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US Corporate AMT: Inbound Investors Beware of Aggregation Rules

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Enacted as part of the Inflation Reduction Act of 2022 (the "Act"), the US Corporate Alternative Minimum Tax ("CAMT") is in effect for all tax years beginning after December 31, 2022, but the IRS and taxpayers alike continue to learn more about the contours and pitfalls of the CAMT. Although initially expected to affect only the largest multinational corporations, the application of certain aggregation rules as described in recent IRS guidance may cause many more corporations to become subject to the CAMT than initially expected and will subject even more to CAMT-related compliance.

The CAMT is intended to impose a minimum tax of 15% on the financial statement income of corporations with reported book income in excess of $1 billion. When it was enacted, estimates indicated that only 80 to 200 of the largest multinational corporations would be subject to the CAMT. However, recent guidance applies the CAMT rules in a manner that appears likely to subject more taxpayers with CAMT-related compliance, even if they will have no additional tax to pay. This recent guidance was issued by the IRS and Treasury Department in Notice 2023-64 (the "Notice"), which serves as an extension of initial CAMT guidance introduced in December 2022 in Notice 2023-07 and in February 2023 in Notice 2023-20. The Notice further complicates the maze of rules that determine whether a particular corporation is an "applicable corporation" required to compute its CAMT in the first instance.

In this article, we focus on these issues and discuss how, in light of the guidance in the Notice, these rules might affect US inbound investors who may have initially thought they would not be caught by the new CAMT. In particular, as illustrated below, majority investments of non-US investors may be subject to different results under the CAMT rules solely as a result of the US tax entity classification of the non-US investor or its investment structure. Treasury has indicated that additional guidance is expected before year-end, and affected taxpayers may consider requesting clarification or limitations in future guidance.

Applicable Corporation Tests

The test for whether a US corporation is an "applicable corporation" depends on whether the corporation is a member of a foreign parented multinational group ("FPMG"). Generally, an FPMG consists of any two or more entities where (1) at least one entity is a US corporation and another is a non-US corporation, (2) the entities are included in the same applicable financial statement ("AFS"), and (3) the common parent of the entities is a non-US corporation (or the entities are treated as having a common parent that is a non-US corporation) (IRC §59(k)(2)).

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The language of the Code does not appear to require that the "common parent" be included in the same applicable financial statement. Under this strict interpretation of the Code, an FPMG could comprise a brother-sister that are a US corporation and non-US corporation and that have a non-US parent corporation, where the brother-sister are included on the same AFS but the parent is not (and is therefore not part of the FPMG). As illustrated in the examples below, this strict interpretation could lead to counterintuitive results, and query whether other interpretations of the definition, e.g., that "common parent" should include only entities that are included in the same AFS, may be more appropriate from a policy perspective (See Example 3, below). Notice 2023-07 requested comments on rules that would be appropriate for purposes of treating entities as having a common parent that is a non-US corporation, and future guidance or regulations could clarify this issue.

Regardless of FPMG status, a US corporation is an "applicable corporation" if its average annual "applicable financial statement income" ("AFSI") for the preceding three years exceeds the applicable threshold. The threshold for a corporation that is not a member of an FPMG is $1 billion (the "$1 billion test") (IRC §59(k)(1)(B)(i)). For a US corporation that is a member of an FPMG, there are two thresholds, both of which must be met for the corporation to be an applicable corporation:

1. $1 billion threshold (the "FPMG $1 billion test") for the entire FPMG; and
2. $100 million threshold for the US members of the FPMG, including "effectively connected" AFSI of non-US members of the FPMG (the "$100 million test") (IRC §59(k)(1)(B)(ii), §59(k)(2)).

A US trade or business of a non-US corporation is treated as a separate US corporation wholly-owned by the non-US corporation for purposes of determining whether any member of the FPMG is an "applicable corporation" (*See* IRC §59(k)(2)(C)). In addition, certain modifications apply to the determination of AFSI for such purposes (*See* §59(k)(2)(A)).

In determining whether a corporation that is a member of an FPMG meets the FPMG $1 billion test, the statute provides that the AFSI of such corporation includes the AFSI of all members of the FPMG (the "FPMG Aggregation Rule") (IRC §59(k)(2)(A)).

