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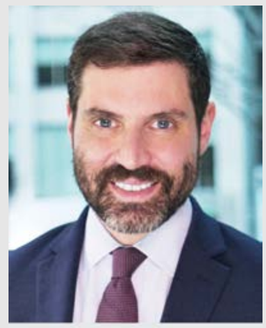
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In this article, the second in a series, the authors continue their use of the classic game Candy Land to assist taxpayers in understanding the corporate alternative minimum tax. This installment is focused on right-sizing for differences between a taxpayer's book consolidated group, tax consolidated group, and single-employer group.

This is the second article in the CAMTyland Adventures series.[1] This series is intended to assist taxpayers in better understanding the requirements of the corporate alternative minimum tax (CAMT) — a minimum tax based on financial statement income that is imposed on applicable corporations.[2] The CAMT has many mysteries, and this series addresses some of the areas where significant complexity or uncertainty exists.

In the first article of the series, we moved through CAMTyland's early stations and provided an overview of certain concepts and definitions fundamental to understanding and applying the CAMT, including adjusted financial statement income (AFSI). As noted in the first article, determining whether a taxpayer is an applicable corporation subject to the CAMT under the safe harbor in Notice 2023-7 (the "first notice") ("safe harbor scope determination") or is an applicable corporation subject to the CAMT under the statutory rules, as interpreted by the notice ("statutory scope determination," with the safe

[1] *See* Monisha C. Santamaria et al., "CAMTyland Adventures, Part I: How to Play the Game — Corporate Alternative Minimum Tax Basics," *Tax Notes Int'l*, July 24, 2023, p. 367. *See also* Notice 2023-7, 2023-3 IRB 390 (the "first notice") for terms used but not defined in this article.

[2] The CAMT is effective for tax years beginning after December 31, 2022 (meaning it is currently in effect).

Table 1. Inclusion of AFSI of Persons Other Than the Taxpayer in Taxpayer's AFSI

	100% Inclusion	Less Than 100% Inclusion
Safe harbor AFSI	A taxpayer generally includes 100% of (i) its own AFSI, (ii) the AFSI of any person who is a member of its book consolidated group, (iii) the AFSI of any person who is a member of its tax consolidated group, and (iv) the AFSI of any person who is a member of its single-employer group (we refer to such persons as the safe harbor group).	If a taxpayer has an equity interest in a person who is not part of its safe harbor group, the taxpayer will generally include an amount for such person that is not 100% of that person's AFSI. These amounts appear to be based on the book inclusion on the taxpayer's consolidated financial statement.
Statutory scope AFSI	A taxpayer generally includes 100% of (i) its own AFSI, (ii) the AFSI of any person who is a member of its tax consolidated group, and (iii) the AFSI of any person who is a member of its single-employer group (we refer to such persons as the scope group).[a]	If a taxpayer has an equity interest in a person who is not part of its scope group, the taxpayer will generally include an amount for such person that is not 100% of the person's AFSI. These amounts may be based on tax amounts (in the case of a non-tax-consolidated corporation) or book amounts (in the case of a partnership) or tax and book amounts (in the case of a controlled foreign corporation).
Liability AFSI	A taxpayer generally includes 100% of (i) the taxpayer's own AFSI and (ii) the AFSI of any member of the taxpayer's tax consolidated group (we refer to these persons as the liability group, and with the safe harbor group and scope group, the CAMT group).	If a taxpayer has an equity interest in a person who is not part of its liability group, the taxpayer will generally include an amount for that person that is not 100% of the person's AFSI. A taxpayer generally includes (i) the dividends and other amounts includable in taxable income from corporate subsidiaries that are not members of its tax consolidated group; (ii) the taxpayer's distributive share of partnership AFSI; and (iii) the taxpayer's pro rata share of the AFSI items of any CFC in which it is a U.S. shareholder.

[a]There is some uncertainty regarding whether 100 percent of the AFSI of a tax partnership that is a member of the taxpayer's book consolidated group but is not a member of the taxpayer's single-employer group is included. *Compare* New York State Bar Association, "Report No. 1473: Report on Selected Issues Relating to the Corporate Alternative Minimum Tax" (Mar. 20, 2023), *with* American Bar Association Section of Taxation, "Comments on the Corporate Alternative Minimum Tax" (Mar. 20, 2023).

harbor scope determination, "scope determination") and the potential CAMT tax liability of an applicable corporation, (the liability determination) are all based on AFSI.

However, while the term "AFSI" is used for each of these purposes, in many cases (if not all) a taxpayer's AFSI for the safe harbor scope determination (safe harbor AFSI), the statutory scope determination (statutory scope AFSI), and the liability determination (liability AFSI) will differ. This is because taxpayers are required to make different adjustments to book income to arrive at AFSI depending on which determination they are performing.[3]

One key reason that a taxpayer's safe harbor AFSI, statutory scope AFSI, and liability AFSI may differ is that while each may include AFSI of persons other than the taxpayer, the persons

[3]Within this article, we use the term "book income" to colloquially refer to "net income or loss on the applicable financial statement" as that term is used in the CAMT statute (that is, the starting number to be used in calculating AFSI). As discussed in Part I, in the absence of guidance, it appears that "net income or loss" as that term is used in CAMT refers to consolidated net income (net income attributable to both the owners of the parent and the owners of the noncontrolling interests). *See* Santamaria et al., *supra* note 1.

included may differ. The rules for whether the AFSI of another person is included, and the amount of such inclusion, depends on whether the person is a member of the taxpayer's book consolidated group, tax consolidated group, and section 52 single-employer group (each as defined below). The rules regarding whether a taxpayer includes 100 percent, or less than 100 percent, of the AFSI of a person are summarized in Table 1.

