White House Proposal on Book Income Minimum Tax Evokes Angst

by Emily L. Foster

The Biden administration's proposed minimum tax on book earnings is spurring concerns about administrability, the disparate treatment of tax incentives, and Treasury's implicit transfer of tax policy decisions to the overseers of financial statement reporting.

According to Treasury's green book explanation of the revenue provisions in President Biden's fiscal 2022 budget plan, released May 28, the proposal to impose a 15 percent minimum tax on the book earnings of large corporations would generate $148 billion in revenue over the 10-year budget window.

The tax is targeted at the disparity between the large profits that corporations report to their shareholders — and on which they reward their executives — and the minimal to no taxable income on their returns that frees them from federal tax obligations. Companies with global book income in excess of $2 billion would be subject to the tax.

Treasury explained in the green book that the computation of "book tentative minimum tax" would be based on worldwide pretax book income "calculated after subtracting book net operating loss deductions from book income," along with other general business credits and foreign tax credits.

"Additionally, taxpayers would be allowed to claim a book tax credit (generated by a positive book tax liability) against regular tax in future years but this credit could not reduce tax liability below book tentative minimum tax in that year," the green book says.

Libin Zhang of Fried, Frank, Harris, Shriver & Jacobson LLP pointed out that the regime would allow credits but not deductions in computing the minimum tax, which could effectively encourage companies to turn deductions into credits because the former wouldn't be useful under the proposed minimum tax.

Zhang noted, for example, that corporations that purchase clean energy property would get the benefit of an energy tax credit but wouldn't get to apply the bonus depreciation on that property in computing the minimum tax, even though it's an incentive to encourage investments in solar energy.

Treasury estimated that 120 corporations in a typical year report pretax net income of $2 billion or more, reduced from prior estimates of 200 companies. Treasury said in April that about 45 corporations would have paid a minimum book tax liability under the proposal in recent years, but it didn't provide an update on that number in the green book.

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Despite the threshold being high and the application limited, some clarifications would be helpful, Kevin M. Jacobs of Alvarez & Marsal Taxand LLC told *Tax Notes*.

Jacobs observed that the proposed approach seems to launch off the previous corporate alternative minimum tax that was repealed by the Tax Cuts and Jobs Act, noting a new book NOL deduction and the carryforward of credits. But the associated complexities would require a lot of tracing and other mechanics for companies to comply with the potential rules, he added.

Lee G. Zimet of Alvarez & Marsal Taxand said it's surprising that the administration continues to prefer going back to book income — a concept that Congress temporarily implemented for tax years 1987 through 1989 but was fraught with difficulties — yet described the proposed "intricate tax" in less than one page.

Zhang pointed out that one issue that hadn't been addressed in former minimum tax variations is the different rules regarding consolidation — those for consolidated tax returns and those for financial statement reporting purposes. It will be interesting to see how any new regulations address that, he added, because "as an intellectual matter, that needs to be built in the systems."

Because there's a much lower threshold for consolidation for financial statements, corporations that aren't part of a consolidated return for tax purposes might need to recalculate their book income to conform with how they compute income on their tax returns, Jacobs suggested.

Multinationals that would be subject to the tax might consider spinning off parts of their businesses, but that raises the question whether Treasury regulations would allow for that, Zimet noted.

Tax Policy Shifting Hands

A common criticism of Biden's proposal is that it would effectively put tax policy in the hands of the Financial Accounting Standards Board, which establishes financial accounting and reporting standards for organizations that follow U.S. generally accepted accounting principles.

Governments generally prefer to exercise taxing power — that is, they decide how much revenue to collect and "change the levers of society through the tax code" — but in this case, Congress seems to think it's a good idea to delegate taxing power to a private institution, Zhang said.

While a minimum tax on book income "could be effective in raising current taxes, there are a lot of questions on how it would be implemented," Sarah Pisacich of KPMG LLP said May 27 during a panel of the virtual Federal Bar Association Insurance Tax Seminar. She agreed that because it's a tax that's based on book income and not taxable income, the biggest question is the implicit role of FASB.

"I'm a little bit nervous about using the . . . FASB," added Daniel J. Kusaila of Crowe LLP, who joined Pisacich on the panel.

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Kusaila pointed to FASB's guidance under Accounting Standards Codification 825, "Financial Instruments," which results in unrealized gains and losses flowing through a company's reported earnings. "We know that's outside the tax code, so I'm a little bit concerned," he said, suggesting that many other differences exist between book and taxable income.

Exceptions Incoming?

Companies with the most exposure to the alternative minimum book tax include, for example, capital-intensive businesses that take advantage of bonus depreciation and immediate expensing in computing taxable income but must apply economic accounting principles for financial statement purposes and amortize the investment cost over the life of the assets.

Companies that might have significant differences between book and taxable income could also be making use of other incentives, such as tax-exempt bonds, or "maybe it's just timing issues with something recognized for book but not recognized for tax," Pam Olson of PwC said May 27, speaking on another panel of the virtual Federal Bar Association seminar.

Olson pointed out that the corporate AMT repealed by the TCJA was a timing issue and included credits, but that many companies were never in a position to use their credits.

"That dynamic is partly what leads us to a book minimum tax," said Tom West, Treasury deputy assistant secretary for business tax, who joined Olson on the panel. "If a company is never going to really end up paying any current tax, pulling some of that liability forward, I think, can be appropriate."

West said he didn't think companies should be penalized for "taking advantage of preferences or credits that Congress has promulgated and encouraged, [but] . . . at the same time, I think with the minimum tax proposal, as we are putting it forward, it's really trying to bring some temporal equity . . . by pulling some of that tax liability into the current years."

That revenue can then be used for infrastructure programs that will benefit the corporate taxpayers subject to the minimum tax, West added.

Regarding base broadeners and any exemptions from the minimum book tax, West said, "I think that's a conversation we'll be having over the next few months." ■