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October 16, 2023

Internal Revenue Service
CC:PA:LPD:PR (Notice 2023-64)
Ben Franklin Station
Washington, D.C. 20044

Re: Comments on Notice 2023-64

Dear Sir or Madam:

The Institute of International Bankers ("IIB") appreciates the interim guidance regarding the corporate alternative minimum tax ("CAMT") issued in Notice 2023-64 (the "Notice").[1] While the Notice provides helpful guidance in many respects, additional clarity regarding the determination of AFSI for U.S. branches and subsidiaries of foreign banks would resolve ambiguity and provide a more administrable, reliable method for taxpayers to comply with their obligations under CAMT.

In particular, we urge the Treasury Department to include in proposed regulations a clear rule permitting foreign-parented groups with U.S. subsidiaries and branches to determine their AFSI based on a "bottom-up" approach that starts with the financial statements and supporting records used for purposes of Schedule M-3, typically U.S. GAAP financial statements (for a U.S. consolidated group) or the applicable income statement of a U.S. branch. As discussed in more detail below, we believe this approach is consistent with how the financial reporting systems of a foreign-parented group with U.S. operations are used to prepare the financial statements of the U.S. entities in the group, and how taxpayers and the IRS ensure the business income and expenses of the U.S. entities are accurately presented. A top-down approach would require the development of new financial accounting and tax compliance systems solely for this purpose, without producing a more accurate picture of AFSI.

I. BACKGROUND & SUMMARY

CAMT generally applies a new alternative minimum tax regime to certain U.S. taxpayers based on such taxpayer's "applicable financial statement income" ("AFSI"). AFSI is broadly defined in

[1] The Institute of International Bankers represents internationally headquartered financial institutions from over 35 countries doing business in the United States. Our members consist mostly of foreign banking organizations that conduct banking operations in the United States through branches, agencies, and bank subsidiaries, and nonbanking operations through subsidiaries such as commercial lending firms, broker-dealers, and investment advisers. Our members' U.S. banking assets are over $3.5 trillion, and their U.S. operations fund 25% of all commercial and industrial bank loans made in the United States, contributing to the vitality of U.S. capital markets. Additionally, our members play a key role in the distribution and market making for U.S. government securities, as foreign-owned primary dealers constitute 14 out of the 25 primary dealers in U.S. Treasury securities. Our members also provide services that are critical to connecting foreign customers to the U.S. market, and vice versa.

section 56A(a) as "the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement for such taxable year" with significant adjustments.[2]

The starting point for AFSI is the taxpayer's applicable financial statement ("AFS"), but the statute requires many adjustments to the net income shown on such AFS. Deriving AFSI from the AFS is particularly complex for foreign taxpayers and other taxpayers whose financial results are reported on a financial statement that is commingled with non-U.S. taxpayers. While the statute expressly contemplates determining the AFSI of a taxpayer that is included in a Consolidated AFS and references existing principles under section 451(b),[3] it is not clear in practice how those principles apply to foreign-parented groups under the Notice. Broadly, there are two approaches available for foreign-parented taxpayers to create an AFS for purposes of CAMT compliance with respect to U.S. operations (in subsidiary or branch form):

- Bottom-Up: The U.S. subsidiary or branch starts with separate source documents, such as the income statement and other financial statements and books and records that it uses to prepare its Form 1120 (in the case of a U.S. subsidiary) or Form 1120-F (in the case of a U.S. branch) Schedule M-3 for the taxable year.
- Top-Down: The process starts with the global parent's consolidated AFS and works down to the U.S. subsidiary or U.S. branch through a multi-step process that eliminates items that are not attributable to the U.S. subsidiary or branch, a process that would be novel and, for most (if not all) taxpayers, exist solely for purposes of complying with CAMT.

The Notice provides some interim guidance on this issue and looks to the supporting books and records for purposes of attributing Consolidated AFSI to a taxpayer without specifying that a "bottom-up" approach is or is not acceptable. While we understand that Treasury and the IRS did not specify a "bottom-up" approach in the Notice in order to provide taxpayers and the IRS flexibility to implement CAMT under *either* a bottom-up or top-down approach, the rules described in the Notice as drafted would in practice require a burdensome "top-down" approach by mandating that the foreign parent's financial statements represent the sole AFS of both the U.S. subsidiaries and U.S. branch.

We strongly recommend that proposed regulations further refine the approach articulated in the Notice and clearly permit a "bottom-up" approach that implements CAMT consistently with its purpose while minimizing compliance and examination burdens on both the IRS and taxpayers by:

- Using the foreign parent's AFS *solely* for determining whether a taxpayer is an "applicable corporation" subject to CAMT.
- Using the highest priority AFS of the taxpayer for determining substantive tax.