Thus, as a necessary first step to apply the CAMT's complex rules, a taxpayer must identify its book consolidated group, tax consolidated group, and single-employer group.[4] Notably, the entities included in a taxpayer's book consolidated group, tax consolidated group and single-employer group may not, and often do not, overlap — increasing the difficulty of CAMTyland.

A taxpayer must then adjust its book income[5] to account for differences between its book consolidated group and relevant CAMT group, referred to herein as right-sizing.[6] These right-sizing adjustments may cause a significant divergence among the book income, safe harbor AFSI, statutory scope AFSI, and liability AFSI.

Stuck in Licorice Lagoon: Group Identifications

Our adventure in this article begins with examining the different inquiries a taxpayer must make to identify its book consolidated group, tax consolidated group, and single-employer group.

Book Group Determination

Before a taxpayer can identify its book consolidated group, the taxpayer must understand which financial statements it prepares, which of these financial statements is the applicable financial statement (AFS),[7] and which entities are included in full (and not included in full) on this AFS. Notably, a taxpayer cannot correctly determine its book consolidated group unless it has correctly identified its AFS, because the entities included in full on a taxpayer's different financial statements may differ (for example, if one financial statement is prepared under U.S. generally accepted accounting principles and another under international financial reporting standards). Said differently, if a taxpayer incorrectly identifies its AFS, it will be sent backward in the game of CAMTyland.

As necessary background, a company is required to prepare consolidated financial statements for its book consolidated group, the objective of which is to present the financial position of a parent and its subsidiaries (including all types of legal entities) as if the consolidated group were a single economic entity. Therefore, 100 percent of the individual assets, liabilities,

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[4]However, if a taxpayer has determined it is an applicable corporation, it need not identify its single-employer group.

[5]Here, book income refers to the net income amount on the consolidated financial statement.

[6]Specifically, right-sizing modifications must be made to book income for (i) purposes of safe harbor AFSI because of differences between a taxpayer's book consolidated group and safe harbor group; (ii) purposes of statutory scope AFSI because of differences between a taxpayer's book consolidated group and scope group; and (iii) purposes of liability AFSI because of differences between a taxpayer's book consolidated group and liability group.

[7]Section 451(b)(3) states that an AFS is (A) a financial statement that is certified as being prepared in accordance with GAAP and is (1) a Form 10-K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the SEC; (2) an audited financial statement of the taxpayer that is used for credit purposes; reporting to shareholders, partners, or other proprietors, or to beneficiaries; or any other substantial nontax purpose, but only if there is no statement of the taxpayer described in clause (1); or (3) filed by the taxpayer with any other federal agency for purposes other than federal tax purposes, but only if there is no statement of the taxpayer described in clauses (1) or (2); (B) a financial statement that is made based on IFRS and is filed by the taxpayer with an agency of a foreign government that is equivalent to the U.S. SEC and that has reporting standards not less stringent than the standards required by such commission, but only if there is no statement of the taxpayer described in clause (A); or (C) a financial statement filed by the taxpayer with any other regulatory or governmental body specified by the secretary, but only if there is no statement of the taxpayer described in clauses (A) or (B). Section 56A(c)(2)(A) provides that if the financial results for an entity are reported on the financial statement for a group of entities, rules similar to section 451(b)(5) apply. Section 451(b)(5) provides that if the financial results of a taxpayer are reported on a consolidated financial statement for a group of entities, the consolidated financial statement is the AFS for the taxpayer.

items of income and loss, and cash flows of the parent's consolidated subsidiaries are presented together with those of the parent. Transactions between entities included in the book consolidated group are excluded from consolidated book income. Thus, for example, if two members of a book consolidated group engage in a sale transaction, there is no effect on consolidated book income.

Under U.S. GAAP, a parent consolidates a subsidiary[8] (that is, includes it in its book consolidated group) if it has a controlling financial interest in that subsidiary. U.S. GAAP contains two primary models for determining whether a company has a controlling financial interest in another entity — the voting interest model and the variable interest model. Determining the right model is essential to properly apply U.S. GAAP, but the determination is complex, requiring companies to navigate numerous scope exceptions.[9] For example, the determination of whether an investee meets the definition of a variable interest entity under the variable interest model can be challenging and often requires significant judgment.

Under the voting interest model, an investor has a controlling financial interest in another entity if its equity interest gives it the ability to control the decisions made in the ordinary course of the investee's business. There is a rebuttable presumption that this control rests with the investor that has majority voting control (that is, more than 50 percent).[10]

Under the variable interest model, an investor has a controlling financial interest in an investee if it has (1) power over the activities that most significantly affect the investee's economics, and (2) the obligation to absorb losses or the right to receive benefits of the investee that could be significant to the investee. The power concept under the variable interest model involves considerable judgment and differs from the majority voting control concept under the voting interest model. This is because the variable interest model was created for situations where control may be exercised through means other than voting interests.

