e) of this section) at any point during the taxable year. If such person was not related to X for the entire taxable year, X's AFSI includes such person's AFSI for the portion of the taxable year in which X and such person were related. Accordingly, X's AFSI for 2021 and 2022 includes the AFSI of Y, PRS1, and PRS2 for 2021 and 2022, as X, Y, PRS1 and PRS2 were related under paragraph (e)(2)(ii)(A) of this section at all times during this period. For 2023, X was related to Y and PRS1 under paragraph (e)(2)(ii)(A) of this section for the entire taxable year and related to PRS2 and PRS3 under paragraph (e)(2)(ii)(A) of this section for portions of the 2023 taxable year. Accordingly, X's AFSI for 2023 includes the AFSI of Y and PRS1 for 2023, PRS2's AFSI attributable to the period beginning January 1, 2023 and ending March 31, 2023, and PRS3's AFSI attributable to the period beginning July 1, 2023 and ending December 31, 2023.

(E) *Analysis: Y's test group for taxable years 2021 through 2023.* The analysis for determining Y's test group for 2021-2023 is the same as in paragraph (f)(3)(i)(D) of this section. Because Y remained in the PRS1 group at all times during 2023, such that Y's test group parent, as defined in paragraph (b)(6) of this section, was the same at the beginning and end 2023, Y did not experience a change in ownership under paragraph (f)(2) of this section in 2023 notwithstanding that PRS2 left the PRS1 group and PRS3 joined the PRS1 group during 2023. Accordingly, under paragraph (f)(1) of this section, Y's AFSI for 2021 and 2022 includes the AFSI of X, PRS1, and PRS2 for 2021 and 2022, as X, Y, PRS1 and PRS2 were related under paragraph (e)(2)(ii)(A) of this section at all times during this period. For 2023, Y was related to X and PRS 1 under paragraph (e)(2)(ii)(A) of this section for the entire taxable year and related to PRS2 and PRS3 under paragraph (e)(2)(ii)(A) of this section for portions of the taxable year. Accordingly, Y's AFSI for 2023 includes the AFSI of X and PRS1 for 2023, PRS2's AFSI attributable to the period January 1, 2023 through March 31, 2023, and PRS3's AFSI attributable to the period July 1, 2023 through December 31, 2023.

(ii) *Example 2: Change in ownership*—(A) *Facts.* The facts are the same as in paragraph (f)(3)(i) of this section *(Example 1)*, except, on September 1, 2023, 70% of the stock of Y was acquired by PRS4. Accordingly, during its 2023 taxable year, Y leaves the PRS1 group and joins the PRS4 group.

(B) *Analysis: Relevant relationship criteria for X and Y's applicable corporation status test.* The analysis for determining the relevant relationship criteria for purposes of determining X and Y's applicable corporation status for 2024 is the same as in paragraph (f)(3)(i)(D) of this section. Accordingly, the relevant relationship criteria for determining whether X and Y are applicable corporations for 2024 are the rules provided under paragraph (c)(1)(ii)(A) of this section and the special rules for determining whether persons are treated as a single employer under paragraph (e) of this section (specifically the rules in paragraph (e)(2) of this section for persons treated a single employer under section 52(b)).

(C) *Analysis: X's test group for taxable years 2021 through 2023.* The analysis for determining X's test group for 2021-2023 is the same as in paragraph (f)(3)(i)(D) of this section. Because X remained in the PRS1 group at all times during 2023, such that X's test group parent, as defined in paragraph (b)(6) of this section, was the same at the beginning and end of 2023, X did not experience a change in ownership under paragraph (f)(2) of this section in 2023 notwithstanding that Y and PRS2 left the PRS1 group and PRS3 joined the PRS1 group during 2023. Therefore, pursuant to paragraph (f)(1) of this section, X's AFSI for 2021 and 2022 includes the AFSI of Y, PRS1, and PRS2 for 2021 and 2022. For 2023, X was related to PRS1 under paragraph (e)(2)(ii)(A) of this section for the entire taxable year and related to Y, PRS2 and PRS3 under paragraph (e)(2)(ii)(A) of this section for portions of that taxable year. Accordingly, X's AFSI for 2023 includes the AFSI of PRS1 for 2023, Y's AFSI attributable to the period

beginning January 1, 2023 and ending August 31, 2023, PRS2's AFSI attributable to the period beginning January 1, 2023 and ending March 31, 2023, and PRS3's AFSI attributable to the period beginning July 1, 2023 and ending December 31, 2023.

(D) *Analysis: Y's change in ownership and test group for taxable years 2021 through 2023.* On September 1, 2023, Y leaves the PRS1 group and joins the PRS4 group. Accordingly, Y experiences a change in ownership under paragraph (f)(2) of this section for 2023 as Y was related to PRS1 (the test group parent of PRS1 group) under paragraph (e)(2)(ii)(A) of this section on January 1, 2023 and Y was no longer related to PRS1) under paragraph (e)(2)(ii)(A) of this section on December 31, 2023 (Y joined the PRS4 group of which PRS4 is the test group parent on September 1, 2023). Therefore, following this change in ownership, Y does not include in its AFSI the AFSI of relevant members of the PRS1 group for any period prior to the change in ownership under paragraph (f)(2) of this section. Accordingly, for purposes of determining its AFSI for the 2021 through 2023 three-taxable-year test period and pursuant to paragraph (f)(2) of this section, Y's AFSI for 2021, 2022, and for the period beginning January 1 and ending August 31, 2023, includes only the AFSI of itself. Y's AFSI for that period does not include the AFSI of X, PRS1, PRS2, or PRS3 (as applicable), even though X, Y, PRS1, PRS2, and PRS3 were related under paragraph (e)(2)(ii)(A) of this section for some or all of that period. For the period beginning September 1, 2023, and ending December 31, 2023, pursuant to paragraph (f)(1) of this section, Y's AFSI includes the AFSI of the members of the PRS4 group as Y was related to those members of the PRS4 group under paragraph (e)(2)(ii)(A) of this section for that period.

(g) *Simplified method for determining applicable corporation status*—(1) *In general*. A corporation may choose to apply the safe harbor method described in paragraph (g)(2) of this section (simplified method) in lieu of the average annual AFSI test and rules described in paragraphs (c) through (f) of this section for purposes of determining whether it is an applicable corporation under paragraph (b)(1) of this section.

(2) *Simplified method*. Under the simplified method, a corporation determines whether it is an applicable corporation under paragraph (b)(1) of this section by applying the average annual AFSI test and paragraphs (c) through (f) of this section with the following modifications:

(i) The average annual AFSI test in paragraphs (c)(1)(i) and (c)(2)(i)(A) of this section, as applicable, is applied by substituting *$500,000,000* (or such other amount specified in IRB guidance the IRS may publish) for *$1,000,000,000*.

(ii) The average annual AFSI test in paragraph (c)(2)(i)(B) of this section, as applicable, is applied by substituting *$50,000,000* (or such other amount specified in IRB guidance the IRS may publish) for *$100,000,000*.

(iii) The rules for determining AFSI under paragraphs (c)(1)(ii)(B), (c)(2)(ii)(B), and (c)(2)(iii)(B) of this section are disregarded and AFSI is instead determined by—

(A) Determining FSI by treating those members of the test group whose financial results are reflected on the same AFS as a single CAMT entity for purposes of §1.56A-1(c)(3) and (4) (that is, AFS consolidation entries between the members of the test group are not disregarded); and

(B) Making no AFSI adjustments other than the AFSI adjustment in §1.56A-8(b) and, solely for purposes of paragraph (c)(2)(i)(B) of this section, the AFSI adjustment in §1.56A-7.

(iv) For a corporation that has an AFS that covers a period (AFS year) that differs from its taxable year—

(A) Paragraphs (c)(1)(i) and (c)(2)(i) of this section are applied by substituting *3-AFS-year period ending during such taxable year* for *3-taxable-year period ending with such taxable year* in each place that phrase appears;

(B) Paragraphs (c)(1)(ii)(B), (c)(2)(ii)(B), (c)(2)(iii)(B), and (d) of this section are applied by substituting *AFS year* for *taxable year* in each place that phrase appears.

(3) *Examples*. The following examples illustrate the application of the rules in paragraphs (g)(2)(i) through (iv) of this section.

(i) *Example 1: AFS consolidation entries*—(A) *Facts*. X, Y, and Z are domestic corporations that are members of a financial statement group (XYZ group). X and Y (but not Z) are treated as a single employer under section 52(a). X, Y, and Z choose to apply the simplified method described in paragraph (g)(2) of this section. During the 2024 taxable year, X provides services to Y and Z. For purposes of the 2024 AFS for the XYZ group, AFS consolidation entries are made to eliminate income and expense from the provision of service transactions between X and Y, and between X and Z.

(B) *Analysis*. Under paragraph (g)(2)(iii)(A) of this section and for purposes of the simplified method described in paragraph (g)(2) of this section, the AFSI of X and Y for the 2024 taxable year is determined by treating X and Y as a single CAMT entity for purposes of §1.56A-1(c)(3), which means the AFS consolidation entries that eliminate the income and expense from the transactions between X and Y are not disregarded. However, the AFS Consolidation Entries that eliminate income and expense from the provision of service transactions between X and Z are disregarded for purposes of determining the FSI and AFSI of X, Y, and Z under the simplified method because X and Z are not treated as a single employer under section 52(a).

(ii) *Example 2: Mismatched tax and AFS year*—(A) *Facts*. W is a corporation that uses the calendar year as its taxable year and has a fiscal AFS year that ends on September 30. W has been in existence since before calendar year 2020 and has never had a short taxable year or short AFS year. W is not an FPMG corporation. W chooses to use the simplified method described in paragraph (g)(2) of this section.

(B) *Analysis*. In determining whether W is an applicable corporation for its taxable year ending December 31, 2024, W applies paragraph (c)(1)(i) of this section (as modified by paragraph (g)(2) of this section) by using the AFSI (as determined under paragraph (g)(2)(iii) of this section) for the 3-AFS-year period ending during its taxable year ending December 31, 2023. That is, W uses AFSI from the AFS years that ended September 30, 2021, September 30, 2022, and September 30, 2023.

(4) *Effect of not meeting the safe harbor*. If a corporation applies the simplified method described in paragraph (g)(2) of this section, and determines that its AFSI (as determined under paragraph (g)(2) of this section) exceeds the relevant simplified method thresholds in paragraphs (g)(2)(i) and (ii) of this section, for example, because it has AFSI in excess of $500 million and is not an FPMG corporation, then the corporation is an applicable corporation for such year only if it is determined to be an applicable corporation under paragraphs (b) through (f) of this section (determined without regard to the modifications described in paragraph (g)(2) of this section).

(h) *Termination of status as an applicable corporation*—(1) *In general*. A corporation's status as an applicable corporation terminates as of the first day of the first taxable year following the taxable year in which the corporation—

(i) Experiences a change in ownership, as described in paragraph (f)(2)(i) of this section, provided that if the corporation is described in paragraph (f)(2)(iii) of this section, the corporation experiences a change in ownership with respect to all test group parents it was related to under the relevant relationship criteria as of the first day of the taxable year; or

(ii) Satisfies the termination test described in paragraph (h)(2) of this section.

(2) *Termination test*. A corporation satisfies the termination test for a taxable year if the corporation does not meet the

average annual AFSI test (as described in paragraph (c) of this section, and taking into account the application of paragraphs (c) through (f) of this section), for 5 consecutive taxable years ending with the taxable year.

(3) *Later change in status*—(i) *In general*. Except as provided in paragraph (h)(3)(ii) of this section, a corporation whose status as an applicable corporation terminates for the taxable year described in paragraph (h)(1) of this section continues to apply the rules in this section to determine whether the corporation is an applicable corporation under paragraph (b)(1) of this section for the taxable year described in paragraph (h)(1) of this section (that is, the corporation may become an applicable corporation for the same taxable year in which its status terminates under paragraph (h)(1) of this section) and each taxable year thereafter.

(ii) *Joining a tax consolidated group*. If a corporation whose status as an applicable corporation terminates for the taxable year described in paragraph (h)(1)(i) of this section due to a change in ownership that results in the corporation joining a tax consolidated group that is an applicable corporation for the tax consolidated group's taxable year that includes such taxable year, then the corporation is treated as an applicable corporation beginning with such taxable year and subsequent taxable years, as applicable. *See* paragraph (f)(2)(ii) of this section.

(i) *Substantiation requirement*. A corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) must maintain books and records sufficient to demonstrate whether it is an applicable corporation for any taxable year, including the identification of all persons treated as a single employer with such corporation under section 52(a) or (b) and whether the corporation is a member of an FPMG under §1.59-3. *See* §1.6001-1(a).