[2] The statute and Notice refer to the "financial statements" of the Taxpayer. In general, the net income of such taxpayer would be set forth on an Income Statement or similar statement, although the statute appears to allow flexibility so long as a taxpayer has an AFS. A "financial statement" should not be conflated, however, with "books and records." As used in this letter, "books and records" refers to a taxpayer's general ledger system and supporting documentation, while the term "financial statements" means a statement derived from the books and records that could be treated as an AFS.

[3] Section 56A(c)(2)(A).

- For a U.S. consolidated group that prepares GAAP financial statements used for Schedule M-3 compliance, this would be such financial statements and supporting documentation.
- For a U.S. branch that does not have standalone financial statements, the income statement and books and records used for Schedule M-3 compliance following a "bottom-up" approach.

- The statute provides authority to define an AFS differently for scoping and substantive tax purposes, but if Treasury has doubts regarding its authority, the proposed regulations could permit taxpayers to elect to be treated as an applicable corporation and call off the special rule applicable to FPMGs (described below).

II. PREVIOUS COMMENTS REGARDING BOTTOM-UP

IIB previously submitted comments (the "2022 Letter") regarding the application of CAMT to U.S. branches and subsidiaries of inbound banks, and we appreciate Treasury and the IRS taking those comments into consideration in drafting the Notice.

- The 2022 Letter addressed two issues:
  - Identifying the "applicable financial statement" within the meaning of Section 56A(b) ("AFS") for a U.S. branch and U.S. subsidiaries of a foreign banking organization; and
  - How to "[apply] the principles of section 882," as required by Section 56A(c)(4), to compute the U.S. branch's "adjusted financial statement income" within the meaning of Section 56A(a) ("AFSI").

This letter supplements the comments regarding the first issue (AFS of a branch or banking subsidiary), which recommended that:

- The AFS of a branch should be the income statement and other financial statement(s) and books and records that it uses to prepare its Form 1120-F Schedule M-3 for the taxable year (in accordance with the rules set out in the Instructions to Form 1120-F Schedule M-3).
- The AFS of a subsidiary should be the income statement and other financial statement(s) and books and records that the U.S. corporation (or the parent of the Section 1502 consolidated return group that includes the U.S. corporation) uses to prepare its Form 1120 Schedule M-3 for the taxable year (in accordance with the rules set out in the Instructions to Form 1120 Schedule M-3).

The proposals in the 2022 Letter were intended to implement CAMT by identifying financial statements that are reliable, prepared in accordance with accepted financial accounting standards, and used by the taxpayer for a significant non-tax business purpose that involves sharing the financial results with third parties who rely on those financial results for a significant non-tax purpose.

As described below, the Notice appears to adopt these general principles, but then implements a set of rules that denies use of the financial statements for Schedule M-3 as the AFS. Proposed regulations should expressly permit the use of the financial statements and supporting

books and records used for purposes of Schedule M-3 to be treated as the AFS of a U.S. branch or subsidiary of a foreign bank.

III. APPLICABLE RULES IN NOTICE 2023-64

A. Statutory Framework for Determining AFS and AFSI

Section 56A(b) defines an AFS as "an applicable financial statement (as defined in section 451(b)(3) or as specified by the Secretary in regulations or other guidance) which covers such taxable year." Section 451(b) provides rules that, in some circumstances, requires book-tax conformity and therefore serves as a logical framework to build upon for CAMT.

Section 56A(c)(2)(A) contemplates that a U.S. taxpayer's results could be reported on a consolidated financial statement and provides that "if the financial results of a taxpayer are reported on the applicable financial statement for a group of entities, rules similar to the rules of section 451(b)(5) shall apply." Existing regulations under Section 451(b)(5) provide that the books and records that were used to provide inputs into the global financial statement are used to determine the items on such global financial statement that are attributable to a U.S. taxpayer, with adjustments being needed for items that were eliminated in consolidation.[4]

B. Relevant Rules in Notice 2023-64

The Notice generally implements the statutory framework described above with one important deviation regarding foreign-parented multinational groups ("FPMGs"). Specifically, section 4 of the Notice provides priority rules for determining a taxpayer's AFS, and the given order follows the priority of Treas. Reg. § 1.451-3 with an addition of a federal income tax return as a lowest-priority AFS:

- A U.S. GAAP financial statement has highest priority.
- If a taxpayer does not have a U.S. GAAP financial statement, certain IFRS statements are given next priority.
- Other government or regulatory statements and then unaudited external statements may qualify as an AFS if a taxpayer does not have a qualifying U.S. GAAP or IFRS statement.
- Finally, a taxpayer's federal income tax return will constitute an AFS is there is no higher priority qualifying AFS.

