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Report No. 1532

August 31, 2026

The Honorable Scott Bessent
Secretary of the Department of the
Treasury, and Acting
Commissioner of the Internal
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1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Kevin Salinger
Acting Assistant Secretary (Tax
Policy) of the Department of the
Treasury, and Acting Chief Counsel
of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: NYSBA Tax Section Report No. 1532 – Further Report on the Application of the Corporate Alternative Minimum Tax to Liabilities and to Distressed Taxpayers

Dear Secretary Bessent and Acting Assistant Secretary Salinger:

Please see attached Report No. 1532 of the Tax Section of the New York State Bar Association (the "Report") commenting on the application of the corporate alternative minimum tax ("CAMT") under Sections 55, 56A, and 59 of the Internal Revenue Code to liabilities and to transactions and circumstances commonly associated with financial distress, including debt restructurings, insolvency proceedings, and proceedings under title 11 of the United States Code. The Report builds on the Tax Section's prior CAMT reports and addresses guidance issued to date, including the proposed regulations under REG-112129-23 and subsequent notices providing interim guidance prior to issuance of revised proposed CAMT regulations. It recommends that the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS"), in order to provide a more consistent, predictable, and administrable framework, apply established tax principles more fully to the treatment of liabilities,

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cancellation of debt income, restructuring transactions, emergence from bankruptcy, and related matters.

The Report further recommends consideration of a “Tax Liability Substitution Approach” under which liabilities and the CAMT consequences arising from those liabilities generally would be determined under regular tax principles. The report describes considerations in favor of, and in opposition to, such approach and identifies various technical and interpretive issues that would be partially or fully resolved if such approach were adopted.

We appreciate the opportunity to comment on these important issues and thank Treasury and the IRS for considering the views of the Tax Section. If you have any questions or would like to discuss any aspect of the Report, please do not hesitate to contact us. We would be pleased to assist in any way.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read 'LMG', followed by a horizontal line extending to the right.

Lawrence M. Garrett
Chair

Enclosure

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New York State Bar Association Tax Section

**Further Report on the Application of the Corporate Alternative
Minimum Tax to Liabilities and to Distressed Taxpayers**

August 31, 2026

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Further Report on the Application of the Corporate Alternative Minimum Tax to Liabilities and to Distressed Taxpayers

I. Introduction

This report (the “**Report**”)¹ of the New York State Bar Association (“**NYSBA**”) Tax Section provides comments on the application of the corporate alternative minimum tax (“**CAMT**”) under Sections² 55, 56A, and 59 of the Internal Revenue Code to taxpayers engaged in transactions and circumstances commonly associated with financial distress, including debt restructurings, cancellations or modifications of indebtedness, insolvency proceedings, and proceedings under title 11 of the United States Code (the “**Bankruptcy Code**,” any such case under the Bankruptcy Code, a “**Title 11 Case**,” and such taxpayers, “**Distressed Taxpayers**”³).

This Report reflects our understanding of the current state of administrative guidance, including the proposed regulations issued under REG-112129-23, as amended by the “**Technical Corrections**,” 89 FR 104909 (collectively referred to herein as the “**Proposed Regulations**”), Notice 2025-27, Notice 2025-28, Notice 2025-46, Notice 2025-49, and Notice 2026-7 (collectively, including the Proposed Regulations, the “**CAMT Guidance**”). For purposes of this Report, we assume that, to the extent subsequent guidance conflicts with earlier guidance, the most recently issued guidance reflects the current position of the Department of the Treasury (“**Treasury**,” including as applicable, the Internal Revenue Service, or “**IRS**”).

¹ The principal authors of this Report are Kevin M. Jacobs and Marie Milnes-Vasquez. Substantial research and drafting assistance were provided by Eric Soto and Peter Berry. Helpful comments were received from William Alexander, Kimberly Blanchard, Lawrence Garrett, Stuart Goldring, Robert Kantowitz, Brian Krause, David Schizer, Michael Schler, Linda Swartz, Wade Sutton, Edward Wei, and Sara Zabloutney. This Report reflects solely the views of the NYSBA Tax Section and not those of its individual members or any other party.

² Unless otherwise noted, references herein to “**Section**” are to sections of the Internal Revenue Code of 1986 (the “**Code**”), as amended, references herein to “**Proposed Regulations Section**” and “**Prop. Treas. Regs. §**” are to sections of the Proposed Regulations (as defined herein), and references herein to “**Treasury Regulations Section**” and “**Treas. Regs. §**” are to sections of the regulations promulgated under the Code.

³ For purposes of this Report, the term “**Distressed Taxpayer**” is used as a convenient shorthand consistent with the Prior NYSBA Tax Section Reports (as defined below). The term is not intended to create a separate legal category of taxpayers or to depend upon satisfaction of any particular insolvency, bankruptcy, liquidity, leverage, or financial-distress threshold. Many of the issues discussed in this Report arise from transactions and circumstances that may be encountered by financially healthy taxpayers as well as taxpayers experiencing financial distress. Within the CAMT Guidance (as defined below), the Treasury has adopted a single framework governing indebtedness, cancellation of debt income (“**CODI**”), insolvency, and related consequences, rather than separate regimes for financially healthy taxpayers and taxpayers experiencing financial distress. In line with that approach, the recommendations contained in this Report generally address transactions and circumstances commonly associated with financial distress, regardless of whether a taxpayer would satisfy any particular insolvency or bankruptcy test.

This Report incorporates and reasserts recommendations contained in a report submitted by the NYSBA Tax Section to the Treasury on March 20, 2023 (“**Report 1473**”),⁴ and a report submitted by the NYSBA Tax Section to the Treasury on January 13, 2025 (“**Report 1506**”),⁵ collectively with Report 1473, the “**Prior NYSBA Tax Section Reports**”), to the extent such recommendations remain unaddressed. In certain cases, subsequent guidance has addressed part of a prior recommendation without resolving the underlying issue. In other cases, subsequent guidance has introduced new frameworks that give rise to additional questions. Accordingly, this Report both cross-references prior recommendations and supplements those recommendations where additional guidance is needed.

Part II summarizes our principal recommendations for the Treasury relating to the adoption of an administrable and predictable framework for the application of the CAMT to CODI and Distressed Taxpayers. Part III provides background on the CAMT and the CAMT Guidance, and Part IV discusses our recommendations in detail.

It is important to emphasize at the outset that the issues discussed in this Report are not merely technical questions concerning the interaction of financial accounting and tax accounting principles. The issues addressed in this Report frequently arise when a corporation in financial distress is seeking to preserve enterprise value, restructure its obligations, negotiate with creditors, pursue a sale transaction, obtain financing, or otherwise restructure in order to emerge from financial distress. In those circumstances, financial statement income (“**FSI**”) may arise from liability remeasurements, debt modifications, debt-for-equity exchanges, fresh-start accounting adjustments, restructuring mechanics, or other accounting events that bear little relationship to current economic income or to income that would be recognized under longstanding tax principles.⁶

The significance of these issues extends beyond taxpayers that are insolvent or subject to a Title 11 Case. Many of the issues discussed in this Report may arise in debt restructurings, financing transactions, liability management transactions, acquisitions, dispositions, recapitalizations, and other significant corporate transactions undertaken by financially healthy corporations as well as corporations experiencing financial distress. As a result, uncertainty regarding the treatment of liabilities, CODI, attribute reduction, and related matters has implications not only for taxpayers in financial distress, but also for other taxpayers engaged in significant corporate transactions.

⁴ See NYSBA Tax Section, Report 1473: “Report on Selected Issues Relating to the Corporate Alternative Minimum Tax” (Mar. 20, 2023).

⁵ See NYSBA Tax Section, Report 1506: “Report on Proposed Regulations on the Corporate Alternative Minimum Tax” (January 13, 2025).

⁶ Report 1473, pp. 82-89; Report 1506, pp. 188-193.

The resulting tax effects, nevertheless, are particularly consequential where a taxpayer is experiencing financial distress. Such a taxpayer may recognize substantial FSI arising from restructuring mechanics, liability adjustments, fresh-start accounting, or other accounting conventions notwithstanding the absence of corresponding economic income or regular taxable income. In certain circumstances, a resulting CAMT liability may affect negotiations among debtors, creditors, lenders, investors, and other stakeholders. In the bankruptcy context, such liabilities may also affect creditor recoveries, restructuring alternatives, and, in some cases, the feasibility of a plan of reorganization itself. These concerns were recognized in both the Prior NYSBA Tax Section Reports and the Preamble to the Proposed Regulations, which acknowledged that troubled companies should not be impaired from achieving solvency or emerging from bankruptcy by CAMT liabilities arising from debt discharge income and fresh-start reporting.⁷

We acknowledge and appreciate the Treasury's efforts to address the application of the CAMT to Distressed Taxpayers thus far. However, we respectfully believe that significant issues remain that require further consideration. If the CAMT rules treat financial statement adjustments arising from liability modifications, debt restructurings, fresh-start accounting, and similar events as adjusted financial statement income ("**AFSI**") without an administrable and predictable framework for conforming those adjustments to established tax principles, the result may be the imposition of CAMT on amounts that do not reflect a taxpayer's economic ability to pay tax, are inconsistent with the economic realities of financial distress and thus impede effective implementation of needed restructurings, and are difficult to administer by taxpayers and the government alike in practice. Such results would also be difficult to reconcile with the Treasury's stated position that the CAMT is directed principally at situations in which profitable taxpayers report substantial FSI while paying little regular federal income tax as a result of differences between book and tax accounting.⁸

We therefore recommend that the Treasury and the IRS consider principles-based revisions to the current guidance. We also provide specific recommendations addressing issues that would remain under the current rules if those broader recommendations are not adopted.

Consistent with the Prior NYSBA Tax Section Reports, this Report does not address whether, as a policy matter, a corporate minimum tax should be imposed as a backstop to the regular tax system. That determination involves broader economic and policy considerations beyond the scope of this Report. Rather, this Report focuses on the administration of the statutory

⁷ See Preamble, 89 Fed. Reg. 75104, 75114 (Sept. 13, 2024) ("absent adjustments to AFSI for income from debt discharges and fresh-start reporting, troubled companies would have additional tax liabilities under the CAMT that could impede the companies from achieving solvency or emerging from bankruptcy. Avoiding this unnecessary harm also would protect the interests of the government in its tax collection efforts.")

⁸ See Kevin Salinger, Deputy Assistant Secretary for Tax Policy, Remarks Before the NYSBA Tax Section (Jan. 13, 2026), Tax Notes Doc. 2026-1184.

framework enacted by Congress and the guidance issued thereunder. It is becoming increasingly apparent that the CAMT provisions applicable to Distressed Taxpayers create a highly complex regime marked by significant uncertainty. The concerns extend beyond taxpayer compliance burdens. Taxpayers and the IRS may be required to administer and audit parallel systems governing liabilities, CODI, attribute reduction, restructuring transaction consequences, and related adjustments, frequently using concepts that overlap with, but do not fully correspond to, established tax principles. Further, the rules in the tax system (including the impact of timing of items) that govern these concepts are intertwined in complex ways that belie straightforward solutions. The failure to adequately address these issues may result in inclusions of income for CAMT purposes that are difficult to reconcile with either the economic consequences of the underlying transaction, established tax principles governing realization of income, or the historic rehabilitation policies reflected in a number of provisions of the Code. These concerns are reflected throughout this Report and underlie many of our recommendations, particularly those intended to promote greater predictability, consistency, administrability, sensitivity to applicable rehabilitation policies, and conformity with well-established tax principles.

II. Summary of Principal Recommendations

A. Principles-Based Recommendations

1. The Treasury should apply regular tax principles to restructuring transactions and to CODI in two respects:
 - a. The Treasury should clarify that transactions involving financially distressed taxpayers are subject to the same regular tax transaction principles that the Treasury applies elsewhere under the CAMT regime, with appropriate CAMT-specific inputs (the “**Uniform Transaction Tax Principles Approach**”).
 - b. The Treasury should apply regular tax principles in determining and administering CAMT CODI and provisions materially intertwined with CODI (the “**CODI Tax Principles Approach**”), modifying those principles only to the extent necessary to account for CAMT-specific attributes, basis, or credits.
2. The Treasury should consider going beyond the CODI Tax Principles Approach by adopting an approach under which, for all taxpayers, the existence, characterization, and amount of liabilities, and the CAMT consequences arising from those liabilities, generally would be determined under regular tax principles rather than applying the relevant accounting standard (the “**Tax Liability Substitution Approach**”). In the CODI context, financial statement CODI (or the equivalent) would be excluded from AFSI and replaced with CODI, including its existence, amount, character, timing, and eligibility for exclusion, as determined under regular tax principles. In connection with the adoption of a Tax Liability Substitution Approach, the Treasury should consider whether to adopt a rule analogous to the tax benefit rule that would recapture

a prior reduction to AFSI to the extent a financial statement liability that created a deduction or other benefit for CAMT purposes subsequently is reduced below the amount of the regular tax liability or otherwise is not satisfied (e.g., where a financial statement liability that previously reduced AFSI and does not correspond to a tax liability gives rise to a reduction in AFSI and is later forgiven or reduced).

B. Cancellation of Debt Income

Scope of CODI

3. If the Treasury does not adopt the Tax Liability Substitution Approach, the Treasury should provide that adjustments to liabilities that do not represent borrowing transactions for regular tax purposes generally should not give rise to any AFSI (including, but not limited to, CODI). Alternatively, if the Treasury determines that such liabilities should give rise to AFSI, the Treasury should clarify whether such amounts constitute CAMT CODI or another category of AFSI and provide an administrable framework governing their treatment.
4. If the Treasury does not adopt either the Tax Liability Substitution Approach or the CODI Tax Principles Approach and instead maintains a separate CAMT concept of indebtedness, it should provide rules for classifying liabilities as recourse or nonrecourse in a manner largely congruent with regular tax principles, including for liabilities that do not have a direct regular tax analogue.

Determination of CODI

5. If the Treasury does not adopt the Tax Liability Substitution Approach, the Treasury should determine the existence and amount of CAMT CODI by reference to principles analogous to Section 108(e), including with respect to provisions of Section 108(e) for which no analogous rule is provided in Notice 2025-46, subject to CAMT-specific modifications. In particular, the Treasury should:
 - a. With respect to the analogue to Section 108(e)(2) in section 4.03(6) of Notice 2025-46, clarify whether a reduction in FSI or in AFSI is the appropriate analogue to a regular tax deduction;
 - b. With respect to contributions of indebtedness to capital under the analogue to Section 108(e)(6) in section 4.03(7) of Notice 2025-46, provide that, where the transferor is not required to and does not determine CAMT basis in such indebtedness, its CAMT basis is deemed equal to its regular tax basis in such indebtedness, clarify the treatment of contributions of partnership indebtedness by partners; and confirm whether the AFSI increase resulting from any excess of the indebtedness over the transferor shareholder's CAMT basis constitutes CODI;

- c. With respect to the analogue to Section 108(e)(8) in section 4.03(8) of Notice 2025-46, clarify the applicable valuation standard for stock or partnership interests transferred and whether the resulting AFSI increase constitutes CODI;
- d. Adopt principles analogous to Section 108(e)(4) governing related-party acquisitions of indebtedness; and
- e. Adopt principles analogous to Section 108(e)(10) and Treas. Regs. § 1.1001-3 governing debt modifications and exchanges.

Exclusion of CODI

- 6. With respect to the insolvency exception, if the Treasury does not adopt the Tax Liability Substitution Approach, the Treasury should apply principles analogous to Section 108(a)(1)(B) using CAMT-specific inputs. In particular, the Treasury should:
 - a. Provide that any liabilities that are capable of generating CAMT CODI and any assets that are taken into account for purposes of the CAMT CODI determination should be taken into account for purposes of determining the extent to which a Distressed Taxpayer is insolvent;
 - b. Permit a Distressed Taxpayer with CAMT CODI but without regular tax CODI to measure its assets using either their fair market value as of the date of the discharge or their book value per the most recent annual financial statement; and
 - c. Confirm that insolvency is determined immediately before the discharge and is not affected by financial statement consequences arising from the CODI transaction itself.
- 7. With respect to the bankruptcy exclusion, if the Treasury does not adopt the Tax Liability Substitution Approach, the Treasury should apply principles analogous to Sections 108(a)(1)(A) and 108(d)(2) using CAMT-specific inputs. In particular, the Treasury should:
 - a. Retain, and where appropriate, expand, the CAMT-specific timing framework of Notice 2025-46 so that FSI or liability adjustments arising in anticipation of, during, or as a result of a Title 11 Case qualify for treatment analogous to the bankruptcy exclusion where sufficiently connected to a restructuring that ultimately addresses the relevant liability through the Title 11 Case;
 - b. Remove the requirement that the CAMT entity be under the jurisdiction of the court “as the debtor” and apply principles analogous to Section 108(d)(2); and

- c. Clarify the application of the exclusion to disregarded entities and partnerships, supported by administrable mechanisms such as rebuttable presumptions and amended-return procedures.

C. Consequences of CODI: Attribute Reduction and Related Rules

Framework for Attribute Reduction

8. If the Treasury determines that excluded CAMT CODI should result in a reduction of CAMT attributes (consistent with the recommendation of a majority of the Executive Committee), it should apply principles analogous to Sections 108(b) and 1017 for purposes of administering an attribute reduction regime in the CODI context, modified as necessary to coordinate CAMT-specific attributes with regular tax attributes.

Scope and Ordering

9. The Treasury should limit the attributes subject to reduction to financial statement net operating losses (“FSNOLs”), CAMT foreign tax credits, and CAMT basis in covered property. Alternatively, if a broader range of attributes are subjected to attribute reduction, the Treasury should exclude items that lack meaningful tax analogues or that create duplication, circularity, or immediate gain-recognition concerns, such as deferred tax assets, certain pension-related assets, and cash.
10. The Treasury should adopt ordering rules analogous to Treas. Regs. § 1.1017-1(a), including a rule that the CAMT basis of covered property is only reduced if the corresponding regular tax basis is reduced under Section 1017 and only to the extent the CAMT basis exceeds the resulting regular tax basis.

Section 108(b)(5) Election, Partnership Interests, and Timing

11. The Treasury should conform the liability floor rule under section 4.03(4)(b)(iv)(C) of Notice 2025-46 more closely to the flush language of the corresponding regular tax rule in Section 1017(b)(2).
12. The Treasury should provide guidance addressing the treatment of attribute reduction with respect to partnership interests.
13. To the extent a separate CAMT CODI regime is retained, the Treasury should provide a comprehensive mechanism for tracking CAMT attribute reductions and coordinating them with subsequent tax and financial statement events.

Subsequent Revaluations

14. The Treasury should confirm that subsequent financial statement remeasurements of property whose CAMT basis has been reduced through attribute reduction do not give rise to AFSI in the absence of a realization event and should provide coordinating rules ensuring that the same economic item is neither duplicated nor omitted.

D. Applicable Corporation Status in Distress

15. For purposes of determining applicable corporation status, the Treasury should exclude AFSI arising from transactions undertaken in connection with a Distressed Taxpayer's Title 11 Case. To implement this recommendation, the Treasury should adopt one of two approaches:
 - a. An approach under which the AFSI of a Distressed Taxpayer for any year in which it is in a Title 11 Case would be limited to the lesser of (i) its average AFSI for the three taxable years preceding the case (or, if fewer, the number of years it was in existence) or (ii) its AFSI otherwise determined under the CAMT rules (such limit, the "**historic AFSI limit**"), or
 - b. An approach under which AFSI directly attributable to transactions for which the Distressed Taxpayer obtains Bankruptcy Court authorization would be excluded (the "**Bankruptcy Court limit**").

Restart of the Testing Period Following a Title 11 Case

16. The Treasury should adopt an automatic, non-elective rule under which an applicable corporation emerging from a Title 11 Case would cease to be so characterized as an applicable corporation upon emergence, and would be treated, solely for purposes of applicable corporation testing, as a new CAMT entity that has been in existence for fewer than three years under a restarted testing period, subject to certain conditions and limitations.

E. Determination of AFSI for Distressed Taxpayers

Treatment of Title 11 Taxpayers

17. For purposes of determining the AFSI of a Distressed Taxpayer while it is in a Title 11 Case, the Treasury should adopt either the historic AFSI limit or the Bankruptcy Court limit. In connection with the adoption of this rule, the Treasury should consider whether corresponding reductions to FSNOLs or CAMT FTCs are appropriate.

Deconsolidation and Reconsolidation of Distressed Entities

18. The Treasury should permanently exclude from AFSI any amounts of FSI (including CODI), gain, loss, and expense arising solely from deconsolidation, reconsolidation, or similar changes in financial statement consolidation status, and, consistent with Section 56A(c)(15)(A), should provide corresponding adjustments to CAMT attributes, including CAMT basis, to prevent the omission or duplication of items and inappropriate step-ups. Alternatively, the Treasury should provide that such amounts are disregarded initially and included only to the extent the affected deconsolidated subsidiary does not rejoin the financial statement group within a specified period.

F. Emergence from Bankruptcy and Fresh-Start Accounting

Scope of Emergence Transactions

19. The Treasury should clarify the scope of section 8.03 of Notice 2026-7 by defining what transactions constitute an “emergence” from bankruptcy, confirming that the rule applies to fresh-start accounting adjustments and not to transactions that would otherwise produce recognition consequences, and providing illustrative examples of transactions that are and are not within its scope.

Disregarded Entities

20. The Treasury should clarify that section 8.03 of Notice 2026-7 applies to the emergence of a disregarded entity from a Title 11 Case, including a Title 11 Case in which the disregarded entity, but not its regarded owner, is a debtor.

G. FSNOLs

21. The Treasury should permit a taxpayer to offset income arising solely from an accounting method change (including a deemed accounting method change resulting from a change in the applicable financial statement (“**AFS**”)) with available FSNOLs without regard to the general 80% limitation. Alternatively, the Treasury should permit the taxpayer to first reduce its FSNOL balance by the amount of such income and to recognize only an amount equal to the excess of such income over such FSNOL balance.

H. Transactions Involving Distressed Taxpayers

22. The Treasury should confirm that the CAMT consequences of transactions involving Distressed Taxpayers are determined under the Uniform Transaction Tax Principles Approach, rather than under a separate Distressed Taxpayer transactional regime.

I. Treatment of Tax Consolidated Groups

Framework for Tax Consolidated Groups

23. The Treasury should adopt an administrable and predictable framework for the treatment of tax consolidated groups under the CAMT that aligns more fully with the principles of the consolidated return regulations under Section 1502.

CODI Exclusions

24. The Treasury should adopt the principles of Treas. Regs. § 1.1502-28(a)(1) in both determining the insolvency and bankruptcy CODI exclusions for members of a consolidated group and applying attribute reduction in respect of CODI recognized by a member.

J. Reliance and Transition Rules

Continued Reliance

25. The Treasury should provide in the New Proposed Regulations (as defined below) that taxpayers may continue to rely on the CAMT Guidance relating to Distressed Taxpayers for any taxable year beginning before the first taxable year that begins after the issuance of final regulations, subject to the Treasury's ability to identify specific rules as ineligible for continued reliance at the time the New Proposed Regulations are issued.

Transition Rules

26. For taxpayers that adopt the New Proposed Regulations, the Treasury should include clear transition rules addressing the coordination of prior reliance positions, including consistency requirements, and should consider permitting transition adjustments to be taken into account over an appropriate adjustment period, consistent with the approach to accounting-principle changes and AFS restatements under Prop. Treas. Regs. § 1.56A-17(c), as modified by section 10 of Notice 2025-49.

III. Background and Overview of CAMT Guidance

The Proposed Regulations, released on September 12, 2024 (and as amended by the Technical Corrections), provided the first comprehensive framework governing the application of the CAMT. The Proposed Regulations addressed numerous aspects of the CAMT, including foreign corporation transactions, covered recognition and nonrecognition transactions, consolidated groups, partnerships, mark-to-market items, and other computational matters. Importantly for purposes of this Report, the Proposed Regulations also represented the Treasury's first comprehensive effort to address transactions commonly associated with financial distress under the CAMT. The Proposed Regulations provided rules governing CODI, insolvency, bankruptcy,

fresh-start accounting, CAMT attribute reduction, and related CAMT basis adjustments. In doing so, the Treasury expressly recognized that a mechanical application of FSI could produce inappropriate results for Distressed Taxpayers, particularly where FSI arises from debt discharge, fresh-start reporting, restructuring-related remeasurements, or similar adjustments that do not reflect operating income. The Proposed Regulations therefore established the foundation for the Treasury's subsequent efforts to reconcile financial statement principles with tax concepts in the distressed-taxpayer context.

