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The Corporate Alternative Minimum Tax: A Critique and Exploration of Alternatives*

John M. Janiga**

I. INTRODUCTION

The Tax Reform Act of 1986¹ repealed the corporate add-on minimum tax and replaced it with a corporate alternative minimum tax ("AMT").² According to both the House Ways and Means Committee Report and the Senate Finance Committee Report, the corporate AMT was designed to "serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits."³

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1. Tax Reform Act of 1986, Pub. L. No. 99-514, § 701, 100 Stat. 2320 (1986). Section 2(a) of the 1986 Act redesignated the Internal Revenue Code of 1954 as the Internal Revenue Code of 1986. Unless otherwise indicated, references to sections are to the Internal Revenue Code of 1986 as amended [hereinafter the Code].

2. See *infra* notes 3-29 and accompanying text for a detailed discussion of the corporate AMT. The corporate AMT provisions are effective for tax years beginning after December 31, 1986. I.R.C. §§ 55-59. For an analysis of the technical rules and mechanical aspects of calculating the corporate AMT, see Feinberg & Robinson, *The Corporate Alternative Minimum Tax: Working With BURP While Waiting for ACE*, 15 J. CORP. TAX'N 3 (1988); Gould, *The Corporate Alternative Minimum Tax: A Search for Equity Through a Maze of Complexity*, 64 TAXES 783 (1986); Haspel & Wertlieb, *New Law Makes Sweeping Changes to Corporate Minimum Tax*, 66 J. TAX'N 22 (1987); Odmarm & Tillman, *Corporate AMT Rules Under the Tax Reform Act of 1986*, 17 TAX ADVISER 656 (1986).

3. S. REP. NO. 313, 99th Cong., 2d Sess. 518 (1986) [hereinafter SENATE REPORT]; H.R. REP. NO. 426, 99th Cong., 2d Sess. 305-06 (1985) [hereinafter HOUSE REPORT]. Although the legislative history does not define the term "economic income," the House Ways and Means Committee apparently equated it with financial statement income. The Committee stated that "[w]ith respect to the taxation of corporations, both the perception and reality of fairness have been harmed by instances in which major companies have paid no taxes in years when they reported substantial earnings [i.e., financial statement income] . . ." HOUSE REPORT, *supra*, at 306. For a discussion of the distinctions between financial statement, taxable, and economic income, see *infra* note 7.

Prior to 1986, the regular corporate tax was supplemented by an add-on minimum tax.⁴ The corporate add-on minimum tax was in the nature of an excise tax.⁵ Essentially, it imposed a fifteen percent tax on certain corporate tax preferences⁶ that was paid in addition to the regular corporate income tax. Despite the existence of the corporate add-on minimum tax, many corporations that reported substantial financial statement incomes paid little or no tax.⁷ Consequently, Congress began to perceive the corporate add-

4. Congress enacted the first corporate minimum tax in the Tax Reform Act of 1969. Tax Reform Act of 1969, Pub. L. No. 91-172, § 301, 83 Stat. 487 (1969). Congress wanted to prevent corporations from escaping tax on all or a large portion of their economic incomes through the use of various deductions and exclusions. S. REP. NO. 552, 91st Cong., 1st Sess. 111, *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 2142.

The 1969 Act created an add-on minimum tax on certain tax preferences that was paid in addition to any regular tax liability. I.R.C. §§ 56-58 (1969). The tax was computed by multiplying the minimum tax base by the minimum tax rate of ten percent. I.R.C. § 56(a) (1969). The minimum tax base was the total specified tax preferences less the regular tax liability and an exemption amount of \$30,000. *Id.* The specified tax preference items for corporations included accelerated depreciation on real property, amortization of certified pollution control facilities, excess reserves for losses on bad debts for certain financial institutions, excess depletion deductions, and a percentage of capital gains. I.R.C. § 57 (1969).

Subsequent to the Tax Reform Act of 1969, Congress attempted to increase the effectiveness of the add-on minimum tax provisions through a series of modifications. For example, the Tax Reform Act of 1976, Pub. L. No. 94-455, § 301, 90 Stat. 1549 (1976), increased the minimum tax rate from ten to fifteen percent, and redefined the minimum tax base as total preferences reduced by the greater of the regular tax or \$10,000. I.R.C. § 56(a)(1976).