For purposes of the $1 billion test and the $100 million test, AFSI of a foreign corporation generally only takes into account effectively connected income. (IRC §56A(c)(4); *see* also IRC §59(k)(2)(A)). 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, generally only profits attributable to the US permanent establishment should be included (Notice 2023-64).

Once a corporation is an "applicable corporation" in one year, it will generally continue to be an "applicable corporation" in all future years unless it undergoes a change in ownership or has experienced a yet-to-be specified number of consecutive taxable years in which it does not meet the applicable AFSI tests and, in all cases, the Secretary of the Treasury determines that it would not be appropriate to treat such corporation as an "applicable corporation" (IRC §59(k)(1)(C)). There is a substantial compliance burden involved in demonstrating that a corporation has not met the specified requirements for the necessary number of years.

Aggregation Rules

Separate from the FPMG Aggregation Rule noted above, §59(k)(1)(D) provides that, solely for purposes of determining whether a corporation (the "Tested Corporation") is an applicable corporation, all AFSI of persons treated as a single employer with the Tested Corporation under §52(a) or §52(b) is treated as AFSI of the Tested Corporation (the "Single-Employer Aggregation Rule") (IRC §59(k)(1)(D)). Therefore, as discussed in more detail below, a corporation's AFSI for purposes of determining whether the corporation is an applicable corporation includes the AFSI of all members of the corporation's "controlled group" (under §52(a)) and the AFSI of all trades or businesses (including those conducted by partnerships or pass-through entities) under common control with the corporation (under §52(b)).

Prior to the Notice, there was uncertainty regarding how the Single-Employer Aggregation Rule interacts with the FPMG Aggregation Rule, e.g., whether the Single-Employer Aggregation Rule applies to the FPMG $1 billion test. Of importance to FPMGs, the Notice provides that both aggregation rules apply with respect to FPMGs. Accordingly, to determine whether a Tested Corporation that is a member of an FPMG meets the FPMG $1 billion test, the Tested Corporation must combine (i) the AFSI of all the FPMG members, and (ii) the AFSI of persons that are not members of the FPMG but are treated as a single employer with the Tested Corporation by reason of §52(a) or §52(b), as discussed below. Notably, any US corporation that is a member of an FPMG and more than 50% owned (directly or indirectly) by a non-US corporation will be required to aggregate the AFSI of that non-US corporation under the Single-Employer Aggregation Rule for purposes of the FPMG tests whether or not the non-US corporation is a member of the FPMG.

It should be noted that there are many reasons why a non-US investor that is not required (and does not) consolidate financial statements with its portfolio companies, and is not a corporation under applicable non-US tax law, might be treated as a corporation for US federal income tax purposes, with the result that Single-Employer Aggregation Rule would apply all of such investor's majority owned portfolio companies. Examples include non-corporate foreign entities that are treated by default as corporations under US federal income tax rules and, prior to CAMT, were indifferent as to their US federal income tax treatment. For example, US federal income tax treatment may have been irrelevant to a non-US entity that does not derive any US effectively connected income and is not otherwise subject to US taxation, such as a business entity wholly owned by a foreign government, which is treated as a corporation for US tax purposes (Treas. Reg. §301.7701-2(b)(6); *see* PLR 202343034, PLR 202343035, PLR 202343036 (holding that a partnership owned by multiple controlled entities is not subject to the per se corporation rules)). Other entities, including investment fund vehicles, may have checked the box to be treated as a corporation for US tax purposes simply to serve as a blocker to alleviate any potential investor concerns with respect to potential tax filing requirements, commercial activity, or trade or business exposure. The proposed application of these aggregation rules, as further illustrated below, may create CAMT complexity and exposure for these investors and their investments solely because of their corporate status for US tax purposes and potentially disadvantage such investors (and their majority-owned portfolio companies) relative to other similarly situated investors that are not treated as corporations for US tax purposes. While concentrated ownership by non-US investors that are not corporations for US tax purposes may similarly result in aggregation under the brother-sister group rules described below (albeit with a higher ownership overlap threshold), those rules are intricate and complex and beyond the scope of this article. Instead, this article and the illustrations below focus on the aggregation issues created by non-US investors that are corporations for US tax purposes.