Rather than relying exclusively on financial statement results or simply incorporating existing tax rules, the Proposed Regulations generally adopted CAMT-specific rules designed to address circumstances unique to distressed companies. At the same time, the Treasury selectively incorporated concepts derived from existing tax law, including insolvency, bankruptcy, and attribute reduction concepts reflected in Section 108 and Section 1017. Therefore, the resulting framework represented a hybrid approach that relied in part on financial statement concepts, in part on tax concepts, and in part on entirely new CAMT-specific rules. The Treasury explained that these provisions were intended to prevent CAMT liabilities from impeding a troubled company's ability to achieve solvency or emerge from bankruptcy. Report 1506 provided our comments regarding the Proposed Regulations, including the provisions applicable to Distressed Taxpayers.

Since the release of the Proposed Regulations, the Treasury has issued several pieces of interim guidance with respect to the CAMT.

- **Notice 2025-27** (released June 2, 2025) primarily provides guidance regarding the simplified applicable corporation test. The Notice does not specifically address insolvency, bankruptcy, indebtedness, CODI, fresh-start accounting, or other issues discussed in this Report.
- **Notice 2025-28** (released July 29, 2025) primarily provides guidance regarding partnerships and partnership-related CAMT issues. Although certain recommendations contained in this Report involve partnerships, Notice 2025-28 does not focus specifically on financial distress, insolvency, bankruptcy, or debt restructuring issues.
- **Notice 2025-46** (released September 30, 2025) significantly expanded the Treasury's framework governing indebtedness, CODI, insolvency, bankruptcy, and related CAMT consequences. Whereas the Proposed Regulations principally addressed the consequences of excluded CODI and related CAMT attribute adjustments, Notice 2025-46 expanded the Treasury's approach by creating a comprehensive framework governing the determination of indebtedness and CAMT CODI itself. Notice 2025-46 generally adopted a financial-statement-based concept of indebtedness and established detailed rules governing whether CAMT CODI exists and, if so, the amount of that CAMT CODI,

including separate rules applicable to recourse liabilities, nonrecourse liabilities, liabilities modified during a Title 11 Case, and liabilities involved in debt-for-equity exchanges and debt contributions to capital. In doing so, the Treasury moved beyond addressing the consequences of CODI and instead constructed a standalone CAMT regime governing the identification, characterization, and measurement of indebtedness and CODI.

At the same time, Notice 2025-46 incorporated an increasing number of concepts derived from existing tax law. The Treasury adopted insolvency and bankruptcy exclusions modeled on Section 108 concepts, created an attribute reduction regime drawing heavily from Sections 108 and 1017, adopted rules analogous to Sections 108(e)(6) and 108(e)(8), and incorporated concepts resembling existing partnership CODI rules. Thus, while Notice 2025-46 established a separate CAMT framework for determining whether CODI exists and the amount of that CODI, it increasingly incorporated concepts derived from established tax law to govern the exclusions, consequences, and administration of CODI. Importantly, the rules governing the existence and amount of CAMT CODI apply broadly and are not limited to taxpayers experiencing financial distress.

- **Notice 2025-49** (released September 30, 2025) primarily addresses reliance on various portions of the CAMT Guidance and provides guidance regarding selected AFSI adjustments. Although the Notice does not directly address insolvency, bankruptcy, CODI, or attribute reduction, it reflects the Treasury’s continued willingness to depart from pure financial statement treatment where the Treasury determines that financial statement results do not provide an appropriate or administrable measure of AFSI. Most notably, the Notice permits taxpayers to disregard certain gains and losses arising when assets are marked-to-market for AFS purposes but not for regular tax purposes. As discussed below, this development is relevant to Distressed Taxpayers because it reflects the Treasury’s recognition that unrealized financial statement remeasurements do not always provide an appropriate measure of the CAMT base.
- **Notice 2026-7** (released February 18, 2026) further expanded the Treasury’s guidance applicable to Distressed Taxpayers and reflected a continued movement toward incorporating established tax principles into the CAMT framework. Most significantly, the Notice provides extensive guidance regarding emergence from bankruptcy and fresh-start accounting. Section 8.03 generally disregards financial statement gain or loss attributable to emergence from bankruptcy and determines CAMT basis without regard to most fresh-start accounting basis adjustments. In doing so, the Treasury moved away from reliance on financial statement outcomes and instead adopted rules designed to prevent fresh-start accounting from independently creating CAMT consequences.

Notice 2026-7 also adopted consolidated return concepts for purposes of CAMT attribute reduction. In particular, section 8.02 applies principles derived from Treas. Regs. § 1.1502-28 in determining the effect of CAMT attribute reduction within consolidated groups. Accordingly, by the time Notice 2026-7 was issued, the Treasury had moved beyond simply recognizing that Distressed Taxpayers presented special issues and had begun systematically incorporating concepts derived from Sections 108, 1017, the consolidated return regulations, and other established tax authorities when addressing the consequences of financial distress, bankruptcy, and debt restructuring transactions.

Viewed collectively, the Proposed Regulations, Notice 2025-46, and Notice 2026-7 demonstrate an evolving approach to the treatment of Distressed Taxpayers under the CAMT. The Treasury initially recognized that a mechanical application of FSI could produce inappropriate results in the distress context and thereafter responded through an increasing combination of CAMT-specific rules and concepts imported from existing tax law. The Treasury then developed additional rules governing indebtedness, CODI, insolvency, bankruptcy, attribute reduction, fresh-start accounting, and related matters. In doing so, the Treasury incorporated concepts derived from existing tax law to a greater extent, while nevertheless maintaining a separate CAMT framework for determining many of these issues. Although this guidance has addressed many concerns identified in the Prior NYSBA Tax Section Reports, significant questions remain regarding consistency with established tax principles, the proper treatment of numerous transactions commonly encountered by Distressed Taxpayers, and the administrability of the system created. The remainder of this Report focuses on those issues.

IV. Discussion of Recommendations

A. Statutory Authority and Principles-Based Recommendations

1. Need for an Administrable and Predictable Framework for Distressed Taxpayers

The CAMT generally begins with net income reported on a taxpayer's AFS,⁹ also known as FSI, and then adjusts that amount as provided in Section 56A. Section 56A contains multiple grants of

⁹ AFS means, with respect to any taxable year, an applicable financial statement (as defined in Section 451(b)(3) or as specified by the Secretary in regulations or other guidance) that covers that taxable year. Section 56A(a). Under Section 451(b)(4), an applicable financial statement includes a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), a financial statement made on the basis of International Financial Reporting Standards ("IFRS"), or a financial statement filed with any other regulatory or governmental body or used for credit purposes or reporting to shareholders.

Similar to our Prior NYSBA Tax Section Reports, this Report assumes that GAAP is the relevant accounting standard. We acknowledge that certain foreign parented groups report on IFRS and that IFRS is therefore also relevant to the CAMT, but a detailed discussion of IFRS is beyond the scope of this Report. For a more detailed discussion associated with GAAP and permitted alternative accounting methods, see footnote 67 of Report 1473.

authority for the Treasury to provide adjustments, regulations, and other guidance necessary to carry out the CAMT rules. Among other things, Section 56A(c)(15) authorizes the Treasury to provide adjustments to AFSI that the Treasury determines are necessary to carry out the purposes of Section 56A, including adjustments to prevent the omission or duplication of items and to carry out the principles of subchapter C and subchapter K. Section 56A(e) separately authorizes the Treasury to provide regulations and other guidance necessary to carry out the purposes of Section 56A.

The Treasury has explained that “the CAMT tax base is not financial statement income; it is adjusted financial statement income,” and that Congress “did not intend CAMT to apply to every difference” between FSI and taxable income.¹⁰ The Treasury also has stated that it has exercised its authority to provide adjustments where a “purely mechanical application of book income would produce results inconsistent with CAMT’s purpose.”¹¹ These statements reflect the Treasury’s view that Section 56A(c)(15) and (e) authorizes adjustments determined to be necessary to prevent unadjusted financial statement results from producing outcomes that the Treasury regards as inconsistent with its view of the objectives of the CAMT regime. As discussed below, the Treasury has already relied on that authority and its view of such objectives in a variety of contexts, including contexts in which its CAMT guidance has disregarded, replaced, or modified financial statement treatment by reference to regular tax concepts or results.¹²

Those considerations are particularly acute in the context of taxpayers experiencing financial distress, especially those subject to a Title 11 Case. Bankruptcy is not merely a more extreme form of financial distress. Rather, it is a congressionally prescribed legal regime that can fundamentally alter creditor rights, liability treatment, capital structure, and financial reporting in ways that often do not correspond to economic income or to taxable income under well-established tax principles and that do not have a direct analogue outside a Title 11 Case. In particular, FSI arising during a Title 11 Case or upon emergence from bankruptcy often reflects restructuring mechanics, including liability adjustments, fresh-start accounting, or other remeasurement events, rather than operating income or economically realized income.

Treating such items as AFSI without adjustment may give rise to a CAMT liability, which, under section 503(b) of the Bankruptcy Code, would be characterized as an administrative expense.

¹⁰ Salinger Remarks, Tax Notes Doc. 2026-1184.

¹¹ *Id.*

¹² The NYSBA Tax Section does not express a definitive conclusion on the scope of the Treasury’s regulatory authority. Accordingly, if the Treasury determines that it has authority to do so, we recommend that it issues regulations consistent with the principal recommendations summarized in Section II of this Report. However, if the Treasury concludes that it lacks authority to do so through regulations, we urge the Treasury to seek a statutory amendment adopting the recommendation or expressly authorizing regulations to implement it.

Administrative expenses are generally entitled to priority over prepetition creditor claims and are paid in full prior to distributions to creditors. A large CAMT charge arising merely as a result of transactions during a Title 11 Case, including emergence, could therefore make confirmation of a plan infeasible. As noted in our Prior NYSBA Tax Section Reports,¹³ the Preamble to the Proposed Regulations recognizes that a Distressed Taxpayer should not be unduly impeded from restructuring its affairs as a result of a CAMT liability.¹⁴ Accordingly, imposing CAMT on such amounts may produce results inconsistent with the concerns the Treasury itself identified in the Proposed Regulations.

The existing guidance already recognizes that Distressed Taxpayers require special treatment. Prop. Treas. Regs. § 1.56A-21 provided rules for determining CAMT consequences resulting from insolvency or bankruptcy, including rules for determining AFSI and adjustments to CAMT basis or other CAMT attributes from the discharge of indebtedness. Notice 2025-46 and Notice 2026-7 further provided interim guidance addressing domestic corporate transactions, tax consolidated groups, acquired FSNOLs, and certain built-in items.

We appreciate that the Treasury has attempted to address many issues raised by Distressed Taxpayers. However, the current CAMT Guidance contains a series of targeted rules that do not always reflect a unifying principle or set of principles. In some cases, the rules rely on financial accounting concepts. In other cases, they borrow selectively from Section 108, Section 1017, subchapter C, subchapter K, or the consolidated return regulations. In still other cases, they create CAMT-specific rules that are similar to, but not the same as, rules that apply for regular tax purposes. These CAMT-specific rules do not always reflect the principles embodied in the bodies of law that have been created over many years under the federal income tax system. Therefore, their interpretation will raise numerous questions that have previously been addressed under the federal income tax.

That approach may be workable for discrete adjustments. It is more difficult in the Distressed Taxpayer context. A distressed company restructuring frequently involves multiple interdependent items, including liability reductions, debt modifications, debt-for-equity exchanges, modifications of instruments that may be treated as debt for financial accounting purposes but not for regular tax purposes, deconsolidation events, entry into and emergence from bankruptcy, fresh-start accounting, section 363 sales of assets or business lines under the Bankruptcy Code, reorganizations, ownership changes, partnership allocations, and attribute reduction. The interaction of these rules is often heavily dependent upon the timing of events.

¹³ See Report 1473, pp. 80-81; Report 1506, p. 188 n. 384 and accompanying text.

¹⁴ See Preamble, 89 Fed. Reg. 75104, 75114 (Sept. 13, 2024) (“absent adjustments to AFSI for income from debt discharges and fresh-start reporting, troubled companies would have additional tax liabilities under the CAMT that could impede the companies from achieving solvency or emerging from bankruptcy. Avoiding this unnecessary harm also would protect the interests of the government in its tax collection efforts.”)

Treating each item as a separate CAMT problem is likely to create a technically elaborate but incomplete regime. The concern extends beyond compliance and administrative burden. Because these transactions frequently involve multiple interdependent items, an issue-by-issue approach may not produce consistent results when those items are integrated into a single restructuring and uncertainty as to results may impede consummation of restructuring transactions.

There are also administration and enforcement concerns. A Distressed Taxpayer regime that depends on a separate, CAMT-specific body of rules for liabilities, CODI, attribute reduction, intercompany items, and restructuring transactions will require taxpayers and the government to apply and audit a set of concepts that frequently overlap with, but do not always correspond to, established regular tax principles. The concern is not merely that CAMT may require additional tracking or adjustments. Rather, as noted above, separate CAMT-specific rules may create uncertainty regarding how those rules interact; therefore, there may be an increased risk of unintended differences in treatment among similarly situated taxpayers, rendering enforcement that is complex and potentially ineffectual.

Accordingly, we recommend that the Treasury consider two related categories of principles-based recommendations. The first category is the “**Tax Principles Recommendations**,” which are intended to further the Treasury’s broader effort to align the CAMT treatment of certain transactions with established regular tax principles while preserving appropriate CAMT-specific modifications where necessary. The Tax Principles Recommendation has two related components. The first is the Uniform Transaction Tax Principles Approach, under which the Treasury should clarify that transactions involving financially distressed taxpayers are subject to the same regular tax principles applicable to financially healthy taxpayers under the CAMT regime. The second is the CODI Tax Principles Approach, under which the Treasury should generally apply regular tax principles in determining and administering CAMT CODI and provisions materially intertwined with CODI. The second category of recommendation is the Tax Liability Substitution Approach, under which liabilities and the CAMT consequences arising from those liabilities generally would be determined under regular tax principles. The Tax Liability Substitution Approach goes beyond the CODI Tax Principles Approach and the adoption of the former would mean that CODI Tax Principles Approach would play a more limited role (i.e., essentially determining the CAMT consequences of CODI determined under the Tax Liability Substitution Approach).

Although the Tax Liability Substitution Approach is most easily evaluated in terms of its implications for CODI, the recommendation necessarily implicates broader questions regarding the classification of liabilities for CAMT purposes. The existence, amount, and character of CODI frequently depend upon whether an instrument constitutes indebtedness under established tax principles and, if so, how that indebtedness is characterized. Thus, the issues discussed throughout Part IV.B of this Report are not limited to CODI in the narrow sense. They also implicate the broader question of whether liabilities that do not constitute indebtedness under

regular tax principles should nevertheless produce CAMT consequences solely because they are treated as liabilities for financial statement purposes. As discussed below, we generally believe that liabilities should be characterized consistently with their treatment under regular tax principles unless the Treasury identifies a specific reason to depart from that framework.

These recommendations are not intended to replace all of the specific comments contained in this Report. Rather, they are intended to provide an overarching framework that, particularly if the Tax Liability Substitution Approach is adopted, would resolve many of the issues that otherwise require detailed, issue-by-issue guidance. Even if the Treasury adopts these recommendations, targeted guidance will remain necessary in a number of areas. Nevertheless, adoption of these approaches would resolve many of the issues discussed throughout this Report and substantially reduce the need for standalone CAMT-specific rules.

2. Tax Principles Recommendations

The Treasury has already determined in numerous CAMT contexts that regular tax principles provide the appropriate organizing framework for resolving issues that otherwise would require separate CAMT-specific rules. For example, Prop. Treas. Regs. § 1.56A-4(c)(1) generally disregards certain items of income, expense, gain, and loss reflected in FSI from ownership of foreign corporation stock and instead takes into account regular tax items. Prop. Treas. Regs. § 1.56A-4(c)(2) similarly addresses certain transactions involving foreign corporations by disregarding financial statement gain or loss with respect to transferred assets and instead taking into account regular tax items, with CAMT basis substituted for regular tax basis where appropriate. These examples reflect a broader principle already embedded in the CAMT Guidance: where financial statement treatment does not provide what the Treasury views as an appropriate or administrable measure of the CAMT base, the Treasury has concluded that financial statement treatment may be modified, replaced, or supplemented by reference to regular tax concepts or regular tax results.

We believe the Treasury should continue along that path. This recommendation is not premised on the view that CAMT and regular tax must always produce identical results. Section 56A begins with FSI and contemplates adjustments from that starting point. Moreover, the CAMT is not merely an alternative method of computing regular taxable income. Nevertheless, where Congress or the Treasury determines that regular tax principles should govern, those principles should be applied in an administrable, predictable, and consistent manner. Once the Treasury determines that tax principles, rather than financial accounting principles, should govern a particular CAMT issue, there is little reason to construct a parallel CAMT regime.

In summary, we recommend that the Treasury apply regular tax principles in two related areas. First, the Treasury should clarify that transactions involving financially distressed taxpayers are governed by the same regular tax transaction principles applicable elsewhere under the CAMT regime. Second, the Treasury should apply regular tax principles to CODI and to issues and

computations materially intertwined with CODI. These approaches operate in different areas of the CAMT, but they reflect the same underlying principle: where the Treasury determines that tax principles should govern, the Treasury generally should apply existing tax frameworks in full, rather than constructing standalone CAMT analogues or incorporating portions of existing frameworks piecemeal.

a) Uniform Transaction Tax Principles Approach

The first component of the Tax Principles Recommendation is the Uniform Transaction Tax Principles Approach. This recommendation is not a request that the Treasury adopt a new policy because the trend in Treasury guidance increasingly is to apply tax principles to determine the consequences of transactions using CAMT inputs; rather, it is a recommendation that the Treasury clarify that the same transactional principles apply irrespective of whether a taxpayer is financially healthy or experiencing financial distress.

Earlier this year at the NYSBA Tax Section Annual Meeting, the Treasury announced that it “plan[s] to re-propose the CAMT regulations [(the “**New Proposed Regulations**”)] as a comprehensive package sometime around the end of 2026 (after October 15th) with the goal of finalizing them in 2027.”¹⁵ In Notice 2025-46, the Treasury announced that the New Proposed Regulations are expected to revise Prop. Treas. Regs. §§ 1.56A-18 and 1.56A-19, the rules governing domestic corporate transactions, to more closely follow regular tax principles and reduce compliance burdens and costs.¹⁶ In our view, the rationale supporting that shift applies equally in the Distressed Taxpayer context.

Moreover, as discussed in Report 1506, the troubled-company provisions of the Proposed Regulations, Prop. Treas. Regs. § 1.56A-21, selectively cross-reference portions of the covered recognition transaction and covered nonrecognition transaction rules.¹⁷ That selective incorporation creates uncertainty regarding whether transactions involving financially distressed taxpayers are intended to be governed by the same broader transaction framework applicable elsewhere in the CAMT Guidance. The Uniform Transaction Tax Principles Approach is intended to resolve that uncertainty and confirm that distressed-company transactions are not excluded from the Treasury’s broader movement toward tax-based transaction principles.

Under the Uniform Transaction Tax Principles Approach, transactions would be analyzed using the same underlying principles, whether regular tax principles or financial statement principles apply, irrespective of whether the taxpayer is financially healthy or experiencing financial

¹⁵ Salinger Remarks, Tax Notes Doc. 2026-1184.

¹⁶ Notice 2025-46, § 3.

¹⁷ See Report 1506, pp. 204-205.

distress, with appropriate CAMT-specific inputs, as described in Notice 2025-46 or other CAMT Guidance. This proposal would help prevent omission, duplication, or inappropriate avoidance.

The transactions addressed throughout this Report often involve restructurings of a taxpayer's assets, liabilities, ownership interests, or legal structure. Examples include reorganizations, liquidations, section 363 sales of assets and business lines under the Bankruptcy Code, emergence transactions, and deconsolidation events. These transactions already are governed by extensive tax authorities that have developed in the regular tax system over decades. The fact that such transactions occur in the context of financial distress should not, by itself, require the application of a separate CAMT transactional framework if regular tax principles already clearly apply outside the financially distressed context and provide an administrable framework that can be applied with CAMT-specific inputs.

Under the Uniform Transaction Tax Principles Approach, the CAMT consequences of such transactions generally would be determined by applying the principles of the corresponding tax provisions, including subchapter C, Section 1001, and related authorities, with CAMT-specific inputs substituted where appropriate, in the same manner as such transactions would be treated outside the financially distressed context. Thus, where tax principles determine whether a transaction is taxable or nonrecognition, whether a reorganization has occurred, whether an asset sale has occurred, or whether a transfer of property subject to liabilities gives rise to gain or loss, those same principles generally should govern the CAMT analysis, with CAMT-specific inputs substituted where appropriate. This recommendation addresses the transactional framework itself and does not resolve the separate questions regarding the treatment of liabilities, CODI, basis, attributes, or other items that may affect the application of those transaction principles in the CAMT context.

The Uniform Transaction Tax Principles Approach would address many of the issues discussed below in the financially distressed context relating to covered recognition transactions, covered nonrecognition transactions, emergence from bankruptcy, deconsolidation, section 363 transactions under the Bankruptcy Code, and reorganizations, including reorganizations under Section 368(a)(1)(G). More importantly, it would confirm that transactions involving Distressed Taxpayers should be analyzed under the same transactional principles the Treasury is already adopting elsewhere in the CAMT regime, rather than under a separate Distressed Taxpayer transaction framework. We do not believe the CAMT Guidance should be read to implicitly exclude Distressed Taxpayer transactions from that broader movement toward regular tax transaction principles absent an express indication that the Treasury intended such a result.

The Uniform Transaction Tax Principles Approach does not eliminate the need for guidance concerning CODI, attribute reduction, fresh-start accounting, subsequent remeasurements, or other consequences of liability adjustments.

b) CODI Tax Principles Approach

The second component of the Tax Principles Recommendation is the CODI Tax Principles Approach. Under this approach, the Treasury would apply regular tax principles in administering CAMT CODI and provisions materially intertwined with CAMT CODI. However, unlike the Tax Liability Substitution Approach discussed below, the CODI Tax Principles Approach does not itself require the Treasury to disregard FSI arising from liability remeasurements or other accounting adjustments that do not correspond to CODI under regular tax principles.

The CODI Tax Principles Approach reflects the same principle underlying the Uniform Transaction Tax Principles Approach. Once the Treasury has determined that tax principles should govern a particular CAMT CODI issue, the Treasury generally should apply established tax principles rather than create a separate standalone CAMT regime. Where tax principles provide an administrable framework for determining the treatment of a CODI-related issue, the Treasury generally should apply those principles and modify them only to the extent necessary to account for CAMT-specific attributes, basis, credits, or other CAMT-specific items.

The scope of the application of the CODI Tax Principles Approach depends in part on whether the Treasury adopts the Tax Liability Substitution Approach. If the Treasury adopts the Tax Liability Substitution Approach, the existence, amount, and character of CODI would be imported into CAMT from the regular tax; the CODI Tax Principles Approach would primarily govern the CAMT consequences of that CODI. If the Treasury does not adopt the Tax Liability Substitution Approach, the CODI Tax Principles Approach would apply more broadly and would generally result in the application of the principles of Sections 108 and 1017 in determining both the existence and treatment of CAMT CODI, subject to CAMT-specific modifications where necessary.

However, absent the Tax Liability Substitution Approach, the CODI Tax Principles Approach may produce questionable results where FSI arises from liabilities, including remeasurements or other accounting adjustments, that do not correspond to CODI under regular tax principles. Accordingly, the CODI Tax Principles Approach would improve the administration of CAMT CODI but would not eliminate all uncertainties and other issues arising from the differences between financial statement treatment and regular tax treatment discussed in Part IV.B of this Report. Questions would remain regarding the application of tax principles using CAMT-specific inputs and attributes, which provide much of the rationale for the Tax Liability Substitution Approach.

Nevertheless, even if the Treasury declines to adopt the Tax Liability Substitution Approach, the CODI Tax Principles Approach would provide the Treasury with a substantially more administrable framework than continuing to develop stand-alone CAMT analogues without reference to the body of law that already governs CODI and related provisions for regular tax purposes.

3. Tax Liability Substitution Approach

As discussed above, the CODI Tax Principles Approach would continue to require a separate determination of CAMT CODI, albeit one informed by regular tax concepts and principles. As the Tax Section has continued to study the issues presented by the Proposed Regulations and subsequent CAMT Guidance, however, it has become apparent that many of the most difficult questions arise not just from determination and treatment of CODI itself, but from more fundamental differences between (i) the scope of liabilities recognized for financial statement purposes and the scope of liabilities recognized under regular tax principles and (ii) the timing of recognition of items of income or loss attributable to liabilities. Many of these issues are identified in summary fashion in Appendix A of this Report.