For further discussion of the corporate add-on minimum tax, see generally Hevener, *Minimum Tax and Alternative Minimum Tax — Computation and Application*, Tax Mgmt. Portfolio (BNA) No. 288-3d (1987). See also Hobbet, *Minimum Tax on Preference Items: An Analysis of a Complex New Concept*, 32 J. TAX'N 194 (1970); Mansfield, Galvin, & Craig, *Minimum Tax and Tax Burden Adjustments*, 23 TAX LAW. 591 (1970); Schenk, *Minimum Tax for Tax Preferences*, 48 TAXES 201 (1970).

5. An excise tax is a "[t]ax laid on manufacture, sale, or consumption of commodities or upon . . . corporate privileges." BLACK'S LAW DICTIONARY 506 (5th ed. 1979).

6. The term "corporate tax preferences" generally refers to any exclusions, deductions, and credits available to a corporation as a means for reducing its income tax liability.

7. SENATE REPORT, *supra* note 3, at 519; HOUSE REPORT, *supra* note 3, at 306-07. The reason for this result lies in the distinction between financial statement income and taxable income. The determination of financial statement (or book) income is normally based upon generally accepted accounting principles, and the objective is to measure operating results as accurately as possible. W. MEIGS & R. MEIGS, ACCOUNTING: THE BASIS FOR BUSINESS DECISIONS 736 (6th ed. 1987). In contrast, taxable income is defined by Congress to meet the government's revenue needs and to achieve certain economic, social, political, and equity objectives. W. HOFFMAN & W. RAABE, WEST'S FEDERAL TAXATION: CORPORATIONS, PARTNERSHIPS, ESTATES, AND TRUSTS 1-2-15 (1988). As a result of differing rules, many corporations reported substantial financial statement incomes, but had little or no taxable incomes. To illustrate, a 1986 study by the Citizens for Tax Justice reported that 42 of the 250 largest U.S. corporations earned large financial statement incomes but paid, on average, no income taxes in the period

on minimum tax as an inadequate solution to these tax avoidance situations. Congress focused upon two reasons for this failure. First, the tax was not designed to define a comprehensive income base. Second, the tax failed to measure adequately economic income.⁸

The corporate AMT attempts to cure the perceived defects in the corporate add-on minimum tax by expanding and redefining the minimum tax base.⁹ The expansion and redefinition of the minimum tax base is accomplished primarily by creating a new category of items referred to as "adjustments."¹⁰

The key feature of the AMT structure is the inclusion of a "special adjustment" in the minimum tax base. For taxable years beginning in 1987, 1988, and 1989, this special adjustment is referred to as the business untaxed reported profits ("BURP") or book income adjustment.¹¹ Basically, the BURP adjustment is equal to fifty percent of the amount by which a corporation's financial statement income exceeds its regular taxable income.¹² The amount so calculated becomes part of the minimum tax base.¹³

For taxable years beginning in 1990, the BURP adjustment is

from 1981 through 1985. *Group Lists 42 Firms That on Average Paid No U.S. Income Tax*, Wall St. J., July 18, 1986, at 9, col. 4.

A third measure of income is economic income (sometimes referred to as "economic profits"). Generally, economic income is similar to financial statement income with one major exception. In deriving financial statement income, no cost charges are made for risk taking and use of owners' capital. Such costs are subtracted, however, in deriving economic income. R. LIPSEY & P. STEINER, *ECONOMICS* 181-82 (6th ed. 1981).

8. SENATE REPORT, *supra* note 3, at 519; HOUSE REPORT, *supra* note 3, at 306.

9. See *infra* note 10 and accompanying text for a discussion of the changes to the minimum tax base. The corporate AMT also increased the minimum tax rate from 15% to 20%. I.R.C. § 55(b)(1)(A).

10. See *infra* note 24 for a listing of the adjustments. The minimum tax base was broadened in two other ways. First, many preferences under the add-on minimum tax structure were expanded. For example, the preferences for accelerated depreciation and intangible drilling costs were made applicable to all corporations. I.R.C. §§ 57(a)(2), 57(a)(7). Second, new preferences were added, including certain tax-exempt interest and percentage of completion income for corporations using the completed contract method. I.R.C. §§ 56(a)(3), 57(a)(5).