(j) *Reporting requirement*. A corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) that does not satisfy the simplified method under paragraph (g) of this section must provide information to demonstrate whether it is an applicable corporation, in such form and manner as Form 4626, *Alternative Minimum Tax-Corporations* (or any successor form), the Federal income tax return required to be filed by such corporation, or their respective instructions prescribe. *See* §§1.6011-1 and 601.602 of this chapter.

(k) *Applicability date*. This section applies to taxable years of the corporation determining its applicable corporation status ending after September 13, 2024.

§1.59-3 Foreign-parented multinational group.

(a) *Overview*. This section provides rules under section 59(k) of the Code for determining a foreign-parented multinational group (FPMG) for purposes of sections 53 and 55 through 59 of the Code and §§1.56A-1 through 1.56A-27, 1.59-2, this section, and §§1.59-4, 1.1502-53, and 1.1502-56A. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides the rules for determining an FPMG. Paragraph (d) of this section describes the treatment of a U.S. trade or business. Paragraph (e) of this section provides for the treatment of certain parent entities as foreign corporations. Paragraph (f) of this section defines the term controlling interest. Paragraph (g) of this section defines the term applicable financial accounting standard. Paragraph (h) of this section defines the term included in the same applicable financial statement for that taxable year. Paragraph (i) of this section specifies who is a member of an FPMG. Paragraph (j) of this section provides examples illustrating the application of the rules in this section. Paragraph (k) of this section provides the applicability date of this section.

(b) *Definitions*. The following definitions apply for purposes of this section. Terms used in this section that are not defined in this section have the meanings provided in §1.56A-1(b).

(1) *Applicable financial accounting standard for that taxable year*. The term *applicable financial accounting standard for that taxable year* has the meaning provided in paragraph (g) of this section.

(2) *Controlling interest*. The term *controlling interest* has the meaning provided in paragraph (f) of this section.

(3) *Deemed domestic corporation*. The term *deemed domestic corporation* has the meaning provided in paragraph (d) of this section.

(4) *Deemed foreign corporation*. The term *deemed foreign corporation* means any entity treated as a foreign corporation under paragraph (e) of this section.

(5) *Domestic corporation*. The term *domestic corporation* includes any domestic corporation for regular tax purposes, as well as any deemed domestic corporation, except as otherwise provided in this section.

(6) *Entity*. The term *entity* means any CAMT entity and any deemed domestic corporation. Any disregarded entity or branch that is owned by a CAMT entity (including through ownership of one or more disregarded entities or branches) is treated as part of that CAMT entity, except to the extent the disregarded entity or branch is a deemed domestic corporation.

(7) *Foreign corporation*. The term *foreign corporation* includes any foreign corporation for regular tax purposes, as well as any deemed foreign corporation, except as otherwise provided in this section.

(8) *Foreign-parented multinational group (FPMG)*. The term *FPMG* has the meaning provided in paragraph (c) of this section.

(9) *FPMG common parent*. The term *FPMG common parent* means an ultimate parent that is a foreign corporation.

(10) *Included in the same applicable financial statement for that taxable year*. The term *included in the same applicable financial statement for that taxable year* has the meaning provided in paragraph (h) of this section.

(11) *Section 52 group*. The term *section 52 group* means, with respect to a person, that person and the group of persons whose AFSI is required to be aggregated with the AFSI of that person under §1.59-2(c)(1)(ii)(A).

(12) *Ultimate parent*. The term *ultimate parent* means an entity that has a controlling interest in at least one other entity and in which no entity has a controlling interest.

(c) *FPMG*. For purposes of this section, the term *FPMG* means, with respect to any taxable year of a corporation, two or more entities, one of which is the corporation, if—

(1) At least one of the entities is a domestic corporation and at least one of the entities is a foreign corporation;

(2) The entities are included in the same applicable financial statement for that taxable year; and

(3) One of the entities is an FPMG common parent.

(d) *Treatment of U.S. trade or business as separate domestic corporation*. For purposes of this section, if a foreign corporation (excluding a deemed foreign corporation) is or is treated as engaged in a trade or business within the United States for purposes of section 882 of the Code (including through one or more disregarded entities or pass-through entities), the trade or business will be treated as a separate domestic corporation (a deemed domestic corporation) that is wholly owned by the foreign corporation.

(e) *Treatment of certain ultimate parents as foreign corporations*. For purposes of this section, an ultimate parent that is not a corporation (determined without regard to this paragraph (e)) is treated as a foreign corporation if—

(1) The ultimate parent directly or indirectly owns (other than through a domestic corporation, excluding a deemed domestic corporation) a foreign trade or business (as defined in §1.989(a)-1(c)); or

(2) The ultimate parent directly or indirectly owns (other than through a domestic corporation, excluding a deemed domestic corporation) any equity interest in a foreign corporation and the ultimate parent has a controlling interest (including through a domestic corporation) in such foreign corporation.

(f) *Controlling interest*—(1) *In general*. An entity (upper-tier entity) has a controlling interest in another entity (lower-tier entity) if the applicable financial accounting standard requires that a consolidated financial statement of the upper-tier entity reflects the assets, liabilities, equity, income, and expenses of the lower-tier entity (regardless of whether or not a consolidated financial statement is or is required to be prepared or is prepared correctly).

(2) *Treatment of certain entities*. For purposes of this section, an upper-tier entity has a controlling interest (if it does not otherwise have a controlling interest under the applicable financial accounting standard) in any of the following entities—

(i) A deemed domestic corporation if either—

(A) The upper-tier entity is the foreign corporation; or

(B) The upper-tier entity has a controlling interest in the foreign corporation;

(ii) Any entity if—

(A) The entity and the upper-tier entity are in the same section 52 group;

(B) The upper-tier entity directly or indirectly (through one or more CAMT entities) owns an interest in the entity; and

(C) The upper-tier entity is a member of an FPMG without regard to this paragraph (f)(2)(ii); or

(iii) Any entity in which the upper-tier entity would be treated as having a controlling interest but for the fact that the entity is (or would be) excluded from the upper-tier entity's consolidated financial statement under the applicable financial accounting standard—

(A) Based on size or materiality;

(B) Because the entity is held for sale;

(C) Because the entity or business of the entity is winding down, liquidating, or otherwise ceasing operations or being terminated or disposed of; or

(D) Because the entity is permitted but not required to be excluded under the applicable financial accounting standard from a consolidated financial statement of the upper-tier entity, regardless of whether or not a consolidated financial statement is (or is required to be) prepared.

(3) *Tiered controlling interests*. For purposes of this section, if an upper-tier entity has a controlling interest in a lower-tier entity, the upper-tier entity will also have a controlling interest in any entity in which the lower-tier entity has a controlling interest under paragraph (f)(2)(ii) of this section. This rule applies iteratively, starting at the bottom of the controlling interest chain and ending with the FPMG common parent.

(g) *Applicable financial accounting standard*—(1) *In general*. For purposes of this section, the term *applicable financial accounting standard* means GAAP except as provided in paragraph (g)(2) of this section.

(2) *Exceptions*—(i) *Rules for applying exceptions*. The exceptions in paragraphs (g)(2)(ii) and (iii) of this section apply in descending order of priority. For example, if an applicable financial accounting standard is determined pursuant to paragraph (g)(2)(ii) of this section, then paragraph (g)(2)(iii) of this section does not apply. Similarly, if an applicable financial accounting standard is determined pursuant to paragraph (g)(2)(iii)(A) of this section, then paragraph (g)(2)(iii)(B) of this section does not apply. For purposes of this paragraph (g)(2), all references to an ultimate parent are to the ultimate parent as determined by treating the accounting standard used to prepare the relevant consolidated financial statement as the applicable financial accounting standard. For example, in paragraph (g)(2)(ii) of this section, the ultimate parent of a consolidated financial statement described in §1.56A-2(c)(2)(i) is determined by treating IFRS as the applicable financial accounting standard and, in paragraph (g)(2)(iii)(B) of this section, each of the ultimate parents would be determined based on the accounting standard used to prepare the applicable consolidated financial statement. If the assets, liabilities, equity, income, and expenses of a corporation are reflected in a consolidated financial statement described in §1.56A-2(c)(1) (qualifying GAAP financial statement) that is of its ultimate parent, the exceptions in this paragraph (g)(2) do not apply.

(ii) *IFRS*. If the assets, liabilities, equity, income, and expenses of a corporation are reflected in a consolidated financial statement described in §1.56A-2(c)(2)(i) that is of its ultimate parent, then the applicable financial accounting standard means the accounting standard used to prepare that consolidated financial statement.

(iii) *Other accounting standard*—(A) *Single accounting standard*. If the assets, liabilities, equity, income, and expenses of a corporation are reflected in a single consolidated financial statement described in §1.56A-2(c)(3)(i) that is of its ultimate parent, then the applicable financial accounting standard means the accounting standard used to prepare that consolidated financial statement.

(B) *Multiple accounting standards*. If the assets, liabilities, equity, income, and expenses of a corporation are reflected in more than one consolidated financial statements described in §1.56A-2(c)(3)

(i) that are of their ultimate parents and all of those consolidated financial statements have the same ultimate parent (each, a parented financial statement), then the applicable financial accounting standard means:

(*1*) If the accounting standard used to prepare one of those parented financial statements was the applicable financial accounting standard in the prior taxable year, that accounting standard; and

(*2*) If no accounting standard is described in paragraph (g)(2)(iii)(B)(*1*) of this section, the accounting standard chosen by the corporation from among the accounting standards used to prepare those parented financial statements, provided that the choice of accounting standard is specified on a statement attached to the Form 4626, *Alternative Minimum Tax-Corporations* (or any successor form), of the corporation or as otherwise directed in the instructions to the form for the first applicable taxable year (statement requirement). If the corporation does not choose an accounting standard, chooses one that is not permitted, or fails to satisfy the statement requirement and does not establish to the Commissioner's satisfaction that the corporation has used the chosen applicable financial accounting standard, the Commissioner has discretion either to treat the applicable financial accounting standard as GAAP or to treat the applicable financial accounting standard as one of the accounting standards used to prepare one of those parented financial statements.

(3) *Reflected in a consolidated financial statement*. For purposes of this paragraph (g), the assets, liabilities, equity, income, and expenses of a corporation are treated as reflected in a consolidated financial statement if either they are reflected in the consolidated financial statement, or they would have been reflected in the consolidated financial statement but for the entity being excluded for a reason specified in paragraphs (f)(2)(iii)(A) through (D) of this section.

(4) *Disclosure requirement*. The corporation must specify the applicable financial accounting standard on a statement attached to the Form 4626 (or any successor form) of the corporation or as otherwise directed in the instructions to the form for each taxable year the applicable financial accounting standard is relevant in determining if the corporation is a member of an FPMG.

(h) *Included in the same applicable financial statement for that taxable year*. For purposes of this section, the FPMG common parent and all entities in which the FPMG common parent has a controlling interest at any time during the taxable year are treated as included in the same applicable financial statement for that taxable year. For purposes of this paragraph (h), it is irrelevant whether a consolidated financial statement of the FPMG common parent is prepared or whether a particular entity is reflected in the consolidated financial statement of the FPMG common parent or would be reflected if a consolidated financial statement of the FPMG common parent were prepared. The entities included in the same applicable financial statement for that taxable year for this purpose may differ from the entities included in the applicable financial statement(s) determined under §1.56A-2.

(i) *Member of an FPMG*. Each entity included in the same applicable financial statement for that taxable year as the FPMG common parent is a member of that FPMG (including the FPMG common parent).

(j) *Examples*. The following examples illustrate the application of the rules in this section.

(1) *Example 1: Determining if there is an FPMG and its members when there is a single foreign corporation that is engaged in U.S. trade or business*—(i) *Facts*. FC is a foreign corporation engaged in a trade or business in the United States for purposes of section 882 of the Code. FC does not own an interest in any entity. FC does not have a controlling interest in any entity under its applicable financial accounting standard and does not prepare a consolidated financial statement. No entity has a controlling interest in FC, within the meaning of paragraph (f) of this section, and FC is not a member of any section 52 group. FC is being tested for applicable corporation status.

(ii) *Analysis*. Under paragraph (d) of this section, the U.S. trade or business is treated as a separate domestic corporation that is wholly owned by FC (the deemed domestic corporation, DC). Under paragraph (f)(2) of this section, FC is treated as having a controlling interest in DC because DC and FC are described in paragraph (d) of this section. As a result, FC is an ultimate parent under paragraph (b)(12) of this section because it has a controlling interest in DC and no entity has a controlling interest in it. Because FC is the ultimate parent and a foreign corporation, it is the FPMG common parent under paragraph (b)(9) of this section. Under paragraph (h) of this section, FC and DC are treated as included in the same applicable financial statement for that taxable year because FC, the FPMG common parent, has a controlling interest in DC. As a result, there is an FPMG comprised of FC and DC under paragraph (c) of this section because the following three requirements are satisfied: there is at least one foreign corporation (FC) and one domestic corporation (DC); the entities (FC and DC) are included in the same applicable financial statement for that taxable year; and one of the entities (FC) is an FPMG common parent.