Even assuming the adoption of the CODI Tax Principles Approach, the issues arising from the fundamental differences between book and tax are many and diverse. For example, in the case of book CODI that arises in anticipation of the filing of a Title 11 Case, what pre-filing items should be brought into the scope of the bankruptcy exclusion? What temporal link should be required, and how would it be measured (*e.g.*, by relation to the filing date or the discharge date)?¹⁸ Which book CODI items (if any) should be exempted from CAMT CODI treatment (*e.g.*, items flowing from revaluations caused by certain book deconsolidations)?¹⁹ To the extent that book CODI items do not qualify for the bankruptcy exception under the principles of Section 108(a), additional pressure would be placed on the determination of insolvency, including identification of the assets and liabilities included in the insolvency determination (book vs. tax), and the valuation of those assets, given the different methodologies applicable in the two systems.²⁰

Accordingly, we recommend that the Treasury consider a broader approach under which liabilities generally would be determined under regular tax principles for purposes of the CAMT.

Description of the Tax Liability Substitution Approach

Under the Tax Liability Substitution Approach, the existence, characterization, and amount of liabilities generally would be determined under regular tax principles rather than financial statement principles for purposes of determining the CAMT consequences that flow from those liabilities. Once the existence of a liability is determined under regular tax principles, the consequences arising from that liability likewise generally would be determined under regular tax principles. The Tax Liability Substitution Approach would not generally replace the book item that gave rise to the liability or substitute the corresponding regular tax deduction or income

¹⁸ See section IV.B.4.b) of this Report.

¹⁹ See section IV.E.2 of this Report.

²⁰ See section IV.B.4.a) of this Report.

item. Rather, it would replace the liability only for purposes of determining prospective, liability-side CAMT consequences. A liability can exist solely for financial statement purposes--for example, a liability created to account for a deduction claimed for book purposes before payment of the amount corresponding to the deduction. Such a liability would generally not generate CAMT CODI or similar liability-related CAMT consequences solely because the liability is modified, reduced, or eliminated as the liability does not exist for regular tax purposes. However, the underlying book deduction that gave rise to creation of the book liability generally would remain reflected in FSI and therefore AFSI, absent another CAMT adjustment. Stated differently, while the proposal substitutes the liability side of the balance sheet for purposes of liability-related CAMT consequences, it does not generally replace the initial items reflected in the income statement upon creation of the liability.

Thus, the approach would determine under regular tax principles whether a balance sheet item constitutes indebtedness (or another form of instrument, such as equity), the amount of the liability attributable to such item, the characterization of payments related to the liability, whether a modification of such instrument constitutes an exchange, whether a discharge or exchange of such instrument gives rise to CODI, the amount and character of any CODI, and whether that CODI is included in, or excluded from, income under Section 108. The same liability determination generally would apply when the liability is taken into account in determining the amount realized on a sale or exchange under principles analogous to Treas. Regs. § 1.1001-2 and Commissioner v. Tufts, 461 U.S. 300 (1983). Applying different liability concepts depending upon whether the relevant consequence arises under Section 108 or Section 1001 would preserve many of the classification and coordination problems that the Tax Liability Substitution Approach is intended to eliminate.²¹

In the CODI context, a taxpayer applying the Tax Liability Substitution Approach generally would disregard FSI, gain, loss, expense, or book-basis adjustments attributable to the discharge, modification, contribution, exchange, or other adjustment of a financial statement liability and instead take into account the amount of CODI, if any, and its character, timing, and inclusion or exclusion, as determined under regular tax principles. The rules governing debt modifications, related-party acquisitions, contributions of indebtedness to capital, and debt-for-equity exchanges likewise would be determined under regular tax principles, including principles reflected in Sections 108(e)(4), 108(e)(6), 108(e)(8), and 108(e)(10) and Treas. Regs. § 1.1001-3. These provisions are part of the regular tax CODI framework because they determine whether a transaction involving indebtedness results in CODI and, if so, the amount of that CODI.

²¹ For example, if an instrument is treated as a debt for purposes of determining gain under principles analogous to Treas. Regs. § 1.1001-3, but as equity for other purposes, such as Treas. Regs. § 1.1001-2. The resulting gain, CODI, basis, and attribute consequences could depend upon which liability concept is applied to the same instrument. The Tax Liability Substitution Approach avoids those issues by applying a single liability determination to all liability-related CAMT consequences.

As a result, items that do not give rise to CODI for regular tax purposes would not give rise to CAMT CODI. For example, the reduction or elimination of a liability reflected on an AFS that does not constitute indebtedness for regular tax purposes, including a deferred tax liability, would not produce CAMT CODI.²² Similarly, if regular tax principles determine that CODI exists but is excluded under Section 108(a), that determination would govern for CAMT purposes, including the determination of whether, and to what extent, excluded CODI should result in the reduction of CAMT attributes, subject to further CAMT-specific considerations.²³

The Tax Liability Substitution Approach would not replace financial statement accounting generally or seek to conform all components of AFSI to regular taxable income. Rather, the Tax Liability Substitution Approach focuses on the impact that liabilities on the financial statement balance sheet have on AFSI subsequent to accounting for the initial creation of the financial statement liability. It generally does not concern the impact that these initial income and expense entries on the FSI statement have on AFSI. Therefore, except as described below with respect to the characterization of payments on an instrument, expenses and deductions reflected in FSI generally would continue to be taken into account in determining AFSI, subject to the adjustments otherwise provided in Section 56A and the CAMT Guidance. Thus, if a taxpayer records a financial statement expense and corresponding liability before the expense is deductible for regular tax purposes, the Tax Liability Substitution Approach would not, merely by reason of that difference in timing, reverse the financial statement expense or substitute the corresponding regular tax deduction. The proposal is directed at the existence, characterization, and amount of liabilities and the CAMT consequences that subsequently flow from those liabilities carried on the financial statement balance sheet. It does not import regular tax deductions or otherwise replace financial statement deductions with regular tax deductions.

The operation of the Tax Liability Substitution Approach can be illustrated through the following two examples, which demonstrate the distinction between substituting liabilities and substituting book accounting more generally. The following examples then illustrate why interest is treated differently and why liability characterization must be applied consistently throughout the CAMT framework.

In the first example, in Year 1, a taxpayer records a \$200 expense for financial statement purposes and, as a result, records a corresponding \$200 liability on its balance sheet. No liability

²² A deferred tax liability reversed on an AFS may generate FSI even though no indebtedness exists for federal income tax purposes and, therefore, no CODI arises. Similar issues may arise with respect to environmental obligations, litigation reserves, pension obligations, contingent consideration, lease liabilities, deferred revenue, and preferred equity classified as a liability for financial statement purposes. See the discussion below regarding potential application of tax benefit concepts to the reduction or discharge of certain financial statement liabilities in specified circumstances.

²³ For a detailed discussion of whether CAMT attributes should be reduced, and if so, which CAMT attributes should be subject to reduction, see Part IV.C.2 of this Report.

exists for regular tax purposes. In Year 2, the amount of the obligation is finalized at \$210 and the obligation is satisfied through a payment of that amount. The taxpayer therefore claims a \$210 deduction for regular tax purposes. The \$200 liability is removed from the financial statement balance sheet and an additional \$10 expense may be recognized in FSI. Under the Tax Liability Substitution Approach, the original \$200 book expense remains reflected in AFSI in Year 1 and the additional \$10 expense remains reflected in AFSI in Year 2. The approach does not substitute the timing or amounts of the corresponding tax deductions. Rather, it substitutes liabilities only for purposes of determining liability-side CAMT consequences.

In the second example, in Year 1, a taxpayer records a \$200 expense and a corresponding \$200 liability for financial statement purposes, corresponding to a payment that is expected to be made. The payment, when made, would not qualify for a deduction under the federal income tax. No liability exists for regular tax purposes. In Year 2, the taxpayer declares bankruptcy, before the payment corresponding to the liability has been made. At the end of Year 2, the taxpayer emerges from bankruptcy, and pursuant to the plan, which was approved by the Bankruptcy Court, the obligation to make the payment is discharged. Under the Tax Liability Substitution Approach, the absence of CODI under regular tax principles would be imported into the CAMT. Accordingly, the discharge would not produce CAMT CODI and therefore would not require CAMT attribute reduction. This example is intended solely to illustrate the operation of the Tax Liability Substitution Approach and does not address whether the Treasury should adopt a separate tax-benefit or recapture rule, which is discussed later in this Part.

One important exception arises where the liability determination itself governs the characterization of subsequent payments. As noted above, interest paid on a debt instrument is an exception to the general treatment described because the characterization of the payment depends directly upon the characterization of the underlying liability. That is, the treatment of payments characterized as interest is inextricably linked to the determination of whether an instrument constitutes indebtedness. Therefore, if an instrument is characterized as indebtedness for financial statement purposes but as equity or as neither debt nor equity for regular tax purposes, amounts treated as interest expense for financial statement purposes generally should not be treated as interest for CAMT purposes. Rather, such amounts should be characterized consistently with the regular tax characterization of the instrument. Otherwise, the CAMT would treat the instrument as equity in determining whether any liability or any CODI exists, but as debt in determining the treatment of payments on the same instrument. Conversely, characterization of an instrument as indebtedness under regular tax principles would cause payments on that instrument to be analyzed as payments on indebtedness for CAMT purposes. This characterization rule would not entitle the taxpayer to an additional CAMT deduction merely because the amount of interest deductible for regular tax purposes exceeds the amount of interest expense reflected in FSI. Rather, the amount and timing of any deduction generally

would remain based on FSI, subject to other applicable CAMT adjustments; only the character of the payment would follow the regular tax characterization of the instrument.²⁴

The treatment of interest can be illustrated through the following examples.

In the first example, a taxpayer issues an interest-bearing instrument that is respected as indebtedness for both financial statement and regular tax purposes. However, because of differences in the applicable accounting and regular tax rules (for example, differences relating to original issue discount), the amount of annual interest expense reflected in FSI differs from the corresponding amount determined under regular tax principles. Under the Tax Liability Substitution Approach, the characterization of the instrument as indebtedness and the characterization of payments on that instrument would follow regular tax principles.

Accordingly, the amount treated as interest for CAMT purposes would generally correspond to the amount reflected in FSI. However, to the extent the liability is adjusted under regular tax principles (for example, through the accrual of original issue discount that affects adjusted issue price), the corresponding adjustment would be reflected in the liability recorded on the CAMT balance sheet, but is not included as an adjustment to AFSI. This result helps ensure that subsequent transactions involving the liability, including its satisfaction, disposition, modification, or the determination of CODI, rely upon a consistent liability measure and adjusted issue price.

In the second example, assume the same facts except that the instrument is characterized as indebtedness for financial statement purposes but as equity for regular tax purposes. Under the Tax Liability Substitution Approach, the instrument would be treated consistently with its regular tax characterization. Accordingly, payments on the instrument generally would not be treated as interest for CAMT purposes because the instrument does not constitute indebtedness under regular tax principles. This result differs from the prior example because the issue is no longer the amount of interest expense taken into account for CAMT purposes but rather the characterization of the underlying instrument itself.

The treatment of interest described above illustrates a broader principle underlying the Tax Liability Substitution Approach. For purposes of determining CAMT consequences arising from liabilities, the Tax Liability Substitution Approach would replace liabilities reflected on the AFS balance sheet with liabilities determined under regular tax principles. If a liability exists for financial statement purposes but not regular tax purposes, a taxpayer generally would not take into account any CODI or other CAMT consequences arising from that liability. Conversely, if a liability exists under regular tax principles but differs in amount from the corresponding financial

²⁴ Compare Sections 163(e), (j), and (l), and the regulations thereunder, to ASC 470 and ASC 835. Compare also Sections 1271 through 1275, and the regulations thereunder, to ASC 470 and ASC 835. For a further discussion of the classification of liabilities and instruments, see Part IV.B.2.a) of this Report.

statement liability, the liability determined under regular tax principles generally would govern those consequences. The Tax Liability Substitution Approach generally substitutes the liability side of the financial statement balance sheet for purposes of determining liability-related CAMT consequences. It generally does not substitute the income statement or replace book income and expense items with their regular tax counterparts. Rather, it focuses on liabilities and the consequences arising from those liabilities subsequent to their creation, including the characterization of payments whose treatment depends upon the characterization of the underlying liability. Accordingly, the Tax Liability Substitution Approach is a substitution approach, not a conformity approach. It uses a single framework to determine liabilities and the CAMT consequences arising from those liabilities.

The Tax Liability Substitution Approach therefore goes beyond the CODI Tax Principles Approach. Under the CODI Tax Principles Approach, the Treasury would continue to determine whether CAMT CODI exists under a separate CAMT framework, but would administer that framework using principles derived from the regular tax context. By contrast, under the Tax Liability Substitution Approach, the determination of the existence and amount of the underlying liability itself begins with regular tax principles. This substituted amount, as determined under regular tax principles, would then be imported into the CAMT, as well as the existence, characterization, amount, timing, and inclusion or exclusion of CODI.

Potential Benefits of the Tax Liability Substitution Approach

The adoption of the Tax Liability Substitution Approach would provide distressed companies with more certainty with less administrative cost with respect to CAMT, which will support the ability of such companies to reorganize as going concerns. In general, Congress and the Treasury have provided a number of provisions in the Code that depart from strict taxation of all economic income in furtherance of such policies.²⁵ Nevertheless, as discussed below, the principal benefit of adopting the Tax Liability Substitution Approach is that it potentially would eliminate many questions that arise in the CAMT context only because the current CAMT Guidance requires the separate identification and measurement of financial statement indebtedness and CAMT CODI.²⁶

As an initial matter, Congress has clearly established that insolvency and bankruptcy present circumstances in which immediate recognition of CODI is inappropriate. Sections 108 and 1017 provide a framework that generally seeks to preserve and later recapture a substantial portion of excluded CODI through the reduction of tax attributes, including net operating losses and basis.²⁷

²⁵ See Sections 108(a) and (b) and 382(l)(5) and (6).

²⁶ See Appendix A of this Report for a non-exclusive list of those questions.

²⁷ See Sections 108(b) and 1017. Excluded CODI generally results in the reduction of tax attributes, including net operating losses and basis, thereby preserving all or a portion of the excluded amount for future tax purposes. See also Preamble, 89 Fed. Reg. 75104, 75114 (Sept. 13, 2024); Report 1506, pp. 188-89 & fn. 384.

Thus, there is both a strong policy argument for preventing the CAMT from frustrating the fresh-start policies embodied in Sections 108 and 1017, and the provisions present an existing statutory framework for carrying out that policy. Importation of liabilities and CODI as determined under regular tax principles would address many of the timing, measurement, and administrative problems presented by CODI without necessarily resulting in permanent exclusion of the corresponding income.

Although these policy considerations are strongest where a taxpayer is insolvent or subject to a Title 11 Case, they are also implicated in other circumstances in which CODI arises, including as a result of a debtor paying, and its creditor accepting, less than the amount otherwise payable on the debtor's indebtedness. Such a reduction frequently reflects some degree of financial distress for the debtor, even if the debtor does not satisfy the technical requirements of the insolvency or bankruptcy exclusions under Section 108(a). A significant modification of publicly traded indebtedness may present a different circumstance because the issue price of the modified instrument may reflect factors other than the debtor's financial condition, including changes in market interest rates or the terms of the instrument. Nevertheless, much of the CODI framework is directed at transactions that arise because a debtor cannot, or may not, satisfy its obligations in accordance with their original terms.

The principal rationale for the Tax Liability Substitution Approach, however, is administrability.²⁸ Administrability concerns are especially acute in the liability and CODI context because the issue is not merely how to adjust a financial accounting concept for purposes of computing AFSI. Financial accounting and regular tax principles may differ regarding whether a liability exists, whether the liability constitutes indebtedness, how the liability is measured, whether a realization event has occurred, whether CODI exists, when CODI exists, the amount and character of the CODI, and whether that CODI is includable or excludable in income (or reflected on an income statement). In addition, the application of many tax rules requires determinations that do not arise under financial accounting principles; for instance, results that may differ depending whether a liability is recourse or nonrecourse as determined for tax purposes. The timing of a CODI event also may determine whether the insolvency or bankruptcy exclusion is available and what consequences follow from the exclusion, timing which can, and often does, vary considerably between tax and financial accounting regimes. As a result, the Treasury is not merely modifying a financial statement concept when applying CODI concepts in the CAMT. It must effectively recreate for CAMT purposes a substantial body of law that already exists under Sections 61, 1001, 108, and 1017 and the authorities interpreting those provisions.

²⁸ The threshold administrability question is whether the benefits of a separate CAMT liability and CODI regime justify the need for taxpayers and the government to develop, interpret, maintain, administer, and audit that regime in addition to the existing regular tax regime.

A regime that begins with determinations of liabilities and CODI under regular tax principles would permit taxpayers and the Treasury to rely on a body of law that is already developed, familiar, and administrable. Increasing administrability is particularly important in the Distressed Taxpayer context, where many of the relevant transactions occur under significant time pressure, involve numerous stakeholders, and arise when a taxpayer may have limited financial and administrative resources. An additional benefit is that reliance on liabilities and CODI as determined for regular tax purposes may reduce opportunities for taxpayers to obtain materially different results under the CAMT and regular tax regimes. Under a separate CAMT liability regime, the government potentially would be required to police not only tax determinations relating to liabilities, but also financial accounting determinations that may affect whether, when, and to what extent CAMT consequences arise. Financial accounting standards often require judgment regarding liability measurement, expected future cash flows, credit deterioration, impairment, settlements, and modifications. To the extent CAMT consequences depend on those determinations, the IRS may need to challenge accounting conclusions regarding liability remeasurements and related adjustments even where no realization event has occurred for regular tax purposes.²⁹ In addition, several issues identified throughout this Report with regard to the current CAMT Guidance, including the absence from the CAMT Guidance of rules comparable to Sections 108(e)(4) and 108(e)(10), may create opportunities for inconsistent characterization or treatment. Reliance on the existing regular tax framework for liability and CODI determination would reduce the need for the Treasury to develop separate CAMT anti-abuse, characterization, and coordination rules.³⁰

The current CAMT Guidance attempts to address questions concerning the treatment of liabilities and CODI by creating a separate CAMT framework. Notice 2025-46 provides rules governing the determination of indebtedness, the existence and amount of CAMT CODI, the application of exclusions, CAMT attribute reduction, contributions of indebtedness to capital, debt-for-equity exchanges, and related matters.³¹ While these rules address a number of

²⁹ For example, assume a taxpayer has elected fair value accounting for indebtedness and later experiences a deterioration in its creditworthiness. FSI may arise because the carrying value of the liability is reduced, notwithstanding that no discharge, exchange, satisfaction, or other realization event has occurred for regular tax purposes. If CAMT relies on a separate liability regime, questions may arise regarding the timing and characterization of the resulting CAMT consequences even though those issues would not arise under the regular tax framework. More broadly, taxpayers and the government may be required to litigate accounting-driven liability adjustments in addition to the already existing tax-law questions.

³⁰ As highlighted throughout this Report, several technical issues within the CAMT Guidance may create opportunities for taxpayers to obtain materially different results under the CAMT and regular tax regimes, including the absence of rules comparable to Sections 108(e)(4) and 108(e)(10). See Parts IV.B.3.b)(1) and IV.B.3.b)(2) of this Report.

³¹ See Notice 2025-46 § 4.

important issues, they do so through a parallel regime that taxpayers and the government must separately interpret, administer, and audit.

Even if the Treasury adopts the CODI Tax Principles Approach discussed above, numerous questions would remain concerning the existence, characterization, amount, and timing of CAMT CODI. Many of those questions are discussed later in this Report, and a non-exclusive list of issues identified to date is provided in Appendix A of this Report. We recognize that the persistence of those questions after the Proposed Regulations, Notice 2025-46, and Notice 2026-7 does not reflect a lack of effort by the Treasury. Rather, it illustrates the inherent difficulty of constructing and coordinating a separate CAMT liability and CODI regime while also importing selected principles from the regular tax.³²

In addition to substantially improving the administration of many of these issues, the Tax Liability Substitution Approach would also eliminate the need to determine separately whether, and to what extent, CAMT CODI exists in the first instance. The Tax Liability Substitution Approach would substantially reduce, and in many cases eliminate, the need for the Treasury to develop separate CAMT rules addressing issues analogous to Sections 108(e)(2), 108(e)(4), 108(e)(6), 108(e)(8), and 108(e)(10), as well as issues involving recourse and nonrecourse liabilities, partnership CODI, liability assumptions, and timing differences between FSI and regular tax income.³³

We also recognize that the Tax Liability Substitution Approach still may produce complexities arising from differences between CAMT and regular tax treatment of liabilities because the regular tax and financial statement rules governing indebtedness do not fully align. For example, the tax rules governing interest deductions and limitations differ significantly from the corresponding financial accounting rules,³⁴ and the tax rules governing original issue discount and debt instruments likewise differ in important respects from the applicable financial accounting standards.³⁵

As discussed above, the Tax Liability Substitution Approach would not generally substitute regular tax deductions for financial statement expenses. Thus, a taxpayer would not obtain an additional reduction to AFSI merely because tax interest exceeds financial statement interest

³² The unresolved issues identified throughout this Report are not intended as criticism of the Treasury's efforts. Rather, they illustrate the difficulty of constructing and administering a separate CAMT liability regime while simultaneously coordinating that regime with existing tax principles governing liabilities, CODI, exclusions, and attribute reduction.

³³ Adoption of the CODI Tax Principles Approach would improve the administration of these issues but would not eliminate the need to determine whether a CAMT liability exists, the amount of that liability, or whether and when a separate CAMT CODI event occurs.

³⁴ Compare Sections 163(e), (j), and (l), and the regulations thereunder, to ASC 470 and ASC 835.

³⁵ Compare Sections 1271 through 1275, and the regulations thereunder, to ASC 470 and ASC 835.

expense.³⁶ Similarly, financial statement interest expense may increase an FSNOL that is subject to the 80% limitation even though a regular tax limitation would defer the corresponding interest deduction to a later period, potentially producing a less favorable CAMT result.³⁷

We acknowledge that the Tax Liability Substitution Approach may produce results that differ from those produced under either financial statement accounting or the regular tax regime standing alone, a fact that itself creates complexity. Such differences are an inherent consequence of a substitution regime. Eliminating them would require reconciliation of financial accounting and regular tax treatment across a broad range of liability-related items, including the classification of liabilities, interest, original issue discount, expenses, and accruals. As discussed above, such reconciliation would require the Treasury to maintain and administer a separate CAMT liability regime, substantially reducing the administrability benefits that motivate the Tax Liability Substitution Approach. It also could require broader substitution of regular tax amounts for financial statement amounts, an undertaking beyond the scope of this recommendation.

Potential Concerns regarding the Tax Liability Substitution Approach and Analysis Thereof

Concerns regarding the Implications of Imposing CAMT / Regular Tax Conformity. We acknowledge that adoption of the Tax Liability Substitution Approach would represent a major departure from the existing CAMT framework as an alternative, financial statement based tax system. It would fundamentally modify the CAMT base, largely conforming the right side of a taxpayer's balance sheet for CAMT purposes to regular tax inputs. Although there are aspects of conformity built into the CAMT system under the Code (e.g., the conformity for AFSI purposes required with respect to depreciation deductions and qualified wireless spectrum under Section 56A(c)(14) and (15)), these provisions are mandated by Congress. It may be argued that, as a matter of policy, a sweeping conformity requirement such as the Tax Liability Substitution Approach should be adopted, if at all, only by Congress through legislation, not by the Treasury through regulation. Moreover, it can also be argued that importing liabilities and the consequences arising from those liabilities from the regular tax system represents an erosion of the CAMT without a principled stopping point. That is, as we have noted, CAMT is inherently rife with complexity, so that, if administrative simplicity justifies conforming the CAMT and regular tax bases, one could assert that it is a very slippery slope indeed.

On the other hand, it should be noted that the CAMT Guidance already reflects the Treasury's willingness to depart from financial statement treatment where the Treasury determines that

³⁶ See the discussion of tax benefit-type concerns, later in this section of the Report.

³⁷ For example, if a taxpayer is already in an FSNOL position, additional financial statement interest expense may merely increase an FSNOL that generally may offset only 80% of future AFSI. By contrast, if the corresponding interest deduction were deferred under the regular tax rules to a later year, the deduction potentially could produce a greater benefit in that later period. The Tax Liability Substitution Approach does not attempt to conform the timing or amount of financial statement interest expense to the regular tax interest deduction.

financial statement treatment does not provide an appropriate or administrable measure of the CAMT base. For example, section 5 of Notice 2025-49 provides that, for certain assets that are marked-to-market for AFS purposes, but not regular tax purposes, taxpayers may elect to disregard gains and losses that are unrealized for regular tax purposes. Notice 2025-49 and Notice 2026-7 also provide adjustments to AFSI for items such as tax repairs, Section 197 amortization, domestic research expenditures, qualified production costs, materials and supplies, and certain foreign transactions, resulting in the substitution of regular tax items into the CAMT system, in place of their treatment for AFS purposes.³⁸

One particularly analogous area where administrability, consistency, or statutory purpose justified imposing conformity between CAMT and regular tax is the treatment of controlled foreign corporation (“CFC”) stock under Prop. Treas. Regs. § 1.56A-6(c). Sections 56A(c)(2)(C) and (c)(3)(A) generally provide that AFSI should not include the regular tax amounts determined under Sections 951 and 951A, but direct the Treasury to apply the principles of those provisions to FSI. Carrying out that direction through a separate financial statement analogue to the international tax regime would resemble the CODI Tax Principles Approach discussed above. Prop. Treas. Regs. § 1.56A-6(c), however, generally disregards certain FSI items arising from ownership of CFC stock and substitutes tax-based items and adjustments. That approach reflects the Treasury’s recognition that applying elements of a complex regular tax regime directly to FSI may require a substitution framework rather than a separate parallel regime.³⁹

The international tax rules illustrate the problems that arise when tax principles, FSI, entity-level computations, and attributes must be coordinated across multiple periods. Similar tracing and coordination issues arise in the liability and CODI context. We therefore believe that the treatment of CFC stock provides meaningful support for the Treasury’s consideration of a substitution approach in the liability area.