11. The reference to the adjustment as business untaxed reported profits is contained in the Senate and Conference Reports. SENATE REPORT, *supra* note 3, at 529; H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess. II-272 (1986) [hereinafter CONFERENCE REPORT]. The Code, however, refers to the adjustment as book income. See *infra* notes 30-33 and accompanying text for a technical description of the BURP adjustment. The BURP adjustment does not apply to any S corporation, real estate investment trust, regulated investment company, or real estate mortgage investment conduit ("REMIC"). I.R.C. § 56(f)(4); Temp. Treas. Reg. § 1.56-IT(a)(2) (1988).

12. See I.R.C. § 56(f)(1). See *infra* notes 30-33 and accompanying text for a more technical definition of the BURP adjustment.

13. See *infra* notes 30-33 and accompanying text.

scheduled to be replaced with the adjusted current earnings ("ACE") adjustment.¹⁴ Under the ACE adjustment, the minimum tax base essentially will be increased or decreased by seventy-five percent of the difference between a corporation's taxable income and its "adjusted" earnings.¹⁵

Section 702 of the Tax Reform Act of 1986 directs the Treasury to study and report to Congress on the operation and effect of the BURP adjustment and the ACE adjustment (as projected) by January 1, 1989.¹⁶ Based on the results of this study, Congress presumably will decide the fate of the BURP and ACE adjustments.¹⁷ Therefore, it is worth analyzing the merits of the BURP and ACE adjustments and the options confronting Congress.

The BURP and ACE adjustments raise serious policy issues and practical concerns.¹⁸ The primary problems with the BURP adjustment are its reliance on generally accepted accounting principles ("GAAP"), the pressure it places on accountants to understate financial statement income, and compliance difficulties. The most significant problem with the ACE adjustment is that it exacerbates BURP's compliance concerns. Part II of this article explores these issues and concerns.¹⁹

Given the problems inherent in the BURP and ACE adjustments, Congress should examine other alternatives for dealing with the problem of corporate tax avoidance. Part III of this article discusses these alternatives and offers suggestions as to the best course of action.²⁰

14. I.R.C. § 56(g). Like the BURP adjustment, the ACE adjustment does not apply to any S corporation, real estate investment trust, regulated investment company, or REMIC. I.R.C. § 56(g)(6).

15. See I.R.C. § 56(g)(1). See *infra* notes 56-67 and accompanying text for a detailed discussion of the ACE adjustment.

16. Tax Reform Act of 1986, Pub. L. No. 99-514, § 702, 100 Stat. 2320, 2345 (1986). See also CONFERENCE REPORT, *supra* note 11, at II-279; STAFF OF JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, 100th Cong., 1st Sess. 461-62 (Comm. Print 1987) [hereinafter BLUE BOOK].

17. See *infra* notes 71-78 and accompanying text for a discussion of the options available to Congress.

18. It should be noted that the BURP and ACE adjustments also raise serious technical problems. These problems are not explored in this article. For a discussion of some of these technical problems, see generally B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 5-50 (example 5) (5th ed. 1987); Committees on Alternative Minimum Tax and Corporations of the New York State Bar Association Tax Section, *The Senate's Proposed Book Income Minimum Tax Preferences*, 32 TAX NOTES 569, 570 (1986) [hereinafter Committees on AMT]; Gould, *supra* note 2, at 796-97.

19. See *infra* notes 21-70 and accompanying text.

20. See *infra* notes 71-78 and accompanying text.

II. THE SPECIAL ADJUSTMENT APPROACH: POLICY ISSUES AND PRACTICAL CONCERNS

A. *The Corporate AMT Structure*²¹

The corporate AMT is equal to the excess, if any, of the tentative minimum tax ("TMT") over the regular tax²² for the taxable year.²³ If the TMT exceeds the regular tax, a corporation's total tax liability is represented by the TMT. If not, a corporation's total tax liability is equal to its regular tax.

The starting point for computing the TMT is the corporation's regular taxable income. This amount is then adjusted for various items, including the BURP or ACE adjustment,²⁴ and increased by items of tax preference,²⁵ resulting in alternative minimum taxable

21. A number of articles examine the intricacies of the AMT structure. See, e.g., Leder, *Giving Rise to BURPs (And Other Preferences) Under the New Corporate Minimum Tax: Selected Aspects*, 40 TAX LAW. 557 (1987); Hevener, *supra* note 4, at A-43.