(2) *Example 2: Partnership treated as a deemed foreign corporation*—(i) *Facts*. PRS is a partnership that directly owns all the stock of X, a domestic corporation, and 15% of the stock of FC, a foreign corporation. The remaining 85% of the stock of FC is directly owned by X. PRS is the ultimate parent and has a controlling interest in X and FC.

(ii) *Analysis*. PRS is treated as a foreign corporation under paragraph (e) of this section because the following three requirements of paragraph (e)(2) of this section are satisfied: PRS is the ultimate parent; PRS owns an interest in FC that is not owned through a domestic corporation; and PRS has a controlling interest in FC because of its direct interest in FC and its indirect interest in FC through X.

(3) *Example 3: Controlling interest*—(i) *Facts*. FC is a foreign corporation that is not required (for example, by regulators or creditors) to prepare a consolidated financial statement and therefore does not prepare a consolidated financial statement. FC directly owns 100% of the stock of X, and X directly owns 100% of the stock of Y. X and Y are domestic corporations. Y is held for sale. If FC were to prepare a consolidated financial statement under GAAP, FC would be required to reflect the assets, liabilities, equity, income, and expenses of X but not Y. However, if Y were not held for sale, FC also would be required to reflect the assets, liabilities, equity, income, and expense of Y on its consolidated financial statement under GAAP.

(ii) *Analysis*. Under paragraph (g) of this section, the applicable financial accounting standard is GAAP because FC does not prepare a consolidated financial statement and therefore none of the exceptions in paragraph (g)(2) of this section apply. FC has a controlling interest in X under paragraph (f)(1) of this section because the applicable financial accounting standard (which is GAAP) requires that FC's consolidated financial statement include the assets, liabilities, equity, income, and expenses of X. Neither the fact that no consolidated financial statement is required to be prepared nor the fact that no consolidated financial statement is prepared is relevant to the controlling interest determination under paragraph (f) of this section. FC also has a controlling interest in Y under paragraph (f)(2)(iii) of this section because Y would have been included on FC's consolidated financial statement under the applicable financial accounting standard (GAAP) but for being excluded because Y was held for sale, and therefore FC would have had a controlling interest under the applicable financial accounting standard (GAAP) but for the exclusion. Therefore, for purposes of this section, FC has a controlling interest in X and Y.

(4) *Example 4: Determining the members of an FPMG*—(i) *Facts*. FC is a foreign corporation. FC has a controlling interest under paragraph (f)(1) of this section in X and A and under paragraph (f)(2)(iii) of this section in B and C. No entity has a controlling interest in FC, and FC does not have any controlling interests other than those specified. In addition, B is part of a section 52 group that includes B, D, and E, and B owns an interest in each of D and E. X is a domestic corporation.

(ii) *Analysis*—(A) *FPMG membership determined without regard to paragraph (f)(2)(ii) of this section*. In determining whether an upper-tier entity has a controlling interest in a lower-tier entity, paragraph (f)(2)(ii) of this section applies only if the upper-tier entity is a member of an FPMG without regard to paragraph (f)(2)(ii) of this section. Accordingly, the first step in determining whether an upper-tier entity may have a controlling interest in a lower-tier entity under paragraph (f)(2)(ii) of this section is to determine whether the upper-tier entity is a member of an FPMG without regard to paragraph (f)(2)(ii) of this section. Without regard to paragraph (f)(2)(ii) of this section, FC is the ultimate parent under paragraph (b)(12) of this section because FC has a controlling interest in X, A, B, and C and no entity has a controlling interest in FC. Because FC is the ultimate parent and a foreign corporation, it is the FPMG common parent under paragraph (b)(9) of this section. Under paragraph (h) of this section, FC, X, A, B, and C are included in the same applicable financial statement for that taxable year because FC is the FPMG common parent and has a controlling interest in X, A, B, and C. There is an FPMG because the requirements of paragraph (c) of this section are satisfied: there is at least one domestic corporation (X) and at least one foreign corporation (FC); the entities are included in the same applicable financial statement for that taxable year; and FC is an FPMG common parent. The members of the FPMG under paragraph (i) of this section are FC, X, A, B, and C.

(B) *FPMG membership determined taking into account paragraph (f)(2)(ii) of this section.* After determining if there is an FPMG and the members of the FPMG without regard to paragraph (f)(2)(ii) of this section, paragraph (f)(2)(ii) of this section needs to be taken into account to determine whether there are any additional members. Under paragraphs (f)(2)(ii) and (f)(3) of this section, if an entity is owned by a member of the FPMG without regard to paragraph (f)(2)(ii) of this section, is part of the same section 52 group, and the FPMG member directly or indirectly owns an interest in the entity, the FPMG common parent will have a controlling interest in the entity. B is a member of the FPMG without regard to paragraph (f)(2)(ii) of this section. B is in the same section 52 group as D and E. B owns an interest in D and E. Consequently, FC has a controlling interest in D and E under paragraphs (f)(2)(ii) and (f)(3) of this section. As a result, because all entities in which the FPMG common parent has a controlling interest are included in the same applicable financial statement for that taxable year under paragraph (h) of this section, D and E are included in the same applicable financial statement for that taxable year as FC, X, A, B, and C. Therefore, the members of the FPMG under paragraph (i) of this section are FC, X, A, B, C, D, and E. This result is not dependent on which entity is being tested for applicable corporation status.

(5) *Example 5: Determining the applicable financial accounting standard*—(i) *Facts*. X, a domestic corporation, is the corporation who is being tested for applicable corporation status. X owns interests in A and B. X is owned by FC, a foreign corporation, and FC owns interests in other entities. Country A is a foreign country. FC is listed on a stock exchange in Country A and required to file a consolidated financial statement of FC under the generally accepted accounting principles of Country A (Country A Accounting Standard) with the agency of Country A that is equivalent to the United States Securities and Exchange Commission (SEC) (Agency A). FC files the required audited consolidated financial statement that is certified (within the meaning of §1.56A-3(d)) with Agency A. FC is the ultimate parent under Country A Accounting Standard. In addition, an audited consolidated financial statement is prepared in accordance with GAAP that is certified (within the meaning of §1.56A-3(d)) and includes the assets, liabilities, equity, income, and expenses of only X, A, and B. Under GAAP, the ultimate parent is FC. Further, an audited consolidated financial statement is prepared in accordance with IFRS that is certified (within the meaning of §1.56A-3(d)) and includes the assets, liabilities, equity, income, and expenses of X; however, it is not filed with the SEC or an agency of a foreign government that is equivalent to the SEC. The financial statements described in this paragraph (j)(5) are the only consolidated financial statements that are prepared that include the assets, liabilities, equity, income, and expenses of X.

(ii) *Analysis*. Unless an exception applies, the applicable financial accounting standard is GAAP. If there is a GAAP consolidated financial statement that meets the description in the last sentence of paragraph (g)(2)(i) of this section, then none of the exceptions in paragraph (g)(2) of this section can apply and therefore the default rule in paragraph (g)(1) of this section that the applicable financial account standard is GAAP applies. As FC is the ultimate parent under GAAP and there is not a GAAP consolidated financial statement that includes the assets, liabilities, equity, income, and expenses of FC, an exception may apply. As provided in paragraph (g)(2)(i) of this section, the exceptions apply in descending order. Therefore, the exception in paragraph (g)(2)(ii) of this section is tested first. In this case, there is not an IFRS consolidated financial statement that is described in §1.56A-2(c)(2)(i) because the IFRS consolidated financial statement is not filed with the SEC or an agency of a foreign government that is equivalent to the SEC. Because the exception in paragraph (g)(2)(ii) of this section does not apply, the exception in paragraph (g)(2)(iii)(A) of this section is tested next. There is only one consolidated financial statement described in §1.56A-2(c)(3)(i), and that consolidated financial statement is filed with Agency A and is of FC, the ultimate parent under Country A Accounting Standard. As a result, the exception applies, and the applicable financial accounting standard is Country A Accounting Standard.

(k) *Applicability date*. This section applies to taxable years of the corporation determining its applicable corporation status ending after September 13, 2024.

§1.59-4 CAMT foreign tax credit.

(a) *Overview*. This section provides rules under section 59(l) of the Code for computing the CAMT foreign tax credit, as defined in proposed §1.56A-1(b)(9). Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section describes how to compute the CAMT foreign tax credit. Paragraph (d) of this section provides rules for determining an applicable corporation's pro rata share of taxes of a controlled foreign corporation. Paragraph (e) of this section provides for the carryover of unused CFC taxes. Paragraph (f) of this section provides rules for foreign tax redeterminations. Paragraph (g) of this section describes the treatment of partnership taxes. Paragraph (h) of this section describes the treatment of members of a tax consolidated group for purposes of this section. Paragraph (i) provides examples illustrating the application of the rules in this section. Paragraph (j) of this section provides the applicability dates of this section.

(b) *Definitions*. The following definitions apply for purposes of this section. Terms used in this section that are not defined in this section have the meanings provided in §1.56A-1(b).

(1) *Eligible tax*. The term *eligible tax* means a foreign income tax, other than a foreign income tax for which a credit is disallowed or suspended for regular tax purposes under section 245A(d), 245A(e)(3), 901(e), 901(f), 901(i), 901(j), 901(k), 901(l), 901(m), 907, 908, 909, 965(g), 999, or 6038(c) of the Code.

(2) *Income group*. The term *income group* has the meaning provided in §1.960-1(b)(13).

(3) *Pro rata share percentage*. The term *pro rata share percentage* means, with respect to a controlled foreign corporation in which an applicable corporation is a United States shareholder and a taxable year of the controlled foreign corporation, a fraction, the numerator of which is the applicable corporation's pro rata share of the adjusted net income or loss of the controlled foreign corporation, as determined under §1.56A-6, for its taxable year, and

the denominator of which is the adjusted net income or loss of the controlled foreign corporation for its taxable year.

(4) *Residual income group*. The term *residual income group* has the meaning provided in §1.960-1(b)(22).

(5) *Section 904 category*. The term *section 904 category* has the meaning provided in §1.960-1(b)(23).

(6) *Subpart F income group*. The term *subpart F income group* has the meaning provided in §1.960-1(b)(31).

(7) *Tested income group*. The term *tested income group* has the meaning provided in §1.960-1(b)(34).

(8) *Unused CFC taxes*. The term *unused CFC taxes* means, with respect to any taxable year of an applicable corporation, the excess (if any) of the amount described in paragraph (c)(1)(i) of this section for the taxable year, over the amount described in paragraph (c)(1)(ii) of this section for the taxable year.

(c) *Computation of CAMT foreign tax credit*. If an applicable corporation chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for a taxable year, the amount of the CAMT foreign tax credit allowed to the applicable corporation under section 59(l) for the taxable year equals the sum of—

(1) The lesser of—

(i) The aggregate of the applicable corporation's pro rata shares of taxes of controlled foreign corporations, as determined under paragraph (d) of this section; or

(ii) The product of the amount of the adjustment under §1.56A-6(b)(1) and the percentage specified in section 55(b)(2)(A)(i) of the Code; and

(2) The amount of eligible taxes paid, within the meaning of §1.901-2(g)(5), by the applicable corporation during the taxable year, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the applicable corporation's AFS.

(d) *Applicable corporation's pro rata share of taxes of a controlled foreign corporation*—(1) *In general*. If an applicable corporation is a United States shareholder of a controlled foreign corporation, the applicable corporation's pro rata share of the taxes of the controlled foreign corporation for a taxable year is equal to the sum of the amounts described in paragraphs (d)(2) and (3) of this section, reduced to reflect the suspensions and disallowances described in paragraph (b)(1) of this section that apply at the level of the United States shareholder.

(2) *Aggregate pro rata share of taxes under section 960(b) of the Code*. The amount described in this paragraph (d)(2) is equal to the sum of the amount of foreign income taxes deemed paid by the applicable corporation under §1.960-3(b) for the taxable year of the applicable corporation, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the AFS of the applicable corporation or any controlled foreign corporation with respect to which the applicable corporation is a United States shareholder.