Moreover, it can be argued that liabilities present a particularly strong case for substitution because financial accounting and regular tax principles may differ not merely as to timing, but as to whether a liability or indebtedness exists, how it is measured, whether a realization event has occurred, and whether income exists at all. As a result, the issue is not merely whether the same item is recognized in different periods. In many cases, financial accounting and regular tax principles differ regarding whether any income exists at all.⁴⁰ As the Tax Section has studied these issues since enactment of the CAMT, we have encountered substantial difficulties in attempting to apply the principles of the regular tax CODI regime to FSI while accounting for

³⁸ See Notice 2025-49 §§ 5, 7, and 9; Notice 2026-7 §§ 3-10.

³⁹ See Sections 56A(c)(2)(C) and 56A(c)(3); Prop. Treas. Regs. § 1.56A-6(c). See also the discussion of foreign corporation transactions in Part IV.A.2 of this Report.

⁴⁰ For example, a deferred tax liability reversed on an AFS may generate FSI even though no indebtedness exists for federal income tax purposes and, therefore, no CODI arises.

differences in liability identification and measurement, timing, amount, exclusion, and the consequences of exclusion. Aligning those determinations across taxable years and systems that do not clearly correspond would require extensive tracing and coordination rules.

In addition, the differences between financial statement and regular tax liability treatment can become especially significant in the Distressed Taxpayer context. Restructurings frequently involve lease liabilities, preferred equity, deferred revenue, environmental liabilities, pension obligations, litigation reserves, warrants, contingent consideration, and other items reflected as liabilities for financial statement purposes but not treated as indebtedness for regular tax purposes. Report 1473 observed that, without additional relief, the modification, reduction, or elimination of such AFS liabilities could produce substantial AFSI in excess of excluded CODI for regular tax purposes, creating concerns similar to those presented by the cancellation of liabilities that constitute indebtedness for regular tax purposes and potentially causing a Distressed Taxpayer to become an applicable corporation notwithstanding a history of economic losses.⁴¹ The Treasury likewise recognized in the Preamble to the Proposed Regulations that troubled companies should not be impaired from achieving solvency or emerging from bankruptcy by CAMT liabilities arising from debt discharge income and fresh-start reporting.⁴²

One particular issue merits special attention: FSI arising from financial statement remeasurements of liabilities. The Treasury has already recognized in other CAMT contexts that financial statement remeasurements that do not give rise to corresponding regular tax consequences may not provide an appropriate measure of AFSI. For example, section 5 of Notice 2025-49 permits taxpayers to disregard certain gains and losses arising from assets that are marked-to-market for AFS purposes but not regular tax purposes.

Similar concerns arise with respect to liabilities. A taxpayer may elect fair-value accounting with respect to indebtedness.⁴³ If the taxpayer's own creditworthiness deteriorates, the carrying value of the liability may decline for financial statement purposes, resulting in FSI, even though no indebtedness has been discharged, exchanged, satisfied, or significantly modified in a manner that gives rise to CODI for regular tax purposes.⁴⁴ Changes in estimated future cash flows also may require remeasurement of environmental remediation obligations, litigation reserves, pension obligations, contingent consideration liabilities, or other financial statement liabilities, producing FSI even though no borrowing transaction or regular tax realization event has occurred.⁴⁵ A restructuring similarly may involve the modification, settlement, or elimination of

⁴¹ See Report 1473, pp. 82-85.

⁴² See Preamble, 89 Fed. Reg. 75104, 75114 (Sept. 13, 2024).

⁴³ See ASC 825-10.

⁴⁴ See ASC 825-10; ASC 820.

⁴⁵ See, e.g., ASC 410; ASC 450; ASC 715; ASC 805.

lease liabilities, deferred revenue obligations, preferred equity classified as a liability for financial statement purposes, or other AFS liabilities that do not constitute indebtedness for regular tax purposes.⁴⁶ Those items may give rise to FSI even though no corresponding CODI arises under Sections 61(a)(11) and 108.

We believe that liability remeasurements represent the mirror image of the mark-to-market asset issues that the Treasury already has determined warrant relief.⁴⁷ If the Treasury concludes that unrealized financial statement remeasurements of assets should not automatically give rise to AFSI, as discussed in Part IV.C.7 of this Report, similar considerations support relief where FSI arises solely from the remeasurement of liabilities.

Tax Benefit Type Concerns. We recognize that the Tax Liability Substitution Approach, while imposing substantial conformity of inputs regarding liabilities, does not completely conform financial statement liabilities and regular tax liabilities and that differences may arise as a result. In certain circumstances, a liability may reduce FSI and AFSI in an amount that exceeds the corresponding liability determined under regular tax principles. If the financial statement liability is later reduced, settled, discharged, or reversed, all or a portion of the resulting FSI inclusion may be disregarded under the Tax Liability Substitution Approach because the corresponding regular tax liability is smaller or no regular tax liability exists. In that circumstance, the taxpayer may retain the benefit of a prior reduction to AFSI without a corresponding CAMT inclusion.⁴⁸ In fact, it would appear that the Tax Liability Substitution Approach inherently produces an asymmetry to the detriment of the fisc with respect to book liabilities that do not correspond to tax liabilities (e.g., an accrued expense for book purposes that has not met the tax requirements for taking the liability into account): although income statement expense items recorded on the creation of a liability would be respected in determining AFSI, a subsequent adjustment that increases the liability would reduce AFSI but a subsequent adjustment that decreases such liability would be disregarded. As a conceptual matter, this seems to be an unwarranted benefit.

As a result, the Treasury could consider adopting a rule analogous to the tax benefit rule that would recapture a prior reduction to AFSI to the extent the corresponding financial statement liability subsequently is reduced below the amount of the regular tax liability or otherwise is not satisfied. Such a rule might appear to increase conformity between the prior AFSI reduction and

⁴⁶ See ASC 842; ASC 606; ASC 480.

⁴⁷ See Notice 2025-49 § 5; ASC 470-50; ASC 405. See also Part IV.C.7 of this Report.

⁴⁸ This concern should not arise with respect to interest on indebtedness. As discussed above, the Tax Liability Substitution Approach would determine whether an instrument constitutes indebtedness, and the characterization of payments on that instrument, under regular tax principles. Accordingly, to the extent a financial statement liability exceeds the corresponding liability determined under regular tax principles, the excess generally would not generate interest consequences for CAMT purposes. The concern described in the text instead relates to situations in which a financial statement liability gives rise to deductions or other reductions to AFSI that exceed those associated with the corresponding liability determined under regular tax principles.

the later CAMT inclusion. However, a rule of this nature would present substantial conceptual and administrative difficulties and would require the Treasury to determine whether it intends to adopt a substitution regime or instead to reconcile financial statement and regular tax treatment over the entire life of each liability.

For example, assume that in Year 1, a taxpayer records a \$500 expense and a corresponding \$500 liability for financial statement purposes, but the corresponding liability determined under regular tax principles is \$300. The \$500 financial statement expense reduces FSI and, absent another CAMT adjustment, AFSI. The Tax Liability Substitution Approach does not reverse that expense or replace it with a \$300 tax deduction. If the financial statement liability later is reduced in Year 2 from \$500 to \$100 while the regular tax liability remains \$300, the taxpayer may recognize \$400 of FSI but no CODI under regular tax principles.

A recapture rule would need to determine how much of the \$400 FSI inclusion should be taken into account for CAMT purposes. One possibility would be to treat the \$200 excess of the original financial statement liability over the regular tax liability as subject to recapture. Subsequent events, however, could produce additional CAMT consequences. If the taxpayer satisfies the \$300 regular tax liability for \$200, it would recognize \$100 of regular tax CODI, which under the Tax Liability Substitution Approach would also constitute CAMT CODI. If instead the taxpayer satisfies the liability for \$300, the financial statement consequences would depend upon the prior accounting for the reduction of the liability. Alternatively, the regular tax liability could itself be reduced, producing CODI under regular tax principles and, therefore, under the Tax Liability Substitution Approach. In each case, the Treasury would need rules determining whether, and to what extent, the prior FSI inclusion and subsequent CODI recognition reflect the same economic event.

We note that application of the Tax Liability Substitution Approach also may produce differences that are unfavorable to the taxpayer. Assume that a taxpayer records a \$200 expense and a corresponding \$200 liability for financial statement purposes, but the liability determined under regular tax principles is \$300. The \$200 financial statement expense reduces FSI and, absent another CAMT adjustment, AFSI. The Tax Liability Substitution Approach does not create an additional \$100 reduction to AFSI merely because the regular tax liability exceeds the financial statement liability. If the \$300 regular tax liability subsequently is satisfied for \$175, then, regular tax principles may produce \$125 of CODI, while AFS principles may produce only \$25 of CODI. Under the Tax Liability Substitution Approach, that \$125 (including the additional \$100 compared to AFS CODI) of CODI generally would be taken into account for CAMT purposes even though the liability produced only a \$200 reduction to AFSI, and the taxpayer ultimately paid \$175.

Thus, differences between financial statement liabilities and regular tax liabilities may produce results that are favorable or unfavorable to taxpayers. A rule intended to recapture only prior

AFSI reductions where the financial statement liability exceeds the regular tax liability would address only one direction of the difference. If the Treasury determines that such differences should be reconciled, it also would need to consider whether corresponding favorable adjustments should be available where the regular tax liability exceeds the financial statement liability and the resulting CAMT inclusion exceeds the prior reduction to AFSI.

More fundamentally, adopting a tax benefit or recapture rule would require the Treasury to retain a separate CAMT liability regime for at least a portion of each liability that differs from the corresponding regular tax liability. In the first example, the Treasury effectively would need to maintain one regime for the \$300 liability determined under regular tax principles and another regime for the \$200 excess financial statement liability. The second regime would need to determine whether a subsequent reduction of the excess financial statement liability gives rise to CAMT income, whether that income constitutes CAMT CODI or another category of AFSI, and whether any exclusion or attribute-reduction rules apply. As reflected in these examples, the relative amounts subject to each regime could change over time as the financial statement and regular tax liabilities are remeasured, modified, accrued, contested, settled, discharged, or paid.

The Treasury then would need to determine how each subsequent adjustment is allocated between the substituted tax liability and the residual financial statement liability. It also would need to determine whether the residual financial statement liability constitutes CAMT indebtedness, whether its reduction gives rise to CAMT CODI, the amount and timing of that CODI, whether the insolvency or bankruptcy exclusion applies, and whether excluded CAMT CODI results in CAMT attribute reduction. If the liability has no regular tax analogue, the Treasury would be required to answer those questions without the benefit of the regular tax liability and CODI framework. These are many of the same questions that the Tax Liability Substitution Approach is intended to eliminate.

A recapture rule also would require tracing prior financial statement expenses and AFSI reductions over potentially extended periods. The financial statement liability may have originated before the taxpayer became an applicable corporation or while the taxpayer was a member of a different financial statement group. It may have contributed to an FSNOL, may have been affected by a change in accounting principles or estimates, or may have been increased or decreased through subsequent remeasurements. The entity recognizing the later FSI inclusion also may differ from the entity that obtained the earlier AFSI reduction as a result of mergers, acquisitions, deconsolidations, reconsolidations, or other changes in the taxpayer's structure. A comprehensive recapture rule therefore would require extensive tracing, allocation, and successor rules.

Accordingly, the dispositive question may not simply be whether a tax-benefit-type concern exists. The Tax Liability Substitution Approach necessarily accepts that the financial statement expense associated with a liability and the subsequent consequences determined under regular

tax principles may not correspond in every case. A relevant question is whether correcting those differences requires the Treasury to recreate and administer the separate CAMT liability system that the Tax Liability Substitution Approach is intended to replace.

We do not suggest that those differences are immaterial. Rather, the Treasury should weigh the additional precision that might be obtained through a reconciliation or recapture regime against the associated complexity, compliance burden, and administrative cost. The Treasury has recognized in other contexts that the effort to achieve greater precision may create unacceptable complexity and that an administrable regime may require acceptance of differences that would not arise under either financial accounting or regular tax principles standing alone.⁴⁹

Potential Limitation of the Tax Liability Substitution Approach to Distressed Taxpayers. The administrability argument supporting the Tax Liability Substitution Approach extends beyond taxpayers that are insolvent or subject to a Title 11 Case. Nevertheless, the Treasury could conclude, as a policy matter, that the arguments in favor of adoption of the Tax Liability Substitution Approach are strong enough to justify the departure from the general CAMT framework only where necessary to further rehabilitation of distressed taxpayers and thus the approach should apply only to taxpayers that are insolvent or subject to a Title 11 Case.⁵⁰

Limiting the Tax Liability Substitution Approach to insolvent and bankrupt taxpayers would focus the proposal on the circumstances giving rise to many of the concerns addressed in this Report. The policy concerns are strongest where a taxpayer is experiencing severe financial distress, shareholder value has been substantially eliminated, creditor recoveries have been materially impaired, and CAMT liabilities may impede a restructuring or emergence from bankruptcy. Such a limitation also would align more closely with the structure of Sections 108(a) and (b) and would avoid extending to financially healthy corporations a rule principally motivated by distressed-taxpayer concerns. In addition, the Treasury and Congress have often described the CAMT as principally directed at highly profitable corporations that report substantial earnings to shareholders while reporting little or no taxable income. Although those descriptions do not determine the proper treatment of liabilities or CODI, they provide support for focusing relief on circumstances more closely connected to the concerns that motivated the CAMT.

⁴⁹ See, e.g., T.D. 9424, 73 Fed. Reg. 53,934, 53,934-35 (Sept. 17, 2008) (discussing the balance between precision, complexity, and administrability in the consolidated return context); T.D. 8364, 56 Fed. Reg. 47,379, 47,386-87 (Sept. 19, 1991) (rejecting a tracing approach because of administrability concerns, difficult valuation issues, and the inability of tracing to measure economic loss reliably in all cases). These authorities do not address CAMT liabilities but illustrate circumstances in which the Treasury has accepted a systemic rule rather than comprehensive tracing in order to achieve an administrable framework.

⁵⁰ As discussed in footnote 3 of this Report, the issues addressed in this Report may arise for both taxpayers experiencing financial distress and financially healthy taxpayers.

Financial distress, however, does not begin at the point at which a taxpayer becomes insolvent under Section 108(d)(3) or commences a Title 11 Case. A creditor generally does not discharge a portion of indebtedness it otherwise expects to collect in full without an economic reason for doing so. The debtor may face liquidity constraints, reduced enterprise value, deteriorating creditworthiness, covenant defaults, or other financial pressure without satisfying the technical requirements for the insolvency or bankruptcy exclusion. In addition, debt modifications may produce CODI where an instrument trades at a discount for reasons that are not limited to the debtor's financial condition, including changes in market interest rates and the terms of the instrument. The circumstances producing CODI therefore do not divide neatly between financially healthy and financially distressed taxpayers.

Moreover, the administrability concerns underlying the Tax Liability Substitution Approach do not depend upon whether a taxpayer satisfies a particular insolvency or bankruptcy standard.⁵¹ As discussed above, financial accounting and regular tax principles may diverge in the identification, characterization, measurement, and timing of liabilities and CODI regardless of the taxpayer's financial condition. Limiting the approach to insolvent or bankrupt taxpayers would require eligibility rules, create boundary issues, and potentially result in economically similar liabilities and transactions receiving different CAMT treatment depending upon whether the taxpayer satisfied a particular distress standard.⁵²

The boundary issues may be particularly difficult because the eligibility determination itself could depend upon which liability regime applies. If a taxpayer is not insolvent using regular tax liabilities but would be insolvent using financial statement liabilities, the Treasury would need to determine which liability measure governs eligibility for the Tax Liability Substitution Approach. If the approach applies because the taxpayer is insolvent using financial statement liabilities, it then would substitute regular tax liabilities that may cause the taxpayer no longer to satisfy the insolvency standard. An eligibility rule based upon insolvency under either financial statement or regular tax principles might avoid that circularity but would require taxpayers and the Treasury

⁵¹ As discussed in footnote 3, the CAMT Guidance generally has not drawn distinctions based on the degree of a taxpayer's financial distress, and similar line-drawing concerns would arise if availability of the Tax Liability Substitution Approach depended upon satisfaction of an insolvency or bankruptcy standard.

⁵² Limiting the Tax Liability Substitution Approach to insolvent or bankrupt taxpayers would introduce additional boundary issues. For example, if the Treasury continues to define liabilities differently for CAMT and regular tax purposes, a taxpayer's insolvency status could vary depending upon whether insolvency is measured using CAMT liabilities, regular tax liabilities, financial statement carrying values, fair market value, or some combination of those measures. The Treasury also would need to determine how and when insolvency is measured, whether the determination is retested, and how taxpayers moving into and out of insolvency are treated. Similar issues would arise if the Treasury adopts timing rules extending bankruptcy-related treatment to adjustments recognized in anticipation of a Title 11 Case. For example, as discussed in Part IV.B.4.b) of this Report, if CODI recognized before commencement of a Title 11 Case may qualify for treatment analogous to the bankruptcy exclusion because it is sufficiently connected to a subsequent restructuring, the Treasury would need to determine how that rule interacts with any insolvency- or bankruptcy-based eligibility requirement for the Tax Liability Substitution Approach.

to perform and administer two insolvency determinations. Similar questions would arise regarding the timing of the eligibility determination and taxpayers that move into and out of financial distress during a restructuring process.

Limiting the Tax Liability Substitution Approach to insolvent or bankrupt taxpayers also would result in the need for the Treasury to develop and administer the separate CAMT liability and CODI regime for all other taxpayers. Although insolvent and bankrupt taxpayers would not be required to apply those rules, the Treasury and taxpayers still would need to resolve the same issues for taxpayers outside the limited class. A narrower rule therefore would reduce the burden for a particular group of taxpayers but would not eliminate the need to construct the parallel regime that gives rise to the principal administrability concerns addressed by the recommendation.

A broader rule would avoid those eligibility and boundary issues, apply a consistent liability framework to economically similar transactions, and eliminate a greater number of the interpretive questions identified throughout this Report and in Appendix A. On the other hand, extending the approach beyond insolvent and bankrupt taxpayers would apply the substitution framework in circumstances where the fresh-start and creditor-recovery policies supporting the recommendation are less directly implicated. The Treasury therefore reasonably could reach different conclusions regarding the appropriate scope of the approach.

We do not take a position regarding whether the Treasury should limit the Tax Liability Substitution Approach to taxpayers that are insolvent or subject to a Title 11 Case or instead apply the approach more broadly. Rather, the threshold question is whether regular tax principles provide a more administrable framework for determining liabilities and the consequences that arise from those liabilities than a separate CAMT liability and CODI regime. If the Treasury answers that question in the affirmative, either a narrower or broader application of the Tax Liability Substitution Approach would substantially reduce the complexity identified throughout this Report and Appendix A, although a broader rule would provide greater administrability benefits.

4. Relationship Between the Principles-Based Recommendations and the Specific Comments Below

The principles-based recommendations above are intended to provide the Treasury with administrable alternatives to a pure issue-by-issue resolution approach. The Uniform Transaction Tax Principles Approach would clarify that restructuring transactions involving financially distressed taxpayers are subject to the same regular tax transaction principles applicable to financially healthy taxpayers under the CAMT regime, while the CODI Tax Principles Approach would apply established tax principles to the consequences of CODI and related CAMT adjustments. Together, those approaches would provide a more administrable framework for

determining both transaction treatment and the consequences of CODI while allowing the Treasury to retain CAMT-specific inputs where appropriate.

The Tax Liability Substitution Approach would go further by addressing the underlying determination of liabilities and many of the consequences arising from those liabilities. Rather than creating and maintaining a separate CAMT-specific framework for determining the existence, characterization, and amount of liabilities and CODI, the Tax Liability Substitution Approach would generally import liabilities and CODI as determined under regular tax principles. Adoption of the Tax Liability Substitution Approach therefore would eliminate many of the liability and CODI determination issues discussed throughout this Report and in Appendix A.

These recommendations are intended to be complementary rather than mutually exclusive. The Treasury may adopt one, some, or all of these recommendations. To the extent the Treasury adopts fewer than all of them, many of the issues identified below would continue to require specific guidance.

In the analysis that follows, we identify when adoption of one or more of these approaches would resolve particular issues discussed below. Where issues would remain notwithstanding adoption of those approaches, we identify the residual issue and recommend targeted guidance.

5. Relationship to Prior NYSBA Tax Section Reports

Both of the Prior NYSBA Tax Section Reports addressed CAMT issues relevant to Distressed Taxpayers. Many of those recommendations remain relevant after the issuance of Notice 2025-46, Notice 2025-49, and Notice 2026-7. In some cases, subsequent guidance addressed part of the issue but left core questions unanswered. In other cases, the guidance adopted an approach that creates new questions or requires further coordination.

Accordingly, throughout this Report we refer to prior NYSBA Tax Section recommendations where applicable and identify whether particular issues remain unaddressed in subsequent guidance. We do not repeat every prior recommendation in full. Rather, we incorporate and reassert those recommendations and provide additional analysis where subsequent guidance has changed the context or introduced new issues.

B. Cancellation of Debt Income (CODI)

1. Overview and Relationship to Principles-Based Recommendations

CODI is one of the areas where the tension between financial accounting principles and tax principles is most pronounced. The CAMT Guidance currently contains a largely self-contained framework for determining the existence, amount, exclusion, and consequences of CODI for

CAMT purposes.⁵³ Both of the Prior NYSBA Tax Section Reports raised concerns regarding the creation of a separate CAMT regime for CODI and the resulting complexity, uncertainty, and compliance burden.⁵⁴ As discussed above, we recommend two principles-based approaches that would substantially simplify many of the issues addressed in this Part IV.B: the Tax Liability Substitution Approach and the CODI Tax Principles Approach.⁵⁵

Under the Tax Liability Substitution Approach, financial statement CODI would be disregarded and replaced with CODI determined under regular tax principles. If the Treasury adopts the Tax Liability Substitution Approach, the issues described in this Part IV.B would be resolved. This is because regular tax determinations would be substituted into the CAMT system with regard to whether CODI exists, the amount and character of such CODI, the application of the exclusions under Section 108(a), the special rules contained in Section 108(e), and the treatment of partnership CODI under Section 108(d)(6). As discussed throughout this Report, financial accounting and regular tax principles may differ not only as to the consequences of CODI, but also as to whether a liability exists, whether that liability constitutes indebtedness, whether a realization event has occurred, when income is recognized, and whether any income exists at all. Adoption of the Tax Liability Substitution Approach would eliminate the need to separately resolve those questions under a standalone CAMT framework. If the Treasury does not adopt the Tax Liability Substitution Approach but does adopt the CODI Tax Principles Approach, certain issues described in this Part IV.B would be simplified or resolved.

Accordingly, this Part first discusses the scope of CODI and whether a liability adjustment gives rise to CODI for CAMT purposes. It then discusses the extent to which principles analogous to Sections 108(e), 108(a), and 108(d)(6) should apply in the CAMT context. To the extent the Treasury continues to maintain a separate CAMT concept of indebtedness or CODI, we recommend that the Treasury conform the CAMT framework as closely as possible to the corresponding regular tax principles.

2. Scope of CODI

a) Definition of Indebtedness and Impact on AFSI

One of the threshold questions remaining under the CAMT Guidance is whether a liability constitutes “indebtedness” for purposes of determining CODI. This question illustrates one of the principal concerns discussed throughout this Report. Financial statement liabilities and tax indebtedness are not coextensive concepts. This issue extends beyond the characterization of CODI. The determination of whether an instrument constitutes indebtedness may affect the

⁵³ See, e.g., Notice 2025-46 § 4.

⁵⁴ See Report 1473, pp. 82-89; Report 1506, pp. 188-193.