If a parent has a controlling financial interest in a subsidiary and the subsidiary is less than wholly owned, the parent is also required to separately present the portion of the subsidiary's net assets, net income, and comprehensive income that is attributable to the noncontrolling interest (NCI) holders. This amount is presented as a single line in the equity section of the parent's consolidated balance sheet, consolidated income statement, and statement of comprehensive income. The net income amount that is attributable to the controlling interest holder (that is, the parent) is also presented as a single line in the consolidated income statement.

Under both U.S. GAAP consolidation models, it is possible for a company to (1) consolidate another entity even if it does not own a majority of the voting or economic interests, and (2) not consolidate another entity despite owning a majority of the voting or economic interests.

Non-Book Consolidated Entities

If a company has an investment in another entity (an investee) that does not represent a controlling financial interest, the consolidated financial statements will still reflect amounts regarding the company's interest in the investee. However, the measurement and presentation of that investment will differ depending on which accounting method applies. A company generally accounts for its noncontrolling investment under one of three methods summarized in Table 2.

[8] A subsidiary need not be a corporation for U.S. federal income tax purposes (for example, it may be a tax partnership) but it must be a legal entity.

[9] The scope exceptions to consolidation may present issues for particular industries. For example, investment companies (as defined under U.S. GAAP) are subject to a special set of rules that generally require using a fair value method.

[10] See chapter 5 of KPMG Financial Reporting View Handbook: Consolidation (May 2022) for more information regarding the voting interest model, including situations in which a majority shareholder would not consolidate a legal entity.

Table 2. Financial Accounting of Non-Book Consolidated Entities

Financial Accounting Method Regarding Investee	When Applied	What Is Presented in Investor's Consolidated Financial Statements
Equity method[a]	Investor does not have a controlling financial interest, but can exercise significant influence over the operating and financial decisions of the investee.	The investment is presented as a single asset on the balance sheet. The investor's share of the investee's earnings or losses is presented as a single line in the income statement (which is included in the investor's book income) and statement of comprehensive income. Dividends received from the investee are generally recognized as a reduction of the carrying value (*i.e.*, basis), rather than in book income. Transactions between the investor and an equity-method investee may be eliminated or partially excluded from consolidated book income.
Fair value vethod[b]	• Investor is neither required to consolidate nor apply the equity method, and the investment has a readily determinable fair value; or • investor makes an election to account for an equity-method investment at fair value (referred to as the fair value option).[c]	The investment is presented as a single asset on the balance sheet. The investor recognizes the changes in fair value of the investment (*i.e.*, a mark-to-market adjustment) in its book income. Dividends received from the investee are generally recognized in book income. Transactions between the investor and the investee are not excluded from consolidated book income.
Measurement alternative method[d]	Investor is neither required to consolidate nor apply the equity method, and the investment does not (1) have a readily determinable fair value or (2) qualify for the net asset value practical expedient. In this situation, the investor may elect to apply the measurement alternative.	The investment is presented as a single asset on the balance sheet. The investor recognizes changes in fair value of the investment in its book income if, and only if, there is a change in the observable price from orderly transactions for identical or similar instruments of the same issuer. Dividends received from the investee are generally recognized in book income. Transactions between the investor and the investee are not excluded from consolidated book income.

[a]*See generally* KPMG, *KPMG Financial Reporting View Handbook: Equity Method of Accounting* (Aug. 2022).

[b]*See generally* KPMG, *KPMG Financial Reporting View Handbook: Investments* (Sept. 2022).

[c]Under ASC 825-10-25-4, an investor may elect to apply the fair value option when an investment becomes subject to the equity method of accounting for the first time.

[d]*Id.*

Tax Group Determinations

As a taxpayer dives into the Licorice Lagoon, it will also need to determine certain tax groupings and the membership of these tax groups. If the taxpayer is engaging in a scope determination, the taxpayer will need to determine its section 52 single-employer group. This is because, for determining the scope (but not liability), the AFSI of a corporation generally includes its own AFSI and 100 percent of the AFSI of any person that is treated as a single employer with that corporation under section 52(a) or (b) (meaning, is a member of the corporation's single-employer group).[11] For both the scope and liability determination analyses, the taxpayer will also need to keep in mind its tax consolidated group.

Single-Employer Group

At a high level, section 52(a) aggregates corporate entities, and only corporate entities, connected through more than 50 percent ownership.[12]

Section 52(b) provides that employees of trades or business (whether or not incorporated) that are under common control are treated as employed by a single employer. Therefore, these rules can result in the inclusion of, for example, partnerships in a single-employer group and, thus, the section 52(b) rules are relevant when the entity structure includes entities other than corporations. In the regulations under section 52(b), "trades or businesses under common control" can include a parent-subsidiary group, a brother-sister group, or a combined group under common control. Generally, the section 52(b) rules for parent-subsidiary groups under common control look for lineal relationships where two or more partnerships, corporations, or other entities/persons are connected through more than 50 percent ownership. In contrast, the brother-sister aggregation rules focus on horizontal relationships where the same five or fewer individuals, estates, or trusts have both a controlling interest and effective control of the organizations. A combined group under common control must have three or more entities that are in both a parent-subsidiary controlled group and a brother-sister controlled group.