Section 52(a) Aggregation under the Single-Employer Aggregation Rule. Under §52(a), a "controlled group of corporations" (within the meaning of §1563(a)) is treated as a single employer. A controlled group of corporations under §1563(a) includes any:

• parent-subsidiary controlled group;
• brother-sister controlled group; or
• combined group.

Generally, under §1563(a), a parent-subsidiary controlled group requires a chain of ownership of at least 80% or more of the vote or value of the corporations included in the group. However, §52(a) reduces the applicable threshold so that only 50% ownership is required to be part of such a controlled group. Accordingly, for CAMT purposes, a parent-subsidiary controlled group is generally any group of one or more chains of corporations connected through stock ownership with a common parent corporation where (A) more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations in the group; and (B) the common parent corporation owns stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of shares of all classes of stock of at least one of the other corporations (IRC §1563(a)(1)).

A brother-sister controlled group is any group of two or more corporations if five or fewer persons who are individuals, estates, or trusts own: (A) 80% of the vote, value, actuarial interest, or profits or capital interest, as applicable, in each of the organizations; and (B) taking into account the ownership of each person only to the extent that person's ownership is identical with respect to each organization, possess more than 50% of the vote, value, actuarial interest, or profits or capital interest, as applicable, in each of the organizations. For this purpose, the stock ownership of those five or fewer persons is taken into account only to the extent that those persons have identical ownership interests in each corporation (IRC §1563(a)(2), as modified by §1563(f)(5)).

A combined group is any three or more corporations each of which is a member of either a parent-subsidiary controlled group or a brother-sister controlled group and with respect to which one of those corporations is both the common parent corporation of a parent-subsidiary controlled group and included in a brother-sister controlled group (IRC §1563(a)(3)).

Section 52(b) Aggregation Under the Single-Employer Aggregation Rule. Under §52(b), all trades or business (whether or not incorporated) under common control are treated as a single employer if those trades or businesses are treated as part of any:

• Parent-subsidiary group under common control;
• Brother-sister group under common control; or
• Combined group under common control (*See* Treas. Reg. §1.52-1(b)).

The term "parent-subsidiary group under common control" largely overlaps with the definition of parent-subsidiary controlled group under §52(a), except that §52(b) also captures trades or business under the common control of any "organization" (which, for §52(b) purposes, includes a sole proprietorship, a partnership, a trust, an estate, or a corporation) where (A) more than 50% of the vote, value, actuarial interest, or profits or capital interest, as applicable, in each of the organizations, except the common parent organization, is owned by one or more of the other organizations and (B) the common parent organization has a similar 50% ownership interest in at least one of the other organizations (Treas. Reg. §1.52-1(c)).

A "brother-sister group under common control" for purposes of the Single-Employer Aggregation Rule is any two or more organizations conducting trades or businesses if five or fewer persons who are individuals, estates, or trusts own (A) 80% of the vote, value, actuarial interest, or profits or capital interest, as applicable, in each of the organizations and (B), taking into account the ownership of each person only to the extent that person's ownership is identical with respect to each organization, possess more than 50% the vote, value, actuarial interest, or profits or capital interest, as applicable, in each of the organizations (Treas. Reg. §1.52-1(d)).

A "combined group under common control" is any group of three or more organizations if (A) each organization is a member of either a parent-subsidiary group under common control or brother-sister group under common control, and (B) at least one organization is the common parent organization of a parent-subsidiary group under common control and also a member of a brother-sister group under common control (Treas. Reg. §1.52-1(e)).