(3) *Aggregate pro rata share of the eligible current year taxes*. The amount described in this paragraph (d)(3) is equal to the sum of—

(i) The amount of eligible current year taxes, as defined in §1.960-1(b)(5), deemed paid by the applicable corporation under §1.960-2(b) for the taxable year of the applicable corporation, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the AFS of the controlled foreign corporation or the applicable corporation;

(ii) The aggregate of the applicable corporation's proportionate share of eligible current year taxes, as defined in §1.960-1(b)(5), of the controlled foreign corporation for each tested income group within each section 904 category of the controlled foreign corporation, as determined under §1.960-2(c)(5) for the taxable year of the applicable corporation, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the AFS of the controlled foreign corporation or applicable corporation;

(iii) Solely with respect to any subpart F income group and tested income group within a section 904 category of the controlled foreign corporation for which the denominator of the applicable corporation's proportionate share fraction (as described in §1.960-2(b)(3)(i) and (c)(5), respectively) is zero or less than zero, the aggregate amount of eligible current year taxes of the controlled foreign corporation for each such income group within each section 904 category of the controlled foreign corporation, for the controlled foreign corporation's taxable year that ends with or within the taxable year of the applicable corporation, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the AFS of the controlled foreign corporation or applicable corporation, multiplied by the pro rata share percentage, as defined in paragraph (b)(3) of this section, for such taxable year of the controlled foreign corporation; and

(iv) The aggregate amount of eligible current year taxes, as defined in §1.960-1(b)(5), of the controlled foreign corporation for each residual income group, as defined in §1.960-1(d)(2)(ii)(D), of the controlled foreign corporation, for the controlled foreign corporation's taxable year that ends with or within the taxable year of the applicable corporation, to the extent the taxes have been taken into account, within the meaning of §1.56A-8(d), on the AFS of the controlled foreign corporation or applicable corporation, multiplied by the pro rata share percentage, as defined in paragraph (b)(3) of this section, for such taxable year of the controlled foreign corporation.

(e) *Carryover of unused CFC taxes*—(1) *In general*. If an applicable corporation chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for a taxable year, any unused CFC taxes for the taxable year are carried to each of the five succeeding taxable years, in chronological order, to increase the amount described in paragraph (c)(1)(i) of this section, but only to the extent not absorbed as taxes deemed paid under paragraph (e)(2) of this section in a prior taxable year. The amount of taxes deemed paid under paragraph (e)(2) of this section in a carryover taxable year is absorbed regardless of whether the taxpayer chooses to have the benefits of subpart A of part III of subchapter N of chapter 1 for the carryover taxable year.

(2) *Amount of unused CFC taxes deemed paid in a carryover taxable year*. The amount of unused CFC taxes deemed paid in any taxable year is equal to the lesser of—

(i) The amount of unused CFC taxes that are carried to the taxable year under paragraph (e)(1) of this section; or

(ii) The excess (if any) of the amount described in paragraph (c)(1)(ii) of this section for the taxable year over the amount described in paragraph (c)(1)(i) of this section for the taxable year.

(3) *Ordering rule.* If, as a result of the limitation in paragraph (e)(2)(ii) of this section, the amount of unused CFC taxes deemed paid under paragraph (e)(2) of this section is less than the full amount of unused CFC taxes that are carried to the taxable year under paragraph (e)(1) of this section, then the unused CFC taxes that are absorbed as deemed paid under paragraph (e)(2) of this section are first the unused CFC taxes from the fifth preceding taxable year, followed sequentially by the unused CFC taxes from the fourth, third, second, and first preceding taxable year, respectively, up to the amount described in paragraph (e)(2)(ii) of this section.

(f) *Foreign tax redetermination*. Foreign income taxes paid or accrued as a result of a foreign tax redetermination, as defined in §1.905-3(a), are eligible to be claimed as a CAMT foreign tax credit only if the domestic corporation is an applicable corporation in the taxable year to which the foreign tax redetermination relates (relation-back year). A CAMT foreign tax credit with respect to such foreign income taxes may be claimed only in the relation-back year, even if the taxes are reflected in a journal entry of an AFS within a taxable year that is later than the relation-back year.

(g) *Treatment of partnership taxes*. For purposes of paragraph (c)(2) of this section, if an applicable corporation is a partner in a partnership (or an indirect partner in the partnership through one or more other partnerships or other pass-through entities), the amount of eligible taxes paid or accrued by the applicable corporation for the taxable year includes the amount of creditable foreign tax expenditures (within the meaning of §1.704-1(b)(4)(viii)) allocated to the applicable corporation for regular tax purposes, reduced to reflect the suspensions and disallowances described in paragraph (b)(1) of this section that apply at the level of the partner.

(h) *Tax consolidated groups*. Members of a tax consolidated group are treated as a single entity for purposes of this section. *See also* §1.1502-56A(a)(2). For rules regarding the use of consolidated unused CFC taxes, *see* §1.1502-56A(i).

(i) *Examples*. The following examples illustrate the application of the rules in this section. For purposes of these examples, each entity uses the calendar year as its taxable year and for AFS purposes and has a U.S. dollar functional currency.

(1) *Example 1: Eligible tax*—(i) *Facts*. X is an applicable corporation for its taxable year ending on December 31, 2024. In 2024, X paid $100x of foreign withholding taxes on dividend payments received on stock in a foreign corporation that X holds for investment purposes. For regular tax purposes, a foreign tax credit is disallowed for the $100x of foreign withholding taxes because X's holding period in the stock did not meet the minimum holding period required under section 901(k).

(ii) *Analysis*. Under paragraph (b)(1) of this section, X's eligible taxes for CAMT foreign tax credit purposes do not include the $100x of foreign withholding taxes for which a credit is disallowed for regular tax purposes under section 901(k).

(2) *Example 2: Pro rata share of taxes of a controlled foreign corporation*—(i) *Facts*. X, a domestic corporation, is an applicable corporation for its taxable year ending on December 31, 2024. X owns 60% of the stock of FC, a controlled foreign corporation. X's pro rata share percentage, as defined in paragraph (b)(3) of this section, with respect to FC is also 60%. FC earns subpart F income, tested income, and residual income. In 2024, X is deemed to pay $4x of foreign income tax under §1.960-2(b) with respect to the subpart F income. In 2024, X's proportionate share, as defined in §1.960-2(c)(5), of eligible current year taxes of FC for the tested income group of FC is $4x. In 2024, FC has $2x of eligible current year taxes in the residual income group. All the taxes paid by FC in 2024 are eligible current year taxes, as defined in §1.960-1(b)(5). All the taxes paid by FC in 2024 are also eligible taxes within the meaning of paragraph (b)(1) of this section, and no suspensions or disallowances described in paragraph (b)(1) of this section apply at the level of X, the United States shareholder of FC. Finally, all the taxes paid by FC in 2024 are taken into account, within the meaning of §1.56A-8(d), in the 2024 AFS of FC or X.

(ii) *Analysis*. Under paragraph (d)(3) of this section, X's aggregate pro rata share of FC's eligible current year taxes is $9.2x. This includes the $4x of foreign income tax X is deemed to pay under §1.960-2(b), X's $4x proportionate share of eligible current year taxes of FC for the tested income group of FC, and X's $1.2x pro rata share of eligible current year taxes of FC in the residual income group (60% x $2x).

(3) *Example 3: Partnership taxes*—(i) *Facts*. X, a domestic corporation, is an applicable corporation for its taxable year ending on December 31, 2024. In 2024, X is a partner in PRS, a domestic partnership that uses the calendar year as its taxable year. In 2024, PRS paid $300x of foreign income taxes to Country G, which PRS accounted for as a current tax expense in its AFS. The $300x of foreign income taxes paid to Country G are creditable foreign tax expenditures (within the meaning of §1.704-1(b)(4)(viii)) of PRS, $180x of which are allocated to X for regular tax purposes. None of the suspensions or disallowances described in paragraph (b)(1) of this section apply at the level of X.

(ii) *Analysis*. Under paragraph (g) of this section, the amount of eligible taxes paid by X for purposes of computing the amount of CAMT foreign tax credit under paragraph (c)(2) of this section includes $180x of creditable foreign tax expenditures of PRS that are allocated to X for regular tax purposes. Under §1.56A-8(d)(3), the foreign income taxes taken into account in the AFS of PRS are considered taken into account in the AFS of X.

(j) *Applicability date*. This section applies to taxable years of applicable corporations ending after September 13, 2024.

Par. 11. Add an undesignated center heading to read "Base Erosion and Anti-Abuse Tax" above §1.59A-0.

Par. 12. Section 1.1502-2 is amended:

a. In paragraph (a)(8), by removing the word "and" at the end of the paragraph;

b. In paragraph (a)(9), by removing the period from the end of the paragraph and adding "; and" in its place;

c. Adding paragraph (a)(10); and

d. Revising paragraph (d).

The addition and revision read as follows:

§1.1502-2 Computation of tax liability.

(a) * * *

(10) The alternative minimum tax imposed by section 55(a).

* * * * *

(d) *Applicability date*—(1) *In general*. Paragraphs (a)(1) through (9), (b), and (c) of this section apply to taxable years for which the original consolidated Federal income tax return is due (without extension) after December 6, 2019.

(2) *Paragraph (a)(10) of this section*. Paragraph (a)(10) of this section applies to taxable years for which the original consolidated Federal income tax return is due (without extension) after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.1502-3 [Amended]

Par. 13. Section 1.1502-3 is amended by removing and reserving paragraph (d)(4).

Par. 14. Section 1.1502-53 is added to read as follows:

§1.1502-53 Consolidated minimum tax credit.

(a) *Overview*. Subject to section 53 of the Code and paragraph (b) of this section, a group's consolidated minimum tax credit is allowed under this section against the group's consolidated liability for tax with respect to consolidated return years after the group's first consolidated return year beginning after 2022. Paragraph (c) of this section provides rules regarding separate return year minimum tax credits arising in separate return limitation years after the first separate return limitation year beginning after 2022. Paragraph (d) of this section provides rules regarding the allocation of the consolidated MTC to a corporation that ceases to be a member (and thus may be carried to the member's separate return years). Paragraph (e) of this section provides the date of applicability.

(b) *Consolidated MTC*—(1) *Definitions*. The definitions in §1.1502-56A(b) apply for purposes of this section, with the following additions:

(i) *Consolidated MTC*. The term *consolidated MTC* means the MTC that is attributable to a tax consolidated group's CAMT liability under section 55 of the Code.

(ii) *MTC*. The term *MTC* means the minimum tax credit, within the meaning of section 53(b) of the Code (as modified by section 53(e)).

(2) *Consolidated MTC earned in taxable year*. For any consolidated return year beginning after 2022, the consolidated MTC earned in the taxable year is the tax imposed on the tax consolidated group by section 55(a) for the taxable year.

(3) *MTC allowed for a taxable year*. Subject to the limitations in paragraphs (b)(5) and (c) of this section, the credit allowed to the tax consolidated group for a taxable year equals the sum of the consolidated MTCs of the group and the separate year MTCs of members of the group for earlier taxable years to the extent they have not been absorbed in earlier years. *See* paragraph (b)(4) of this section.

(4) *Absorption of MTCs*. For purposes of determining the amount, if any, of an unused credit (whether consolidated or separate) that can be allowed in a taxable year (consolidated or separate), the amount of such unused credit that is absorbed in a prior consolidated return year is determined by:

(i) Applying all unused credits that can be carried to such prior year in the order of the taxable years in which such unused credits arose, beginning with the taxable year which ends earliest; and

(ii) Applying all such unused credits that can be carried to such prior year from taxable years ending on the same date on a pro rata basis.

(5) *Limitation*. Under section 53(c), the MTC allowed for any consolidated return year cannot exceed the excess (if any) of—

(i) The group's consolidated regular tax liability for such consolidated return year reduced by the sum of the credits allowable under subparts B, D, E, and F of part IV of subchapter A of chapter 1 of the Code, increased by the amount of tax imposed under section 59A of the Code for the consolidated return year; over

(ii) The group's consolidated tentative minimum tax for the consolidated return year.

(c) *Separate return year MTC*—(1) *Limitation on portion of separate return year MTC arising in separate return limitation years*. The aggregate of a member's minimum tax credits arising in SRLYs that are included in the consolidated MTCs allowed for all consolidated return years of the group may not exceed—

(i) The aggregate for all consolidated return years of the member's contributions to the consolidated section 53(c) limitation for each consolidated return year (determined under paragraph (c)(2) of this section); reduced by

(ii) The aggregate of consolidated MTCs attributable to the member (determined in the manner provided in §1.1502-56A(j)) that are absorbed in all consolidated return years (whether or not absorbed by the member).