⁵⁵ See Part IV.A.3 of this Report for a discussion of the Tax Liability Substitution Approach and Part IV.A.2.b) of this Report for a discussion of the CODI Tax Principles Approach.

treatment of interest expense, liability modifications, debt-for-equity exchanges, disposition transactions governed by principles analogous to Treas. Regs. § 1.1001-2 and Commissioner v. Tufts, 461 U.S. 300 (1983), and numerous other CAMT consequences. Accordingly, the question is not merely whether a liability can generate CAMT CODI, but whether liabilities that are not treated as indebtedness under established tax principles should nevertheless generate CAMT consequences associated with indebtedness, including interest determinations and deductions, CODI, gain or loss recognition, and other liability-related consequences, solely because they are classified as liabilities for financial statement purposes.

If the Treasury adopts the Tax Liability Substitution Approach, this issue will be resolved, as the definition of a liability would be based on the tax classification of an instrument. The determination of whether a liability constitutes indebtedness would be governed by Section 108(d)(1) and the considerable body of authorities interpreting that provision. In that event, liabilities that do not constitute indebtedness for regular tax purposes would not generate CAMT CODI or, subject to the possible adoption of tax benefit type principles (as discussed above), other liability-side AFSI solely as a result of their modification, reduction, or elimination, even if those events generate FSI.

If the Treasury does not adopt the Tax Liability Substitution Approach, the Treasury must determine the scope of the CAMT concept of indebtedness. Notice 2025-46 generally adopts a broader concept of indebtedness that is informed by financial statement treatment rather than conformed to tax characterizations.⁵⁶ As a result, liabilities reflected on an AFS may produce CAMT CODI even where those liabilities would not constitute indebtedness for purposes of Sections 61(a)(11) and 108.

We continue to believe that this divergence is problematic. As discussed in Report 1473, a taxpayer may recognize FSI from the modification, reduction, or elimination of liabilities that are not debt for tax purposes.⁵⁷ The distinction is not merely theoretical. Deferred tax liabilities, environmental reserves, litigation reserves, pension obligations, contingent consideration liabilities, lease liabilities, and preferred equity classified as liabilities for financial accounting purposes may all be reflected as liabilities on an AFS even though they are not indebtedness for purposes of Sections 61(a)(11) and 108. Adjustments to those items may produce FSI without involving a borrowing transaction, a discharge of indebtedness, or any other event that generally would be associated with CODI under regular tax principles.

Accordingly, even if the Treasury does not adopt the Tax Liability Substitution Approach, we independently recommend that adjustments to liabilities that do not represent borrowing transactions for regular tax purposes generally should not give rise to AFSI. This

⁵⁶ See Notice 2025-46 § 4.01.

⁵⁷ See Report 1473, pp. 82-85.

recommendation is not limited to the characterization of such amounts as CODI. Rather, where a liability does not arise from a borrowing transaction and does not have a meaningful regular tax analogue, we do not believe that FSI arising from the modification, reduction, or elimination of that liability should be taken into account in determining AFSI, subject to the possible adoption of tax benefit type principles (as discussed above). In those circumstances, the resulting FSI often reflects a financial accounting construct rather than income arising from a borrowing transaction and therefore does not present the type of liability-related income that the CAMT CODI framework was intended to address. To the extent such amounts nevertheless are reflected in AFSI, the Treasury should clarify whether they constitute CAMT CODI or another category of AFSI and provide an administrable framework governing their treatment.

If the Treasury nevertheless determines that such liabilities should give rise to AFSI upon modification or elimination, the Treasury should clarify that adjustments to those liabilities are characterized as CODI for purposes of the CAMT rules, as generally provided in Notice 2025-46.⁵⁸ The Treasury also would be required to develop a separate CAMT-specific framework governing liabilities that are not indebtedness under established tax principles. We believe that such a parallel regime is likely to be complex and difficult to administer for taxpayers and the government alike, given the administrability concerns discussed throughout this Report.

b) Recourse vs. nonrecourse liabilities

The distinction between recourse and nonrecourse indebtedness further illustrates the difficulty of developing a separate CAMT concept of indebtedness. Under well-established tax principles, recourse and nonrecourse liabilities frequently produce different consequences upon discharge, modification, foreclosure, or transfer of property.⁵⁹ Notice 2025-46 adopts that paradigm by providing different rules for recourse and nonrecourse indebtedness.⁶⁰ While we generally agree with the Treasury's decision to distinguish between recourse and nonrecourse liabilities, the CAMT Guidance largely imports the income tax consequences of that distinction under established law without providing a corresponding framework for determining when a liability is properly characterized as recourse or nonrecourse for purposes of the CAMT.

If the Treasury adopts the Tax Liability Substitution Approach, these issues are resolved, because the classification of a liability as recourse or nonrecourse, as well as whether a transaction gives rise to CODI, gain from the disposition of property, or both would follow existing tax principles. Similarly, if the Treasury adopts the CODI Tax Principles Approach, principles analogous to

⁵⁸ Notice 2025-46 §§ 4.02(3)(a)-(d), (f). Because these liabilities do not have a regular tax corollaries, a reference to Section 108(d)(1) could be construed as applying only to liabilities recognized for regular tax purposes. Adoption of the CODI Tax Principles Approach might address this by applying the principles of Section 108(d)(1) to the financial statement liabilities.

⁵⁹ See, e.g., *Commissioner v. Tufts*, 461 U.S. 300 (1983); Treas. Regs. § 1.1001-2; Rev. Rul. 90-16, 1990-1 C.B. 12.

⁶⁰ See Notice 2025-46 §§ 4.02(3)(c) and (d).

Sections 61(a)(11) and 1001, Treas. Regs. § 1.1001-2, and Commissioner v. Tufts, should govern the classification and treatment of indebtedness. Under those approaches, where property is taken subject to nonrecourse indebtedness, the amount realized for CAMT purposes generally would be determined under tax principles. If the Treasury adopts the Tax Liability Substitution Approach, the amount of the liability taken into account generally would be determined under the regular tax rules. By contrast, if the Treasury adopts the CODI Tax Principles Approach but not the Tax Liability Substitution Approach, the relevant liability amount generally would continue to be determined under the CAMT framework unless the Treasury provides otherwise. In either case, any resulting gain or loss recognized on property securing the debt generally would be computed using CAMT basis rather than regular tax basis.

If the Treasury does not adopt the Tax Liability Substitution Approach or the CODI Tax Principles Approach and instead continues to maintain a separate CAMT concept of indebtedness, the Treasury should provide guidance regarding the manner in which liabilities are classified as recourse or nonrecourse. In particular, the Treasury should clarify how those concepts apply to liabilities that do not have direct analogues under the regular tax rules, including liabilities that arise solely as a result of financial statement classification. Without such guidance, similarly situated taxpayers may reach different conclusions regarding the characterization of liabilities (i.e., recourse versus nonrecourse) and the resulting determination of CAMT CODI. We note that, if the Treasury adopts a separate CAMT liability determination regime, where property is taken subject to nonrecourse indebtedness, for CAMT purposes, the amount realized would be based on the amount of the liability determined under those separate CAMT rules (rather than under regular tax principles), with the resulting gain or loss computed using CAMT basis.

3. Determination of CODI

As discussed above, if the Treasury adopts the Tax Liability Substitution Approach, the issues addressed in this Part IV.B.3 are generally resolved because the existence and amount of CODI in the CAMT system would equal the amount of CODI in the regular tax system. If the Treasury does not adopt the Tax Liability Substitution Approach but adopts the CODI Tax Principles Approach, principles analogous to Section 108(e) (along with the extensive body of authorities interpreting that provision) should govern the determination of CODI, subject to CAMT-specific modifications already provided for in the CAMT Guidance and the further modifications identified below. We believe either of these approaches would be more administrable and produce more consistent results than maintaining a separate CAMT-specific framework that attempts to recreate the operation of Section 108(e).

Notice 2025-46 adopts rules analogous to Sections 108(e)(2), 108(e)(6), and 108(e)(8), modified to utilize CAMT-specific concepts and attributes,⁶¹ reflecting the Treasury's recognition that principles similar to those contained in Section 108(e) are relevant in the CAMT context. However, Notice 2025-46 adopts no analogue to Sections 108(e)(4) or 108(e)(10). The omission of rules analogous to Sections 108(e)(4) and 108(e)(10) further illustrates the difficult, drawn-out process of constructing a comprehensive CAMT-specific CODI regime. Once the Treasury departs from established tax principles, the Treasury must determine whether, and to what extent, each individual provision of Section 108(e) should be replicated through separate CAMT guidance.

Unless otherwise noted, the discussion in this Part IV.B.3 of this Report assumes that (i) the Tax Liability Substitution Approach would resolve the relevant issue, (ii) the CODI Tax Principles Approach would apply the corresponding regular tax principle with CAMT-specific inputs, and (iii) absent either approach, the Treasury would need to develop freestanding CAMT rules (e.g., specifying each individual regular tax principle that is incorporated into CAMT and any CAMT-only rules that apply where the corresponding regular tax principle is not incorporated). Under those assumptions, the discussion focuses on the specific gaps and questions raised in relation to each provision.

a) Transactions Addressed Through a Parallel CAMT Regime

(1) Reductions in AFSI

Under regular tax principles, Section 108(e)(2) generally provides that the discharge of indebtedness does not result in CODI to the extent payment of the liability would have given rise to a deduction. Section 4.03(6) of Notice 2025-46 adopts a similar principle, but replaces the regular tax concept of a deduction with the CAMT concept of a direct reduction in AFSI.

The Treasury should clarify whether a reduction in FSI, rather than AFSI, is the appropriate analogue to a regular tax deduction under Section 108(e)(2). Because AFSI reflects FSI after CAMT-specific adjustments, otherwise similar liabilities may be treated differently depending on the answer to that question, rather than on the nature of the liability itself. For example, if the Treasury does not adopt our recommendation in Part IV.B.2.a) of this Report to exclude from AFSI adjustments to liabilities that do not represent borrowing transactions for regular tax purposes, questions may arise regarding the treatment of liabilities such as federal income tax liabilities. For example, payment of a federal income tax liability generally reduces FSI but does not directly reduce AFSI under the CAMT adjustments applicable to federal income taxes under Section 56A(c)(5). As a result, a subsequent reduction to such a liability should not increase AFSI, even though the payment of such liability would not give rise to a reduction to AFSI.

⁶¹ See Notice 2025-46 §§ 4.03(6), (7), and (8).

(2) Contributions of Debt to Capital

Under regular tax principles, Section 108(e)(6) generally provides that indebtedness that is contributed to capital is deemed satisfied for an amount of money equal to the shareholder's adjusted basis in the indebtedness. Section 4.03(7) of Notice 2025-46 adopts a similar principle, but replaces the regular tax concept of shareholder's adjusted basis in the indebtedness with a shareholder's CAMT basis in such indebtedness.

This substitution leaves several questions unaddressed. In particular, the CAMT Guidance does not address contributions by persons who do not track CAMT basis in their indebtedness, such as non-applicable corporations, certain minority U.S. shareholders, or foreign persons that are not U.S. taxpayers. Similar to the rule adopted in section 3.04(4)(a) of Notice 2025-46, the Treasury should provide that, if the transferor is not required to and does not determine CAMT basis in the indebtedness, the shareholder's CAMT basis in the indebtedness is deemed to equal its basis in the indebtedness for regular tax purposes.

A number of other questions exist with regard to contributions of debt to capital under the parallel CAMT regime adopted by Notice 2025-46. For example, as highlighted in a report submitted by the NYSBA Tax Section to the Treasury on June 7, 2026 ("**Report 1530**"),⁶² numerous interpretive questions arise under the regular income tax application of Section 108(e)(6), and they are incorporated herein by reference. Once the Treasury adopts a parallel CAMT regime using CAMT-specific concepts such as CAMT basis, the Treasury must determine whether the regular tax resolutions to those questions should apply in the CAMT context or whether CAMT-specific concepts require different treatment. The Treasury must still determine whether those principles apply without modification in the CAMT context. In many cases, the same substantive resolution likely will be appropriate. However, unless and until the Treasury clarifies the principles developed under Section 108(e)(6) that will apply and the extent to which CAMT-specific concepts alter the analysis, these unanswered questions will complicate the application and administration of the CAMT.

In addition, it is unclear whether the Treasury intended section 4.03(7) to apply to contributions of partnership indebtedness by partners. This issue is not unique to the CAMT and reflects a longstanding debate regarding whether Section 108(e)(6) applies where the debtor is a partnership rather than a corporation.⁶³ The uncertainty is exacerbated under the parallel CAMT regime because section 4.03(7) of Notice 2025-46 expressly adopts a CAMT analogue to Section

⁶² See NYSBA Tax Section, Report 1530: "Report on Selected Issues under Section 108(e)(6)" (June 7, 2026).

⁶³ Notwithstanding the specific language within Section 108(e)(6) which only refers to a "debtor corporation," some practitioners have argued that the provision applies to contributions by a partner to a partnership. See, e.g., Kimberly S. Blanchard, "The Taxability of Capital Subsidies and Other Targeted Incentives" Tax Notes pp. 781-797 (Nov. 8, 1999).

108(e)(6), but it is not clear whether the Treasury intended that analogue to apply only in the corporate context or more broadly.

Finally, while section 4.03(7) increases AFSI by the excess of the indebtedness over the shareholder's CAMT basis, the Notice does not state whether the resulting AFSI increase constitutes CODI (rather than another form of AFSI) for purposes of the remainder of the CAMT framework. This characterization issue affects the availability of exclusions, attribute reduction, partnership allocations, and other provisions of the CAMT Guidance.

(3) Debt-for-Equity Exchanges

Under regular tax principles, Section 108(e)(8) generally treats a debtor corporation or partnership as satisfying indebtedness with an amount of money equal to the fair market value of the stock or partnership interest transferred to the creditor. Section 4.03(8) of Notice 2025-46 adopts a similar principle.

This substitution leaves two questions unaddressed. First, the Notice provides that the amount of money deemed transferred is based on the fair market value of the stock or partnership interest. However, if CAMT is based on financial statements, the appropriate valuation standard may be the fair value of the stock or partnership interest for the CAMT taxpayer's accounting purposes.⁶⁴ Second, as with section 4.03(7), section 4.03(8) of Notice 2025-46 does not state whether the resulting AFSI increase constitutes CODI (rather than another form of AFSI) for purposes of the remainder of the CAMT framework, a characterization issue that affects the availability of exclusions, attribute reduction, partnership allocations, and other provisions of the CAMT Guidance.

b) Transactions Not Addressed by the CAMT Guidance

(1) Related-Party Acquisitions

Under regular tax principles, Section 108(e)(4) generally treats a taxpayer as realizing CODI when a person related to the taxpayer acquires the taxpayer's indebtedness from an unrelated person. This rule appropriately prevents taxpayers from avoiding CODI through the use of related-party acquisition structures while simultaneously providing a clear framework for determining the resulting consequences. The CAMT Guidance contains no analogous rule. We note that adoption of either the Tax Liability Substitution Approach or the CODI Tax Principles Approach would resolve this issue by incorporating Section 108(e)(4) into CAMT.

⁶⁴ See *JPMorgan Chase & Co., successor in interest to Bank One Corp. v. Commissioner*, 458 F.3d 564 (7th Cir. 2006), *aff'd* in part, *vacating and remanding in part Bank One Corp. v. Commissioner*, 120 T.C. 174 (2003); see also Richard Huesseini and Philippe Penelle, *What Does "Fair Market Value" Mean for Tax Purposes and What Should It Mean? A Reality Based Standard for Determining Fair Market Value for Tax Purposes*, TAXES, Mar. 2025, at 80.

We do not believe the Treasury should create a separate CAMT-specific framework governing related-party acquisitions, as doing so would require the Treasury to replicate a well-developed body of tax law that already addresses these issues. If the Treasury adopts neither the Tax Liability Substitution Approach nor the CODI Tax Principles Approach, the Treasury should adopt principles analogous to Section 108(e)(4) in determining whether, and to what extent, a related-party acquisition of indebtedness gives rise to CODI. The absence of an explicit CAMT rule is particularly significant because a related-party acquisition may not independently give rise to a corresponding financial statement gain event for the debtor. Accordingly, if the Treasury wishes the CAMT to reach the same result as regular tax law in this context, the Treasury should expressly incorporate principles analogous to Section 108(e)(4) rather than relying on financial statement treatment alone.

(2) Debt Modifications and Exchanges

Under regular tax principles, Section 108(e)(10), Treas. Regs. § 1.1001-3, and related authorities provide a developed framework for determining whether a modification or exchange of indebtedness results in a deemed exchange and whether that exchange gives rise to CODI. The CAMT Guidance contains no analogous rule, notwithstanding that debt modifications and exchanges, extensions of maturity, interest rate modifications, covenant amendments, and exchanges of existing for new indebtedness, are among the most common transactions in Distressed Taxpayer restructurings.

This omission does not merely leave a valuation or characterization question open; it leaves open whether a modification produces AFSI at all. For example, a debt-for-debt exchange involving non-publicly traded debt generally produces no CODI for regular tax purposes, but may nonetheless give rise to FSI.⁶⁵ Absent guidance analogous to Section 108(e)(10), it is unclear whether, and if so, to what extent, such FSI is taken into account for CAMT purposes, how issue price and original issue discount concepts should translate into the CAMT framework, and how significant modifications under Treas. Regs. § 1.1001-3 that produce no regular tax CODI but do produce FSI or loss should be treated. Given the prevalence of debt modifications in Distressed Taxpayer restructurings, this is one of the more consequential gaps in the current guidance.

If the Treasury adopts neither the Tax Liability Substitution Approach nor the CODI Tax Principles Approach, it should adopt principles analogous to Section 108(e)(10) and Treas. Regs. § 1.1001-3 for determining whether, and to what extent, debt modifications and exchanges give rise to CODI.

⁶⁵ See ASC 405-20 and 470-50.

4. Exclusion of CODI

As discussed above, if the Treasury adopts the Tax Liability Substitution Approach, the issues addressed in this Part IV.B.4 are generally resolved because the characterization of CODI as taxable or excluded would be determined under regular tax rules, including Section 108(a) and the extensive body of authorities interpreting that provision. If the Treasury does not adopt the Tax Liability Substitution Approach but adopts the CODI Tax Principles Approach, principles analogous to Section 108(a) should govern the determination of CODI. Nevertheless, the Treasury would still need to address how those principles operate in the CAMT system, including the determination of insolvency. We believe that either recommended approach would be more administrable and produce more consistent results than maintaining a separate CAMT-specific framework that attempts to recreate the operation of Section 108(a).

a) Insolvency Exception

Notice 2025-46 generally provides that a CAMT entity is insolvent for CAMT purposes to the extent that the CAMT entity is insolvent for regular tax purposes under Section 108(d)(3), determined immediately before the discharge of indebtedness.⁶⁶ In addition, Notice 2025-46 provides that, for purposes of determining insolvency, a member of a tax consolidated group is treated as a separate taxpayer from all other members of the group.⁶⁷

We appreciate the Treasury's decision to adopt an insolvency framework that is generally aligned with Section 108(d)(3). However, the current approach raises an important question: If the Treasury adopts a broader concept of indebtedness for CAMT purposes than applies under regular tax rules, should the determination of insolvency nevertheless be made solely by reference to regular tax assets and liabilities?

As discussed in Part IV.B.2.a) of this Report, we continue to believe that liabilities that do not represent borrowing transactions for regular tax purposes generally should not give rise to AFSI, including CAMT CODI. If the Treasury adopts that recommendation of Part IV.B.2.a) of this Report, then use of a regular tax insolvency framework is generally appropriate. However, if the Treasury determines that liabilities recognized for financial statement purposes may give rise to CAMT CODI notwithstanding the absence of regular tax indebtedness, we believe those same liabilities generally should be taken into account in determining the extent of insolvency. Stated differently, liabilities capable of generating CAMT CODI should generally be the liabilities taken into account in measuring insolvency.

The same principle should apply to assets. If the Treasury determines that financial statement concepts are relevant in determining whether a taxpayer has realized CAMT CODI, the Treasury

⁶⁶ Notice 2025-46 § 4.02(3)(g)(i) and (ii).

⁶⁷ Notice 2025-46 § 4.02(3)(g)(iii).

should also determine insolvency by using assets reflected for financial statement purposes rather than solely by reference to tax concepts. In our view, the assets used in measuring insolvency generally should correspond to the liabilities capable of generating CAMT CODI. Taxpayers should not be required to determine insolvency using one set of concepts while determining CODI using another.

Similar coordination issues may arise in the partnership context.⁶⁸

The coordination of CAMT liabilities and CODI presents a related valuation question. If the Treasury continues to recognize financial statement liabilities in determining CAMT CODI, the Treasury must also determine how assets should be valued in measuring insolvency. As recommended in Report 1506, in cases where there is CAMT CODI but no regular tax CODI for which the regular tax insolvency exception is available, we recommend that a Distressed Taxpayer be permitted to use either the fair market value of its assets as of the date of the cancellation (recognizing that its assets for regular tax purposes may not fully match its assets for AFS purposes) or the book value of its assets as of the most recent annual financial statement for the calculation, though we recognize that the latter approach may be distortive.⁶⁹ We further recommend that the Treasury consider whether this choice should be available in determining CAMT CODI even where the regular tax insolvency exception is applicable.⁷⁰

We also continue to believe that the Treasury should clarify that insolvency is determined immediately before the discharge and should not be affected by financial statement consequences arising from the CODI transaction itself. For example, adjustments associated with deferred tax assets or deferred tax liabilities should not affect the determination of the extent of insolvency immediately before the discharge.

Additional issues relating to the application of the insolvency and bankruptcy exclusions in the context of tax consolidated groups, including the interaction of Notice 2026-7 with Treas. Regs. § 1.1502-28 and other consolidated return principles, are discussed in Part IV.I.2 of this Report.

In summary, if the Treasury declines to adopt the Tax Liability Substitution Approach, we recommend, consistent with the CODI Tax Principles Approach, that the Treasury apply principles analogous to Section 108(a)(1)(B) using CAMT-specific inputs. Doing so would ensure that the determination of insolvency takes into account all liabilities that are capable of

⁶⁸ See prior discussion in Report 1506, pp. 198-199.

⁶⁹ *Id.* at 197.

⁷⁰ *Id.* at 197-198 fn. 397. The footnote continues on to note that it is possible that the definition and characterization of assets for AFS purposes may differ from the definition and characterization of assets for tax purposes, which could impact relevant valuations for purposes of the insolvency calculation. In the absence of this expanded election, we note that a “cliff effect” could apply denying this alternative where there is a limited amount of tax CODI for which the insolvency exception is available, but a large amount of AFS CODI.

generating CAMT CODI, subject to safe harbors permitting reliance on fair market value or regular tax insolvency determinations.

b) Bankruptcy Exclusion

Notice 2025-46 provides that a CAMT entity qualifies for the bankruptcy exclusion only if the CAMT entity itself is under the jurisdiction of the court in a Title 11 Case “as the debtor” in that case.⁷¹ We agree with the Treasury’s decision to adopt a bankruptcy exclusion that generally follows the principles of Section 108(a)(1)(A). However, the current guidance raises several questions concerning both the scope of the exclusion and the extent to which the Treasury intends to depart from the regular tax framework.

Most fundamentally, the phrase “as the debtor” creates uncertainty regarding the circumstances in which a taxpayer qualifies for the bankruptcy exclusion. Section 108(d)(2) generally requires only that the taxpayer be under the jurisdiction of the court in a Title 11 Case. By contrast, Notice 2025-46 can be read to require that the taxpayer claiming the exclusion be the debtor in the particular Title 11 Case giving rise to the discharge. It is unclear whether the Treasury intentionally created an additional limitation, and what the argument supporting such an additional limitation would be. We recommend that the Treasury remove this requirement. If the Tax Liability Substitution Approach is not adopted, then under the CODI Tax Principles Approach, we believe that principles analogous to Section 108(d)(2) should govern the determination of whether a taxpayer is participating in a qualifying Title 11 Case.

The issue presented is illustrated by the treatment of disregarded entities and partnerships. In both cases, indebtedness is discharged at the level of one entity (the disregarded entity or partnership), while the availability of the bankruptcy exclusion is determined at the level of another entity (the regarded owner or partner).⁷² The reference to being “the debtor” appears intended to incorporate the principles reflected in Treas. Regs. § 1.108-9(a)(2), which requires the owner of a disregarded entity to be “under the jurisdiction of the court in a title 11 case as the title 11 debtor.”⁷³ We generally agree with that rule in the disregarded entity context. However, Treas. Regs. § 1.108-9(a)(2) does not require the owner to be “the debtor” in the particular Title 11 Case in which the indebtedness is discharged, which is essential as each debtor, even members within the same consolidated group, has its own Title 11 Case, even if administered on a consolidated basis. As a result, the debt of a disregarded entity that is cancelled as part of a Title 11 Case is done in the case in which the disregarded entity is “the debtor,” even if its regarded owner is also a debtor in a separate Title 11 Case. By contrast, Notice 2025-46 can be read to impose such a requirement. Accordingly, if the Treasury intends to incorporate the

⁷¹ Notice 2025-46 § 4.02(4).