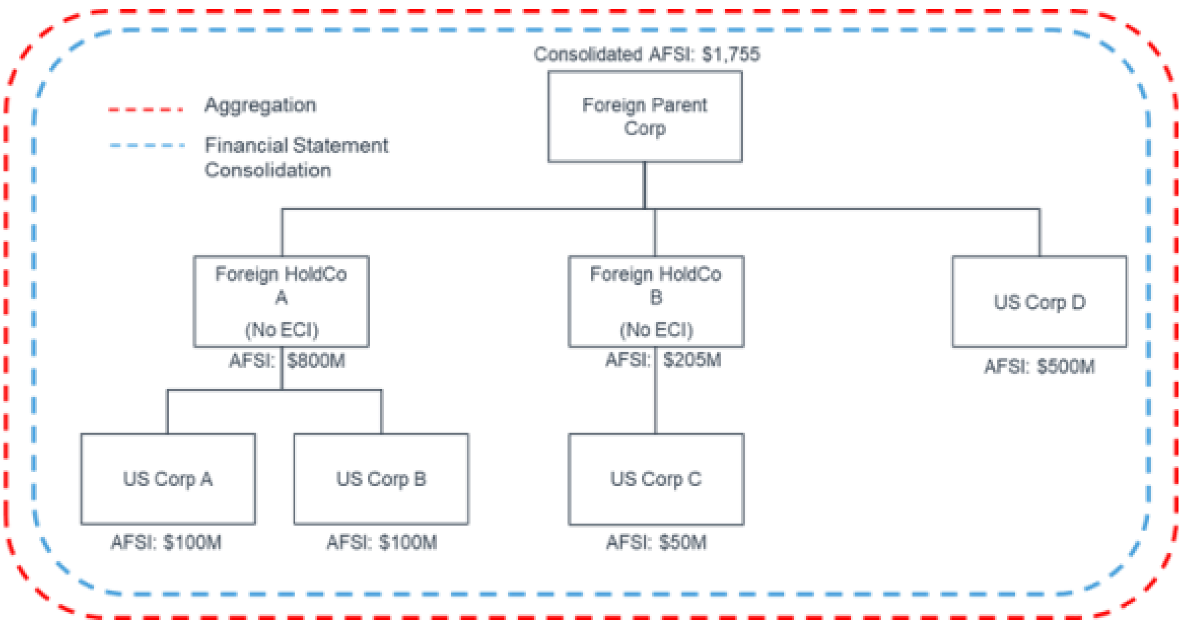
Thune Amendment. Early draft versions of the Act included additional language in the aggregation rules that would have treated activities conducted in connection with the production of income as a trade or business for purposes of applying §52(b). Such an expansion of the §52(b) rules would have caused many private equity fund entities to be treated as the common parent organization of their controlled portfolio companies, leading to the potential aggregation of those portfolio companies for CAMT purposes and raising the possibility that those portfolio companies would become subject to CAMT even though none would separately be anywhere near meeting the $1 billion test.

In response to the potential impact to the private equity industry, Senators John Thune (R-SD) and Kyrsten Sinema (D-Ariz) sponsored an amendment to the Act to remove the additional language (the "Thune Amendment"). While it is obvious that the Thune Amendment was intended to remove private equity from the CAMT's clutches, it remains possible that both private equity funds and similarly situated or organized investors (e.g., foreign pension funds and sovereign wealth funds) could be swept up by the regulations or interpretations of the aggregation rules in the Act. For example, there is existing case law in which private equity funds have, for certain purposes, been held to be in the trade or business of buying and selling securities (*See, e.g.*, Sun Capital Partners III, LP v. New England Teamsters & Truckers Indus. Pension Fund, 943 F.3d 49 (1st Cir. 2019)). Query whether future regulations may assert such a position or whether the IRS will take such a position with respect to CAMT.

Examples

To demonstrate the complexity that could arise when determining a corporation's status as an "applicable corporation" for CAMT purposes, we offer the following relatively simple examples. As our readers will notice from these examples, many corporations that would not appear to be at risk of CAMT-related compliance at first glance will, at the very least, need to consider whether their group structure might put them at risk and require careful consideration whether any of their US entities may be an applicable corporation under the CAMT.