(2) *Member's contribution to the consolidated section 53(c) limitation*—(i) *Year in which CAMT is not incurred*. For a year in which consolidated regular tax liability is greater than consolidated tentative minimum tax, a member's contribution to the consolidated section 53(c) limitation for a consolidated return year equals the member's share of the consolidated regular tax liability minus its share of consolidated tentative minimum tax. The group computes the member's share of consolidated regular tax liability by applying to the respective consolidated amounts the principles of section 1552 and the percentage method under §1.1502-33(d)(3), assuming a 100 percent allocation of any decreased tax liability. The group computes the member's share of consolidated tentative minimum tax by multiplying the consolidated tentative minimum tax by a fraction. The denominator of the fraction is the group's AFSI, and the numerator of the fraction is the member's positive separate AFSI as defined in §1.1502-56A(j)(2).

(ii) *Year in which CAMT is incurred*. For a consolidated return year for which consolidated tentative minimum tax is greater than consolidated regular tax liability, the group reduces the member's aggregate contribution to the consolidated section 53(c) limitation by the member's share of the consolidated CAMT for the year as determined under §1.1502-56A(j).

(iii) *Years included in computation*. For purposes of computing the member's contribution under this paragraph (c)(2), the consolidated return years of the group include only those years, including the year to which a credit is carried, that the member has been continuously included in the group's consolidated return, but exclude any years after the year to which the credit is carried.

(iv) *Subgroup principles*. The SRLY subgroup principles under §1.1502-21(c)(2) apply for purposes of this paragraph (c)(2). The predecessor and successor principles under §1.1502-21(f) also apply for purposes of this paragraph (c)(2).

(v) *Overlap with section 383*. The principles under §1.1502-21(g) apply for purposes of this paragraph (c)(2). For example, an overlap of this paragraph (c)(2) and the application of section 383 of the Code with respect to a credit carryover occurs if a corporation becomes a member of a consolidated group (that is, the SRLY event) within six months of the change date of an ownership change giving rise to a section 383 credit limitation with respect to that carryover (that is, the section 383 event), with the result that the limitation of this paragraph (c)(2) does not apply. *See* §§1.1502-21(g)(2)(ii)(A) and 1.383-1; *see also* §1.1502-21(g)(4) (subgroup rules).

(d) *Carryovers of tax consolidated MTC to separate return years*—(1) *In general.* If any consolidated MTC that is attributable to a member may be carried to a separate return year of the member, the amount attributable to the member is apportioned to the member and carried to the separate return year. If carried over to a separate return year, the apportioned MTC may not be carried over to an equivalent, or later, consolidated return year of the group. The amount attributable to the member is determined in the manner provided in §1.1502-56A(j) (with regard to allocation of CAMT liability).

(2) *Recomputed percentage*. If, for any reason, a member's portion of a consolidated MTC is absorbed or reduced on a non-pro rata basis, the percentage of the consolidated MTC attributable to each member is recomputed as provided in paragraph (d)(3) of this section. In addition, if a member with a separate MTC ceases to be a member, or if a member that ceases to be a member is allocated and apportioned MTC of the group under this paragraph (d)(2), the percentage of the consolidated MTC attributable to each remaining member is recomputed. For purposes of this paragraph (d)(2), an MTC that is permanently disallowed, eliminated, or reduced under section 108(b) of the Code or §1.1502-28 is treated as absorbed.

(3) *Recomputation*. The recomputed percentage of the consolidated MTC attributable to each member equals the remaining MTC attributable to the member at the time of the recomputation, divided by the sum of the remaining MTC attributable to all of the remaining members at the time of the recomputation.

(4) *Example*. The following example illustrates the application of the rules in this paragraph (d).

(i) *Facts*. P, S, and T are members of the P tax consolidated group (P Group), which uses the calendar year as its taxable year. P, S, and T report their financial results on a tax consolidated group AFS. For 2024, if AFSI were computed by reference to only each member's items of income, expense, gain, and loss, P would have separate AFSI of $1,000x, S would have a separate FSNOL of $100x, and T would have separate AFSI of $200x. The P Group has no regular tax liability, no liability for tax on base erosion payments under section 59A of the Code, and no CAMT foreign tax credit for 2024. Thus, the P Group's AFSI for 2024 is $1,100x, and the P Group's liability for the tentative minimum tax under section 55(b)(2)(A) is $165x ($1,100x x 15% = $165x). On December 31, 2024, T is acquired by an unrelated party and ceases to be a member of the P Group.

(ii) *Analysis*. Of the P Group's tax consolidated MTC of $165x, as determined under section 53(b), $27.5x is apportioned to T (($200x / ($200x + $1,000x)) x $165x) = $27.5x), and $137.5x remains to offset the P Group's regular income tax liability.

(e) *Applicability date.* This section applies to consolidated return years for which the due date of the income tax return (without extensions) is after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

§1.1502-55 [Removed and Reserved]

Par. 15. Remove and reserve §1.1502-55.

Par. 16. Section 1.1502-56A is added to read as follows.

§1.1502-56A Corporate alternative minimum tax.

(a) *Overview*—(1) *Scope*. This section provides rules for applying the corporate alternative minimum tax (CAMT) under sections 55, 56A, and 59(k) and (l) of the Internal Revenue Code (Code) to tax consolidated groups. Paragraph (b) of this section provides definitions that apply for purposes of this section. Paragraph (c) of this section provides rules for calculating the FSI of a tax consolidated group. Paragraph (d) of this section provides rules regarding the disposition of stock of a tax consolidated group member by another member. Paragraph (e) of this section provides rules regarding tax items relating to intercompany transactions (as defined in §1.1502-13(b)(1)(i)). Paragraph (f) of this section provides rules regarding the use of financial statement net operating loss (FSNOL) carryovers. Paragraph (g) of this section provides a cross-reference to §1.56A-23 for rules regarding the use of attributes from separate return years. Paragraph (h) of this section provides rules regarding the use of CFC adjustment carryovers. Paragraph (i) of this section provides rules regarding the use of consolidated unused CFC taxes. Paragraph (j) of this section provides rules regarding the allocation of the tentative minimum tax under section 55(b)(2)(A). Paragraph (k) of this section provides rules regarding the allocation of adjusted financial statement income (AFSI) when a corporation ceases to be a member of a tax consolidated group. Paragraph (l) of this section provides the applicability date of this section.

(2) *General rule*. Except as otherwise provided in this section, for purposes of determining the AFSI of the tax consolidated group, the tentative minimum tax under section 55(b)(2)(A), and status as an applicable corporation under section 59(k), members of a tax consolidated group are treated as a single CAMT entity solely during the period in which those members are members of that tax consolidated group.

(b) *Definitions*. The following definitions apply for purposes of this section:

(1) *AFS*. The term *AFS* has the meaning given the term *applicable financial statement* (AFS) in §1.56A-2(b). For special rules regarding the AFS of a tax consolidated group, *see* §§1.56A-1(c)(2)(i) and 1.56A-2(g).

(2) *AFSI*. The term *AFSI* has the meaning given the term *adjusted statement financial income* (AFSI) in §1.56A-1(b)(1).

(3) *CAMT entity*. The term *CAMT entity* has the meaning given the term in §1.56A-1(b)(8).

(4) *CFC adjustment carryover*. The term *CFC adjustment carryover* has the meaning given the term in §1.56A-6(b).

(5) *Chapter 1; Code*—(i) *Chapter 1*. The term *chapter 1* means chapter 1 of subtitle A of the Code.

(ii) *Code*. The term *Code* means the Internal Revenue Code.

(6) *Consolidated FSNOL*. The term *consolidated FSNOL* means the portion of an FSNOL that is attributable to a tax consolidated group, as determined under paragraph (f) of this section.

(7) *FSI*. The term *FSI* has the meaning given the term *financial statement income* (FSI) in §1.56A-1(b)(20).

(8) *FSNOL*. The term *FSNOL* has the meaning given the term *financial state-*

ment net operating loss (FSNOL) in §1.56A-23(b).

(9) *Section 56A regulations*. The term *section 56A regulations* means §§1.56A-1 through 1.56A-27 and this section.

(10) *Tax consolidated group*. The term *tax consolidated group* has the meaning given the term *consolidated group* in §1.1502-1(h).

(11) *Tax consolidated group AFS*. The term *tax consolidated group AFS* means the AFS of a tax consolidated group and all its members, as determined under §§1.56A-1(c)(2)(i) and 1.56A-2(g). A tax consolidated group AFS may include one or more CAMT entities that are not members of the tax consolidated group.

(c) *Calculation of FSI of a tax consolidated group*. A tax consolidated group determines the group's FSI for a taxable year based on the tax consolidated group AFS in the following manner:

(1) *AFS comprising solely tax consolidated group members*. If the financial statement group (including tax consolidated group members described in §1.56A-1(c)(2)(i)) for which the tax consolidated group AFS for a taxable year is prepared includes only members of the tax consolidated group, the FSI of the tax consolidated group for the taxable year equals the consolidated FSI reflected on that AFS. *See* §1.56A-1(c).

(2) *AFS comprising members and non-members*. If the financial statement group (including tax consolidated group members described in §1.56A-1(c)(2)(i)) for which the tax consolidated group AFS for a taxable year is prepared includes one or more CAMT entities that are not members of the tax consolidated group, the tax consolidated group's FSI for the taxable year is determined from that AFS under §1.56A-1(c)(3) by treating all members of the tax consolidated group as a single CAMT entity. Accordingly, for example, the FSI of the tax consolidated group is determined by:

(i) Disregarding each AFS consolidation entry regarding—

(A) A transaction between a member and a non-member;

(B) A member's investment in a non-member; and

(C) A non-member's investment in a member.

(ii) Taking into account each AFS consolidation entry regarding—

(A) A transaction between members; and

(B) A member's investment in another member.

(3) *Operating rules regarding AFS consolidation entries*. For purposes of determining the AFSI of a tax consolidated group for a taxable year:

(i) *Conditions for taking into account AFS consolidation entries*. The tax consolidated group takes into account each AFS consolidation entry that eliminates the effect of a transaction between or among members of the group, provided that—

(A) Each member that was a party to the transaction, that continued to exist after the transaction, and that had effects from that transaction (or the member's successor in a section 381(a) transaction) continues to be a member of that tax consolidated group at the end of the group's taxable year; and

(B) All property that is the subject of the transaction continues to be held by the tax consolidated group at the end of the group's taxable year.

(ii) *Conditions for disregarding AFS consolidation entries and applying section 56A regulations*. Except as provided in paragraph (c)(3)(ii)(C) of this section, to the extent that any requirement in paragraph (c)(3)(i) of this section is not satisfied at any time during the taxable year of the tax consolidated group, then on the earliest date on which that requirement is not satisfied certain AFS consolidation entries described in paragraph (c)(2)(i) of this section cease to be taken into account as provided in paragraphs (c)(3)(ii)(A) through (D) of this section, immediately before the earliest date that any requirement of paragraph (c)(3)(i) of this section is not satisfied.

(A) *Property ceases to be held by group*. If one or more pieces of property that were the subject of the transaction cease to be held by the tax consolidated group during the group's taxable year, any AFS consolidation entry described in paragraph (c)(2)(i) of this section that pertains to that property ceases to be taken into account immediately before that earliest date.

(B) *Party to the transaction ceases to be a member of group*. If a party to the transaction (or a successor to that member in a section 381(a) transaction) ceases to be a member of the tax consolidated group during the group's taxable year, then all AFS consolidation entries with regard to that party cease to be taken into account immediately before that earliest date.

(C) *Whole-group exception*. Paragraphs (c)(3)(ii)(A) and (B) of this section do not apply to the extent that §1.1502-13(j)(5) applies to an acquisition of the tax consolidated group. Therefore, AFS consolidation entries continue to be taken into account.

(D) *Determination of CAMT consequences based on section 56A regulations*. If an AFS consolidation entry of a tax consolidated group ceases to be taken into account under paragraph (c)(3)(ii)(A) through (C) of this section, the CAMT consequences of the transaction(s) to which to that AFS consolidation entry pertains are determined by applying the section 56A regulations. *See generally* §1.56A-1.

(iii) *Example*. The rules of this paragraph (c)(3) are illustrated by the following example.

(A) *Facts.* P is the common parent of a tax consolidated group that uses the calendar year as its taxable year, of which S1, S2, and S3 are members (P group). S2 owns all of the stock of S3. On February 1, 2023, S3 merges into S1 in a transaction that qualifies as a reorganization under section 368(a)(1)(A) of the Code (Merger). In the Merger, S2 receives both S1 voting stock and cash. On December 31, 2024, P sells S1 to X, a corporation unrelated to P or any member of P's tax consolidated group.