Two critical points cannot be overemphasized. First, the rules for determining the single-employer group are akin to playing in a molasses swamp — they are complex and idiosyncratic.[13] Second, and even more importantly, the rules for determining the single-employer group are not coextensive with the rules for determining the book consolidated group — and the fact both use 50 percent thresholds is best viewed as a red herring. At a high level, this is because the two primary consolidation models under U.S. GAAP (discussed above) are focused on *control* whereas section 52 may use a standard that is more focused on *economics* (for example, a partnership, or ownership of more than 50 percent of profits or capital). Further, even in instances when both rules look to control (for example, section 52(a)'s vote test), the measurement is different. Also, the single-employer group rules can result in the aggregation of trades or business that are not legal entities. In contrast, the book consolidation rules only allow for the grouping of legal entities (a taxpayer that is not a legal entity may not be part of the book consolidated group).

Tax Consolidated Group

A corporation is tax consolidated if it is (1) a member of an affiliated group of corporations that (2) files a consolidated return. Affiliated groups are required to meet stringent stock ownership requirements, which at a high level incorporate an 80 percent vote and value test.[14]

Under the statutory CAMT rules, if a corporation is part of a tax consolidated group, then its AFSI includes items on the group's AFS that are properly allocable to members of the tax consolidated group.[15] Further, under the first notice, a tax consolidated group is treated as a single entity when calculating AFSI for both scope determination and liability determination purposes.[16] This generally means that 100 percent of the AFSI of any tax consolidated group member is included and suggests that income from transactions between entities included in the group should be excluded.

This contrasts with the treatment of corporate subsidiaries that are *not* included in the tax consolidated group of the taxpayer — which look to include tax amounts, rather than amounts based on book income. Specifically, the statutory CAMT rules provide that if a corporate subsidiary

[11] Section 59(k)(1)(D).

[12] Specifically, section 52(a) relates to a controlled group of corporations within the meaning of section 1563(a), "except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563."

[13] These complexities and idiosyncrasies are beyond the scope of this article.

[14] Section 1504(a).

[15] Section 56A(c)(2)(B).

[16] Notice 2023-7, section 3.05. Also, the first notice does *not* turn off the rules for tax consolidated groups regarding the safe harbor scope determination.

is not included in the tax consolidated group of the taxpayer, only dividends and certain other amounts includable in gross income or deductible as a loss for U.S. federal income tax purposes are included in AFSI.[17] Thus, this rule can be read to remove book items regarding stock held in a non-tax-consolidated corporation and add certain tax amounts.

Importantly, a taxpayer's tax consolidated group may not be coextensive with the book consolidated group because of the U.S. GAAP consolidation models discussed above. That is, an entity may own less than 80 percent of a domestic corporation, yet still consolidate the corporation for financial reporting purposes (in this case, the domestic corporation would be included in the book consolidated group but not the tax consolidated group). Conversely, although likely rare in practice, an entity may own more than 80 percent of a domestic corporation, yet not consolidate the corporation for financial reporting purposes (so the domestic corporation would be included in the tax consolidated group but not the book consolidated group). Notably, a taxpayer's tax consolidated group may not be coextensive with the taxpayer's single-employer group, because the rules for single-employer groups use a lower threshold (50 percent instead of 80 percent) and allow for the inclusion of noncorporate entities. A taxpayer's single-employer group will generally encompass its tax consolidated group (that is, there generally will be no members of a taxpayer's tax consolidated group who are not members of the taxpayer's single-employer group).

Rule Variation: Foreign-Parented Multinational Groups

Special rules for foreign-parented multinational groups (FPMGs) change the rules of the game for determining applicable corporation status. A player must read the instructions carefully, and a careful read will generate more questions than answers. An FPMG exists if a domestic corporation and a foreign corporation share the same AFS for a tax year and the common parent of the group is a foreign corporation, or the domestic corporation and foreign corporation are treated as having a common parent under rules prescribed by the Treasury secretary.[18] Section 59(k)(2)(D) directs the Treasury secretary to provide guidance for applying the FPMG rule.[19]

As discussed in the first article in this series, there are two prongs to the scope rules for FPMGs, and both must be satisfied to be considered an applicable corporation. The first prong uses a $1 billion threshold (or $500 million under the safe harbor scope determination rule). At a high level, this first prong looks to the worldwide income of the FPMG's book consolidated group. The second prong uses a $100 million threshold (or $50 million under the safe harbor scope determination rule). Broadly, this second prong looks to the U.S. nexus income of the FPMG member's section 52 single-employer group.

The rules for FPMGs are apt to confuse players. It is critical for taxpayers to understand that for the first prong (generally, the $1 billion test for global income), a taxpayer must look to its *book consolidated* group. However, for the second prong (generally, the $100 million test for U.S. nexus income), a taxpayer must look to its single-employer group. The book consolidated group and the single-employer group rules do not necessarily combine the same entities. If a corporation is a member of the single-employer group but in a different book consolidated group, the single-employer group may be broader than

[17] Section 56A(c)(2)(C). Specifically, if a taxpayer corporation holds an interest in another corporation not included in the taxpayer's consolidated return (that is, a non-tax-consolidated corporation) the taxpayer corporation's AFSI for that other corporation includes only dividends and certain other amounts includable in gross income (but excluding subpart F and global intangible low-taxed income or deductible as a loss for U.S. federal income tax purposes by the taxpayer).