For most foreign-parented banks, the highest priority financial statement of the global parent are IFRS statements, but frequently a component of the group (generally U.S. subsidiaries) will have a higher-priority U.S. GAAP financial statement.

Section 4.02(5)(a) of the Notice provides that, "[i]f a Taxpayer's financial results are consolidated with the financial results of one or more other Taxpayers on a Consolidated AFS (as defined in section 2.03(1) of this notice), the Taxpayer's AFS is the Consolidated AFS. However, except as provided in section 4.02(5)(b) of this notice, if the Taxpayer's financial results are also

[4] *See generally* Treas. Reg. § 1.451-3(h).

separately reported on an AFS that is of equal or higher priority to the Consolidated AFS under section 4.02(1) of this notice (Separate AFS), then the Taxpayer's AFS is the Separate AFS." Accordingly, for a typical foreign-parented bank, the U.S. GAAP financial statements would constitute the AFS for all taxpayers that have such a financial statement, and the global parent's IFRS statements would constitute the AFS for all other taxpayers.

The next sub-section, however, appears to call off this rule and instead require use of the foreign parent's IFRS financial statements as the AFS. In particular, a special rule in Section 4.02(5)(b)(ii) provides that, "if a Taxpayer is a member of a FPMG and if the FPMG Common Parent (as defined in section 2.04(3) of this notice) prepares a Consolidated AFS (FPMG Consolidated AFS) that includes the Taxpayer, the Taxpayer must use the FPMG Consolidated AFS, regardless of whether the Taxpayer's financial results also are reported on a Separate AFS that is of equal or higher priority to the FPMG Consolidated AFS." This means that despite having a U.S. GAAP financial statement used for Schedule M-3 compliance purposes, a U.S. subsidiary of a foreign banking organization will be required to use the foreign parent's IFRS financial statement as its AFS.

Section 5.02(3)(c) generally provides that, "[i]f a Taxpayer's AFS is a Consolidated AFS . . . the Taxpayer must determine the amount of the portion of the net income or loss of the AFS Group . . . set forth on the income statement included in the Consolidated AFS (Consolidated FSI) that is the Taxpayer's FSI." A Consolidated AFS is defined in Section 2.03(1) such that for a foreign-parented banking group, the foreign parent's IFRS financial statements would constitute the Consolidated AFS of the group. Section 5.02(3)(c)(i) provides that for purposes of attributing AFSI to a taxpayer that is included on a Consolidated AFS, "the portion of Consolidated FSI that is the Taxpayer's FSI must be supported by the Taxpayer's separate books and records (including trial balances) used to create the Consolidated AFS and generally would equal the FSI that the Taxpayer would have reported had the Taxpayer prepared a Separate AFS."

While this rule does not use the term "top-down" or "bottom-up" to describe the approach required to determine AFSI, and therefore could arguably be read to permit either approach, we understand that the separate books and records must be reconciled with the Consolidated AFS in order to meet the "supported by the Taxpayer's separate books and records" standard. Such an approach to Section 5.02(3)(c)(i) and the structure of the rules in the Notice requiring the global parent's AFS to be the AFS for all members of an FPMG effectively requires taxpayers to use a "top-down" approach by requiring the foreign-parent Consolidated AFS to serve as the starting point, and then determine Consolidated FSI attributable to the U.S. subsidiary or branch.

IV. CAMT PRINCIPLES & NEED FOR BOTTOM-UP APPROACH

The Notice provides helpful guidance regarding many uncertainties under CAMT. Despite the lack of formal Congressional reports addressing the intent of CAMT, we believe the text and policy aims of the statute establishes general principles that should inform the issues discussed in this letter:

- Non-Tax Purpose: By using a statement of the taxpayer's financial results for the year computed in accordance with accounting principles and used by the taxpayer for a non-tax business purpose that is shared with one or more third parties who rely on those results for some significant non-tax purpose, CAMT ensures that taxpayers' reported income is subject to both

review by the tax authority and also relied upon (and thus potentially verified) by an independent third party.

- Primacy of U.S. GAAP: The cross-reference to section 451(b)(3) in section 56A(b) clarifies that Congress intended that financial statements prepared in accordance with U.S. GAAP should be used for CAMT purposes when available.[5] This is also reflected in the approach to Schedule M-3, which prioritizes U.S. GAAP financial statements.[6]
- Administrability: We further assume that the regulatory regime should reflect a general principle that CAMT should be implemented in a manner that is administrable, efficient, and effective for taxpayers and the Service.