⁷² Notice 2025-46 §§ 4.03(3)(b), 4.05(2)(b)(i).

⁷³ (emphasis added).

principles reflected in Treas. Regs. § 1.108-9(a)(2), the Treasury should clarify that the relevant taxpayer need only be under the jurisdiction of the court as a title 11 debtor and need not be the debtor in the particular Title 11 Case in which the indebtedness is discharged.

As noted, the rule in Notice 2025-46 appears to paraphrase Treas. Regs. § 1.108-9(a)(2), which provides a specific rule for disregarded entities. However, the CAMT Guidance contains no analogous rule for partnerships or other taxpayers. The Treasury should therefore either adopt the principles of Treas. Regs. § 1.108-9(b) (which is specific to partnerships) or otherwise provide explicit guidance regarding how the bankruptcy exclusion applies where partnership indebtedness is discharged but the availability of the exclusion is determined at the partner level.

The current guidance also raises timing questions that would not be resolved merely by incorporating Section 108 bankruptcy principles without modification. Notice 2025-46 adopts the definition of a Title 11 Case contained in Section 108(d)(2), but it does not require that the discharge of indebtedness be granted by, or pursuant to a plan approved by, the court. Instead, Notice 2025-46 appears to apply the bankruptcy exclusion to reductions in the AFS basis of indebtedness, other than reductions resulting from payments, that occur during the pendency of a Title 11 Case, even if no discharge of indebtedness has yet been granted by the court or pursuant to a confirmed plan.⁷⁴ That approach is broader than the regular tax rule under Section 108 and reflects the fact that financial statement consequences may arise before the legal discharge of indebtedness occurs for regular tax purposes. Accordingly, if the Treasury declines to adopt the Tax Liability Substitution Approach but adopts the CODI Tax Principles Approach, the Treasury should not simply import the regular tax bankruptcy exclusion without modification. Rather, the Treasury should preserve, and where appropriate expand, the CAMT-specific timing principles reflected in Notice 2025-46 so that financial statement CODI or analogous liability adjustments sufficiently connected to a Title 11 Case restructuring may qualify for bankruptcy-exclusion treatment even if the corresponding regular tax discharge occurs later or does not arise in the same period.⁷⁵

The broader timing framework reflected in Notice 2025-46 also raises questions regarding adjustments recognized before a formal discharge of indebtedness occurs. As discussed in Report 1506, financial statement consequences may arise in anticipation of, as a result of, during, or in connection with a Title 11 Case even though no formal discharge of indebtedness has yet occurred for regular tax purposes.

If the Treasury continues to recognize financial statement CODI through a separate CAMT framework, the Treasury should clarify the extent to which such amounts qualify for treatment analogous to the bankruptcy exclusion when the indebtedness is ultimately discharged through a

⁷⁴ Notice 2025-46, § 4.02(4).

⁷⁵ Compare Notice 2025-46 with Section 108(a)(1)(A) and Section 108(d)(2).

Title 11 Case. We continue to believe that the Treasury should adopt a practical approach in this area. To the extent FSI arises in anticipation of, during, or as a result of a Title 11 Case, and the relevant liabilities are ultimately addressed through a Title 11 Case restructuring, such amounts generally should qualify for treatment analogous to the bankruptcy exclusion. This rule should not depend solely on whether the financial statement adjustment occurs in the same taxable year as the legal discharge of indebtedness for regular tax purposes. The Treasury could implement such a rule through a facts-and-circumstances standard, supplemented by objective presumptions. For example, the Treasury could provide a rebuttable presumption that FSI recognized within one year before the filing of a Title 11 Case arose in anticipation of, or as a result of, the Title 11 Case if the relevant liability is ultimately addressed through the restructuring. Conversely, the Treasury could provide a rebuttable presumption that FSI recognized more than one year before the filing did not arise in anticipation of, or as a result of, the Title 11 Case, subject to facts demonstrating a sufficient connection to the restructuring process. The failure to satisfy these presumptions would not preclude the taxpayer from qualifying for another exclusion, including the insolvency exclusion, if otherwise applicable.

Although Report 1506 suggested a specified temporal period as an administrable mechanism for identifying adjustments connected to a bankruptcy restructuring, we do not believe relief necessarily should depend upon satisfaction of a fixed temporal requirement. Title 11 Cases frequently extend beyond any fixed period, and Notice 2025-46 already recognizes that qualifying adjustments may arise during the pendency of a case without requiring that the discharge itself be granted by, or pursuant to a plan approved by, the court. Accordingly, the more relevant inquiry should be whether the financial statement adjustment is sufficiently connected to a restructuring process that ultimately addresses the relevant liability through a Title 11 Case. If the legal discharge or other relevant restructuring event occurs after the filing of the tax return for the year in which the carrying value was adjusted, the Treasury should provide administrable rules for claiming the exclusion, including amended return procedures or other appropriate adjustment mechanisms.

Accordingly, if the Treasury declines to adopt the Tax Liability Substitution Approach, in line with the CODI Tax Principles Approach, we recommend that the Treasury apply principles analogous to Sections 108(a)(1)(A) and 108(d)(2) in determining the availability of the bankruptcy exclusion, but with CAMT-specific modifications necessary to account for the timing and character of financial statement liability adjustments. In particular, the Treasury should retain the broader Title 11 framework adopted in Notice 2025-46, under which reductions in the AFS basis of indebtedness, other than reductions resulting from payments, may qualify for bankruptcy-exclusion treatment during the pendency of a Title 11 Case even before a discharge is granted by the court or pursuant to a confirmed plan. The Treasury also should clarify that financial statement CODI or analogous liability adjustments arising in anticipation of, during, or as a result of a Title 11 Case may qualify for analogous bankruptcy-exclusion treatment if

sufficiently connected to a restructuring process that ultimately addresses the relevant liability through the Title 11 Case. In addition, the Treasury should remove the requirement that the CAMT entity be under the jurisdiction of the court “as the debtor,” except to the extent the Treasury determines that a special rule analogous to Treas. Regs. § 1.108-9(a)(2) is appropriate for disregarded entities, and should clarify the application of the exclusion in the context of disregarded entities, partnerships, timing differences, and consolidated groups.⁷⁶

C. Consequences of CODI: Attribute Reduction and Related Rules

1. Overview and Relationship to Tax Principles

As discussed above, if the Treasury adopts the Tax Liability Substitution Approach, the existence, amount, and exclusion of CODI generally would be determined under regular tax principles. Even under that approach, however, the Treasury would still need to determine the consequences of excluded CODI for CAMT purposes, including whether excluded CAMT CODI should result in the reduction of CAMT attributes and, if so, the manner in which such reductions should occur.

The CAMT Guidance generally follows the structure of Sections 108 and 1017 by requiring the reduction of certain CAMT attributes following the exclusion of CODI. We appreciate the Treasury’s decision to adopt a framework informed by existing tax principles. However, the current guidance creates a separate CAMT-specific attribute reduction regime that raises many of the same administrability concerns discussed above with respect to the determination of CODI itself.

Under regular tax principles, attribute reduction serves as the mechanism through which the future tax consequences of excluded CODI are preserved. Rather than permanently eliminating the consequences of CODI, Sections 108 and 1017 generally defer those consequences by reducing specified tax attributes. Accordingly, the threshold policy question for CAMT is whether attribute reduction should apply at all and, if so, the extent to which the CAMT framework should follow the structure of Sections 108(b) and 1017.

As discussed in Report 1473, a minority of the members of the Executive Committee questioned whether attribute reduction is appropriate in the CAMT context at all.⁷⁷ If the purpose of CAMT is to measure taxable income against the profits reported on financial statements, it is not clear that preserving future CAMT taxation potential through financial statement attribute reduction (that will not show up on a financial statement except as a deferred tax liability) is appropriate.

⁷⁶ See Part IV.I.2 of this Report for a discussion of the application of the bankruptcy exclusion within a consolidated group.

⁷⁷ Report 1473, pp. 89-90.

Attribute reduction in the CAMT context will create significant complexity, and there is a reasonable likelihood that double- or under-counting of attributes will arise.

That said, the statutory framework of CAMT does not look purely to financial statement results (*e.g.*, importation of a tax depreciation concept for fixed assets). Further, in the regular tax context, Congress clearly evidenced a desire to combine debt cancellation relief for Distressed Taxpayers with attribute reduction that would result in a successfully rehabilitated taxpayer paying additional taxes in the future. Therefore, the majority of the members of the Executive Committee believe that if a Distressed Taxpayer excludes CODI for CAMT purposes, its tax attributes for CAMT purposes (however ultimately defined) should also be reduced.

While we recognize the complexity and administrability concerns associated with a CAMT-specific attribute reduction regime, if the Treasury determines that excluded CAMT CODI should result in the reduction of CAMT attributes, we believe the Treasury generally should apply principles analogous to Sections 108(b) and 1017, as contemplated by the CODI Tax Principles Approach, modified as necessary to coordinate with CAMT-specific concepts and attributes, rather than continuing to develop a separate CAMT-specific attribute reduction regime.

Complexity in this area will be especially acute if the Treasury declines to adopt the Tax Liability Substitution Approach. In that circumstance, CAMT CODI may differ from regular tax CODI in timing, amount, or character. The discussion in Parts IV.B.2 through IV.B.4 of this Report identifies a number of situations in which such differences may arise. Accordingly, while principles analogous to Sections 108(b) and 1017 should provide the governing framework, the Treasury should retain CAMT-specific modifications where necessary to coordinate CAMT attributes with regular tax attributes and with the CAMT items that gave rise to the exclusion.

The Treasury should retain CAMT-specific modifications that appropriately coordinate CAMT attributes with regular tax attributes. For example, assuming no Section 108(b)(5) election was made, we agree with the Treasury's approach of first reducing CAMT basis of covered property only where the corresponding regular tax basis is reduced under Section 1017 and only to the extent the CAMT basis exceeds the resulting regular tax basis. We do not believe adoption of the CODI Tax Principles Approach should require the Treasury to abandon such coordination rules. Rather, tax principles should provide the framework, while appropriate CAMT-specific modifications should continue to apply where necessary to coordinate CAMT and regular tax attributes.

2. Scope of Attribute Reduction

Notice 2025-46 generally provides that the attributes subject to reduction include CAMT basis (other than regular tax basis in stock of a foreign corporation), CAMT foreign tax credits, CFC adjustment carryovers, and FSNOLs.

We continue to believe that the Treasury should carefully consider the scope of any attribute reduction regime. As discussed in Report 1473, one approach would be to limit attribute reduction to FSNOLs, CAMT foreign tax credits, and CAMT basis in “**covered property**,” as defined in section 4.02(2) of Notice 2025-46.⁷⁸ Such an approach would reduce complexity and limit the need to create comprehensive CAMT-specific adjustments to the regular tax attribute-reduction system.

As an alternative, the Treasury could instead adopt a broader approach under which attribute reduction applies to all CAMT assets and attributes. While this approach more closely resembles the structure of Section 1017, because of issues specific to the financial accounting rules, at the very least certain items should be excluded. In particular, the Treasury should exclude items that do not have meaningful tax analogues or that would create duplication, circularity, or immediate gain recognition concerns. For example, certain assets should not be subject to basis reduction, including deferred tax assets and certain pension-related assets, cash, and other items that do not function like traditional tax attributes. The difficulty in identifying the proper scope of assets subject to reduction, together with the additional issues discussed below involving partially owned entities, present administrability concerns. This may suggest that the scope of property subject to reduction should be more limited than the Treasury currently contemplates.

Further, applying basis reduction at all raises additional administrative concerns. In particular, basis reduction requires taxpayers to track historical reductions to CAMT basis and coordinate those reductions with subsequent depreciation, amortization, appreciation, impairments, revaluations, and disposition events over potentially long periods of time. Those tracking requirements arise because the attribute reduction rules create CAMT basis adjustments that do not necessarily correspond to subsequent financial statement carrying values. The Treasury would also need to provide rules determining how subsequent revaluations should be treated, as discussed in more detail in Part IV.C.7 of this Report.

The application of attribute reduction also raises difficult questions in the context of non-wholly owned entities. Many of those concerns are substantially reduced under the CODI Tax Principles Approach because the regular tax principles governing attribute reduction, including principles applicable to partially owned entities, generally would govern the CAMT consequences as well. The concerns discussed below principally arise if the Treasury adopts a separate CAMT attribute reduction regime, rather than adopting the CODI Tax Principles Approach.

As discussed in Report 1473, the Treasury has not provided guidance regarding the extent to which a taxpayer should be treated as owning the assets or attributes of an entity that is not wholly-owned.⁷⁹ Where attribute reduction applies in a separate CAMT attribute reduction

⁷⁸ *Id.* at pp. 90-92.

⁷⁹ Report 1473, p. 94.

regime to CAMT basis in assets held by such an entity, it is unclear whether the reduction should be determined by reference to the taxpayer's proportionate interest in the entity, the basis of the entity's underlying assets, or some other measure. Similar questions arise when excluded CODI is recognized by one entity, but attribute reduction is intended to affect assets held by another entity in which the taxpayer owns only a partial interest.

The regular tax authorities provide an existing framework for addressing these issues. The concern here is not that CAMT necessarily should reach a different result. Rather, once the Treasury creates a standalone CAMT attribute reduction regime using CAMT-specific concepts, the regular tax authorities no longer automatically govern. The Treasury therefore should clarify whether those same principles apply in the CAMT context or whether the Treasury contemplates a separate CAMT-specific approach. To the extent the Treasury requires reductions to CAMT basis in assets held indirectly through partially owned entities, the Treasury should provide clear rules addressing how attribute reduction applies to partially owned entities and how the relevant CAMT attributes are identified and measured. Absent such guidance, taxpayers may be required to make difficult judgments with regard to these issues, and similarly situated taxpayers may come to differing conclusions.

3. Ordering Rules and General Mechanics

Section 4.03(4)(b) of Notice 2025-46 establishes a detailed ordering regime governing the reduction of CAMT attributes in which CAMT foreign tax credits are reduced before certain CAMT basis in property. While we appreciate the Treasury's effort to provide a comprehensive framework, we continue to believe that the Treasury should more directly incorporate principles analogous to Treas. Regs. § 1.1017-1(a), rather than creating a separate CAMT-specific ordering regime.⁸⁰ Such an approach would improve administrability and reduce the need for taxpayers and the Treasury to maintain two independent attribute reduction systems.

One aspect of the current guidance that we generally support is the Treasury's effort to coordinate CAMT basis reductions with corresponding regular tax basis reductions. We specifically commend the Treasury for requiring that the first basis reduction apply to CAMT basis of covered property, but only where the corresponding regular tax basis is reduced under Section 1017 and only to the extent the CAMT basis exceeds the resulting regular tax basis. We believe that approach should be retained even if the Treasury adopts the CODI Tax Principles Approach, because it represents an appropriate coordination rule between CAMT and regular tax attributes rather than a departure from tax principles. This rule generally ensures that the CAMT basis of covered property is conformed to the regular tax basis of that property.

⁸⁰ Report 1506, pp. 199-200.

However, we continue to believe that such coordination should be carried further with respect to covered property. Under the ordering regime in Notice 2025-46, there is no prohibition on the reduction of CAMT basis of the covered property below the regular tax basis of the same property. As discussed in Report 1506, we do not believe that should be the case.⁸¹

To the extent the Treasury permits additional CAMT basis reductions for covered property, the Treasury should clarify whether subsequent regular tax depreciation gives rise to negative CAMT basis, deferred CAMT gain, immediate CAMT gain recognition, or some other coordinating adjustment.

4. Section 108(b)(5) Election and Liability Floor

For regular tax purposes, a taxpayer is generally not required to reduce its basis in property beyond the excess of the taxpayer's aggregate basis in its assets immediately after the discharge over the taxpayer's aggregate liabilities immediately after the discharge (the "**liability floor**").⁸² However, if a taxpayer makes a Section 108(b)(5) election, then the liability floor does not apply with respect to any reduction in basis by reason of the Section 108(b)(5) election. Importantly, the liability floor does continue to apply with regard to reduction in basis in all other property.⁸³

For CAMT purposes, section 4.05(5)(b) of Notice 2025-46 adopts a liability floor by not requiring a taxpayer to reduce its CAMT basis in property beyond the excess of the taxpayer's aggregate CAMT basis of property (including the regular tax basis in stock of a foreign corporation) and money immediately after the discharge over the taxpayer's aggregate liabilities reflected on the AFS immediately after the discharge (the "**CAMT liability floor**"). Irrespective of whether the Treasury adopts the Tax Liability Substitution Approach or the recommendation in Part IV.B.2.a) of the Report, we believe the Treasury should retain the approach in Notice 2025-46 that measures liabilities for purposes of the CAMT liability floor by reference to liabilities reflected on the AFS. We acknowledge that this approach may appear difficult to reconcile with recommendations elsewhere in this Report that generally look to regular tax principles in determining liabilities and CODI. However, unlike the determination of CAMT CODI, the CAMT liability floor functions as a balance-sheet limitation. Its purpose is not to determine whether CODI exists or the amount of such CODI, but rather to measure the extent to which a taxpayer's assets exceed its liabilities immediately after the discharge. Because the CAMT liability floor is calculated using AFS asset values rather than tax basis, we believe it is appropriate to measure liabilities using the corresponding AFS liability values. Using regular tax

⁸¹ *Id.*

⁸² See Section 1017(b)(2).

⁸³ Section 1017(b)(2).

liabilities in conjunction with AFS asset values would combine measurements derived from different systems and could distort the operation of the limitation.

Further, section 4.03(4)(b)(iv)(C) of Notice 2025-46 generally provides that a Section 108(b)(5) election applies for CAMT purposes if a corresponding election is made for regular tax purposes. However, sections 4.03(5)(b) and (c) of Notice 2025-46 also adopt a CAMT-specific liability floor that is not in conformity with the regular tax rules described above. That CAMT-specific liability floor does not apply to basis reduction to any property (whether related to Section 108(b)(5) or otherwise) if a Section 108(b)(5) election is made. We recommend that the Treasury conform that rule more closely to the flush language of Section 1017(b)(2). To the extent the Treasury intends to depart from Section 1017(b)(2), the Treasury should clearly articulate the policy justification for doing so.

5. Treatment of Partnership Interests

The treatment of partnership interests continues to be uncertain.⁸⁴

6. Timing and Coordination Issues

Attribute reduction raises a number of timing and coordination issues that remain unresolved under the current guidance.

As discussed in the Prior NYSBA Tax Section Reports, significant timing differences may arise between FSI and regular tax income.⁸⁵ Financial statement liabilities may be adjusted or remeasured in circumstances that do not give rise to corresponding regular tax consequences. Examples include remeasurements resulting from fair-value accounting, changes in expected future cash flows underlying environmental obligations, litigation reserves, pension obligations, or contingent liabilities, and certain debt modifications.⁸⁶ In those circumstances, FSI may be recognized despite the absence of a discharge of indebtedness, realization event, or other corresponding regular tax consequence. As a result, a taxpayer may be required to recognize

⁸⁴ See Report 1506, pp. 198-199. In addition to the issues discussed in Report 1506, additional issues may arise where the partner is a member of a consolidated group. Those issues are discussed further in Part IV.I of this Report.

⁸⁵ Report 1473, pp. 81, 86-88; Report 1506, pp. 200-203.

⁸⁶ Under GAAP, liabilities may need to be remeasured under a variety of circumstances that do not give rise to adjustments under regular tax rules, including remeasurement:

- Under the fair-value-option liabilities method where own-credit risk causes reduction in carrying value (ASC 825-10-25, -45, -50);
- For liabilities that depend on expected future cash flows (e.g., environmental obligations (ASC 410-30), asset retirement obligations (ASC 410-20), pension-related obligations (ASC 715), litigation reserves (ASC 450-20), and contingent consideration liabilities are adjusted (ASC 805-30-35)); and
- Due to modifications to debt that are either not treated as significant modifications for regular tax purposes or the debt is not publicly traded for regular tax purposes. (ASC 470-50).

CAMT CODI and reduce CAMT attributes in one period even though the corresponding regular tax consequences arise in a later period, or do not arise at all. In some circumstances, these timing differences may cause a taxpayer to incur adverse CAMT consequences for an extended period before the taxpayer is able to recover the benefit of the attribute reduction through a subsequent disposition or other offsetting event.⁸⁷

To the extent the Treasury maintains a separate CAMT CODI regime, the Treasury should consider whether a tracking mechanism, suspense account, carryforward system, or other coordination mechanism is necessary to prevent the duplication or omission of CAMT consequences.⁸⁸ Without such a mechanism, it may be difficult to determine how subsequent tax or financial statement events should affect attributes that were previously reduced as a result of CAMT CODI. Accordingly, if the Treasury continues to maintain a separate CAMT CODI regime, we recommend that the Treasury provide a comprehensive framework for tracking CAMT attribute reductions, including rules coordinating subsequent tax and financial statement events with prior CAMT attribute adjustments. In Report 1506, we proposed one potential tracking approach that, although admittedly complex, would prevent potential whipsaws that would be caused by the interplay of the attribute reduction rules and the use of regular tax depreciation for covered property in computing AFSI.⁸⁹

If the Treasury adopts the Tax Liability Substitution Approach, the timing of CAMT CODI would generally track the corresponding regular tax determination. As a result, the timing mismatches that currently require separate CAMT tracking rules would be eliminated, significantly reducing the risk of the taxpayer and government whipsaw situations described in Report 1506.

7. Subsequent Adjustments to CAMT Basis

Under financial statement rules, a taxpayer may be required to remeasure assets and recognize financial statement gain or loss even though no realization event has occurred for regular tax purposes. The New Proposed Regulations should address the CAMT consequences of such subsequent remeasurements, including remeasurements of assets whose CAMT basis was previously reduced as a result of excluded CAMT CODI.

⁸⁷ As discussed in Report 1506, pp. 200-203, if a taxpayer recognized excluded AFS CODI in Year 1 and reduces its FSNOL, and in Year 2, recognizes the same amount of CODI with respect to the same liability, it could reduce its basis in covered property, which would in turn reduce the amount of its depreciation deductions for CAMT purposes. In order to address this, a taxpayer would be forced to sell such covered property, which would be a loss or less gain for CAMT purposes, in order to be made whole.

⁸⁸ See Report 1473, pp. 81, 86-88; Report 1506, pp. 200-203.

⁸⁹ Report 1506, pp. 200-203.

We recommend that subsequent financial statement remeasurements not, by themselves, give rise to AFSI or adjust CAMT basis where the remeasurement does not correspond to a realization event or other transaction that affects CAMT basis.⁹⁰ The purpose of CAMT attribute reduction is to preserve the consequences of excluded CAMT CODI through corresponding reductions in CAMT attributes, including CAMT basis. That is, a successfully rehabilitated taxpayer should recognize greater gain on the later sale of assets whose basis has been reduced, as the price for the exclusion of CODI. Subsequent financial statement remeasurements should not restore, reduce, or otherwise alter those CAMT basis consequences merely because the asset's AFS carrying value changes for financial statement purposes.

For example, assume a taxpayer owns covered property with an AFS carrying value, CAMT basis, and regular tax basis of \$100. As a result of excluded CODI, the taxpayer reduces its CAMT basis and regular tax basis to \$90. If the taxpayer subsequently remeasures the covered property for financial statement purposes to \$95, we believe the resulting financial statement adjustment should not be included in AFSI and should not adjust CAMT basis. In that case, the prior CAMT basis reduction should remain operative, and the taxpayer should continue to have \$90 of CAMT basis in the property. If the Treasury disagrees, it should clarify whether the financial statement remeasurement is taken into account in AFSI, whether CAMT basis is adjusted to reflect the remeasurement, whether the remeasurement affects only future depreciation, amortization, or disposition consequences, or whether some other coordination rule applies.

If the Treasury determines that subsequent financial statement remeasurements may affect AFSI or CAMT basis, it also should clarify how the resulting amount is measured. In the example above, if the covered property is remeasured from an AFS carrying value of \$100 to \$95 after CAMT basis was reduced to \$90, it is unclear whether any CAMT consequence should be measured by reference to the \$5 financial statement loss, the \$5 excess of AFS carrying value over CAMT basis after the remeasurement, or some other amount. Similar questions would arise if the property were remeasured upward rather than downward. Those questions demonstrate the need for clear coordination rules if the Treasury does not adopt the approach recommended above.

The need for coordination is particularly important where subsequent remeasurements could affect the operation of later CAMT attribute reductions. For example, assume property with an AFS carrying value and CAMT basis of \$100 is reduced to \$0 for CAMT purposes pursuant to attribute reduction. If the property is later remeasured to \$90 for financial statement purposes and subsequently becomes subject to an additional CAMT basis reduction, it is unclear whether the prior attribute reduction remains operative, whether the remeasurement effectively restores

⁹⁰ See Report 1473, p. 91.