Example 1 – §52(a) Aggregation – Corporate Parent

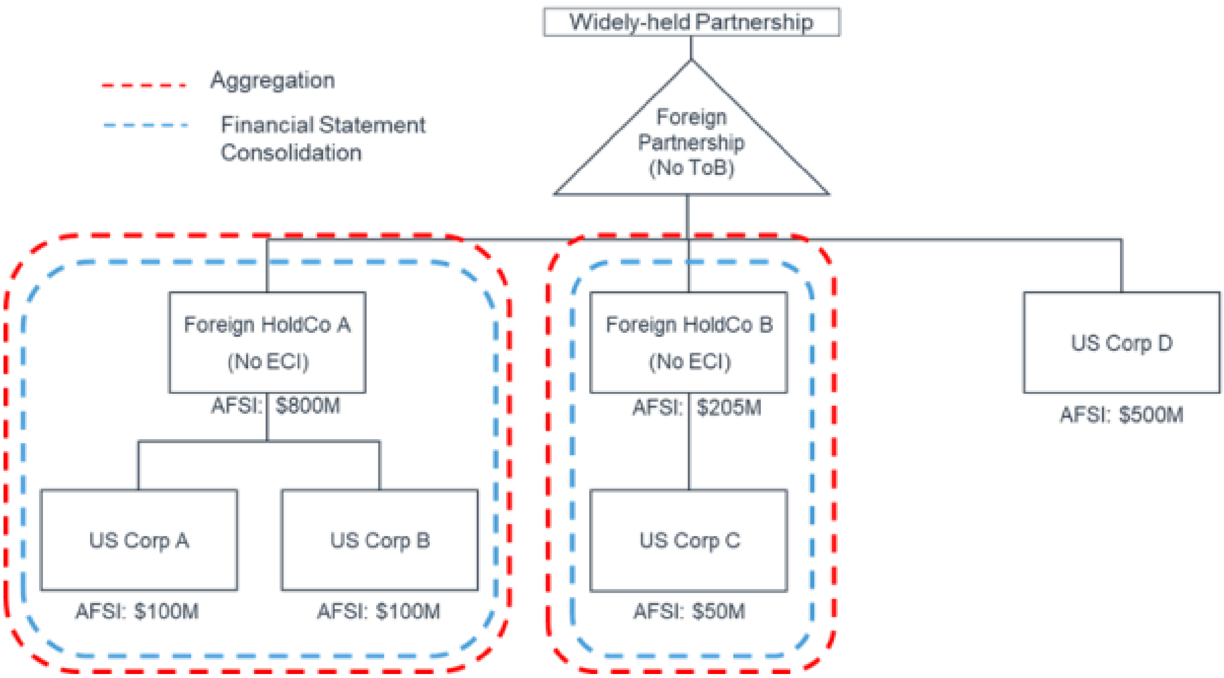


Example 1 depicts a typical parent-subsidiary controlled group with Foreign Parent as the group's parent corporation. In this structure, Foreign Parent is the parent of a consolidated financial statement group and therefore all corporations shown in the structure are members of an FPMG. Each of the corporations depicted is also treated as a single employer under §52(a), and therefore, the FPMG Aggregation Rule and Single-Employer Aggregation Rule overlap. For purposes of determining whether each US corporation in the structure is an "applicable corporation," each US corporation must take into account the AFSI of its FPMG group members and the AFSI of each other corporation with which it is aggregated under §52(a), being all of the entities in this example. As a result of the aggregation rules, the group meets the FPMG $1 billion test, and each US corporation that is a member of the group meets the $100 million test. Accordingly, each of US Corp A, US Corp, B, US Corp C, and US Corp D is an applicable corporation subject to CAMT.

If the parent entity was instead a partnership engaged in a trade or business, the group would be a parent subsidiary group under common control aggregated under §52(b), and the results would generally be the same except for the following: given that the parent entity is not a foreign corporation, there does not appear to be a "common parent" that is a foreign corporation. Without a common parent of US Corp D, absent regulations, US Corp D is subject to the $1 billion test (which is not met in this case) instead of the

FPMG $1 billion/$100 million tests. The Secretary has the authority to promulgate regulations under §59(k)(2)(D) to treat entities included in the same applicable financial statement as having a common parent which is a foreign corporation, so this fact pattern may be addressed in regulations.