All of these principles are sensible and derived from the statutory language or general tax administration principles more broadly. One principle that the Notice appears to reflect that is not derived from the statute, however, is a singular, inflexible definition of an AFS. As described above, the Notice requires all members of a FPMG to use an IFRS-based Consolidated AFS, even if a taxpayer that is a member of such group prepares a higher-priority AFS. We do not believe that section 56A mandates this result. In fact, we believe there are compelling policy and administrative reasons to use the Consolidated IFRS statement for scoping purposes, but use a more specific AFS for substantive tax determinations.

A. Scope & Application

For purposes of determining whether a taxpayer is subject to CAMT in the first instance (i.e., an "applicable corporation" as defined in section 59(k)), using the foreign parent's IFRS-prepared financial statements is sensible. In particular, it is relatively easy to test the $1 billion threshold in section 59(k)(1)(B)(i) by looking at a single line on an IFRS prepared financial statement rather than compile and reconcile multiple AFS of members of the group (even if some of such members have a GAAP AFS).

In addition to being easier for taxpayers and the Service, the proposal to deviate from GAAP for a FPMG and override the primacy of GAAP also prevents GAAP-IFRS disparities from causing income to be inappropriately excluded from CAMT, or for taxpayers to inappropriately be excluded as an "applicable taxpayer." Stated differently, we understand there is some concern that using GAAP financial statements for some group members and IFRS for others could result in the sum of the parts of the worldwide group to not equal the whole. While we believe this concern is likely immaterial to

[5] Section 451(b)(3)(A) (first priority) includes financial statements prepared in accordance with U.S. GAAP, while financial statements prepared on the basis of international financial reporting standards are lower priority under section 451(b)(3)(B). Under this hierarchy, a GAAP-based statement used for "any other substantial nontax purpose" outranks the equivalent of a Form 10-K filed with a foreign equivalent of the SEC. The general priority rules for financial statements are derived from Rev. Proc. 2004-34 (2004-1 CB 991). *See* H.R. Rep. No. 115-466, at 429 (2017) (indicating that the rules under Rev. Proc. 2004-34 were intended to apply for purposes of section 451(b)). Congress further incorporated these principles into CAMT.

[6] The Schedule M-3 instructions provide that, "if the U.S. corporation filing a U.S. income tax return (or the U.S. parent corporation of a U.S. consolidated tax group) prepares its own financial statements but is controlled by another corporation (U.S. or foreign) that prepares financial statements that include the U.S. corporation, the U.S. corporation (or the U.S. parent corporation of a U.S. consolidated tax group) must use for its Schedule M-3, Part I, its own financial statements and not the financial statements of the controlling corporation." The instructions then adopt rules that prioritize GAAP.

the overall administration of CAMT as a vast majority of taxpayers will be clearly in-scope or out, using a single Consolidated AFS ameliorates this risk to the extent it exists.

B. Substantive Tax

Once a group of taxpayers is in scope, however, the general principles described above and reflected in the Notice should control the determination of AFSI of a particular taxpayer for purposes of determining substantive tax under CAMT. Using the Consolidated AFS of the foreign parent undermines two of the key principles set forth above (U.S. GAAP and administrability) while providing no clear benefit to the third (non-tax purpose).

First, the rule inappropriately creates two different tax bases for similarly situated taxpayers. Such disparate treatment is unwarranted: There is no discernable reason that a U.S. corporation that prepares GAAP-based financial statements should calculate its liability under CAMT using a different tax base depending on whether it is foreign-parented or not.[7] Furthermore, as an alternative minimum tax that is compared with regular tax, financial statements prepared on a GAAP basis employ an income base that overlaps with the U.S. regular tax base more than an IFRS financial statement. That is, a U.S.-imposed alternative minimum tax based on financial accounting should look first and foremost to U.S. accounting standards. Only when financial statements prepared in accordance with such standards are unavailable should an AFS prepared on a different basis (such as IFRS) be used.

Second, anchoring to the Consolidated AFS creates administrative complexity by effectively mandating a "top-down" approach, which we understand may not have been intended. By beginning with the Consolidated AFS, the AFSI of a taxpayer must be determined starting from the "top" and then working down by eliminating irrelevant data, reversing elimination entries and accounting standardization adjustments, *and* translating from the foreign parent's currency to U.S. dollars. This complexity is further compounded for foreign parents that prepare financial statements using a different fiscal year than the GAAP financial statements of the U.S. group and taxable year. For example, if the foreign parent uses an October 31 year end, but the U.S. consolidated group uses a calendar year for book and tax purposes, the "top-down" approach would apparently require the taxpayer to annualize the foreign parent's IFRS financial data to align with the consolidated group taxable year, then somehow attribute a portion of such annualized AFSI to the U.S. consolidated group.