(B) *Analysis*. The Merger is a covered nonrecognition transaction. At the end of the P group's 2023 taxable year, S1 remains a member of the group, and no property transferred in the Merger has left the P group. As a result, under paragraph (c)(3)(i) of this section, any AFS consolidating entries related to the Merger continue to be given effect and the section 56A regulations do not apply to the Merger. At the end of the P group's 2024 taxable year, S1 is no longer a member of the P group. As a result, under paragraph (c)(3)(ii)(B) of this section, all AFS consolidating entries relating to the Merger cease to be taken into account immediately before S1 ceases to be a member of the P

group, and, under paragraph (c)(3)(ii)(D) of this section, the CAMT consequences of the Merger are determined under the section 56A regulations. *See generally* §1.56A-19(c) (providing the CAMT consequences of acquisitive reorganizations).

(4) *Captive partnership*. Treating a tax consolidated group as a single CAMT entity for purposes of this section does not change the Federal tax classification of an entity classified as a partnership owned solely by members of the group.

(5) *Examples*. The following examples illustrate the application of the rules in this paragraph (c). For purposes of these examples: each of P, S, B, and Z is a domestic corporation that uses the calendar year as its taxable year and has only one class of stock outstanding, and S and B are the sole subsidiary members of the P tax consolidated group (P Group).

(i) *Example 1: Tax consolidated group AFS that includes corporations other than tax consolidated group members*—(A) *Facts*. P owns 60 percent of the stock of Z. The remaining stock of Z is held by unrelated persons. The financial results of corporations P, B, S, and Z are reported on a tax consolidated group AFS (PBSZ Consolidated AFS) for all relevant financial reporting periods. P, B, S, and Z are the only taxpayers whose financial results are reported on the PBSZ Consolidated AFS. Under §1.56A-2(g), the PBSZ Consolidated AFS is the AFS of P, B, S, and Z. In 2024, B sells Asset N to S for $10x. Books and records used to prepare the PBSZ Consolidated AFS, including trial balances, show that B has gain of $2x ($10x - $8x) on the sale of Asset N. The $2x of gain is eliminated from consolidated FSI through AFS consolidation entries made in preparing the PBSZ Consolidated AFS. In 2025, S sells Asset N to Z for $13x. Books and records used to prepare the PBSZ Consolidated AFS, including trial balances, show that S has gain of $3x ($13x - $10x) on the sale of Asset N. The gain is eliminated from consolidated FSI through AFS consolidation entries made in preparing the PBSZ Consolidated AFS.

(B) *Analysis: In general*. The PBSZ Consolidated AFS includes items of Z, an entity that is not a member of the P Group. Therefore, the FSI of the P Group is determined under paragraph (c)(2) of this section. Under paragraph (c)(2) of this section, the P Group's FSI is determined from the PBSZ Consolidated AFS by treating the P Group as a single CAMT entity. Accordingly, AFS consolidation entries eliminating transactions between Z and a member of the P Group (that is, P, S, or B) are disregarded in determining the FSI of the P Group, (that is, such consolidation entries are reversed) but AFS consolidation entries eliminating transactions between P, S, and B are taken into account.

(C) *Analysis: 2024*. In 2024, because the AFS consolidation entries eliminate a transaction between S and B (that is, a transaction between members of the P Group), those consolidation entries are taken into account. *See* paragraph (c)(2)(ii)(A) of this section. Therefore, B's $2x gain on the sale of Asset N to S is not included in the P Group's FSI in 2024.

(D) *Analysis: 2025*. In 2025, because the AFS consolidation entries eliminate a transaction between S (a member of the P Group) and Z (a CAMT entity that is not a member of the P Group), these AFS consolidation entries are disregarded (that is, these consolidation entries are reversed). In addition, because Asset N leaves the P Group in 2025, immediately before the sale of Asset N to Z, the consolidating entries between S and B are disregarded with regard to their transaction with regard to Asset N. *See* paragraph (c)(3) of this section. Therefore, the P Group's FSI in 2025 includes $5x of gain on the sale of Asset N—$2x of gain to B, and $3x of gain to S.

(ii) *Example 2: Tax consolidated group AFS that includes solely tax consolidated group members; buying member leaves the group*—(A) *Facts*. The financial results of the members of the P Group are reported on the tax consolidated group AFS of the P Group (P Group AFS) for all relevant financial reporting periods. P, S, and B are the only entities whose financial results are reported on the P Group AFS. Under §1.56A-2(g), the P Group AFS is the AFS of P, S, and B. Z is unrelated to the P Group. In 2024, S sells Asset N to B for $10x. Books and records used to prepare the P Group AFS, including trial balances, show that S has gain of $2x on the sale of Asset N. The gain is eliminated from consolidated FSI through AFS consolidation entries made in preparing the P Group AFS. In 2025, P sells all the stock of B to Z, and B joins the Z consolidated AFS. At the time of the sale of its stock, B continues to hold Asset N, which has a value of $13x.

(B) *Analysis: In general*. The P Group AFS includes items solely of members of the P Group. Therefore, the FSI of the P Group is determined under paragraph (c)(1) of this section to be the FSI reflected on the group's AFS for the taxable year. Under paragraph (a)(2) of this section, P, S, and B are treated as a single CAMT entity for purposes of computing the P Group's AFSI and liability for the tentative minimum tax under section 55(b)(2)(A).

(C) *Analysis: 2024*. In 2024, because the AFS consolidation entries eliminate a transaction between S and B (that is, a transaction between members of the P Group), those consolidation entries are taken into account. Therefore, S's $2x of gain on the sale of Asset N is not included in the P Group's FSI in 2024.

(D) *Analysis: 2025*. In 2025, upon P's sale of all of the B stock to Z, B ceases to be a member of the P Group, and B's FSI ceases to be reflected in the P Group AFS. Because B ceases to be a member of the P Group, the AFS consolidation entries eliminating the sale of Asset N from S to B are disregarded (that is, these consolidation entries are reversed). *See* paragraph (c)(3) of this section. As a result, immediately before the sale of the B stock, S takes into account its $2x of gain on its sale of Asset N to B. B carries Asset N into the Z consolidated AFS with a basis of $10x, reflecting the reversal of the consolidating entries on the sale of Asset N. Compare §1.56A-18(c)(3) (disregarding purchase accounting and push down accounting adjustments to AFS basis in assets resulting from stock acquisitions).

(iii) *Example 3: Tax consolidated group AFS that includes solely tax consolidated group members; selling member leaves the group*. The facts are the same as in paragraph (c)(5)(ii)(A) of this section (*Example 2*), except that, in 2025, P sells all the stock of S (rather than B) to Z. Consistent with the results described in paragraph (c)(5)(ii)(D) of this section, immediately before S leaves the P group, the consolidating entries relating to the sale of Asset N from S to B are disregarded (that is, the consolidating entries are reversed). Therefore, S's $2x of gain is taken into account in determining the FSI of the P Group for 2025. B's CAMT basis in Asset N equals $10x.

(d) *Gain or loss on disposition of member stock by another member*—(1) *In general*. Notwithstanding paragraph (a)(2) of this section, the AFSI of a tax consolidated group for a taxable year includes gain or loss from one member's sale or exchange of stock of another member, as determined under this paragraph (d). For rules regarding the timing of the inclusion of the gain or loss, *see* paragraph (c) of this section.

(2) *Computation of gain or loss*. A tax consolidated group computes AFSI resulting from the sale or exchange of stock of one member by another member by—

(i) Applying the rules that otherwise apply to the sale or exchange under the section 56A regulations; and

(ii) Using the CAMT basis (as determined under paragraph (d)(3) of this section).

(3) *CAMT basis of member stock*—(i) *Stock held by group members on the first day of the first taxable year beginning after December 31, 2019*. The CAMT basis in a share of stock of a subsidiary member held by another member of a tax consolidated group (shareholder member) equals the sum of:

(A) The regular tax basis of the subsidiary member stock in the hands of the shareholder member on the first day of the shareholder member's first taxable year beginning after December 31, 2019 (*see* §1.56A-18(c)(6));

(B) Any adjustments described in §1.56A-18(c)(2); and

(C) Any adjustments described in paragraph (d)(3)(iii) of this section.

(ii) *Stock acquired by group members after the first day of the first taxable year beginning after December 31, 2019*. The CAMT basis in a share of stock of a subsidiary member acquired by a shareholder member from a taxpayer that is not a member of the same tax consolidated group equals the sum of:

(A) The CAMT basis of the subsidiary member stock immediately after the acquisition of that stock;

(B) Any adjustments described in §1.56A-18(c)(2); and

(C) Any adjustments described in paragraph (d)(3)(iii) of this section.

(iii) *Adjustment to basis during consolidation*—(A) *In general*. CAMT stock basis is adjusted under this paragraph (d)(3)(iii) to take into account adjustments to the AFS basis of the member stock for the period during which the member was a member of a tax consolidated group (incorporating adjustments to reflect all other adjustments to FSI in determining AFSI under the section 56A regulations).

(B) *Negative basis adjustments*. For purposes of this paragraph (d)(3)(iii), the CAMT basis of stock includes negative adjustments for expenses or losses of a member only to the extent that those items are absorbed by a member of the tax consolidated group under the section 56A regulations.

(e) *Tax items relating to intercompany transactions*—(1) *In general*. Certain AFSI adjustments under the section 56A regulations disregard items reflected in a CAMT entity's FSI and replace those items with items that are taken into account for regular tax purposes (regular tax items) (for example, under §§1.56A-15 and 1.56A-16). This paragraph (e) applies if the regular tax item relates to an intercompany transaction, in order to ensure that the regular tax item reflects the treatment of members of a tax consolidated group as divisions of a single corporation (single entity treatment) within the meaning of §1.1502-13(a)(2). *See also* paragraph (a)(2) of this section.

(2) *Disregarding impact of intercompany transaction*. Except as provided in paragraph (e)(3) of this section, any increase or decrease in the amount of a regular tax item described in paragraph (e)(1) of this section that results from an intercompany transaction is disregarded for purposes of inclusion of the item in AFSI.

(3) *Acceleration of impact of intercompany transaction*. This paragraph (e)(3) applies if, pursuant to paragraph (c)(3)(ii) of this section, AFS consolidation entries related to an item described in paragraph (e)(1) of this section become disregarded. Under this paragraph (e)(3), immediately before the AFS consolidation entries become disregarded, AFSI of the tax consolidated group is increased or decreased by the regular tax items that previously were disregarded under paragraph (e)(2) of this section.

(4) *Examples*. The following examples illustrate the application of the rules in this paragraph (e). For purposes of these examples, S and B are members of the P consolidated group (P Group), which uses the calendar year as its taxable year.

(i) *Example 1: Intercompany sale*—(A) *Facts*. On January 1, 2024, S buys section 168 property (as defined in §1.56A-15(b)(6)) for $100x (Asset A) and depreciates it using the straight-line method and a 10-year recovery period for regular tax purposes. For AFS purposes, S depreciates Asset A over 20 years using the straight-line method. On January 1, 2026, S sells Asset A to B for $130x and S recognizes a $40x net gain for AFS purposes ($130x consideration - $90x AFS basis ($100x cost - $10x accumulated book depreciation)). However, the P Group's AFS includes AFS consolidating entries that eliminate the effect of the sale of Asset A to B. For regular tax purposes, under section 168(i)(7) of the Code, B is treated as S to the extent B's $130x basis does not exceed S's adjusted basis at the time of the sale. Accordingly, B takes a $80x carryover basis (S's $100x cost - S's $20x accumulated tax depreciation) in Asset A and continues to depreciate the $80x basis using S's depreciation methods. B has additional basis of $50x in Asset A ($130x consideration - $80x section 168(i)(7) basis) which B treats as new 10-year recovery section 168 property and depreciates using the straight-line method. (To simplify the example, the half-year convention is disregarded by both S and B for AFS and regular tax purposes, and any depreciation on Asset A is not subject to capitalization under any other Code provision.)

(B) *Analysis*. Under §1.56A-15(d)(1)(iii), covered book depreciation expense (as defined in §1.56A-15(b)(3)) taken into account in FSI by S or B with respect to Asset A is disregarded in computing AFSI and replaced with deductible tax depreciation (as defined in §1.56A-15(b)(5)). In each of 2024 and 2025, the P Group's AFSI therefore reflects S's $10x of deductible tax depreciation from Asset A ($100x cost / 10 years). In 2026, for regular tax purposes, B takes into account $15x of deductible tax depreciation from Asset A ($10x under section 168(i)(7) + $5x (($130x - $80x) / 10 years) relating to B's additional depreciable basis in Asset A). However, pursuant to paragraph (e)(2) of this section, the P Group's AFSI disregards the $5x increase resulting from the intercompany transaction between S and B. Thus, the P Group's AFSI in 2026 reflects only $10x of deductible tax depreciation from Asset A. Pursuant to paragraph (c)(2)(i) of this section, the P Group's AFSI for 2026 takes into account the AFS consolidation entries that eliminate the effect of the sale of Asset A to B and, pursuant to §1.56A-15(e)(7), the P Group does not adjust AFSI for 2026 for S's AFSI adjustment determined under §1.56A-15(e)(1) of $10x (S's redetermined gain or loss from the sale of Asset A on January 1, 2026 of $50x ($130x consideration - $80x CAMT basis ($90x AFS basis + $10x covered book depreciation expense - $20x deductible tax depreciation) minus the $40x net gain included in S's FSI prior to elimination)). Accordingly, the P Group's AFSI in 2026 does not reflect any gain from the intercompany sale.