[18] Section 59(k)(2)(B). Section 59(k)(2)(C) requires that the U.S. trade or business of a foreign corporation be treated as a separate domestic corporation. This rule, for scoping purposes, ensures that a foreign corporation with a U.S. trade or business but without a domestic subsidiary satisfies the requirement that an FPMG include both a domestic corporation and a foreign corporation. Because both the income of the U.S. branch and its foreign parent are considered for purposes of the rule, the treatment of the U.S. branch as a separate foreign corporation for this purpose should not affect the AFSI computation. For other purposes, including the second prong of the scope test for FPMGs, the rule in section 56A(c)(4) applies, so only financial statement income that is effectively connected with a U.S. trade or business (or CFC inclusions of a U.S. shareholder) is included in determining if the second prong is met.

[19] The first notice defines the common parent as the parent corporation of a group of entities whose activities are consolidated for financial accounting purposes.

the book consolidated group. It is also possible for two corporations to be included in the same book consolidated group but not satisfy the requirements of section 52(a) or (b) to be treated as a single-employer group.

Also, the CAMT's generally applicable rules may leave its FPMG players stuck more often than their domestic companions on CAMTyland's winding path. FPMGs may struggle to determine which financial statement is the AFS. For example, a foreign parent may file with its home country securities regulator a financial statement prepared in accordance with IFRS, but its U.S. subsidiary may file a Form 10-K prepared in accordance with U.S. GAAP with the SEC. In this case, it is possible that the financial statement income for purposes of the first prong will need to be made based on the IFRS statement, because that is the only statement which includes the results of the common parent and its non-U.S. subsidiaries; however, to determine the second prong and the liability AFSI for the U.S. subsidiary's CAMT group, the GAAP financial statements may be required — particularly if they take into account all the taxpayer's income that is included in liability AFSI.[20]

Escaping Licorice Lagoon: Right-Sizing

As explained, the entities included in a taxpayer's book consolidated group (and thus on its AFS) may include entities that are not part of its safe harbor group, statutory scope group, or liability group (and may not include in full entities that are part of its CAMT group). As a result, modifications must be made to book income to right-size such income for CAMT purposes. The modifications that must be made depend on the purpose of the calculation (for example, safe harbor AFSI vs. statutory AFSI vs. liability AFSI). Thus, we progress though the Licorice Lagoon by examining our different vine flavors and walking through the different right-sizing modifications for each AFSI computation.

For this discussion, we make several simplifying assumptions. We assume no differences exist between the CAMT basis of property and the financial reporting carrying value (that is, book basis).[21] Also, when the equity method is used regarding the investee, we assume that there are no investor-level adjustments to book income (for example, the amortization and depreciation of equity-method basis differences).[22] Further, for equity-method investments, although fair value and equity-method income are reported in the aggregate and presented on an equity-method investor's financial statement as a single line item, we assume that an equity-method investor will have the ability to determine these items reported in the single line item on a disaggregated (that is, entity-by-entity) basis. Making these assumptions can be analogized to playing Candy Land using the instructions for very young players.

Safe Harbor AFSI: Right-Sizing

As described in more detail in Part I of the CAMTyland Adventures series, the first notice introduced the safe harbor scope determination for whether a taxpayer is an applicable corporation for its first tax year beginning after December 31, 2022. The calculation of AFSI for safe harbor scope determination purposes is intended to be simpler than the statutory scope determination because it turns off certain adjustments found in section 56A(c) that would otherwise be required to be made to book income. However, certain section 56A(c) adjustments are *not* turned off. For example, safe harbor AFSI is computed using the rule in section 56A(c)(2)(B), which generally requires a taxpayer to include 100 percent of the AFSI of any member of its tax consolidated group. Further, it appears that a taxpayer is required to include 100 percent of the AFSI of the entities included in its single-employer group for the safe harbor scope determination. Thus, for safe harbor AFSI, a taxpayer generally includes 100 percent of the AFSI of any person who is (i) a member of its book consolidated group, (ii) a member of its tax

[20]Reg. section 1.451-3.

[21]To the extent that a taxpayer engaged in a covered nonrecognition transaction (as defined in the first notice) or holds section 168 property, this assumption is likely counterfactual.

[22]See discussion of investor-level adjustments in Table 3, note a, *infra*. We note that in many cases, including situations where an investor bought its interest after the formation of the investee or engages in a transaction with the equity-method investee, this assumption is likely counterfactual.

Table 3. Right-Sizing for Safe Harbor AFSI

		Single-Employer Group Determination	
		Member of the Single-Employer Group	***Not Member of the Single-Employer Group***
Book consolidated group determination	*Member of book consolidated group*	No right-sizing adjustment to book income is necessary.	No right-sizing adjustment to book income is necessary.
	Not member of book consolidated group	A taxpayer would adjust its book income by: • removing all book income associated with the particular entity;[a] and • adding 100% of the AFSI of the entity. This adjustment may have the effect of treating the entity as if it was consolidated for financial reporting purposes.	No right-sizing adjustment to book income is necessary.