22. The "regular tax" means the regular tax liability as defined in § 26(b), less the foreign tax credit under § 27(a). I.R.C. § 55(c)(1). Regular tax liability is the tax imposed by Chapter 1 with certain exceptions. See I.R.C. § 26(b). Among the exceptions are the accumulated earnings tax, the personal holding company tax, and the minimum tax. I.R.C. §§ 26(b)(2)(E), 26(b)(2)(F), 26(b)(2)(A).

23. I.R.C. § 55(a). The basic AMT calculation can be illustrated as follows:

	Regular taxable income
+/-	Adjustments per Code sections 56 and 58 (including BURP and ACE)
+	Preferences per Code section 57
=	<u>Alternative Minimum Taxable Income (AMTI)</u>
-	\$40,000 exemption amount (reduced by 25% of AMTI over \$150,000)
×	20% tax rate
-	<u>AMT foreign tax credit</u>
=	<u>Tentative Minimum Tax (TMT)</u>
-	<u>Regular tax liability</u>
=	<u><u>Alternative Minimum Tax (AMT)</u></u>

See I.R.C. §§ 55-59. See *infra* notes 24-29 and accompanying text for a further explanation of this calculation.

24. I.R.C. § 56. The adjustments include: depreciation for tangible property placed in service after December 31, 1986; mining exploration and development costs; use of the completed contract method of accounting; deduction for certified pollution control facilities; deduction for merchant marine capital construction funds; use of the installment method; deduction for certain tax-exempt insurance providers; alternative minimum tax net operating loss ("AMT NOL") deduction; and the BURP adjustment. *Id.* Effective for taxable years beginning in 1990, the ACE adjustment is scheduled to replace the BURP adjustment. I.R.C. §§ 56(c)(1)(B), 56(g).

25. I.R.C. § 57. The preferences include: excess deduction for depletion; excess deduction for intangible drilling costs; reserves for losses on bad debts of financial institutions; tax-exempt interest on certain bonds; excess appreciated property charitable deduction; and depreciation deduction for certain property placed in service before January 1, 1987. *Id.*

income ("AMTI").²⁶ The TMT is then calculated by applying the corporate AMT rate of twenty percent²⁷ to the excess of the AMTI, over an exemption amount,²⁸ and reduced by the AMT foreign tax credit.²⁹

B. The BURP Adjustment

A corporation's BURP adjustment³⁰ is calculated as fifty percent of the excess of its adjusted net book income ("ANBI") over its tentative AMTI.³¹ ANBI is generally the net book income or loss shown on the corporation's applicable financial statement.³² Ten-

26. I.R.C. § 55(a).

27. I.R.C. § 55(b)(1)(A).

28. I.R.C. § 55(d)(2). If a corporation's AMTI is \$150,000 or less, the first \$40,000 of AMTI is exempt. *Id.* The exemption amount is phased out by twenty-five percent of AMTI in excess of \$150,000. I.R.C. § 55(d)(3). As a result, a full phase out of the exemption occurs when AMTI reaches \$310,000 (*i.e.*, $(310,000 - 150,000) \times 25\% = 40,000$). I.R.C. § 55(d)(3)(A).

29. I.R.C. §§ 55(b)(1). The amount of foreign taxes accrued or paid during the year available to offset TMT is limited to ninety percent of the TMT determined without regard to the AMT foreign tax credit. *See* I.R.C. § 59(a)(2).

30. The reference to BURP as an adjustment is a misnomer. It is more appropriately viewed as a preference, as the Staff of the Joint Committee implicitly recognized. BLUE BOOK, *supra* note 16, at 448. The importance of this distinction lies in the fact that preferences can only increase AMTI, whereas adjustments can either increase or decrease AMTI. *See* I.R.C. § 55(b)(2). The BURP adjustment operates like a preference because it can only increase AMTI. *See* I.R.C. § 56(f)(1). The ACE adjustment is a true adjustment in that it can increase or decrease AMTI. *See infra* note 56.

