American Bankers Association

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December 20, 2023

Hon. Lily L. Batchelder
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Daniel I. Werfel
Commissioner
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

RE: Comments on Notice 2023-7 Regarding Treatment of Section 597 Federal Financial Assistance for Corporate Alternative Minimum Tax (CAMT) Purposes

Submitted via regulations.gov and via email

Dear Assistant Secretary Batchelder and Commissioner Werfel:

The American Bankers Association (ABA)[1] submits these comments in response to the request for comments in Notice 2023-7, initial guidance issued by the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) regarding the corporate alternative minimum tax (CAMT) under Sections 55, 56A, and 59.[2] In particular, this letter addresses the application of CAMT to federal financial assistance (FFA)[3] in Section 597 transactions.

In summary, the practical effects of the CAMT will unintentionally increase the costs to the Federal Deposit Insurance Corporation's (FDIC's) Deposit Insurance Fund (DIF) when FFA is provided, and also generally will discourage mid-sized institutions from participating in such transactions. As a result, we recommend Treasury issue guidance that excludes the initial income reported under Generally Accepted Accounting Principles (GAAP) upon the execution of Section 597 transactions from the calculation of Adjusted Financial Statement Income (AFSI) for CAMT purposes.

We appreciate your consideration of the recommendations discussed in this letter.

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[1] The American Bankers Association is the voice of the nation's $23.4 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.6 trillion in deposits and extend $12.3 trillion in loans.

[2] References to "Section" or "Sections" are to the Internal Revenue Code of 1986, as amended (Code), or Treasury regulations promulgated thereunder.

[3] FFA is defined as any money or property provided by the FDIC (or similar institution) to a bank under the National Housing Act, Federal Home Loan Bank Act, Federal Deposit Insurance Act, or under any similar provision of law, and includes net worth assistance, loss guarantee payments, yield maintenance payments, cost to carry or cost of funds reimbursement payments, expense reimbursement or indemnity payments, and interest (including original issue discount) on an agency obligation. *See* I.R.C. §597(c); Treas. Reg. § 1.597-1(b).

Introduction

In the Spring of 2023, the United States witnessed certain banks entering receivership by the FDIC. The FDIC conducted orderly liquidations of those banks by selling their assets and liabilities to acquiring banks with a partial guarantee of the assets in what is commonly referred to as an "FDIC-assisted transaction." The tax treatment of FFA received in FDIC-assisted transactions is governed by Section 597. The subject of this letter is the appropriate treatment of FFA-related income under the CAMT to prevent the unintended consequence of restricting the available liquidity of acquiring corporations—specifically, mid-sized banks—during the orderly liquidation of banks in FDIC receivership.

Recommendation

We recommend that Treasury and the IRS exercise their authority under Section 56A(c)(15) and 56A(e) to provide adjustments to AFSI that exclude immediately-recorded GAAP-based income that is attributable to FFA provided in a Section 597 FDIC-assisted transaction, and instead treat the income in a manner consistent with intended regular federal tax treatment under Section 597. We specifically recommend that Treasury and IRS issue guidance providing that:

> Any financial accounting gain resulting from application of the accounting standards used to prepare the applicable financial statement of an acquiring institution in an FDIC-assisted transaction that is attributable to federal financial assistance, as defined in Section 597(c) and Treas. Reg. § 1.597-1(b), is excluded for purposes of calculating AFSI of the acquiring bank for the taxable year in which the acquisition occurs. Instead, such income is accounted for in the same manner as it is accounted for under Section 597.

Background

The CAMT is a 15% minimum tax imposed on the AFSI of applicable corporations. Applicable corporations are those with average annual AFSI exceeding $1 billion for any three consecutive tax years preceding the current tax year. [4] AFSI is defined as the net income or loss of the taxpayer as set forth on the taxpayer's applicable financial statements, which includes financial statements prepared under GAAP, as adjusted by provisions defined in Section 56A. The amount of CAMT in excess of the reported net income tax is a payment that creates a tax credit carryforward (a temporary deferred tax asset) that is excluded from Tier 1 capital for bank regulatory purposes.[5]

[4] Section 59(k)(1)
[5] *See* 12 CFR 1240.22(a)(3).

Once a corporation qualifies as an applicable corporation, it remains an applicable corporation until it has either a change in ownership or a series of years (as determined by the IRS) have passed during which its average annual AFSI does not exceed $1 billion.[6]

In each FDIC-assisted transaction, the acquiring bank purchases assets and assumes liabilities of the bank in receivership with consideration it paid in a Section 597 transaction. An excess of the value of the assets acquired over the liabilities assumed and consideration paid is recorded under GAAP at the time of the transaction as a gain (net of deferred tax liabilities).[7] The gain is largely the result of FFA.

For federal income tax purposes, an FFA gain under Section 597 is taxed over time, as the acquired assets (e.g., loans and other bank assets) are resolved and income is realized. In other words, FFA (often provided in the form of loss guarantees, yield maintenance payments, cost to carry or cost of funds, expense reimbursements or indemnity payments)[8] is not immediately includible in taxable income and the related taxes are paid concurrently with the resolution of the related assets acquired from the bank in receivership. This treatment under Section 597 avoids a disincentive companies may have from acquiring assets or otherwise participating in an FDIC liquidation by virtue of the upfront tax cost.

Section 56A does not expressly exempt GAAP income attributable to FFA in Section 597 transactions from inclusion in the general AFSI computations. However, Section 56A(c)(15) grants broad authority to Treasury and the IRS to "issue regulations or other guidance to provide for such adjustments to [AFSI] as the Secretary determines necessary to carry out the purposes of this Section." In addition, Section 56A(e) grants broad authority to issue "regulations and other guidance as necessary to carry out the purposes of this Section."