[a]Our discussion in this CAMTyland Adventure generally assumes that there are no investor-level adjustments to book income. However, as limited background, under U.S. GAAP, if the taxpayer accounts for an unconsolidated investment in another entity under the equity method, it may recognize investor-level adjustments in its book income. These investor-level adjustments are recognized in addition to recognizing a share of the investee's income. These investor-level adjustments could include gains or losses related to a change in ownership in the investee (for example, sale or purchase of additional ownership interests), amortization of equity-method basis differences, elimination of profits or losses from transactions occurring between the investor and the investee, impairment, and share-based compensation granted to the investee's employees. See chapter 5 of KPMG's *KPMG Financial Reporting View Handbook: Equity Method of Accounting* (Aug. 2022) for more guidance regarding investor-level adjustments. While not entirely clear, it appears that investor-level adjustments related to an investee should be removed from book income for safe harbor AFSI purposes in this scenario.

consolidated group, or (iii) a member of its section 52 single-employer group.

Because any member of a taxpayer's tax consolidated group will be a member of its single-employer group, the necessary right-sizing analysis vis-à-vis safe harbor AFSI may be done by looking at differences between a taxpayer's book group and the section 52 single-employer group. Table 3 illustrates the right-sizing adjustments that a taxpayer would be required to make to its book income for entities that are included in its book consolidated group, but not its single-employer group, and vice versa, for the safe harbor AFSI.

Note that the tax classification of the investee (for example, corporation or partnership) does not appear to affect the nature or amount of the adjustment to book income for the safe harbor scope determination. In both cases, the book treatment of the investee appears determinative.

Statutory Scope AFSI: Right-Sizing

In Part I of the CAMTyland Adventures series, we also provided an overview of the statutory scope determination. The statutory CAMT rules provide for numerous adjustments to book income to arrive at AFSI. Specifically, three categories of rules may be relevant when right-sizing book income for statutory scope AFSI purposes. First, section 56A(c)(2) has rules regarding related entities; these rules apply with one notable exception. Second, section 59(k)(1)(D), as interpreted by the first notice, provides that section 56A(c)(2)(D)(i)'s distributive share-only rule for partnerships does not apply.[23]

[23]Notice 2023-7, section 7.02.

Third, as discussed above, section 59(k)(1)(D) mandates that for scope determination purposes (but not liability determination purposes), the AFSI of a corporation generally includes its own AFSI and the AFSI of any member of the corporation's single-employer group. Importantly, with one significant caveat, this rule appears to take precedence over the first two categories of rules.

A Large Lagoon: Swimming in the Relevant Related Entity Rules

The CAMT contains different rules for adjusting financial statement income related to: (1) tax-consolidated corporations, (2) non-tax-consolidated corporations, (3) partnerships, and (4) CFCs. The adjustments for tax-consolidated corporations[24] and non-tax-consolidated entities (that is, the first and second adjustment) are discussed above, and we hope our CAMTyland players are familiar with these rules.

Partnerships

CAMTyland's third related-party rule, as (non-)applied in the scope determination context, could leave players floundering. As noted above, the first notice provides that section 56A(c)(2)(D)(i)'s distributive share-only rule for partnerships does not apply for scope determination purposes and, thus, appears to create a special inquiry regarding the correct inclusion regarding a partnership.[25] As a result, it appears that the financial accounting (for example, U.S. GAAP) treatment of a partnership investment is the starting point for the scope AFSI inclusion regarding a partnership investment,[26] subject to a significant caveat. That caveat is: If the partnership is part of the taxpayer's section 52 single-employer group and not part of its book consolidated group, players need to pay careful attention. As noted, the rules of the game require that 100 percent of the AFSI of a member of a single-employer group is included for scope purposes and we believe that this rule trumps the apparent need to look to the book treatment of a partnership investment for scope determination purposes.[27] For example, if a taxpayer owns a 60 percent interest in a partnership so that the partnership is part of the taxpayer's section 52 single-employer group and the taxpayer accounts for the partnership using the equity method, it appears that the equity-method one-line inclusion would be removed and 100 percent of partnership AFSI would be included in statutory scope AFSI.[28]

[24]If a corporation joins in filing a consolidated return for U.S. federal income tax purposes for a particular tax year (that is, is a tax consolidated corporation), AFSI for the group for that year generally takes into account items on the group's AFS that are properly allocable to members of the consolidated group. Section 56A(c)(2).

[25]Several comment letters have asked for clarification regarding the correct amount of the inclusion for a partnership interest for statutory scope AFSI purposes. *See* New York State Bar Association, "Report No. 1473: Report on Selected Issues Relating to the Corporate Alternative Minimum Tax" (Mar. 20, 2023); *see also* American Bar Association Section of Taxation, "Comments on the Corporate Alternative Minimum Tax" (Mar. 20, 2023). Further, the other section 56A(c) adjustments generally will modify the inclusion regarding a partnership.

[26]If the corporation and partnership are not part of the same section 52 single-employer group, in the absence of other guidance, we believe a reasonable approach would be to follow the taxpayer's accounting for the partnership investment. However, to the extent that any transactions between the taxpayer and the partnership were eliminated for financial reporting purposes (for example, because the taxpayer consolidated the partnership), the taxpayer may need to adjust its book income to include the income or loss related to those transactions.