31. I.R.C. § 56(f)(1); Temp. Treas. Reg. § 1.56-IT(a) (1988). The calculation of the BURP adjustment is illustrated by the following schedule:

	X	Y
(1) ANBI	\$100	\$100
(2) AMTI (before BURP adjustment)	50	(50)
(3) Excess ((1) - (2))	50	150
(4) BURP Adjustment ($\frac{1}{2} \times (3)$)	25	75
(5) AMTI ((2) + (4))	75	25

32. I.R.C. § 56(f)(2)(A). The Code defines the term "applicable financial statement" and provides priority rules for determining the statement that a corporation must use in computing the BURP adjustment:

- (A) IN GENERAL.—The term "applicable financial statement" means, with respect to any taxable year, any statement covering such taxable year—
- (i) which is required to be filed with the Securities and Exchange Commission,
 - (ii) which is a certified audited income statement to be used for the purposes of a statement or report —
 - (I) for credit purposes,
 - (II) to shareholders, or
 - (III) for any other substantial nontax purpose,
 - (iii) which is an income statement required to be provided to —
 - (I) the Federal Government or any agency thereof,

tative AMTI consists of AMTI before the BURP adjustment and any AMT net operating loss ("NOL") deduction.³³

1. Shortcomings of the GAAP Standard

The primary problem with the BURP adjustment is that it derives from financial statement income which often is determined in accordance with GAAP.³⁴ Relying on GAAP-based financial statement income is problematic because a number of alternative accounting methods meet GAAP requirements, and because subjective judgment is often necessary in applying GAAP. As a result, similarly situated corporations may pay different income taxes simply because of accounting choices and the subjective judgments of their accountants.³⁵ This result is suspect in a tax system supposedly designed to ensure, as far as possible, that similarly situ-

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- (II) a State government or any agency thereof, or
 - (III) a political subdivision of a State or any agency thereof, or
 - (iv) which is an income statement to be used for the purposes of a statement or report —
 - (I) for credit purposes,
 - (II) to shareholders, or
 - (III) for any other substantial nontax purpose.

(B) EARNINGS AND PROFITS USED IN CERTAIN CASES. — If —

- (i) a taxpayer has no applicable financial statement, or
- (ii) a taxpayer has only a statement described in subparagraph (A)(iv) and the taxpayer elects the application of this subparagraph, the net income or loss set forth on the taxpayer's applicable financial statement shall, for purposes of paragraph (3)(A), be treated as being equal to the taxpayer's earnings and profits for the taxable year (without diminution by reason of distributions during the tax year). Such election, once made, shall remain in effect for any taxable year for which the taxpayer is described in this subparagraph unless revoked with the consent of the Secretary.

(C) SPECIAL RULE WHERE MORE THAN 1 STATEMENT. — For purposes of subparagraph (A), if a taxpayer has a statement described in more than 1 clause or subclause, the applicable financial statement shall be the statement described in the clause or subclause with the lowest number designation.

I.R.C. § 56(f)(3).

33. See I.R.C. § 56(f)(1). For loss years beginning after December 31, 1986, the AMT NOL is generally calculated in the same manner as for regular tax purposes under section 172(c), with two important modifications. First, the adjustments provided in section 56 must be applied in computing AMT NOL. Second, the preferences provided in section 57 reduce the AMT NOL. I.R.C. § 56(d).

34. See *supra* note 32 to determine the financial statement a corporation should use for BURP purposes. The highest priority financial statements are GAAP-based: (1) statements filed with the Securities and Exchange Commission, and (2) certified audited income statements used for credit, shareholder, or any other substantial non-tax purpose. I.R.C. § 56(f)(3)(A)(i)-(ii). These two categories encompass many corporations' statements including those corporations whose shares are publicly traded.

35. See *infra* notes 37-44 and accompanying text.

ated taxpayers incur equivalent income tax liabilities.³⁶

The myriad of alternative methods under GAAP are exemplified by the several acceptable methods for both cost apportionment (*i.e.*, depreciation),³⁷ and the valuation of inventory and cost of goods sold.³⁸ The effect on financial statement income can be dramatically different depending on the method selected.³⁹ Given the options available under GAAP for treating certain transactions, corporations can easily select those alternatives that will minimize the impact of the AMT amount.⁴⁰ Consequently, income tax liability becomes subject to the vagaries of corporate accountants.