Finally, such an approach would create significant compliance difficulties given that "top-down" can only be implemented *after* book consolidation is complete. This would result in a new, complicated, tax-only process being implemented at the same time the global books are to be closed and reported to the public.

A much simpler approach would use the data already mapped to be U.S. tax relevant (and typically recorded in U.S. dollars) and that forms the basis for the financial statements used for purposes of Schedule M-3. Starting from the bottom and working up would conceptually reach the

[7] While the relevance of any treaty would depend upon the particular taxpayer, we would encourage Treasury to adopt an approach that would avoid any potential violations of a treaty nondiscrimination articles.

same AFSI, but without the need to deconstruct the global parent's AFS. This would also resolve the difficulties inherent in year-end mismatches between a foreign parent and a U.S. group.

Finally, the purpose of CAMT is not undermined by using the highest priority AFS for a particular taxpayer (that is, the section 451 regulations establish a hierarchy that reflects a judgment that a higher priority statement is preferable for U.S. tax purposes). If anything, using an AFS that includes a greater proportion of U.S. relevant income is likely to produce a more accurate, reliable measure of AFSI than attempting to attribute to the taxpayer a portion of a larger Consolidated AFSI, which includes additional income that is irrelevant from a U.S. substantive tax perspective.

We believe the statute provides ample authority for this approach. Specifically, section 56A(b) defines an AFS as the financial statement designated in regulations, and section 56(e) provides general authority to "provide for such regulations and other guidance as necessary to carry out the purposes of this section." This grant of authority regarding an AFS should be sufficiently broad to permit an approach that uses the global Consolidated AFS for purposes of section 59(k)(1)(B) (scoping for the group), but then uses the highest priority AFS of the particular taxpayer for purposes of determining AFSI. Accordingly, a U.S. consolidated group that prepares GAAP financial statements would use such statements for CAMT purposes. For a taxpayer such as a U.S. branch that does not have a separate financial statement but is included in the IFRS financial statements of the foreign bank, the AFS should be the financial statements used for purposes of completing Schedule M-3, created using a bottom-up approach.

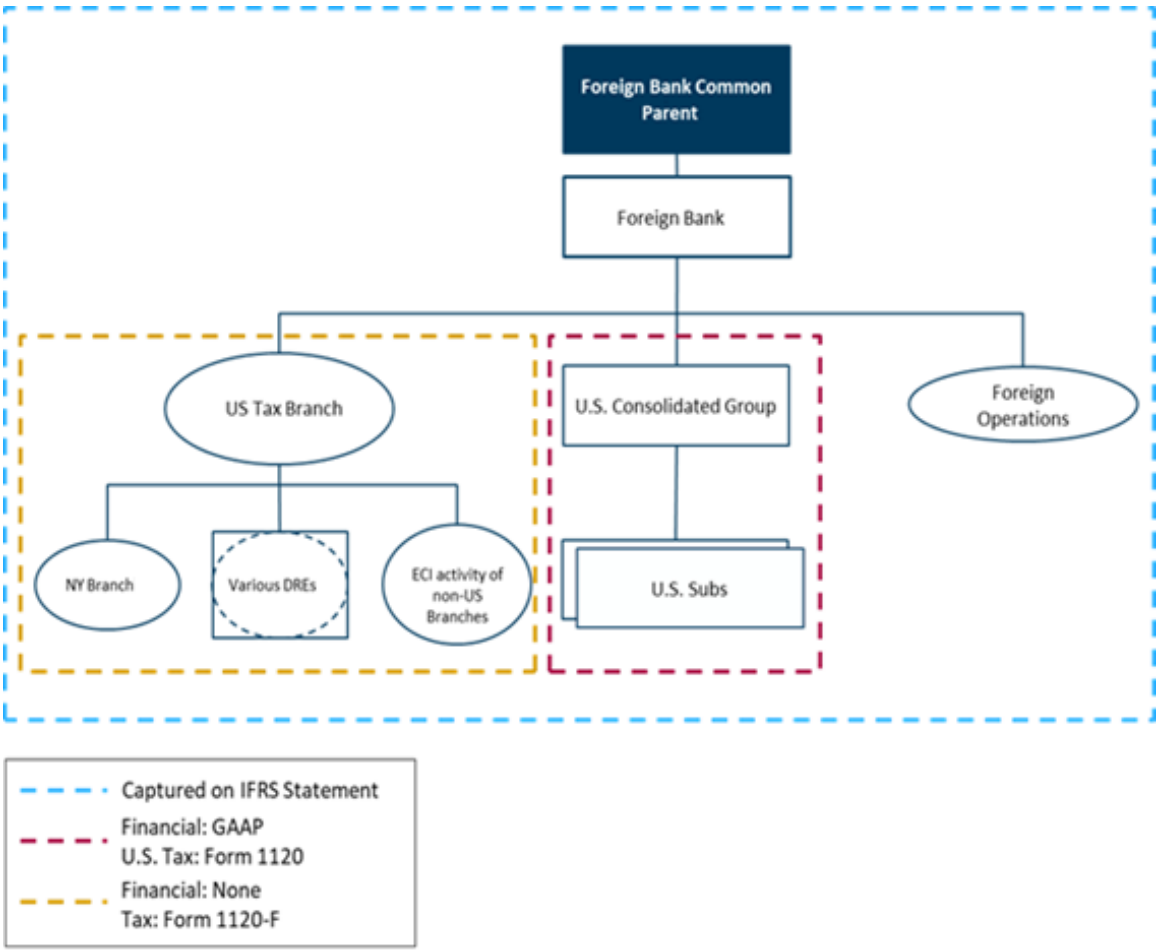
If there were any concerns regarding the authority for such an approach, however, then taxpayers should be permitted to elect to be treated as an applicable corporation without regard to section 59(k)(1)(B), and then the FPMG rule should not apply and such taxpayer's AFS should be its highest priority AFS.