[27]Special considerations apply if a CFC owns a partnership interest. *See* KPMG, "Comments on Initial Guidance Regarding the Application of the Corporate Alternative Minimum Tax Under Sections 55, 56A, and 59 of the Internal Revenue Code Relating to the Distributive Share of Partnership Adjusted Financial Statement Income" (June 26, 2023).

[28]This also appears to be the case for safe harbor AFSI computations. Note that regulations could, instead, take a gross-up approach. Under this approach, in the example, the equity-method one-line inclusion could be multiplied by 1.66 (100%/60%).

Table 4. Right-Sizing for Statutory Scope AFSI

		Single-Employer Group Determination			
		Member of Single-Employer Group or Tax Consolidated Group[a]	Not Member of the Single-Employer Group		Immaterial
		Domestic Corporation or Partnership	Domestic Corporation	Partnership	CFC
Book consolidated group determination	*Member of book consolidated group*	No right-sizing adjustment to book income is necessary.	A taxpayer would adjust its book income by: • removing all book income associated with the particular entity; and • adding (1) any dividends received from the corporate entity and (2) other amounts includable in (or deductible from) gross income for U.S. federal income tax purposes regarding the corporate entity.	A reasonable approach, in the absence of other guidance, would be to start with the taxpayer's financial treatment of the partnership. Therefore, in this scenario, no right-sizing adjustment would be required to book income.[b]	A reasonable approach for a U.S. shareholder of a CFC, in the absence of other guidance, would be to adjust book income by: • removing all book income associated with the CFC; • adding (1) any dividends received from the CFC and (2) other amounts includable in (or deductible from) gross income for U.S. federal income tax purposes for the CFC; and • adding the taxpayer's pro rata share of the CFC AFSI items. Adjustments may need to be made to prevent duplications. If the CFC AFSI items are (across all CFCs) negative, no adjustment is made and the CFC loss is carried forward.

Table 4. Right-Sizing for Statutory Scope AFSI *(Continued)*

		Single-Employer Group Determination			
		Member of Single-Employer Group or Tax Consolidated Group[a]	Not Member of the Single-Employer Group		Immaterial
		Domestic Corporation or Partnership	Domestic Corporation	Partnership	CFC
	Not member of book consolidated group	A taxpayer would adjust its book income by: • removing all book income associated with the particular entity; and • adding 100% of the AFSI of the particular entity. In certain fact patterns (for example, where there are no transactions between the entities and the entities share an AFS), this adjustment generally has the effect of treating the entity as if it was book consolidated.	Same as above.	Same as above.[c]	A reasonable approach for a U.S. shareholder of a CFC, in the absence of other guidance, would be to adjust book income by adding the taxpayer's pro rata share of the CFC AFSI items. Adjustments may need to be made to prevent duplications. If the CFC AFSI items are (across all CFCs) negative, no adjustment is made and the CFC loss is carried forward.

[a]As noted, all members of a taxpayer's tax consolidated group generally will be members of the taxpayer's single-employer group.

[b]It is currently unclear what amount of book income would be included for the partnership in this scenario because of NCIs. That is, whether the taxpayer would include 100 percent of the partnership's AFSI or if it would be permitted to exclude the portion of AFSI that is attributable to the NCI holders.

[c]In this scenario, if the taxpayer accounts for its investment using either the fair value method or measurement alternative method under U.S. GAAP, this means that its AFSI would include the unrealized gains and losses associated with remeasuring the investment to its fair value that are included in book income.

CFCs

CAMTyland's fourth related-party rule — section 56A(c)(2)(C)'s pro rata share rule — requires a player to be completely submerged in the game's rules. A player cannot apply the pro rata share rule without first understanding another rule: A foreign corporation without income effectively connected with a trade or business does not have AFSI, but the foreign corporation does have an AFS.[29] However, CAMTyland's pro rata share rule provides that if, and only if, a taxpayer is a U.S. shareholder of one or more CFCs, the taxpayer generally must include its pro rata share of income shown on the AFS of each of its CFCs ("CFC AFSI items").[30] Because of this rule, the CAMT functions as a worldwide, full-inclusion system. Said differently, the language of this CFC pro rata share rule does not suggest the existence of CFC-level AFSI; rather, the CFC AFSI items (whether or not they are akin to effectively connected income) need to be taken into account by direct or indirect owners who are U.S. shareholders of the CFC when computing their AFSI.

Further, a player must understand the interaction of the pro rata share rule with another rule. As noted, the rules of the game require that 100 percent of the AFSI of a member of single-employer group is included for scope purposes, and we believe that this rule trumps the applicable section 56A(c) related-party rules. However, the interaction of this rule and the pro rata share rule is likely to confuse even advanced players. Because a foreign corporation's (including a CFC's) AFSI includes only items that are akin to ECI, CFCs will have AFSI only in very limited circumstances. Therefore, the single-employer rule has limited significance to CFCs. The more significant CFC inclusion would be a U.S. shareholder's pro rata share inclusion from its CFCs.