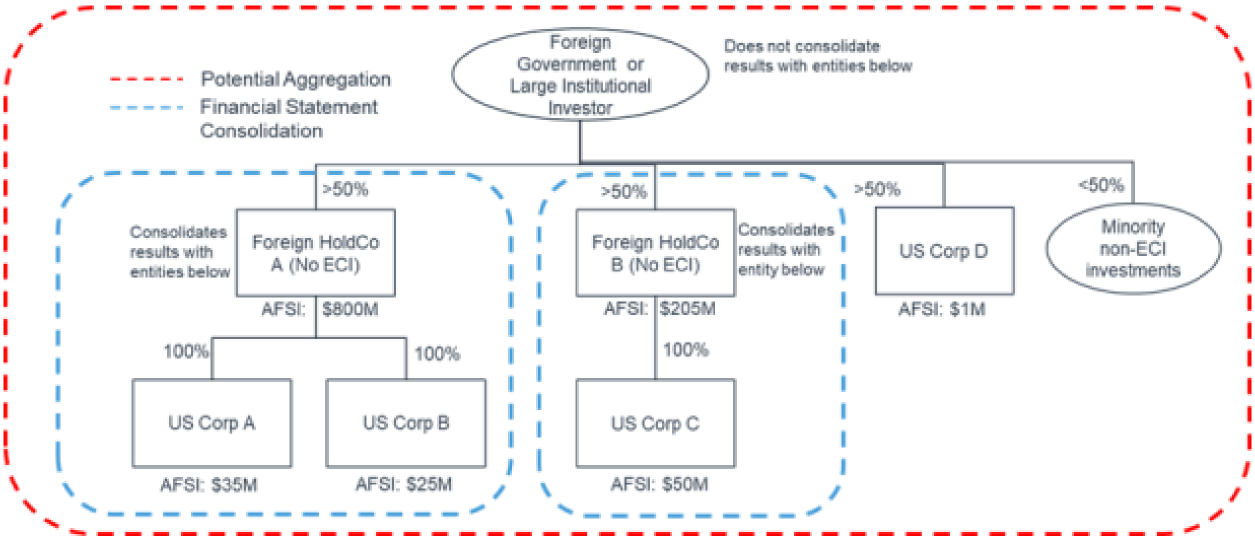
Example 2 – §52(a) Aggregation – No Corporate Parent



In this example, the facts are the same as in Example 1 except that the parent organization is a widely-held non-US partnership that is not engaged in a trade or business. Thanks to the Thune Amendment, there should not be aggregation among the two depicted FPMGs or US Corp D.

Example 3 – Unexpected Aggregation

When the group in question is a wholly-owned group of entities and financial information is (presumably) easily shared, determining whether any US corporation in the group is an applicable corporation will be burdensome enough. However, consider the example below, where Foreign Parent is a large non-US institutional investor that holds: (1) greater than 50% interests in non-US corporations that in turn own otherwise unrelated US corporations, (2) minority interests in investments that do not generate US effectively connected income, and (3) a greater than 50% interest in a US corporation.



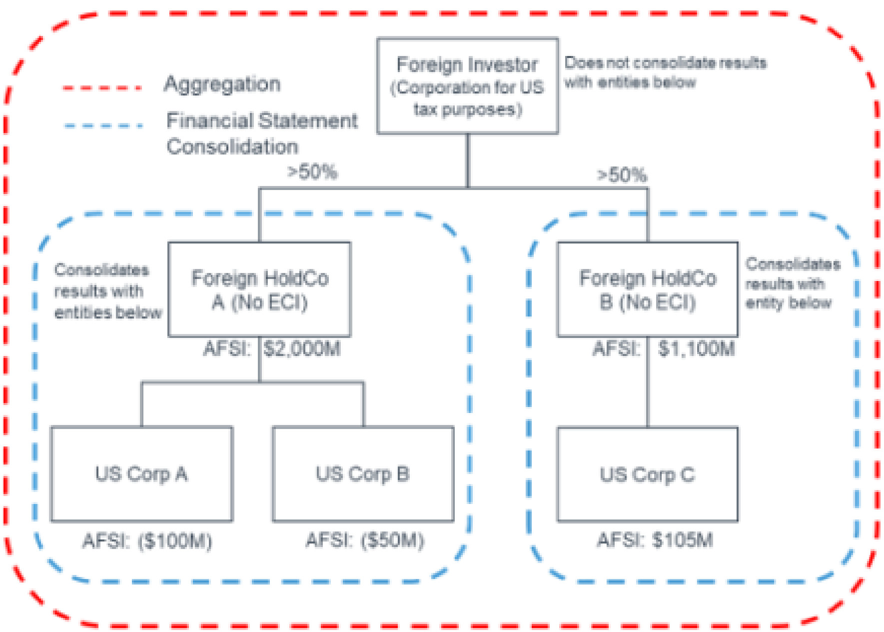
In this example, the two consolidated financial statement groups (and US Corp D) could be aggregated as members of a parent-subsidiary group or as members of a brother-sister group if the investor were a corporation for US tax purposes or were treated as engaged in a trade or business. Each of US Corp A, US Corp B and US Corp C is a member of an FPMG (status of US Corp D is separately discussed below). The aggregation rules result in US Corp A, US Corp B, and US Corp C being applicable corporations for CAMT purposes despite each separately not being close to the $100 million test or the FPMG $1 billion test if tested based only on the consolidated financial statement in which its income is included. Critically, from a practical perspective, none of these US corporations is likely to have access to the information necessary to make the determination in the first instance, which was a key criticism of applying the CAMT to portfolio companies of private equity funds that led to the Thune Amendment.