V. INFORMATION SYSTEMS OF INBOUND BANKS & SCHEDULE M-3

As described below, the financial reporting systems of any multinational enterprise are inherently complex, but an understanding of how transactions are booked and eventually incorporated into financial statements, tax returns, and regulatory filings is critical to understanding the benefits of a bottom-up approach that uses the Schedule M-3 inputs relative to the challenges of a top-down approach.

A. Financial Reporting Systems of Foreign Banks

As a general matter, multinational enterprises (including inbound banks) use a general ledger system for financial reporting. The general ledger system forms the basis for the various financial statements and tax returns relevant to an inbound banking enterprise:



Every financial statement and tax return is ultimately derived from transactions recorded in the general ledger system. Within such system, data is compiled from single entries on a "book" through multiple levels of consolidation and elimination to meet various regulatory and financial reporting requirements. As noted in the diagram above, there is no separate financial statement for the U.S. tax branch. Therefore, a U.S. tax branch financial statement must be constructed from various parts of the general ledger system. This process will vary for each bank, but generally relies on a booking structure that includes the following features:

- **General Ledger Systems**: A system supplied by a third-party maintains all ledgers and sub-ledgers throughout the enterprise, and is reviewed by external accountants.
- **Accounting Entities Are Separately Tracked**
    - Within the general ledger, data is subdivided into accounting "entities" with transactions booked to a particular entity.
    - Accounting entities might be a "legal entity" but also include non-legal entities (for example branches or businesses) and can be designated for any cognizable groups of transactions or activities that should be separately tracked (for example, any regulated branch).

- An accounting entity might exist in multiple "legal" entities and comprise multiple books each with a unique identifier.

- **Coding and Mapping of Entities and Books**

For data management purposes, the General Ledger is mapped using several levels of codes to create the financial statements for each legal entity.

- A General Code is assigned to each legal entity.
- A Sub-General Code is assigned to each accounting entity.
- Lower-level identifiers "Company Code" can be assigned to separate books within each accounting entity such that General or Sub-General Code can include one or many Booking Codes.

Legal Entity	Accounting Entity	Company Name	Company Code	Description
1	11	Bank Country X	7100	Bank Branch
			7111	Commodities Branch
			7112	Power and Gas
	12	Bank Bonds Branch	7200	Bonds Branch
	13	Bank Fx Branch	7300	Euro
2	21	Loans	7400	Loan Servicing Unit
			7401	Credit Markets
			7402	Global Loans
3	31	Equities	7500	Equities Branch X
			7501	Equities Branch Y

Where there are no separate financial statements for the foreign bank's U.S. tax branch,[8] a process to segregate attributable and non-attributable activity to the U.S. designations is used to determine Schedule M-3 book income. The process aggregates data from the financial statement of the U.S regulated branch (generally the New York Branch) with data derived from a lower general ledger level using company codes, which have been assigned attributable or non-attributable designations. A company code is assigned an attributable designation where U.S. employees are authorized to record transactions within the books included in that company.