In addition to providing alternative accounting methods, GAAP requires, in many cases, the application of subjective judgment. One area in which subjective judgment becomes a factor is loss contingencies. Under GAAP, a loss contingency can be recorded only if (1) it is probable that an asset has been impaired, and (2) the amount of the loss can be reasonably estimated.⁴¹ The subjective quality of the terms "probable" and "reasonably" renders them likely to cause disagreement among accountants whether the requirements for a loss contingency are met. Another situation involving judgment concerns depreciation. Under most GAAP-based depreciation methods, accountants must estimate an asset's useful life and residual or salvage value.⁴² As might be expected, accountants often disagree over these subjective estimates. Thus, due to items such as loss contingencies and depreciation, the amount of income tax paid by a corporation depends in part on the subjective judgment of its own accountants.

Due to the numerous options and the subjective elements of GAAP, two entities with identical transactions can report very different financial statement incomes. If both entities are subject to

36. See *infra* note 46 and accompanying text.

37. D. KIESO & J. WEYGANDT, *INTERMEDIATE ACCOUNTING* 459-65 (rev. 5th ed. 1986). These alternative methods include activity methods based on either units of use or production; straight-line methods; and decreasing charge methods such as sum-of-the-years' digits and double declining balance. *Id.*

38. *Id.* at 333-44. These methods include specific identification; first-in, first-out; last-in, first-out ("LIFO"); dollar-value LIFO; and average cost. *Id.*

39. See, e.g., D. KIESO & J. WEYGANDT, *supra* note 37, at 325-28, 459-62.

40. For example, "[o]ne attorney admitted that his firm may have to use different accounting methods which, although valid under [GAAP], will reduce his firm's book income and lessen the bite of the minimum tax." Uhlfelder, *Corporate Tax Managers to Take on New Tasks with Tax Reform*, 32 *TAX NOTES* 942, 942 (1986).

41. Accounting for Contingencies, Statement of Financial Accounting Standards No. 5, Para. 8 (Fin. Accounting Standards Bd. 1975).

42. See D. KIESO & J. WEYGANDT, *supra* note 37, at 459-62.

the corporate AMT, the AMT for each entity will differ accordingly because of the disparate financial statement incomes.

This point is best illustrated by an example. Assume the following: (1) corporations *X* and *Y* have identical financial histories and operations; (2) both have AMTI (before the BURP adjustment) and taxable income of zero; (3) both receive \$600,000 of tax-exempt interest; (4) both are made aware of a potential tort claim of \$1,200,000; (5) *X* reports book income of zero because it creates a reserve for the contingent tort liability of \$600,000 that offsets its tax-exempt interest of \$600,000; and (6) *Y* reports \$600,000 of book income because it decides not to set up a contingency reserve for the tort liability.⁴³

Given these assumptions, *X* incurs no AMT liability, but *Y* does, solely because their reported book incomes differ. This result is clearly inequitable and arises only because BURP relies on GAAP-based financial statements.⁴⁴ In fact, the use of GAAP to determine tax liability was strongly criticized in *Thor Power Tool v. Commissioner*.⁴⁵ In *Thor Power Tool*, the Supreme Court stated

43. This example was adapted from a discussion in B. BITTKER & J. EUSTICE, *supra* note 18, at 5-46.

44. The corporate AMT contains a minimum tax credit ("MTC") ostensibly designed to address the inequity of such a result. See I.R.C. § 53. The effect of the MTC is that to the extent that a corporation has AMT liability in one taxable year because of deferral preferences, the amount of AMT liability is allowed as a credit against the corporation's regular tax liability in appropriate subsequent years. *Id.* Deferral preferences arise because AMTI includes certain items of income that are deferred for regular tax purposes and disallows certain accelerated deductions. See, e.g., I.R.C. § 56(a).

There are at least two reasons why the MTC does not fully respond to the inequitable results possible under a GAAP-based BURP adjustment. First, a corporation may always be subject to the AMT, and thus, no possibility exists for offsetting MTC against regular tax liability. This situation may arise if a corporation has extensive net operating losses. Second, even if a regular tax position is achieved it may not occur for several years. Thus, the MTC ignores the time value of money.