(ii) *Example 2: Sale of property to a non-member*—(A) *Facts*. The facts are the same as in paragraph (e)(4)(i)(A) of this section (*Example 1*), except that, on January 1, 2028, B sells Asset A to non-member X for $110x. As of January 1, 2028, B's accumulated book depreciation for Asset A is $13x (computed using a recovery period of 20 years and the straight-line method), and B has an AFS basis in Asset A of $117x ($130x consideration - $13x accumulated book depreciation). B's net loss included in FSI from the sale of Asset A to non-member X is $7x ($110x consideration - $117x AFS basis). For regular tax purposes, as of January 1, 2028, B's accumulated deductible tax depreciation for Asset A is $30x ($20x under section 168(i)(7) + $10x from B's additional depreciable basis in Asset A).

(B) *Analysis*. Under paragraph (c)(3)(ii) of this section, immediately before Asset A leaves the P Group, the AFS consolidating entries relating to the intercompany sale of Asset A on January 1, 2026, become disregarded for purposes of computing the P Group's AFSI for 2028. Therefore, S takes into account its $40x net gain in FSI for 2028 and B takes into account its increased $40x of basis in Asset A for AFS purposes from that intercompany sale immediately before Asset A leaves the P Group. Due to the $40x net gain being included in FSI for 2028, pursuant to §1.56A-15(e)(7), S redetermines its gain taken into account in FSI for 2028, and the P Group adjusts AFSI for 2028 for the difference between the net gain included in FSI and the redetermined gain or loss (computed as of January 1, 2026) under §1.56A-15(e). Accordingly, the P Group's AFSI adjustment under §1.56A-15(e) for 2028 is a positive adjustment of $10x, which equals S's $50x redetermined gain ($130x consideration - $80x CAMT basis ($90x AFS basis + $10x covered book depreciation expense - $20x deductible tax depreciation)) minus the $40x net gain in FSI. Additionally, under paragraph (e)(3) of this section, immediately before Asset A leaves the P Group, B takes into account in AFSI for 2028 the $10x of deductible tax depreciation that was disregarded in 2026 and 2027 under paragraph (e)(2) of this section ($5x + $5x). Under §1.56A-15(e)(1) and (7), the P Group also adjusts AFSI for 2028 by a positive adjustment of $17x, which equals B's redetermined gain of $10x ($110x consideration - $100x CAMT basis ($117x AFS basis + $13x accumulated covered book depreciation expense – $30x deductible tax depreciation)) minus the $7x net loss in FSI.

(iii) *Example 3: Buying member leaves the group*—(A) *Facts*. The facts are the same as in paragraph (e)(4)(ii)(A) of this section (*Example 2*), except that, instead of selling Asset A, on January 1, 2028, all the stock of B is sold to non-member X, causing B to leave the P Group.

(B) *Analysis.* Under paragraph (c)(3)(ii) of this section, immediately before B leaves the P Group, the AFS consolidating entries relating to the intercompany sale of Asset A become disregarded for purposes of computing the P Group's AFSI. Therefore, S takes into account its $40x net gain attributable to the sale of Asset A on January 1, 2026 in

FSI for 2028 and B takes into account its increased $40x of basis in Asset A for AFS purposes from that intercompany sale immediately before B leaves the P Group. Due to the $40x net gain included in FSI for 2028, pursuant to §1.56A-15(e)(7), S redetermines its gain taken into account in FSI with respect to Asset A, and the P Group adjusts AFSI for the difference between the net gain in FSI and the redetermined gain or loss (computed as of January 1, 2026) under §1.56A-15(e). Accordingly, the P Group's AFSI adjustment under §1.56A-15(e) for 2028 is a positive adjustment of $10x, which equals S's $50x redetermined gain ($130x consideration - $80x CAMT basis ($90x AFS basis + $10x covered book depreciation expense - $20x deductible tax depreciation)) minus the $40x net gain in FSI. Additionally, under paragraph (e)(3) of this section, immediately before B leaves the P Group, B takes into account in AFSI for 2028 the $10x of deductible tax depreciation that was disregarded in 2026 and 2027 under paragraph (e)(2) of this section ($5x + $5x).

(f) *Use of FSNOL carryovers*—(1) *Amount of consolidated AFSI reduced*. Subject to the limitations under §1.56A-23 and this paragraph (f), the amount of consolidated FSNOL carryovers of a tax consolidated group that can be used to reduce the AFSI of the group for any consolidated return year is the aggregate of the group's consolidated FSNOL carryovers to that year.

(2) *Composition of consolidated FSNOL carryovers*. The consolidated FSNOL carryovers described in paragraph (f)(1) of this section consist of—

(i) Any consolidated FSNOL of the tax consolidated group; and

(ii) Any FSNOLs of the members of the group arising in the respective separate return years (as defined in §1.1502-1(e)) of those members (to the extent available for use under §1.56A-23 and this section).

(3) *Application of 80-percent limitation*—(i) *Group application*. With regard to a consolidated return year of a tax consolidated group, the 80-percent limitation under section 56A(d)(1) applies to the consolidated AFSI of the group for that year.

(ii) *Group limitation*. The amount of FSNOL that a tax consolidated group can use to reduce the AFSI of the group for a consolidated return year equals the lesser of—

(A) The aggregate amount of FSNOLs carried to that consolidated return year; or

(B) The amount determined by multiplying 80 percent by the consolidated AFSI for the group for that year, computed without regard to the FSNOL deduction allowable under section 56A(d).

(4) *General ordering rules for use of FSNOLs*—(i) *Taxable year in which FSNOL arose*. Except as provided in paragraph (f)(4)(ii) of this section, FSNOLs permitted to be used by a tax consolidated group to reduce the AFSI of the group in its consolidated return year are used to reduce the group's AFSI in the order of the taxable years in which the FSNOLs arose.

(ii) *FSNOLs carried from same taxable year*. Except as otherwise provided in paragraph (f)(5) of this section, FSNOLs carried from taxable years ending on the same date, and that are available to reduce the AFSI of the tax consolidated group for the consolidated return year, are used to reduce the group's AFSI on a pro rata basis.

(iii) *Apportionment of consolidated FSNOL*. Except as otherwise provided in paragraph (f)(5) of this section, the amount of any consolidated FSNOL absorbed by a tax consolidated group in any year is apportioned among members based on the percentage of the FSNOL eligible for carryover that is attributable to each member and is available for absorption. The percentage of the consolidated FSNOL attributable to a member is determined pursuant to paragraph (f)(5)(iv) of this section.

(iv) *Certain adjustments to CAMT basis of member stock*. For rules regarding adjustments to the CAMT basis of member stock resulting from the absorption of loss, *see* paragraph (d)(3)(ii) of this section.

(5) *Carryovers of FSNOLs to separate return years*—(i) *In general*. If any consolidated FSNOL that is attributable to a member may be carried to a separate return year of the member, the amount of the FSNOL that is attributable to the member is apportioned to the member and carried to the separate return year. If carried over to a separate return year of the member, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group.

(ii) *Special rules*—(A) *Year of departure from group*. If a corporation ceases to be a member of a group during a consolidated return year of the group, consolidated FSNOL carryovers attributable to the corporation are first carried to the consolidated return year. Only the amount of consolidated FSNOL carryover that is not absorbed by the group in that year may be carried to the corporation's first separate return year.

(B) *Equivalent years*. Taxable years are equivalent if they bear the same numerical relationship to the consolidated return year in which a consolidated FSNOL arises, counting forward or backward from the year in which the FSNOL arose.

(C) *Short years in connection with transactions to which section 381(a) of the Code applies*. If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a consolidated FSNOL may be carried.

(iii) *Amount of FSNOL attributable to a member*. The amount of a consolidated FSNOL of a tax consolidated group that is attributable to a member equals the product obtained by multiplying the consolidated FSNOL and the percentage of the FSNOL attributable to the member.

(iv) *Percentage of FSNOL attributable to a member*—(A) *In general*. Except as provided in paragraph (f)(5)(iv)(C) of this section, the percentage of the consolidated FSNOL for the consolidated return year attributable to a member equals the separate FSNOL of the member for the consolidated return year divided by the sum of the separate FSNOLs for that year of all members having FSNOLs for that year.

(B) *Separate FSNOL*. For purposes of paragraph (f)(5)(iv)(A) of this section, the separate FSNOL of a member is determined by computing the FSNOL by reference to only the member's items of income, expense, gain, and loss, including the member's losses and expenses actually absorbed by the group in the consolidated return year (whether or not absorbed by the member).

(C) *Recomputed percentage*. If, for any reason, a member's portion of a consolidated FSNOL is absorbed or reduced on a non-pro rata basis, the percentage of the consolidated FSNOL attributable to each member is recomputed as provided in paragraph (f)(5)(iv)(D) of this section. In addition, if a member with a

separate FSNOL ceases to be a member, or if a member that ceases to be a member is allocated and apportioned FSNOL of the group under this paragraph (f)(5), the percentage of the consolidated FSNOL attributable to each remaining member is recomputed. For purposes of this paragraph (f)(5)(iv), an FSNOL that is permanently disallowed, eliminated, or reduced under §1.56A-21(c)(5) and (6) is treated as absorbed.

(D) *Recomputation*. The recomputed percentage of the consolidated FSNOL attributable to each member equals the remaining FSNOL attributable to the member at the time of the recomputation divided by the sum of the remaining FSNOL attributable to all of the remaining members at the time of the recomputation.

(6) *Example*. The following example illustrates the application of the rules in this paragraph (f).

(i) *Facts*. P, M1, M2, and M3 are members of the P tax consolidated group (P Group), which uses the calendar year as its taxable year. P, M1, M2, and M3 report their financial results on a tax consolidated group AFS. In 2026, the P Group generates an FSNOL of $55x, computed by the P Group as a single CAMT entity. *See* paragraph (a)(2) of this section. In that year, P has a separate FSNOL of $40x, M1 has separate AFSI of $10x, M2 has a separate FSNOL of $20x, and M3 has a separate FSNOL of $5x. On December 31, 2026, M2 ceases to be a member of the P group, but M2's FSI continues to be reported on P's consolidated AFS.

(ii) *Analysis: Allocation and apportionment of FSNOL*. Under paragraph (f)(5) of this section, a portion of the P Group's $55x FSNOL is apportioned to M2 because M2 ceases to be a member of the P Group. Specifically, $16.9x of FSNOL is apportioned to M2 (($20x / ($20x + $40x + $5x)) x $55x = $16.9x). *See* paragraphs (f)(5)(iii) and (f)(5)(iv)(A) and (B) of this section. The remaining $38.1x of FSNOL remains with the P Group.

(iii) *Analysis: Year of departure from group*. Under paragraph (f)(5)(iv)(C) of this section, the percentages of the remaining FSNOL attributable to P and to M3 are recomputed when M2 ceases to be a member of the P Group. The recomputed percentage attributable to P is 89% ($40x / ($40x + $5x) = 89%), and the recomputed percentage attributable to M3 is 11% ($5x / ($40x + $5x) = 11%). The result would be the same if M2's FSI had ceased to be reported on P's consolidated AFS in 2027.

(g) *Limitation on the use of attributes from separate return years*. For the use of FSNOLs, built-in losses, and other attributes generated in separate return years, *see* §1.56A-23(e) through (g) and paragraphs (h) and (i) of this section.

(h) *Use of CFC adjustment carryovers of a tax consolidated group*—(1) *Amount of consolidated §1.56A-6(b)(1) adjustment reduced*. Subject to the limitations under §1.56A-6 and this paragraph (h), the amount of CFC adjustment carryovers of a tax consolidated group that can be used to reduce the group's adjustment to AFSI under §1.56A-6(b)(1) is the aggregate of the group's consolidated CFC adjustment carryovers to that year.

(2) *Composition of consolidated CFC adjustment carryovers*. The consolidated CFC adjustment carryovers described in paragraph (h)(1) of this section consist of—

(i) Any consolidated CFC adjustment carryovers of the tax consolidated group; and

(ii) Any CFC adjustment carryovers of the members of the group arising in the respective separate return years (as defined in §1.1502-1(e)) of those members to the extent available for use under §1.56A-6 and this section.