Although the exact procedures vary by bank, in general there are opening procedures and on-going review in order to determine that any U.S.-relevant companies and books are so designated in the system. Opening a new company and book requires an approval process that includes the internal tax function. Before approving the new company code, the tax function documents (i) the

[8] As noted earlier, while a Bank's U.S. regulated branch may prepare a Call Report that includes financial statements, the U.S. branch for CAMT purposes (i.e., branch for U.S. federal income tax purposes) generally does not prepare separate financial statements.

expected activity, (ii) who within the organization will be doing the activity, and (iii) the location of the associated costs and revenue.

The general ledger company and accounting entity-opening process is typically backstopped by an annual review conducted by the tax or finance function.

For example, code 11-7112 would refer to the power and gas business within the Country X Bank. In establishing this company code, the tax function (among other teams) would have evaluated whether the transactions recorded on the associated book should be treated as effectively connected with a U.S. trade or business, and if so, such code would have been mapped to an appropriate company code to facilitate U.S. tax compliance, including Schedule M-3 as described below.

B. Schedule M-3

1. U.S. Branch

As the transactions of the foreign bank include income attributable and not attributable to activities conducted in the United States, a process extracts the income, expense, gains and losses related to U.S.-attributable activity ultimately incorporated into the Schedule M-3. The process combines book P&L that is mapped to U.S. activity and adjusted as required under section 882.

In this sense, the income statement used for purposes of Schedule M-3 is compiled using a "bottom-up" approach: Lowest-level data marked in the system as U.S. relevant forms the starting point for the compilation of the "applicable income statement" used in preparing the taxpayer's Schedule M-3, which is necessary because the U.S. tax branch does not compile its own *separate* balance sheet and income statement. Instead its various general ledger items flow into the foreign parent's consolidated financial statement and are audited by external accountants. This method is also used to create a financial report provided to bank regulators, but such a report does not include all of the same data as the Schedule M-3 because a U.S. tax branch includes items that are not part of the regulated branch (i.e., income attributable to activities conducted outside the United States).[9]

2. U.S. Subsidiaries

In general, the Form 1120 Schedule M-3 for the U.S. consolidated group of an inbound bank is simpler in the sense that such groups generally prepare financial statements in accordance with U.S. GAAP. As described above, there is no benefit to requiring such taxpayers to begin with the global Consolidated AFS and attribute AFSI to the U.S. consolidated group when such group already prepares a higher priority financial statement that is provided to regulators and used for purposes of Schedule M-3.

C. Existing IRS Procedures With Respect to Schedule M-3

Once completed in accordance with the procedures described above, the Schedule M-3 becomes part of the tax return of the U.S. branch or consolidated group (as applicable). The Internal Revenue Manual ("IRM") expressly acknowledges the purpose and importance of Schedule M-3,

[9] As described above, the U.S. *tax* branch is distinguishable from a regulated U.S. branch that files Consolidated Reports of Condition and Income (a "Call Report"). The Call Report includes audited financial statements, but such financial statements are incomplete with respect to the U.S. tax branch.

Specifically, the IRM states that "[t]he purpose of the Schedule M-3 is to provide increased transparency and disclosure of the differences between financial statement income and tax return income."[10]

Furthermore, the information provided on Schedule M-3 is critical to Exam, as "[t]he information required on Schedule M-3 provides examiners with data needed to perform more efficient risk analysis and improved audit selection capability"[11]and "Schedule M-3 is a critical schedule for identifying potential tax issues resulting from both temporary and permanent differences between financial and tax accounting."[12]

The IRM accordingly provides detailed instructions regarding how the Service should examine Schedule M-3 and adopts two processes with slightly different objectives: (1) the "minimum income probe," and (2) risk analysis.

- Minimum income probe: Whenever the IRS does an examination, it must do a minimum income probe unless the examination consists of a "limited scope probe" or is a "correspondence examination[] conducted by the Campus."[13] "The minimum income probes are designed as a set of analytical tests intended to determine whether the taxpayer accurately reported income."[14] A minimum income probe of a "business" return includes performing a reconciliation of Schedule M-3.[15] Details on analyzing Schedule M-3, however, are provided on an internal "Technical Guidance" website.
- Risk analysis: Risk analysis "is an on-going process throughout the examination."[16] It is used to "[d]efine the scope of the audit," "[a]ssign the right resources to the issues," and "[e]stablish the case timeline based on all the issue timelines."[17] "A risk analysis must be completed during the planning stage of the examination"; subsequently, it "should be reviewed and updated throughout the examination as warranted."[18] One of the factors considered in the risk-analysis process is an analysis of Schedules M-2 and M-3. As noted, the IRM describes Schedule M-3, in particular, as "a critical schedule for identifying potential tax issues resulting from both temporary and permanent differences between financial and tax accounting."[19] As a result, "[i]t is important to verify that net income per the taxpayer's books agrees with net income per Schedule M-3. It is also crucial to reconcile the taxpayer's worldwide net income (or loss) on Schedule M-3 to the financial statements."[20]