Also, the pro rata share rule raises several technical and practical questions that even advanced players will be unable to answer. For example, this section 56A(c)(3) pro rata share rule appears to apply in addition to the section 56A(c)(2)(C) adjustment for non-tax-consolidated corporations if, and only if, there is a U.S. shareholder. Thus, for a CFC, a U.S. shareholder appears to include both tax amounts — specifically dividends and gain under section 56A(c)(2)(C) — and book amounts — specifically a pro rata share of CFC book items under section 56A(c)(3). This could result in a duplication if CFC income is included in AFSI both when earned and when distributed, unless section 56A(c)(15)'s regulatory directive regarding duplicated items applies.[31] Until guidance is issued, a taxpayer may need to grapple with whether section 56A(c)(15) language is self-executing in this fact pattern. In some situations (for example, when the CFC holds multiple classes of stock or when the U.S. shareholder holds the interest in the CFC through one or more partnerships), the correct (pro rata) amount to include for an item of AFSI may be unclear.

Almost Out of the Lagoon

Table 4 illustrates the statutory scope AFSI right-sizing adjustments discussed above.[32]

Liability AFSI: Right-Sizing

Unlike the safe harbor scope determination and the statutory scope determination, the single-employer group rules are not relevant for the liability determination. Therefore, taxpayers are not required to include 100 percent of the AFSI of members of the single-employer group and not required to identify differences between their book consolidated group and single-employer group for the liability determination.

However, because a taxpayer is required under section 56A(c)(2)(C) to adjust its book income for domestic corporations not included in its tax consolidated group for the liability determination, a taxpayer must be able to identify differences between its book consolidated group and tax consolidated group.

[29] This is clear from both section 56A(c)(3), which refers to a U.S. shareholder's share of income "taken into account in computing the net income or loss set forth on the applicable financial statement (as adjusted under rules similar to those that apply in determining adjusted financial statement income)," and section 56A(c)(4), which states that the principles of section 882 apply to the determination of AFSI. Thus, the rules of CAMTyland carve out income that is not effectively connected with a U.S. trade or business out of a foreign corporation's AFSI.

[30] Section 56A(c)(3)(A). However, if this computation yields a negative adjustment, no adjustment is made for the year under this rule and instead the negative amount of CFC AFSI items is carried forward and may reduce future inclusions of CFC AFSI items (but not below zero). Section 56A(c)(3)(B).

[31] *See* KPMG, "Comments on the Treatment of CFC Dividends and Partnership Taxes" (June 23, 2023).

[32] Even when no right-sizing adjustments are required, taxpayers will need to make adjustments under section 56A(c).

Table 5. Right-Sizing for Liability AFSI

		Entity Type			
		Tax-Consolidated Domestic Corporation	Non-Tax-Consolidated Domestic Corporation	Partnership	CFC
Book consolidated group determination	*Member of book consolidated group*	No right-sizing adjustment to book income is necessary.	A taxpayer would adjust its book income by: • removing all book income associated with the corporation; and • adding (1) any dividends received from the corporate entity and (2) other amounts includable in (or deductible from) gross income for U.S. federal income tax purposes regarding the corporation.	It is unclear how a taxpayer should determine its distributive share of the partnership's AFSI. We would generally expect a downward right-sizing adjustment to book income.	A reasonable approach for a U.S. shareholder of a CFC, in the absence of other guidance, would be to adjust book income by: • removing all book income associated with the CFC; • adding (1) any dividends received from the CFC and (2) other amounts includable in (or deductible from) gross income for U.S. federal income tax purposes for the CFC; and • adding the taxpayer's pro rata share of CFC AFSI items. Adjustments may need to be made to prevent duplications. Special considerations also apply if the aggregate CFC AFSI items are negative.

Table 5. Right-Sizing for Liability AFSI *(Continued)*

		Entity Type			
		Tax-Consolidated Domestic Corporation	Non-Tax-Consolidated Domestic Corporation	Partnership	CFC
	Not member of book consolidated group	A taxpayer would adjust its book income by: • removing all book income associated with the entity; and • adding 100% of the AFSI of the entity. In certain fact patterns (for example, where there are no transactions between the entities and the entities share an AFS), this adjustment generally has the effect of treating the entity as if it was book consolidated.	Same as above.	It is unclear how a taxpayer should determine its distributive share of partnership AFSI.	A reasonable approach for a U.S. shareholder of a CFC, in the absence of other guidance, would be to adjust book income by adding the taxpayer's pro rata share of the CFC AFSI items. Adjustments may need to be made to prevent duplications. If the CFC AFSI items are (across all CFCs) negative, no adjustment is made and the CFC loss is carried forward.

Also, since the distributive share-only rule for partnerships and the pro rata share rule for CFCs apply for liability determination purposes, right-sizing adjustments required to be made to book income in computing liability AFSI will vary depending on the type of entity. Table 5 illustrates the right-sizing adjustments for liability AFSI.[33]

Conclusion

Today's CAMTyland Adventure provides instructions for a taxpayer to identify its book consolidated group, tax consolidated group, and single-employer group. While a player may believe that they are close — or should be close — to the rainbow-colored space in front of King Kandy's Castle after completing this step, that space remains far, far away.[34] ■

[33]Even when no right-sizing adjustments are required, taxpayers will need to make adjustments under section 56A(c) and (d).

[34]The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only, and does not necessarily represent the views or professional advice of KPMG LLP.