(3) *Limitation on use of CFC adjustment carryovers*. In any consolidated return year, the aggregate amount of CFC adjustment carryovers from all separate return years of a member of a tax consolidated group that can be used to reduce the group's adjustment to AFSI under §1.56A-6(b)(1) cannot exceed the adjustment to AFSI under §1.56A-6(b)(1) generated by the member.

(4) *General ordering rules for use of CFC adjustment carryovers*—(i) *Taxable year in which CFC adjustment carryover arose*. Except as provided in paragraph (h)(4)(ii) of this section, CFC adjustment carryovers permitted to be used by a tax consolidated group to reduce the group's adjustment to AFSI under §1.56A-6(b)(1) in its consolidated return year are used in the order of the taxable years in which the CFC adjustment carryovers arose.

(ii) *CFC adjustment carryovers carried from same taxable year*. Except as otherwise provided in paragraph (h)(5) of this section, CFC adjustment carryovers carried from taxable years ending on the same date, and that are available to reduce the tax consolidated group's adjustment to AFSI under §1.56A-6(b)(1) for the consolidated return year, are used to reduce the group's adjustment to AFSI under §1.56A-6(b)(1) on a pro rata basis.

(iii) *Apportionment of consolidated CFC adjustment carryovers*. Except as otherwise provided in paragraph (h)(5) of this section, the amount of any consolidated CFC adjustment carryover absorbed by a tax consolidated group in any year is apportioned among members based on the percentage of the consolidated CFC adjustment carryover that is attributable to each member as of the beginning of the year. The percentage of the consolidated CFC adjustment carryover attributable to a member is determined applying the principles of paragraph (f)(5)(iv) of this section.

(5) *Carryover of CFC adjustment carryovers to separate return* years. If any consolidated CFC adjustment carryover that is attributable to a member may be carried to a separate return year of the member, the amount of the CFC adjustment carryover that is attributable to the member is apportioned to the member and carried to the separate return year of the member, and the amount of the CFC adjustment carryover attributable to each remaining member is recomputed applying the principles of paragraph (f)(5) of this section.

(6) *Example*. The following example illustrates the application of the rules in this paragraph (h).

(i) *Facts*—(A) *General*. P, M1, M2 and M3 are members of the P consolidated group (P group), which uses the calendar year as its taxable year. Each of P, M1, M2 and M3 is a United States shareholder of controlled foreign corporations. Prior to 2025, the P group had not generated a CFC adjustment carryover for any taxable year.

(B) *2025 taxable year*. In 2025, the P group generates a CFC adjustment carryover of $60x, computed by the P group as a single corporation. In that year, P's pro rata share of the adjusted net income

or loss of the controlled foreign corporations of which it was a United States shareholder is -$10x, M1's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$20x, M2's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$10x, and M3's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$20x.

(C) *2026 taxable year*. In 2026, the P group generates a CFC adjustment carryover of $40x, computed by the P group as a single corporation. In that year, P's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is $10x, M1's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$10x, M2's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$20x, and M3's pro rata share of the adjusted net income or loss of the controlled foreign corporations of which it was a United States shareholder is -$20x. On December 31, 2026, M2 ceases to be a member of the P group.

(ii) *Analysis*—(A) *Allocation and apportionment of 2025 CFC adjustment carryover*. Under the principles of paragraph (f)(5) of this section, a portion of the P group's CFC adjustment carryover from 2025 ($60x) is apportioned to M2 because M2 ceases to be a member of the P group. Specifically, $10x of the CFC adjustment carryover from 2025 is apportioned to M2 (($10x /($10x + $20x + $10x + $20x) x $60x) = $10x). The remaining $50x of the CFC adjustment carryover from 2025 remains with the P group. The percentages of the remaining CFC adjustment carryover from 2025 attributable to P, M1 and M3 are recomputed when M2 ceases to be a member of the P group. The recomputed percentage attributable to P is 20% ($10x / ($10x + $20x + $20x) = 20%), the recomputed percentage attributable to M1 is 40% ($20x / ($10x + $20x + $20x) = 40%), and the recomputed percentage attributable to M3 is 40% ($20x / ($10x + $20x + $20x) = 40%).

(B) *Allocation and apportionment of 2026 CFC adjustment carryover*. Under the principles of paragraph (f)(5) of this section, a portion of the P group's CFC adjustment carryover from 2026 ($40x) is apportioned to M2 because M2 ceases to be a member of the P group. Specifically, $16x of the CFC adjustment carryover from 2026 is apportioned to M2 (($20x /($10x + $20x + $20x) x $40x) = $16x). The remaining $24x of the CFC adjustment carryover from 2026 remains with the P group. The percentages of the remaining CFC adjustment carryover from 2026 attributable to M1 and M3 are recomputed when M2 ceases to be a member of the P group. The recomputed percentage attributable to M1 is 33.3% ($10x / ($10x + $20x) = 33.3%), and the recomputed percentage attributable to M3 is 66.7% ($20x / ($10x + $20x) = 66.7%).

(i) *Use of consolidated unused CFC taxes*—(1) *Determination of consolidated tentative minimum tax*. Subject to the limitations under §1.59-4 and this paragraph (i), the amount of consolidated unused CFC taxes that can be used to determine the consolidated tentative minimum tax under section 55(b)(2)(A) of the group for any consolidated return year is the aggregate of the group's consolidated unused CFC taxes for that year.

(2) *Composition of consolidated unused CFC taxes*. The consolidated unused CFC taxes described in paragraph (i)(1) of this section consist of—

(i) Any unused CFC taxes of the tax consolidated group to the extent available for use under §1.59-4(e); and

(ii) Any unused CFC taxes of members of the group arising in the respective separate return years (as defined in §1.1502-1(e)) of those members (or predecessors of those members within the meaning of §1.1502-1(f)(4)) to the extent available for use under §1.59-4(e).

(3) *Limitation on use of unused CFC taxes*. In any consolidated return year, the aggregate amount of unused CFC taxes from all separate return years of a member (or predecessor of the member within the meaning of §1.1502-1(f)(4)) of a tax consolidated group that can be used cannot exceed the excess (if any) of—

(i) The product of the §1.56A-6(b)(1) adjustment generated by the member and the percentage specified in section 55(b)(2)(A)(i) for the consolidated return year; over

(ii) The aggregate of the member's pro rata shares of taxes of controlled foreign corporations with regard to which it is a United States shareholder, as determined under §1.59-4(d), for the consolidated return year.

(4) *Amount of unused CFC taxes that can be used in a consolidated return year*—(i) *In general*. For purposes of §1.59-4(e), and except as provided in paragraph (i)(4)(ii) of this section, the amount of unused CFC taxes that can be used in any consolidated return year is determined by applying all unused CFC taxes that may be carried to the consolidated return year in the order of the taxable years (whether a consolidated return year or a separate return year) in which those unused CFC taxes arose, beginning with the taxable year that ends earliest.

(ii) *Unused CFC taxes carried from same taxable year*. Except as otherwise provided in paragraph (i)(5) of this section, unused CFC taxes carried from taxable years ending on the same date, and that are available to determine the consolidated tentative minimum tax of the group for the consolidated return year, are used to determine the group's consolidated tentative minimum tax on a pro rata basis.

(5) *Carryover of consolidated unused CFC taxes to separate return years*—(i) *Unused CFC taxes attributable to a departing member*. If a corporation ceases to be a member of a tax consolidated group during a consolidated return year, the consolidated unused CFC taxes that are attributable to the departing member consist of—

(A) All unused CFC taxes of the departing member arising in all separate return years of the departing member that have not been absorbed by the tax consolidated group; and

(B) The portion of the consolidated unused CFC taxes for each consolidated return year of which the departing member was a member of the group that have not been absorbed by the group multiplied by a fraction, the numerator of which is the amount of CFC taxes described in §1.59-4(c)(1)(i) of the member for the year, and

the denominator of which is the amount of CFC taxes described in §1.59-4(c)(1)(i) of the group for the year.

(ii) *Year of departure from group*. If a corporation ceases to be a member of a tax consolidated group during a consolidated return year of the group, consolidated unused CFC taxes attributable to the corporation are first carried to the consolidated return year.

(iii) *Carryover to first separate return year.* The amount of consolidated unused CFC taxes attributable to the corporation that is not absorbed by the group in the year of departure from the group is carried to the corporation's first separate return year and is not carried to any consolidated return year of the group.

(iv) *Short years in connection with transactions to which section 381(a) of the Code applies*. If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a consolidated unused CFC tax may be carried.

(v) *Example*. The following example illustrates the application of the rules in this paragraph (i)(5).

(A) *Facts*. P, S, and T are members of the P tax consolidated group (P Group), which uses the calendar year as its taxable year. P, S, and T report their financial results on a tax consolidated group AFS. For 2024, the P Group has $1000x of CFC taxes described in §1.59-4(c)(1)(i), of which $200x are attributable to T. After determining its consolidated tentative minimum tax under section 55(b)(2)(A) for 2024, P Group has $300x of unused CFC taxes for the year. P Group has no unused CFC taxes for any other taxable year. On December 31, 2024, T is acquired by an unrelated party and ceases to be a member of the P Group.

(B) *Analysis*. Under paragraph (i)(5)(i) of this section, $60x of the P Group's 2024 unused CFC taxes are attributable to T ($300x x ($200x/$1000x)). Under paragraph (i)(5)(iii) of this section, the $60x of unused CFC taxes attributable to T is carried to T's first separate return year and is not carried to any consolidated return year of the P Group.

(j) *CAMT liability*—(1) *Allocation*. Liability for the tentative minimum tax under section 55(b)(2)(A) for a consolidated return year is apportioned among members of the tax consolidated group based on the percentage of AFSI that is attributable to each member for the year, as determined under paragraph (j)(2) of this section.

(2) *Percentage of AFSI attributable to a member*. The percentage of AFSI for the consolidated return year attributable to a member equals the separate positive AFSI of the member for the consolidated return year divided by the sum of the AFSI for that year of all members having separate positive AFSI for that year. For this purpose, the separate AFSI of a member is determined by computing AFSI by reference to only the member's items of income, expense, gain, and loss.

(3) *Example*. The following example illustrates the application of the rules in paragraphs (j)(1) and (2) of this section.

(i) *Facts*. P, S, and T are members of the P tax consolidated group (P Group), which uses the calendar year as its taxable year. P, S, and T report their financial results on a tax consolidated group AFS. For 2024, if AFSI were computed by reference to only each member's items of income, expense, gain, and loss, P would have separate AFSI of $1,000x, S would have a separate FSNOL of $100x, and T would have separate AFSI of $200x. The P Group has no regular tax liability, no liability for tax on base erosion payments under section 59A of the Code, and no CAMT foreign tax credit for 2024. Thus, the P Group's AFSI for 2024 is $1,100x, and the P Group's liability for the tentative minimum tax under section 55(b)(2)(A) is $165x ($1,100x x 15% = $165x).

(ii) *Analysis*. Under paragraphs (j)(1) and (2) of this section, $137.5x of the P Group's 2024 liability for the tentative minimum tax under section 55(b)(2)(A) is apportioned to P (($1,000x / ($1,000x + $200x)) x $165x = $137.5x), and $27.5x is apportioned to T (($200x /($200x + $1,000x)) x $165x = $27.5x).

(4) *Cross-reference. See* §1.1502-53 for rules regarding the allocation of any consolidated MTC attributable to a separate return year of a member.

(k) *Allocation of AFSI when members leave the group*—(1) *Treatment of departing member*. When a member leaves a tax consolidated group (departing member), the group allocates to the departing member the member's AFSI (for purposes of applying the average annual AFSI test under §1.59-2(c)) for each taxable year (or portion thereof) in which the departing member was a member of the tax consolidated group (for taxable years relevant under §1.59-2(c)(1)(i) and (c)(2)(i)). The amount of AFSI allocated to the departing member under this paragraph (k)(1) is determined as if the member had been a separate CAMT entity during the period in which it was a member of the tax consolidated group.

(2) *Treatment of group*. The AFSI allocated to the departing member is not subtracted from the AFSI of the tax consolidated group of which the departing member ceased to be a member. *See* §1.59-2(f).

(l) *Applicability date*. This section applies to consolidated return years for which the due date of the income tax return (without extensions) is after [DATE OF PUBLICATION OF FINAL RULE IN THE ***FEDERAL REGISTER***].

Douglas W. O'Donnell,
Deputy Commissioner.

(Filed by the Office of the Federal Register September 12, 2024, 8:45 a.m., and published in the issue of the Federal Register for September 13, 2024, 89 FR 75062)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2024–27 through 2024–52 is in Internal Revenue Bulletin 2024–52, dated December 30, 2024.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2024–27 through 2024–52 is in Internal Revenue Bulletin 2024–52, dated December 30, 2024.

Internal Revenue Service
Washington, DC 20224

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