To verify the above procedures, "[t]he taxpayer's workpapers should be obtained for selected Schedule M-3 adjustment calculations and corresponding supporting schedules." These adjustments "should be reviewed to identify potential issues," and "[i]nquiries should be made regarding items or

[10] IRM 4.10.3.8.3(1).
[11] IRM 4.10.3.8.3(1).
[12] IRM 4.46.3.3.5.3(1).
[13] IRM 4.10.4.1.1; IRM 4.10.4.3.1.
[14] IRM 4.10.4.3(2).
[15] IRM 4.10.4.3.4.2(3).
[16] IRM 4.46.3.3(1).
[17] IRM 4.46.3.3(2).
[18] IRM 4.46.3.3.3(1).
[19] IRM 4.46.3.3.5.3(1).
[20] IRM 4.46.3.3.5.3(2).

transactions that have a different treatment for book and tax that are not shown on Schedule M-3."[21]

In summary, the Schedule M-3 is (1) important and credible for audit purposes, (2) familiar to exam, and (3) already audited through well-developed procedures. This existing approach could be leveraged for CAMT purposes to the benefit of taxpayers and the IRS. Taking a top-down approach would create unnecessary administrative complexity—in contrast to the treatment of Schedule M-3 and the underlying books and records, the IRM contains no such procedures addressing the treatment of IFRS prepared financial statements.

D. Relationship to Pillar Two Compliance

We understand that Treasury and the IRS's approach to CAMT documentation is informed in part by Pillar Two and the compliance burden imposed on taxpayers to determine their tax liability based on financial statements rather than tax concepts. As a preliminary matter, we caution against developing CAMT guidance by reference to Pillar Two. CAMT is a currently applicable and unique U.S. domestic law. While CAMT and Pillar Two (when effective) start with financial statement income as a base, the two concepts in theory and in practice are not the same, embodying numerous adjustments to taxes and financial statement income that are very different and consequential. Moreover, the OECD guidance with respect to financial statements and its adjustments continues to evolve. A more stable solution in implementing the U.S. CAMT would be to focus on practical solutions that are already in use and knowable by taxpayers and tax administrators.

To the extent a general approach to Pillar Two is informative, however, it should be noted that a "bottom-up" approach will likely apply for such purposes as well. For example, HMRC has accepted taxpayers' use of the practical "bottom-up" approach to derive the U.S. effective tax rate for Pillar Two purposes. It is likely that other jurisdictions will follow.

VI. NEED FOR ADDITIONAL GUIDANCE

As described above, a "top-down" approach is burdensome for the IRS and taxpayers, inconsistent with existing compliance requirements for Schedule M-3, and would require substantial changes and implementation to existing bank reporting systems while providing no identifiable benefit to the Service. We accordingly recommend that the forthcoming proposed regulations provide that:

- For purposes of determining whether a taxpayer meets the $1 billion threshold of section 59(k)(1)(B)(i), the current FPMG rule in Section 4.02(5)(b)(ii) should apply.
  - This both ensures consistent accounting treatment and provides a relatively easy way to test the $1 billon threshold (by reference to a single Consolidated AFS).
  - To the extent Treasury has any concerns regarding its authority to require the use of a different AFS for purposes of determining whether a taxpayer is an "applicable taxpayer" than for determining AFSI of a taxpayer, a taxpayer

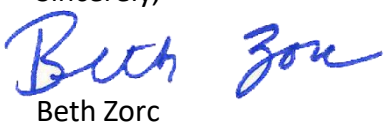
[21] IRM 4.46.3.3.5.3(3).

should be permitted to elect to treat itself as an applicable taxpayer and then use the highest priority financial statements for purposes of determining AFSI.

- For purposes of determining AFSI and calculating substantive tax liability under CAMT, however, the AFS of a taxpayer should be based on the books and records used to prepare the financial statement(s) for purposes of Schedule M-3 filed with Form 1120 or Form 1120-F (as applicable).
    - For a U.S. consolidated group, this would generally be the GAAP based financial statements that are used for Schedule M-3.
    - For a U.S. branch, the income statement and supporting books and records used for Schedule M-3 compliance using a bottom-up approach.

We very much appreciate the efforts of the Treasury Department and the IRS to work with the industry to develop guidance implementing the CAMT that is both practical and administrable for taxpayers and tax administrators while adhering to the intent of Congress. O a The CAMT creates unique challenges and we hope you find the material in this letter useful as you work to develop proposed regulations.

Sincerely,



Beth Zorc

Chief Executive Officer