CAMT basis, and how any subsequent basis reduction should be coordinated with the earlier reduction. In our view, the remeasurement should not restore CAMT basis or otherwise affect the earlier attribute reduction. In effect, subsequent financial statement remeasurements should not permit prior CAMT basis reductions to be reversed, diminished, or revisited absent a realization event. If the Treasury adopts a different approach, it should provide rules ensuring that the same economic item is neither duplicated nor omitted.

The appropriate treatment of subsequent remeasurements is even less clear with respect to non-covered property. If the Treasury does not adopt our recommendation in Part IV.C.2 of this Report to limit basis reductions to covered property, the Treasury would need to provide comprehensive rules governing subsequent impairments, appreciation, remeasurements, and dispositions involving property whose CAMT basis was previously reduced pursuant to the attribute reduction rules.⁹¹ For example, assume a taxpayer holds property with an AFS carrying value of \$100 and a CAMT basis of \$90 as a result of a prior attribute reduction. If the property is subsequently remeasured upward to \$110 for AFS purposes, it is unclear whether any CAMT consequence should be measured by reference to the \$10 financial statement remeasurement, the \$20 difference between AFS carrying value and CAMT basis, or some other amount.

Accordingly, if the Treasury does not agree that subsequent financial statement remeasurements should be ignored for CAMT purposes, we recommend that the Treasury at a minimum exclude covered property from any rule that treats subsequent remeasurements as giving rise to AFSI or as adjusting CAMT basis. Covered property is already subject to specific CAMT basis and depreciation rules, the operation of which require coordination between CAMT basis and regular tax basis. Allowing subsequent financial statement remeasurements to alter the relationship between those basis amounts would create additional complexity and could undermine the proper operation of the CAMT depreciation rules.

We also note that section 5 of Notice 2025-49 excludes certain gains and losses arising from assets that are marked-to-market for AFS purposes, but not for regular tax purposes. In doing so, the Treasury recognized that unrealized financial statement remeasurements do not always provide an appropriate measure of AFSI. Although that provision does not directly apply to the circumstances described above, similar concerns arise where CAMT basis and AFS carrying value diverge as a result of attribute reduction and the property is subsequently remeasured for financial statement purposes. The Treasury should therefore clarify whether, and to what extent, such remeasurements are intended to affect AFSI, CAMT basis, or future CAMT consequences.

In summary, the Treasury should provide comprehensive rules coordinating subsequent financial statement adjustments with prior CAMT attribute reductions. We recommend that those rules provide that subsequent financial statement remeasurements do not, by themselves, give rise to

⁹¹ See Part IV.C.2 of this Report.

AFSI or adjust CAMT basis. If the Treasury adopts a different approach, it should clarify how the amount of any AFSI item is measured, whether CAMT basis is adjusted, how prior CAMT basis reductions remain operative, and how future depreciation, amortization, disposition, and attribute reduction consequences are coordinated. Otherwise, taxpayers may be required to track historical CAMT attribute reductions and reconcile those reductions with future financial statement remeasurements over extended periods.

D. Applicable Corporation Status of Distressed Taxpayers

1. Distortion of Testing by Inclusion of Restructuring Items in a Title 11 Case

This section of the Report addresses circumstances in which a Distressed Taxpayer may become an applicable corporation while in a Title 11 Case. Distressed Taxpayers generally cannot enter a Title 11 Case solely to obtain a federal income tax benefit and must satisfy applicable good-faith requirements under the Bankruptcy Code.⁹² Once a Distressed Taxpayer files a petition for relief under the Bankruptcy Code, its activities often shift from ordinary-course operations to restructuring, preserving value, satisfying creditor claims, disposing of assets, and emerging from bankruptcy. Those events may be necessary to the restructuring process, but the resulting book income items do not necessarily measure the taxpayer's ongoing profitability or post-emergence economic profile.

The Treasury has not specifically addressed in the CAMT Guidance whether restructuring income should be included in AFSI for purposes of testing income into applicable corporation status. Accordingly, it is unclear whether the absence of a specific adjustment for restructuring-related items in determining applicable corporation status reflects a considered policy determination that such items should be taken into account in determining applicable corporation status, or simply a decision not to address the issue in the CAMT Guidance issued to date. While certain items of income have specific rules governing their treatment for CAMT purposes, such as CODI, other items, including gains resulting from deconsolidation, remeasurement of liabilities, and dispositions of assets in distressed circumstances, may be included in AFSI for the testing period. The inclusion of these temporary, nonrecurring, or accounting-driven items may cause a Distressed Taxpayer to meet the applicable corporation threshold, although such items are not indicative of ongoing financial statement profitability.

⁹² See 11 U.S.C. §§ 1112(b) (providing that a Bankruptcy Court can dismiss a case for cause); 1141(d)(6) (providing that a plan does not discharge a debtor corporation's tax liability, if among other things, the taxpayer "willfully attempted in any manner to evade or to defeat such tax"). See also, *In re LTL Management, LLC*, 64 F.4th 84 (3d Cir. 2023) (dismissing a Chapter 11 petition for lack of good faith because the debtor lacked genuine financial distress); *In re NRA of Am.*, 628 B.R. 262 (Bankr. N.D. Tex. 2021) (dismissing a Chapter 11 petition which was filed to escape regulatory oversight and a dissolution lawsuit brought by the New York Attorney General); *In re Marsch*, 36 F.3d 825 (9th Cir. 1994) (dismissing a Chapter 11 petition which was filed solely to avoid posting a costly appeal bond following an adverse state court judgment).

This concern is not limited to the inclusion of a single extraordinary item. A Title 11 Case may materially re-sequence income, gain, loss, and deductions across the three-year testing period. A taxpayer may recognize significant AFSI during a Title 11 Case as a result of asset dispositions, liability adjustments, or other restructuring mechanics. The same process may reduce or eliminate future AFSI by shrinking the taxpayer's asset base, changing its capital structure, or causing a disposition of historic business lines. In that circumstance, the three-year testing period may capture a temporary restructuring effect rather than the taxpayer's ongoing economic scale.

We previously recommended that the Treasury consider excluding AFSI arising from any transactions in connection with a Distressed Taxpayer's Title 11 Case for purposes of determining applicable corporation status.⁹³ We continue to believe that this recommendation is appropriate. Subsequent guidance has not addressed this concern, and restructuring-driven distortions in AFSI may continue to affect the scope of the applicable corporation status determination.

To implement this recommendation, the Treasury could adopt one of two approaches. The first approach is simple and focuses on administrability. Under this approach, the AFSI of a Distressed Taxpayer for any taxable year in which it was, in whole or in part, in a Title 11 Case would be subject to the historic AFSI limit, under which the AFSI of a Distressed Taxpayer for any year in which it is in a Title 11 Case would be limited to the lesser of (i) its average AFSI for the three taxable years preceding the case (or, if fewer, the number of years it was in existence) or (ii) its AFSI otherwise determined under the CAMT rules.⁹⁴ While this approach may be taxpayer-favorable, it addresses the reality that Distressed Taxpayers in Title 11 Cases very often recognize one-time income from asset dispositions or other restructuring events that may be followed by substantially lower AFSI in subsequent years. The historic AFSI limit has the advantage of administrability, but may exclude income that is not attributable to restructuring-related activity.

As an alternative, the Treasury could seek to identify restructuring-related distortions by adopting the Bankruptcy Court limit, under which AFSI directly attributable to transactions for which the Distressed Taxpayer obtains Bankruptcy Court authorization would be excluded (i.e., the Bankruptcy Court limit). Such transactions generally reflect actions undertaken as part of the restructuring process rather than the taxpayer's ordinary-course operations. Accordingly, the Treasury could exclude AFSI attributable to such transactions from the determination of

⁹³ See Report 1473, pp. 80–81.

⁹⁴ This approach may overstate or understate a taxpayer's ordinary-course AFSI depending on the taxpayer's circumstances before entering the Title 11 Case. For example, the use of a historic average for a taxpayer with increasing AFSI before the Title 11 Case could be understating its ongoing economic profile, while using the same average for a taxpayer with declining AFSI may be overstating its ordinary-course results. Nevertheless, this approach has the benefit of administrability and reduces the likelihood that one-time restructuring events will cause a Distressed Taxpayer to become an applicable corporation.

applicable corporation status. While potentially more complex to administer, the Bankruptcy Court limit more directly targets the restructuring-related items that give rise to the concerns described in this Report.⁹⁵

Adopting either approach would reduce the risk that a Distressed Taxpayer becomes subject to CAMT based solely on accounting effects or transactions that do not reflect its ongoing operations or post-emergence profitability.

2. Restart of Testing Period Following a Title 11 Case

This section of the Report addresses the treatment of a Distressed Taxpayer upon emergence from a Title 11 Case. The issue applies both to taxpayers that have already become applicable corporations and to taxpayers that might otherwise become applicable corporations as a result of AFSI recognized before or during a Title 11 Case.

The CAMT Guidance does not provide for a restart of the applicable corporation testing period for taxpayers emerging from a Title 11 Case, notwithstanding that an emerging company is often treated as a “new entity” for financial accounting purposes.⁹⁶ As a result, AFSI generated prior to or during the Title 11 Case, potentially including amounts that reflect restructuring-related distortions depending on the Treasury’s implementation of the recommendation in Part IV.D.1, continues to be included in the three-year testing period following emergence. This approach may result in a reorganized taxpayer being treated as an applicable corporation based on historical AFSI that is no longer indicative of its post-emergence operations, asset base, ownership, or capital structure. If the inclusion of restructuring items results in applicable corporation status, the viability of the Title 11 plan could be threatened, as the Distressed Taxpayer could have material CAMT liability during the pendency of the bankruptcy, as well as for a number of years following emergence from bankruptcy, subject to the adoption of the restart rule discussed below.

⁹⁵ We recognize that certain accounting-driven items arising from a Title 11 Case, including financial statement remeasurement gains, deconsolidation income, and similar adjustments, may not be directly attributable to a specific Bankruptcy Court authorization. The Treasury may wish to consider whether additional guidance is appropriate with respect to such items.

In addition, the Treasury may wish to consider explicitly limiting the Bankruptcy Court limit to non-ordinary-course transactions. Inclusion of an explicit limitation of this nature may be viewed as appropriate if the Treasury is concerned that otherwise the Bankruptcy Court limit could expand in practice to exclude from AFSI income recognized in the ordinary course. However, adding such a limitation would create an interpretive hurdle outside of the bright line rule based on the Bankruptcy Court’s authorization, thereby complicating administration of the provision.

⁹⁶ See ASC 852-10-45-26 (“Fresh-start financial statements prepared by entities emerging from Chapter 11 will not be comparable with those prepared before their plans were confirmed because they are, in effect, those of a new entity.”).

The Tax Section previously recommended that the Treasury adopt a restart rule for taxpayers emerging from bankruptcy under certain circumstances. Under this recommendation, where applicable, a Distressed Taxpayer that was classified as an applicable corporation prior to emergence from the Title 11 Case would cease being so characterized upon emergence, and the applicable corporation testing period would restart (the “**restart rule**”).⁹⁷ Further, under the restart rule, solely for purposes of applicable corporation status testing, an entity emerging from a Title 11 Case would be treated as a new CAMT entity that has been in existence for fewer than three years.

The consequences of the restart rule depend in part on whether the emergence transaction causes the taxpayer’s taxable year to close. For example, assume that an applicable corporation with a calendar year taxable year enters a Title 11 Case on January 1, Year 1 and emerges on July 1, Year 1. If emergence does not cause the taxpayer’s taxable year to close, then under the restart rule the taxpayer would not be treated as an applicable corporation during Year 1.⁹⁸ Conversely, if emergence causes the taxpayer’s taxable year to close on July 1, Year 1, then the taxpayer would remain an applicable corporation for the short taxable year ending July 1, Year 1, but would not be treated as an applicable corporation for the short taxable year ending December 31, Year 1.

The Treasury may be concerned that the restart rule could permit a taxpayer to avoid applicable corporation status notwithstanding substantial AFSI both before (applying the exclusions recommended in Part IV.E.1 of this Report) and after emergence. In that case, the Treasury could provide that a taxpayer that was an applicable corporation immediately prior to emergence (determined without regard to the restart rule) continues to be classified as an applicable corporation if, after applying the restart rule, it otherwise would be classified as an applicable corporation as of the beginning of the first taxable year following the period for which the restart rule causes the taxpayer not to be treated as an applicable corporation (the “**restart rule limitation**”).

Applying the restart rule limitation to the examples above, the taxpayer would continue to be classified as an applicable corporation notwithstanding the restart rule only if, after application of the restart rule, it otherwise would be classified as an applicable corporation as of the beginning of Year 2. In the first example, because the taxpayer’s taxable year does not end upon emergence, the restart rule causes the taxpayer not to be treated as an applicable corporation for Year 1. Accordingly, the relevant inquiry is whether it otherwise would be classified as an applicable corporation as of the beginning of Year 2. In the second example, because the taxpayer’s taxable year ends upon emergence, the restart rule causes the taxpayer not to be treated as an applicable

⁹⁷ See Report 1473, pp. 81, 95-96; Report 1506, pp. 193-194.

⁹⁸ The restart rule would apply solely for purposes of applicable corporation status and would not cause the taxpayer’s taxable year to close upon emergence.

corporation during the post-emergence short taxable year ending December 31, Year 1. Accordingly, the relevant inquiry again is whether it otherwise would be classified as an applicable corporation as of the beginning of Year 2. Thus, although the mechanics differ depending on whether emergence ends the taxable year, both examples ultimately focus on whether the taxpayer otherwise would be classified as an applicable corporation as of the beginning of Year 2.

The restart rule would apply automatically and would not be elective. Further, the restart rule limitation would not apply if the taxpayer was not an applicable corporation immediately prior to emergence (determined without regard to the restart rule). This would allow the applicable corporation determination to be based on the taxpayer's post-emergence AFSI, rather than on pre-emergence results, which may correspond to a materially different enterprise.

As previously recommended, if the Treasury adopts the restart rule, it should condition application of the restart rule on appropriate objective criteria, such as the Distressed Taxpayer having either (i) a significant change in ownership, for example, a 50% change in ownership using a Section 382 construct or borrowing from rules such as Section 267, or (ii) a material reduction in the fair value of its assets, for example, a 25% reduction relative to the fair value of its assets before the filing of the Title 11 Case. We believe these thresholds would provide a principled basis for determining when a taxpayer should be treated as a new economic entity for purposes of the CAMT.⁹⁹

We further recommend that, if the Distressed Taxpayer is a member of a consolidated group for tax purposes, the restart rule generally should apply only where all members of the consolidated group (subject to a de minimis exception) at the time of the filing of the Title 11 Case are part of the Title 11 Case. For purposes of applying the restart rule, assets and activities conducted through disregarded entities should be treated as assets and activities of their regarded owner. Where only some members of a consolidated group enter bankruptcy, a group-wide restart rule would be overbroad and would permit pre-bankruptcy AFSI of non-debtor members to be disregarded even though those members did not undergo the type of restructuring that justifies treating the taxpayer as a new economic entity. We believe that the Treasury should adopt a de minimis exception to address circumstances in which neither the AFSI or CAMT asset basis of any members of the consolidated group that did not join in the filing of the Title 11 Case represents a significant amount (such as 5%) of the aggregate of the consolidated group's AFSI or CAMT asset basis prior to the filing of the Title 11 Case.

⁹⁹ See Report 1473, pp. 81, 95-96; Report 1506, pp. 193-194.

We continue to believe that a restart rule is necessary to ensure that the determination of applicable corporation status reflects the taxpayer's post-restructuring economic profile rather than pre-emergence financial statement results.

E. Determination of AFSI for Distressed Taxpayers

1. Treatment of Title 11 Taxpayers

As discussed above in Part IV.D.1 of this Report, a Distressed Taxpayer generally cannot enter a Title 11 Case simply to obtain a federal income tax benefit and must satisfy applicable legal requirements before obtaining relief under the Bankruptcy Code.¹⁰⁰ Given the unique legal and economic consequences of a Title 11 Case and the unlikelihood that Congress would have intended for the CAMT to target Distressed Taxpayers, the inclusion of restructuring items in the CAMT tax base of an applicable corporation is problematic. Unlike the recommendations in Part IV.D.1 of this Report, which address the determination of applicable corporation status, the recommendations in this Part assume that the taxpayer is already an applicable corporation and address only the determination of AFSI and CAMT liability during a Title 11 Case.

The Treasury has recognized that bankruptcy situations may warrant special treatment under the CAMT. As discussed in Part IV.A.1 of this Report, the Treasury has stated that it exercised its regulatory authority to provide adjustments “where a purely mechanical application of book income would produce” inappropriate results, including in bankruptcy situations.¹⁰¹ To that end, similar to our recommendation in Part IV.D.1 of this Report, we recommend that the Treasury adopt either the historic AFSI limit or the Bankruptcy Court limit for purposes of determining the AFSI of a Distressed Taxpayer while it is in a Title 11 Case. The considerations supporting those approaches, including the tradeoff between administrability and precision, are discussed in Part IV.D.1 of this Report.

The Treasury may wish to consider whether exclusion of restructuring-related AFSI during a Title 11 Case should be accompanied by corresponding reductions to certain CAMT attributes, such as FSNOLs or CAMT FTCs. Proponents of such an approach argue that it would reduce perceived planning opportunities and mitigate concerns about inconsistent treatment of deductions and income that produce any inappropriate permanent benefit (rather than simply relief from financial distress) – i.e., that a Distressed Taxpayer could emerge from bankruptcy

¹⁰⁰ See footnote 92 and corresponding text.

¹⁰¹ Salinger Remarks, Tax Notes Doc. 2026-1184 (“Members of Congress repeatedly described CAMT as a response to ‘giant corporations’ exploiting ‘loopholes’ to drive down their tax bills, even while reporting substantial book profits. ... Treasury has treated [the] statutory carve-outs [from CAMT] as guideposts. Where the underlying activity has nothing to do with tax avoidance, we have exercised our regulatory authority to provide analogous adjustments. That is why, across multiple Notices, we have addressed unrealized gains, industry-specific regimes, bankruptcy situations, and other contexts where a purely mechanical application of book income would produce results inconsistent with CAMT’s purpose.”) (emphasis added) (footnote omitted).

having excluded substantial restructuring-related AFSI while retaining CAMT attributes generated in prior years. In addition, some restructuring-related gains may reflect appreciation in assets or prior deductions that contributed to the generation of FSNOLs. In such cases, a taxpayer may recognize gain in connection with the disposition of assets during a Title 11 Case while preserving attributes generated, in part, through deductions previously attributable to those same assets. The Treasury, therefore, could conclude that some corresponding adjustment to CAMT attributes is appropriate to reduce perceived asymmetries and to promote consistency with other provisions, such as Sections 108 and 1017, that condition favorable treatment on the reduction of tax attributes.

On the other hand, the Treasury may conclude that corresponding reductions to FSNOLs or CAMT FTCs are unnecessary or inappropriate. The recommendation in this Part is not premised on the view that restructuring-related items should be treated as excluded CODI or should be subject to an attribute-reduction regime analogous to Section 108 and 1017. Rather, the recommendation reflects the distinct judgment that, during a Title 11 Case, certain restructuring-related items may warrant special treatment under the CAMT because they arise in connection with a court-supervised process directed toward preserving value, maximizing creditor recoveries, and facilitating emergence from bankruptcy. In many cases, the transactions generating restructuring-related AFSI also reduce the taxpayer's asset base, alter its capital structure, dispose of historic business lines, or otherwise diminish the taxpayer's future earning capacity. The Treasury, therefore, could reasonably conclude that a separate attribute-reduction regime is not necessary to achieve the objectives of this recommendation.

In addition, reductions to FSNOLs or CAMT FTCs may, in many circumstances, largely defer rather than eliminate the CAMT consequences associated with the restructuring-related items (i.e., a feature inherent in any attribute reduction framework). A Distressed Taxpayer ultimately could bear a substantial economic burden through reduced attribute utilization following emergence from bankruptcy, notwithstanding the determination that special treatment was warranted during the Title 11 Case. The Treasury, therefore, may wish to consider whether such reductions would principally convert the relief provided by the special rules for determination of AFSI in a Title 11 Case into a timing mechanism and whether doing so is appropriate.

2. Deconsolidation and Reconsolidation of Distressed Entities

This issue is closely related to the determination of applicable corporation status discussed in Part IV.D.1 of this Report. As discussed, a Distressed Taxpayer in a Title 11 Case may recognize AFSI attributable to restructuring sales and mechanics, fresh-start accounting, liability remeasurement, deconsolidation events, or other financial statement consequences that do not necessarily reflect operating income.

If the Treasury adopts the historic AFSI limit pursuant to our recommendation in Part IV.D.1 of this Report, many of the concerns described below would be addressed because significant

amounts of restructuring-related AFSI would no longer be taken into account. Nevertheless, certain accounting consequences arising solely from deconsolidation, reconsolidation, or similar changes in financial statement consolidation status would remain unresolved. If the Treasury instead adopts the Bankruptcy Court limit, the concerns in this area may be broader because certain financial statement consequences arising from financial distress may not be directly attributable to a specific Bankruptcy Court authorization.

As noted in the Prior NYSBA Tax Section Reports, a Distressed Taxpayer may be required to deconsolidate a subsidiary from its financial statement group as a result of financial distress, a restructuring transaction, a Title 11 Case, changes in governance rights, or similar circumstances.¹⁰² Conversely, a previously deconsolidated subsidiary may subsequently become reconsolidated following a restructuring. These events may produce substantial financial statement consequences notwithstanding the absence of a corresponding tax realization event or meaningful change in the taxpayer's economic position.

Because the Uniform Transaction Tax Principles Approach addresses the CAMT consequences associated with a transaction, it does not provide relief where no transaction exists for regular tax purposes. Absent a special rule, gain attributable solely to deconsolidation for financial statement purposes therefore could remain includible in AFSI. The Treasury would still need to address whether accounting consequences arising solely from a change in financial statement consolidation status are appropriately reflected in AFSI.

We therefore continue to recommend that FSI (including CODI), gain, loss, and expense arising solely from deconsolidation, reconsolidation, or similar changes in financial statement consolidation status be excluded from AFSI. Further, consistent with Section 56A(c)(15)(A), the Treasury should provide corresponding adjustments to CAMT attributes, including CAMT basis, to prevent omissions, duplications, or inappropriate step-ups. Such adjustments would ensure that taxpayers neither obtain a permanent benefit nor suffer a permanent detriment merely because a change in financial statement consolidation status produced accounting consequences that do not correspond to an underlying realization event.

If the Treasury determines that a permanent exclusion is inappropriate, the Treasury could alternatively provide that such amounts are disregarded initially and included only if the affected subsidiary does not rejoin the financial statement group within a specified period, such as three years.¹⁰³ Such an approach would provide relief for temporary restructuring-driven

¹⁰² See Report 1473, pp. 89, 98-99; Report 1506, pp. 194-195.

¹⁰³ It is worth noting here, that in Part IV.B.4.b) of this Report, we recommend that if the Tax Liability Substitution Approach is not adopted, then CODI that is recognized in anticipation of a Title 11 Case should also be viewed as recognized as part of the Title 11 Case, thereby increasing the scope of CODI that is eligible for the bankruptcy exclusion, as opposed to requiring the taxpayer to rely on the insolvency exclusion for CODI.

deconsolidation events while preserving the Treasury’s ability to address more permanent separations.

F. Emergence from Bankruptcy and Fresh-Start Accounting

1. Treatment of Income and Basis

Depending upon the Treasury’s decisions regarding our recommendations in Parts IV.D.2 and IV.E.1 of this Report, the treatment of the emergence transactions may or may not be relevant because such transactions generally occur immediately before a Distressed Taxpayer emerges from a Title 11 Case.

Section 8.03 of Notice 2026-7 generally provides that the CAMT consequences resulting from an emergence from bankruptcy (which excludes CODI and a “domestic covered asset transaction”¹⁰⁴) are determined by (i) disregarding any financial statement gain or loss resulting from the emergence and (ii) determining the CAMT basis of the assets of the CAMT entity (other than the regular tax basis in stock of a foreign corporation) by disregarding any adjustment to AFS basis resulting from the emergence from bankruptcy.

We believe that this provision was intended to address fresh-start accounting, as described in Report 1473,¹⁰⁵ and we appreciate the Treasury’s efforts to provide a simplified rule governing those consequences. The rule avoids the inclusion of potentially significant amounts of FSI resulting solely from fresh-start accounting. However, the scope of the rule appears to be both ambiguous and rather broad. Because the rule both excludes financial statement gain or loss and imposes a carryover basis regime, uncertainty regarding its scope can materially affect the treatment of transactions that otherwise would be expected to produce recognition consequences under either financial accounting or regular tax principles.