Furthermore, if the investor was treated as a corporation or other entity engaged in a trade or business, all of the income of the investor (including amounts received by the investor from the minority investments and/or other directly held securities) would be aggregated and taken into account when US Corp A, US Corp B, and US Corp C make the determination of whether the FPMG $1 billion test is met. In the case of a single corporate parent engaged in a multinational business, this may be a fair result given the underlying policy of the CAMT. However, where the investor is a foreign governmental entity or a large institutional investor treated as a corporation for US tax purposes, query whether aggregating all the income of such an investor aligns with the policies of the CAMT, especially in light of the Thune Amendment and how subjecting the portfolio investments of such an investor to aggregation presents many of the same problems intended to be addressed by the amendment.

With respect to US Corp D, given that it is not included in a financial statement with a foreign corporation (and therefore is not a member of an FPMG), US Corp D's AFSI for purposes of the $1 billion test would include the AFSI of the other US Corps, but would not include the non-ECI income of the Foreign HoldCos, the investor, or the minority investments (IRC §56A(c)(4)). Accordingly, US Corp D should not be treated as an applicable corporation since its income, taking into account the aggregation rules, should not exceed the $1 billion threshold applicable to corporations that are not members of an FPMG.

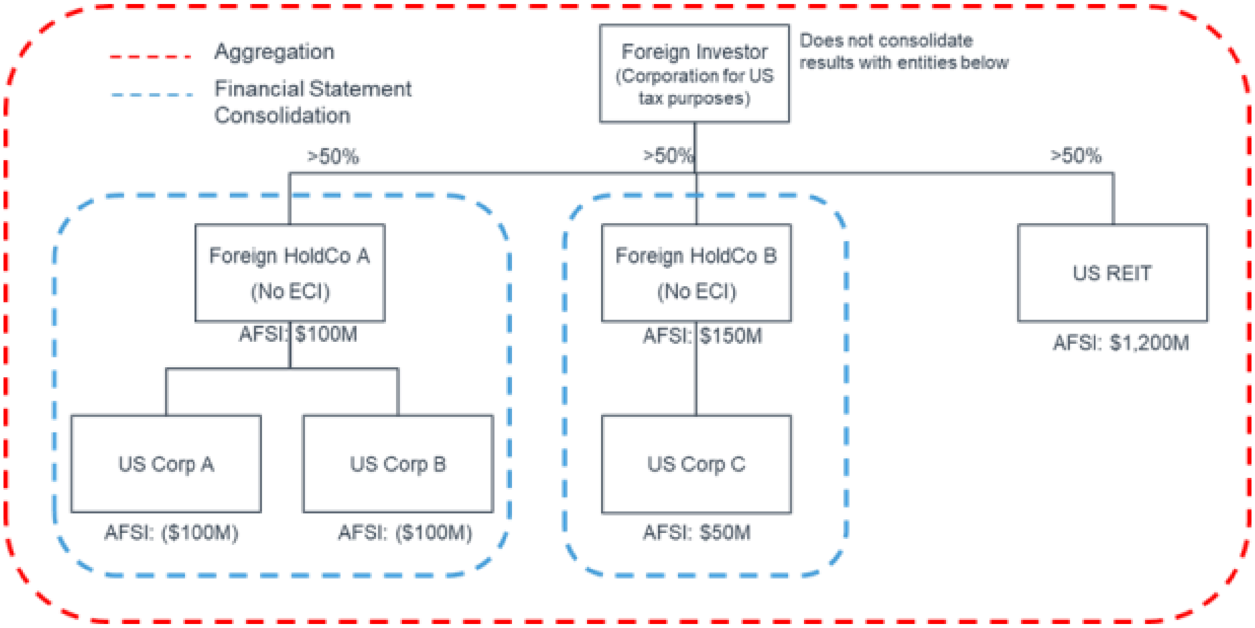
However, consider slightly different facts: if the investor was treated as a corporation for US tax purposes and US Corp D had a consolidated non-US subsidiary, the strict reading of the FPMG definition set forth above could be interpreted to lead to the result that US Corp D is a member of an FPMG comprised of itself and its non-US subsidiary because there would be a US and non-US corporation included on the same AFS and the foreign investor could be the common parent (even though it is not included on the same AFS). If US Corp D were a member of an FPMG, US Corp D's aggregated AFSI would be in excess of the much lower $100 million test (and the FPMG $1 billion test would be met after aggregating the AFSI of the entire [§52(a)] group). However, not only does this seem to the authors to be the wrong result, but also there is nothing in the legislative history of the CAMT indicating that Congress intended the CAMT to cover this type of structure, where a US corporation is not consolidated on an AFS with its non-US parent and would be treated as a member of an FPMG only because it has a consolidated non-US subsidiary. Moreover, bringing this type of structure under the CAMT umbrella would seem likely to cause the CAMT to apply to numerous corporations far in excess of the estimated 80 to 200 multinationals that would be subject to CAMT.