Policy Considerations

FFA is intended to generate capital and liquidity to initially support a bank that acquires assets from the FDIC. In 1989, Section 597 was amended to provide that FFA would be taxable to the bank in receivership, and it was intended that concurrently that bank's net operating losses and built-in losses would be used to offset any initial potential tax liability on the FFA.[9] Thus, the intent of the amendment was to defer any tax to the acquiror until the associated assets were disposed of. The immediate inclusion of GAAP income attributable to FFA within AFSI accelerates taxation of the FFA, however, effectively reducing the intended capital support provided to the acquiror by the FDIC. This appears contrary to the purpose of Section 597 and counter to the FDIC's efforts to liquidate a bank in receivership in an orderly and expeditious manner.

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[6] *See* Section 59(k)(1)(C).
[7] *See* ASC 805.
[8] Treas. Reg. § 1.597-5(d)(1), (d)(2)(ii).
[9] *See* H. Rep. No. 101-222 (1989).

Accelerating the taxation of the FFA is not necessary to carry out the primary purpose of the CAMT. Income attributable to FFA arises in a fairly limited context for a very limited number of taxpayers—typically in times of financial stress. Thus, the impact can be a significant one-time event, rather than an accounting treatment that results in tax expense less than 15% of AFSI over a more persistent time period.

On the contrary, particularly for mid-sized banks in the United States, the immediate inclusion of income attributable to FFA in AFSI may cause the acquiring bank that would not otherwise meet the AFSI threshold to qualify as an applicable corporation. This result seems unintended—especially considering that once a corporation qualifies as an applicable corporation under the CAMT, it will *always* be considered an applicable corporation (unless future IRS guidance provides further clarification). The related ongoing operational burden of calculating AFSI to these institutions would likely be onerous.

Adverse Effect on Orderly and Expeditious Resolution of banks in FDIC Receivership

Accelerating the taxation of the FFA is also inconsistent with the limited purposes of FDIC-provided FFA program. While an acquiring bank's initial income attributable to FFA is recorded as income on the financial statements for GAAP purposes, this gain reflects the fact that the FDIC has agreed to mitigate, to a limited extent, the risk associated with the acquiring bank taking on the distressed assets and, therefore, to help prevent erosion of the acquiring bank's capital on account of the acquisition. This often may be necessary to obtain regulatory approval for the transaction.

The payment of CAMT creates a CAMT carryforward that can offset tax in future tax years. However, for regulatory capital purposes, a CAMT carryforward must be excluded from a bank's Tier 1 regulatory capital. As a result, application of CAMT to FFA received in Section 597 transactions adversely impacts the acquiring bank's otherwise sound capital position. Simply stated, application of CAMT to FFA effectively converts a portion of the FFA into an asset that must be excluded from the bank's regulatory capital during the critical time when banking regulators and the acquiring bank must make every effort to ensure adequate regulatory capital levels that support the resolution of the bank in receivership. This is in direct conflict with the very purpose of FFA.

Immediate inclusion of FFA income in AFSI also disincentivizes banks from purchasing banks or bank assets from FDIC receivership for two reasons.

First, the purchasing bank might be considered an applicable corporation for CAMT purposes indefinitely, whereas it might otherwise never have been. The challenging ongoing AFSI calculations may simply be unpalatable for many potential acquiring banks that are not yet applicable corporations—and this will discourage their participation in an FDIC liquidation. This issue is of particular concern to mid-sized banks, as many of these institutions may not qualify as applicable corporations but-for the FFA recorded upon execution of the transaction.

Second, an upfront cash tax liability for the acquiring bank will impact the pricing of the transaction and reduce the amount of funds that the FDIC is able to realize from the resolution of the acquired bank. This will result in less funds available for creditors by reason of the additional 15% FFA needed to make the immediate CAMT cash payment capital-neutral.

The practical effect of immediate inclusion of FFA income to the CAMT is that when the FDIC seeks to resolve banks falling into receivership in the future, the banks acquiring the assets from the FDIC must anticipate the impact of the transaction on CAMT and likely increase their requests for FDIC assistance in the transaction so that the acquisition is financially sound "net of CAMT." This, in turn, will reduce the amount available to creditors of the bank in receivership and increase costs to the FDIC, an outcome at odds with the mandate of the FDIC. In other words, including FFA within AFSI will *increase* the costs to the DIF.

Conclusion

Immediate inclusion of FFA within AFSI will diminish the effectiveness of the FDIC in providing FFA and could discourage mid-sized financial institutions from participating in FDIC-assisted transactions. We request that Treasury and the IRS exercise their authority under Section 56A(c)(15) and 56A(e) to provide that income attributable to FFA received in Section 597 transactions be excluded from AFSI until such gain is recognized for regular federal income tax purposes under Section 597. FFA is not the type of income targeted by the CAMT. Indeed, the relief requested only affects a very small number of financial institutions that acquire banks or bank assets from the FDIC in times of financial stress. But the benefits of such an exclusion, including protecting needed capital for FDIC-assisted transactions and preserving the DIF, will enable the FDIC to continue to perform such orderly resolutions in an efficient and equitable manner.

Thank you for your attention to these concerns and for considering our recommendations. Please feel free to contact me (JConnor@aba.com; 571-275-4096) if you would like to discuss this further.

Sincerely,

Joey Connor

cc: Thomas West, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Brett York, Deputy Tax Legislative Counsel, Department of the Treasury
William M. Paul, Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service
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