First, as noted in Report 1473, the guidance does not define what transactions constitute part of an “emergence” from bankruptcy.¹⁰⁶ As a result, it is uncertain whether the Treasury intends the rule to apply solely to fresh-start accounting adjustments, which we believe is the intention, or more broadly to transactions occurring in connection with a bankruptcy, such as sales of assets or a business line under section 363 of the Bankruptcy Code that might precede emergence from a Title 11 Case.

¹⁰⁴ The phrase a “domestic covered asset transaction” is defined in section 3.02(1) of Notice 2025-46 as a transaction in which one or more assets are: (1) transferred by a domestic corporation that is part of a tax-free liquidation or to which Sections 311, 355, or 361 applies; (2) transferred to a domestic corporation to which Sections 351 or 361 applies; or (3) stock or securities of a domestic corporation that is party to a Section 368 reorganization and that stock or securities are transferred in a transfer to which Sections 354 or 356 applies. The phrase excludes certain transfers by or to foreign corporations or stock of a foreign corporation.

¹⁰⁵ Report 1473, p. 95.

¹⁰⁶ See Report 1473, p. 95.

Similar concerns arise with respect to equitization transactions. Report 1473 observed that where creditors acquire a controlling ownership interest in a reorganized debtor, purchase accounting concepts may apply rather than traditional fresh-start accounting concepts.¹⁰⁷ In those circumstances, we believe the Treasury should clarify whether the transaction is intended to be governed by the emergence rule or instead treated consistently with the broader CAMT transaction rules discussed in Parts IV.A.2.a) and IV.H of this Report.

Second, the breadth of the rule appears to encompass transactions that we would expect to be treated as taxable transactions in which gain or loss would be recognized. For example, it appears that, under the CAMT Guidance, the income exclusion and basis carryover rules would apply to a “Bruno’s transaction,” which, for regular tax purposes and often for financial statement purposes, is a taxable sale of a company’s assets to a new entity, which is usually formed by the company’s lenders. Such a transaction generally occurs at emergence and would not give rise to CODI or be characterized as a domestic covered asset transaction. We would not have thought the income exclusion and basis carryover rules of the emergence rule should apply to that transaction.¹⁰⁸ This example illustrates that the absence of a definition of “emergence” may cause the rule to apply to transactions that do not appear to involve fresh-start accounting adjustments at all.¹⁰⁹ Therefore, we recommend that the Treasury clarify the scope of the transactions for which financial statement gain or loss is disregarded and for which the carryover basis regime applies.

More generally, if the Treasury’s objective is to address only fresh-start accounting consequences, the carveout for CODI and domestic covered asset transactions appears overly narrow. CODI and domestic covered asset transactions are two categories of transactions that the Treasury has expressly excluded from the rule, but they do not define the outer boundary of fresh-start accounting. As discussed, numerous transactions may occur in connection with emergence from bankruptcy that are neither CODI nor domestic covered asset transactions. Without additional guidance, it is unclear whether those transactions are intended to be governed by the emergence rule or by the broader CAMT transaction rules. The Treasury, therefore, should clarify the intended scope of the rule and provide examples illustrating the transactions that are and are not intended to fall within it.

Further, consistent with the discussion in Report 1473, members of the Executive Committee continue to be divided on whether the basis consequences of fresh-start accounting should be

¹⁰⁷ *Id.* at p. 98.

¹⁰⁸ We note that income and gain associated with a Bruno’s transaction generally would be excluded if the historic AFSI limit or the Bankruptcy Court limit applies.

¹⁰⁹ *Id.* at pp. 97-98.

disregarded where the corresponding emergence-related income is excluded from AFSI.¹¹⁰ We continue to refer the Treasury to that discussion as it develops the New Proposed Regulations.

2. Disregarded Entities

The application of the emergence-from-bankruptcy rule in section 8.03 of Notice 2026-7 is unclear in the case of multi-entity structures. Section 4.03(3)(b) of Notice 2025-46 provides a special rule for CODI recognized by a disregarded entity in a Title 11 Case by applying the relevant bankruptcy test at the regarded owner level. However, there is no analogous rule for the fresh-start accounting provision. Notice 2025-46 and Notice 2026-7 provide that the fresh-start rule applies only to the emergence from bankruptcy of a “CAMT entity.” Prop. Treas. Regs. § 1.56A-1(a)(8) defines a CAMT entity as any entity identified in Section 7701 and the regulations thereunder other than a disregarded entity. Accordingly, the fresh-start rule appears not to apply to the emergence of a disregarded entity, even if the disregarded entity applied fresh-start accounting as part of its emergence from bankruptcy.

We do not believe that result was intended. For example, assume Parent owns LLC, which is disregarded for regular tax purposes. Both Parent and LLC file for bankruptcy and, upon emergence, apply fresh-start accounting. Because section 8.03 of Notice 2026-7 refers to a CAMT entity, it appears that the fresh-start rule applies with respect to assets held directly by Parent but not with respect to assets held by LLC. As a result, economically similar assets could receive different CAMT treatment solely because they are held directly by a regarded debtor rather than through a disregarded entity. Depending on the assets involved, this distinction could produce favorable or unfavorable results and could create opportunities to obtain different CAMT consequences by locating assets with built-in gain and assets with built-in loss in different entities within the bankruptcy structure. We do not believe those differences are related to the policy objectives underlying the fresh-start rule and instead appear to arise solely from the manner in which the provision is drafted.

Further, assume Parent does not file for bankruptcy, but LLC does. It is not clear to us why the fresh-start rule should not apply merely because the entity emerging from bankruptcy is disregarded for federal income tax purposes. Unlike the CODI exclusion applicable to disregarded entities discussed in Part IV.B.4.b) of this Report, which is intended to identify the taxpayer entitled to claim the bankruptcy exclusion and therefore appropriately focuses on the regarded owner, the fresh-start rule is directed at accounting consequences arising from the emergence transaction itself. Those consequences arise regardless of whether the debtor is respected as a separate taxpayer for federal income tax purposes. As a result, even if the Treasury intended to deny the bankruptcy exclusion for CODI recognized by a disregarded entity when the

¹¹⁰ For a detailed discussion associated with the views of the Executive Committee, see *id.* at pp. 96-97 for a discussion of both views.

regarded owner is not a debtor in a Title 11 Case, it does not necessarily follow that fresh-start accounting adjustments arising from the emergence of that disregarded entity should be recognized for CAMT purposes.

We believe the more appropriate inquiry is whether the entity undergoing emergence from bankruptcy applied fresh-start accounting, rather than whether that entity is treated as a separate CAMT entity for federal income tax purposes. Accordingly, the Treasury should clarify the application of the fresh-start rule to disregarded entities and, in particular, should clarify whether the rule applies at the level of the entity emerging from bankruptcy rather than by reference to the regarded/disregarded distinction.

G. FSNOLs and Accounting Method Changes

The CAMT Guidance does not currently address the interaction between FSNOLs and accounting method changes. As discussed in Report 1506, this omission may create inappropriate results where a taxpayer recognizes a significant amount of AFSI solely as a consequence of an actual accounting method change resulting from a change in GAAP or IFRS, or a deemed accounting method change resulting from a change in the AFS used for CAMT purposes.¹¹¹

In these circumstances, the recognition of income generally does not reflect current-period economic activity. Rather, the income represents the cumulative effect of reconciling prior financial statement treatment with a new accounting methodology. As a result, applying the general 80% limitation on the use of FSNOLs may cause a taxpayer to recognize CAMT liability with respect to income that is attributable to prior periods and that may have arisen during periods in which the taxpayer generated the FSNOLs. In effect, the accounting method change can accelerate CAMT liability even though the taxpayer has sufficient FSNOLs to offset the underlying economic income on a cumulative basis.

We acknowledge that this concern is strongest where the accounting method adjustment relates to periods that contributed to the generation of the relevant FSNOLs. Different considerations may apply where the adjustment relates primarily to periods occurring after the FSNOLs were generated. Nevertheless, we believe the approaches described below represent the most administrable solutions. If the Treasury concludes that a narrower relief provision is appropriate, the rule could be limited to FSNOLs where the accounting adjustments are attributable to untaxed income in prior periods that contributed to the generation of the FSNOLs. However, as discussed in this Part, unlike for regular tax purposes, a CAMT accounting method adjustment may arise solely from a change in AFS or financial reporting framework, in which case identifying the periods to which the adjustment is attributable may be difficult.

¹¹¹ Report 1506, pp. 206-207.

Accordingly, we continue to believe that the Treasury should permit a taxpayer to fully offset accounting method change income with available FSNOLs without regard to the general 80% limitation.¹¹² Although accounting method adjustments also arise in the regular tax system, the CAMT context presents unique concerns because the adjustment may result solely from a change in the taxpayer's AFS or a change in the accounting framework governing that statement. In those circumstances, the resulting AFSI does not reflect current-period economic activity, but rather a reconciliation of prior-period financial reporting. This concern may be particularly significant in the Distressed Taxpayer context, where events such as entry into bankruptcy, operation during a Title 11 Case, emergence from bankruptcy, fresh-start accounting, deconsolidation, reconsolidation, or other changes in financial reporting may result in one or more changes to the AFS used for CAMT purposes. Applying the ordinary FSNOL limitation in those circumstances may accelerate CAMT liability even though the taxpayer possesses sufficient FSNOLs to offset the underlying cumulative economic income.

As discussed in Report 1506, an alternative approach would be to allow the taxpayer to first adjust the taxpayer's FSNOL balance for the amount of accounting method change income and only recognize any excess income remaining after that adjustment.¹¹³ Although we believe full utilization of FSNOLs represents the preferable approach, either method would be more appropriate than applying the ordinary FSNOL limitation to income that arises solely from an accounting method change.

H. Transactions Involving Distressed Taxpayers

As discussed in Part IV.A.2.a) of this Report, we recommend that the Treasury adopt the Uniform Transaction Tax Principles Approach under which the CAMT consequences of transactions involving financially distressed taxpayers are analyzed under the same regular tax transaction principles applicable to financially healthy taxpayers elsewhere under the CAMT regime, with appropriate CAMT-specific inputs where necessary. We believe that the principles of the Uniform Transaction Tax Principles Approach are particularly important in the Distressed Taxpayer context because many of the issues described above arise solely from the existence of a separate CAMT restructuring regime. To the extent the Treasury adopts the Uniform Transaction Tax Principles Approach and the Tax Liability Substitution Approach described in Part IV.A.3, many of these issues would be substantially simplified or eliminated.

If the Treasury declines to adopt the Tax Liability Substitution Approach and the Uniform Transaction Tax Principles Approach, we continue to believe that the transaction-related issues

¹¹² See *id.*

¹¹³ *Id.* at p. 208.

identified in the Prior NYSBA Tax Section Reports remain relevant and should be addressed in future guidance.¹¹⁴

I. Treatment of Tax Consolidated Groups

1. Need for an Administrable and Predictable Framework for Tax Consolidated Groups

The CAMT Guidance incorporates both single-entity¹¹⁵ and separate-entity¹¹⁶ concepts in the treatment of tax consolidated groups. That fact, standing alone, is not problematic. The consolidated return regulations similarly employ both single-entity and separate-entity principles in different contexts. The concern instead is that the CAMT Guidance often adopts elements of those approaches without incorporating the coordinating rules that exist under the consolidated return regulations. As a result, taxpayers may be required to apply concepts derived from the consolidated return regulations without clear guidance regarding how those concepts interact within the broader CAMT framework. In practice, the absence of coordinating rules increases compliance burdens and makes it more difficult for both taxpayers and the government to apply the CAMT Guidance in a consistent and administrable manner.

We recommend that the Treasury generally adopt an administrable and predictable framework for the treatment of tax consolidated groups under the CAMT that aligns with the principles of the consolidated return regulations under Section 1502, which we believe is the intention of the CAMT Guidance. While those regulations incorporate both single-entity and separate-entity concepts, they do so pursuant to a coordinated set of rules that produce consistent and predictable outcomes. By contrast (and as discussed below), the CAMT Guidance adopts different elements of those approaches in isolation, without incorporating the corresponding coordinating principles, resulting in a fragmented and less administrable regime.

¹¹⁴ See Report 1473, pp. 96-97; Report 1506, pp. 204-205, discussing, among other things: (i) the meaning of the phrase “in connection with a Title 11 Case or insolvency”; (ii) the application of the Distressed Taxpayer rules to transactions styled as sales for bankruptcy purposes but qualifying as reorganizations under Section 368(a)(1)(G); (iii) the interaction between covered recognition transactions and covered nonrecognition transactions; (iv) the application of Prop. Treas. Regs. § 1.56A-18 to transactions involving Distressed Taxpayers; (v) the application of Prop. Treas. Regs. § 1.56A-19 to transactions involving Distressed Taxpayers; and (vi) the treatment of intercompany transactions and consolidated groups in the Distressed Taxpayer context.

¹¹⁵ See, e.g., Prop. Treas. Regs. § 1.1502-56A(a)(2) (“Except as otherwise provided in this section, for purposes of determining the AFSI of the tax consolidated group, the tentative minimum tax under section 55(b)(2)(A), and status as an applicable corporation under section 59(k), members of a tax consolidated group are treated as a single CAMT entity solely during the period in which those members are members of that tax consolidated group”).

¹¹⁶ See, e.g., Notice 2025-46 § 4.02(3)(g)(iii) (“In determining whether a CAMT entity that is a member of a tax consolidated group is insolvent, the CAMT entity is treated as a separate taxpayer from all other members of its tax consolidated group.”). As noted in Notice 2025-46 § 2.03(3)(b), “commenters [to the Proposed Regulations] requested clarity on the application of the proposed rules to tax consolidated groups”

2. CODI Exclusions

The need for a consistent framework is particularly acute in the context of CODI and related exclusions. The determination of whether CODI is excluded under the insolvency or bankruptcy exclusions, and the extent of any such exclusion, depends on the identification of the relevant taxpayer. The CAMT Guidance suggests that this determination may be made, in at least certain circumstances, on a separate-entity basis, even though the underlying AFSI computation reflects consolidated financial statement results. This mismatch creates uncertainty as to how items eliminated in financial statement consolidation are treated for purposes of determining CODI, the availability of exclusions, and the resulting consequences.

If the Tax Liability Substitution Approach is adopted, many of these issues would be significantly simplified, as CODI would be determined under regular tax principles and the application of Sections 108 and 1502 would provide an established, administrable, and predictable framework for determining the relevant taxpayer and the availability of exclusions. However, even under that approach, questions would remain regarding the application of attribute reduction, as discussed in Part IV.C of this Report.

If the Tax Liability Substitution Approach is not adopted, it is particularly important that the Treasury clarify whether the CODI exclusions are determined on a consolidated or separate entity basis, and how that determination interacts with the computation of AFSI. Section 8.02 of Notice 2026-7 limits the application of Treas. Regs. § 1.1502-28 to attribute reduction, thereby not incorporating the member-by-member determination for the insolvency and bankruptcy CODI exclusions in Treas. Regs. § 1.1502-28(a)(1).¹¹⁷ Instead, Notice 2026-7 provides a member-by-member determination for the insolvency exclusion, but does not address the bankruptcy exclusion in the same manner. As a result, the CAMT Guidance reflects a partial and inconsistent importation of Section 1502 principles via a parallel regime without incorporating the coordinating rules that make those principles administrable. In line with the CODI Tax Principles Approach, we recommend that the Treasury adopt the principles of Treas. Regs. § 1.1502-28(a)(1) for both the insolvency and bankruptcy exclusions, rather than continuing to apply a parallel regime.¹¹⁸ The Treasury should also provide explicit coordination rules addressing how items eliminated in consolidated financial statements are taken into account for purposes of determining CODI and the corresponding exclusions.

¹¹⁷ Notice 2026-7 §8.02.

¹¹⁸ Report 1506 discussed certain other frameworks for applying attribute reduction in the context of consolidated groups in response to proposed rules that would not have applied Treas. Regs. 1.1502-28 to insolvency and bankruptcy determinations. Report 1506 at pp. 203-204. On balance, while recognizing that Treas. Regs. 1.1502-28 has its complexities, we believe that applying it across the board makes sense from an administrability perspective and is superior to the available alternatives.

J. Reliance and Transition Rules

For purposes of reliance, the Proposed Regulations break up the included rules into four categories. The first category is the “specified regulations,” which are provisions that generally cover foundational definitions and rules of the CAMT. For these regulations, taxpayers may rely on the specified proposed regulations for taxable years ending on or before September 13, 2024, if the taxpayer and its entire test group consistently apply those regulations in full for that year and all subsequent years until the first taxable year to which final regulations apply.¹¹⁹

For certain transfers that occurred on or before September 13, 2024, taxpayers may rely on certain provisions (Prop. Treas. Regs. §§ 1.56A-4 and 1.56A-6) only if the taxpayer and its test group consistently apply those rules to all such transfers and rely on the specified regulations for any affected taxable years.¹²⁰ With respect to the provisions governing corporate transactions, including reorganizations (Prop. Treas. Regs. §§ 1.56A-18 and 1.56A-19), and Distressed Taxpayers (Prop. Treas. Regs. § 1.56A-21), taxpayers may rely on those provisions so long as they and all members of their test group rely on each such section in its entirety.¹²¹ Lastly, the Proposed Regulations permit taxpayers to rely on any other section of the Proposed Regulations for taxable years ending on or before the date final regulations are published, so long as the taxpayer and its test group consistently apply such relied-upon section and all of the specified regulations in their entirety for all relevant years.

Taxpayers’ continuing ability to rely on all or portions of the CAMT Guidance after the release of the New Proposed Regulations is currently unclear. Each item of CAMT Guidance issued after the issuance of the Proposed Regulations contains its own reliance language, most of which permit reliance on such guidance for taxable years beginning before the date on which the New Proposed Regulations are published in the Federal Register.¹²² However, importantly, section 3.02 of Notice 2025-49 modifies the reliance language within the Proposed Regulations by allowing taxpayers to rely on any section of the Proposed Regulations for any taxable year beginning before the date the corresponding final regulation is published in the Federal Register, so long as the taxpayer consistently follows such section for all taxable years beginning with the first taxable year for which the taxpayer relies on the provision. Section 3.02 also provides that taxpayers may rely on any section of the Proposed Regulations, as modified by subsequently issued guidance, for any taxable year beginning before the date the New Proposed Regulations are published in the Federal Register, provided that the taxpayer consistently follows such

¹¹⁹ 89 Fed. Reg. 75127 (Sept. 13, 2024).

¹²⁰ *Id.*

¹²¹ *Id.* It is worth noting that under the language within the Proposed Regulations, it is unclear whether reliance on the provisions governing corporate transactions, including reorganizations, and provisions applicable to Distressed Taxpayers, also requires reliance on the specified regulations.

¹²² See, e.g., Notice 2025-46 § 7.

section (as so modified). In addition, certain items of CAMT Guidance provide for continued reliance on the Proposed Regulations even after the issuance of New Proposed Regulations.¹²³

This modification was significant and appreciated, but it also creates uncertainty. As currently structured, a taxpayer may rely on particular sections of the CAMT Guidance, including modifications provided in the notices; however, once the New Proposed Regulations are released, it appears that taxpayers may be required to choose between relying on the original Proposed Regulations or the New Proposed Regulations; there is no clear ability to continue relying on the intervening modifications. This creates an anomalous result. The notices were issued to reduce burden and respond to comments, including those in Report 1506, but under this structure taxpayers may be unable to continue to avail themselves of those modifications after the New Proposed Regulations are issued and before final regulations are promulgated. As a practical matter, taxpayers may be required to reconfigure their reliance positions multiple times over a relatively short period, creating unnecessary complexity and compliance burden.

In the interest of sound tax administration, we recommend that the New Proposed Regulations generally extend the ability to rely on any CAMT Guidance relating to Distressed Taxpayers, including the Proposed Regulations, as modified by subsequently issued guidance, in the manner described in section 3.02 of Notice 2025-49, for any taxable year beginning before the first taxable year that begins after the issuance of final regulations.¹²⁴ This approach would promote stability, reduce burden, and avoid penalizing taxpayers that reasonably relied on interim guidance issued after the Proposed Regulations. Without such relief, taxpayers that have relied upon certain aspects of the CAMT Guidance may be required to change their application of the CAMT upon the release of the New Proposed Regulations and then again when the final regulations are promulgated. We acknowledge that the Treasury may wish to end the ability of taxpayers to rely on specific rules in the prior CAMT Guidance prior to the issuance of final regulations. In that case, such specific rules could be separately identified, at the time of issuance of the New Proposed Regulations, as ineligible for further reliance.

In addition, for taxpayers that choose to adopt the New Proposed Regulations (assuming such reliance is permitted), the Treasury should include clear transition rules in the New Proposed Regulations. Such rules should address the coordination of prior reliance positions, including consistency requirements and the treatment of positions taken under the CAMT Guidance. The Treasury should also consider incorporating an approach similar to the rules governing adjustments for accounting principle changes and AFS restatements under Prop. Treas. Regs.

¹²³ See, e.g., Notice 2025-28 § 8, which permits taxpayers to continue to rely on the guidance governing partnerships (Prop. Treas. Regs. §§ 1.56A-5 and 1.56A-20) without modifications provided in Notice 2025-28 after the issuance of the subsequent proposed regulations but before the applicability date of the final regulations, so long as certain other criteria are satisfied.

¹²⁴ Although this Report is limited to issues affecting Distressed Taxpayers, similar considerations may support broader reliance relief across the CAMT regime. We do not address that issue here.

§ 1.56A-17(c) (as modified by section 10 of Notice 2025-49), permitting taxpayers to take transition adjustments into account over an appropriate adjustment period in a manner that avoids distortion and promotes administrability.¹²⁵

¹²⁵ See Part IV.G of this Report regarding the ability to utilize FSNOLs to offset adjustment income.

Appendix A: Illustrative Questions Addressed by the Tax Liability Substitution Approach

The Tax Liability Substitution Approach would substantially reduce the need for the Treasury and the IRS to develop a separate CAMT-specific regime governing CODI. The following non-exclusive list illustrates some of the questions that would otherwise require separate guidance.

A. Scope and Characterization of CODI

- Whether liabilities that are not indebtedness for regular tax purposes should give rise to AFSI and, if so, whether such AFSI constitutes CODI.
- Whether liabilities that do not produce CODI for regular tax purposes should nevertheless produce CAMT CODI (though such liabilities may produce other CAMT income if the tax benefit type principles are adopted).
- How partnership liabilities and partnership allocations of CODI should be treated.
- How transactions involving built-in gain or built-in loss property used to satisfy liabilities should be characterized.
- Whether amounts arising under provisions analogous to Sections 108(e)(6) and 108(e)(8) constitute CODI.
- How liabilities should be characterized as recourse or nonrecourse for CAMT purposes.

B. Determination of the Amount of CODI

- Section 108(e)(2)
 - Whether the CAMT analogue to a tax deduction should be measured by reference to a reduction in AFSI, a reduction in FSI, or another CAMT-specific measure.
- Section 108(e)(4)
 - Whether related-party acquisitions of indebtedness should give rise to CAMT CODI.
 - How related-party acquisition rules should apply within consolidated groups and other related-party structures.
- Section 108(e)(6)
 - Whether the provision should apply to contributions of indebtedness to partnerships.
 - How the provision should apply when the contributor does not track CAMT basis.
 - How the provision should apply where the liability is not indebtedness for regular tax purposes.
 - The additional issues identified in Report 1530.
- Section 108(e)(8)
 - Whether debt-for-equity exchanges should be measured using fair value or fair market value.
 - How illiquid, newly issued, restricted, or distressed equity should be valued.

- Section 108(e)(10)
 - How issue price, original issue discount, and related debt-modification principles should be translated into the CAMT framework.
 - Whether non-publicly traded debt should produce CAMT CODI.
 - How significant modifications and debt-for-debt exchanges should be treated where no tax CODI arises, but FSI is recognized.

C. Inclusion and Exclusion of CODI

- Insolvency
 - Whether insolvency should be determined using tax liabilities or financial statement liabilities.
 - Whether insolvency should be determined using tax assets or financial statement assets.
 - Whether asset values should be measured using fair value or fair market value.
 - Whether deferred tax assets and deferred tax liabilities should be included in the determination.
 - How insolvency should be determined when no corresponding tax CODI exists.
 - Whether insolvency should be determined on a member-by-member basis within a consolidated group.
- Bankruptcy
 - Whether liabilities adjusted in anticipation of a Title 11 Case should qualify for the bankruptcy exclusion.
 - Whether a CAMT entity must be under the jurisdiction of the bankruptcy court “as the debtor.”
 - How the bankruptcy exclusion should apply to partnerships.
 - How the bankruptcy exclusion should apply within consolidated groups.

D. Timing Issues

- How taxpayers and the government should account for situations in which FSI is recognized in a different period than the corresponding tax consequences, including liability remeasurements that produce FSI in the absence of a corresponding realization event for regular tax purposes.