Example 4 – Netting of Losses in Aggregation



In this example, Foreign Holdco A and Foreign Holdco B are the parents of their respective consolidated financial statement groups, and all of the corporations depicted are treated as a single employer under §52(a)as members of a parent-subsidiary controlled group. The FPMG $1 billion test is met, but how will netting of current losses work in this situation for purposes of the $100 million test? Based on the statutory language, the AFSI of each of US Corp A, US Corp B, and US Corp C should be netted for purposes of the $100 million test, and therefore none of the entities in this structure should be an applicable corporation because the $100 million test is not met. This result should be clarified by regulation or other guidance.

Example 5 – Tainting by Aggregation with a CAMT-Exempt Entity



In this example, US REIT is a real estate investment trust (REIT). REITs are not subject to CAMT (IRC §59(k)(1)(A)). However, as in Example 1, each of the entities depicted, including US REIT, is a member of a parent subsidiary-controlled group treated as a single employer under §52(a). Accordingly, US REIT's AFSI would taint each of the other US Corps, causing them to be treated as applicable corporations, because US REIT's AFSI is large enough to cause each US Corp to meet both the FPMG $1 billion test and $100 million test, even if netting the current losses of Foreign Holdco A, US Corp A, and US Corp B will be permitted. While neither US Corp A nor US Corp B should have substantive CAMT liability in the current year (given their negative AFSI), recall that "applicable corporation" status is generally retained until the Secretary determines otherwise, creating potential CAMT liability exposure in the future, and CAMT compliance costs in the meantime.

Implications

Despite initial projections that the CAMT would affect only the largest multinational corporations, we are starting to see that the way in which the FPMG and aggregation rules work together could cause many more corporations to become subject to CAMT. Even if the initial projections are ultimately proven correct as to the number of actual payers of CAMT, many more corporations and their investors will be subject to the compliance burden of determining whether they are subject to CAMT. Large non-US institutional investors will need to consider whether their current investment structures, in light of the aggregation and FPMG rules described above, could cause any of their investments to be treated as applicable corporations, which may be an onerous, if not impossible, task unto itself and will require complex calculations of FSI and adjustments to arrive at AFSI by the various entities involved. The Notice promised proposed regulations in the near future on these topics. Hopefully, taxpayers will be provided some clarity and relief when those regulations are released.