45. 439 U.S. 522 (1979). The petitioner in *Thor Power Tool* was a tool manufacturer that possessed what it considered "excess" inventory. In accordance with GAAP, the petitioner wrote down this "excess" inventory to an amount representing net realizable value. By offsetting this write-down against annual sales, the petitioner generated a net operating loss for the taxable year. *Id.* at 524.

In disallowing the offset, the Commissioner maintained that the write-down did not reflect income clearly for tax purposes. *Id.* at 537-38. The petitioner responded with two arguments. First, the petitioner argued that there is a presumption that an inventory practice is valid for tax purposes if it conforms with GAAP. Second, the petitioner argued that once this conformity is established by a taxpayer, the Commissioner has the burden to establish that the GAAP-based method does not reflect income clearly. *Id.* at 538-39.

The Supreme Court concluded that such a presumption could not be supported in light of the Code, case law, and the differing objectives of financial and tax accounting. *Id.* at 540. As a result, it affirmed the judgment of the appellate court in favor of the Commissioner. *Id.* at 550.

that:

Accountants long have recognized that 'generally accepted accounting principles' are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions Variances of this sort may be tolerable in financial reporting, but they are questionable in a tax system designed to ensure as far as possible that similarly situated taxpayers pay the same tax. If management's election among 'acceptable' options were dispositive for tax purposes, a firm, indeed, could decide unilaterally — within limits dictated only by its accountants — the tax it wished to pay. Such unilateral decisions would not just make the Code inequitable; they would make it unenforceable.⁴⁶

In short, BURP's reliance on financial statement income is misguided and leads to tax inequities.

2. Pressure on Accountants

Another significant problem with the BURP adjustment is that it may place undue pressure on accountants to understate financial statement income to minimize the effect of the AMT. This concern has been expressed by members of the accounting profession,⁴⁷ as well as members of the legal profession.⁴⁸ To the extent that accountants succumb to this pressure, the reliability and integrity of GAAP is threatened.⁴⁹ Additionally, the pressure placed on

46. *Id.* at 544.

47. Uhlfelder, *Earnings and Profits May Replace Book Income as AMT Preference; SEC Will Not Lobby on Issue*, 32 TAX NOTES 197, 197 (1986). For example, Albert Ellentuck, Chairman of the American Institute of Certified Public Accountants, stated that the BURP adjustment "would cause 'mischief in the accounting world and complexity in the tax world'" and would "put [] companies in the unfortunate position of thinking about the tax consequences, rather than the accounting consequences, of their actions and may cause a distortion of book income." *Id.* Ira H. Shapiro, the Director of the National Tax Office of Coopers & Lybrand, argued that the BURP adjustment "'may cause companies to resist adopting a new accounting principle or changing to a GAAP method of reporting, even though the application of the new principle or accounting method would provide shareholders, creditors and other users of financial statements with more complete and accurate information.'" *Id.* The Securities and Exchange Commission ("SEC") expressed these same concerns. *Id.* After debate, however, the Chairman and four commissioners of the SEC decided not to send a letter to the congressional tax-writing committee asking that they drop the BURP adjustment. *Id.* This decision was apparently based on a desire to avoid getting involved in a dispute with the Internal Revenue Service and the Treasury regarding jurisdiction. *Id.* at 198.

48. For example, a report by the Committees on Alternative Minimum Tax and Corporations of the New York State Bar Association Tax Section stated that "[w]e are . . . concerned that [the BURP adjustment] would place an undesirable pressure on accountants and the accounting system generally. The provision would create an obvious incentive for companies to reduce their book income." Committees on AMT, *supra* note 18, at 570.

49. See *supra* notes 47-48 and accompanying text.

accountants directly affects the BURP adjustment: if accountants understate financial statement income, then the BURP adjustment decreases. Therefore, aside from tax inequities, BURP is likely to distort financial reporting because of the pressure it places on accountants.

One commentator has argued that concerns about pressure on accountants should not be overemphasized because they are offset by the pressure placed on corporations to reflect high earnings for shareholders and creditors.⁵⁰ This argument, however, ignores two important points. First, shareholder pressure does not apply to most privately-held corporations. These corporations are more concerned with minimizing taxes and maximizing shareholder return than in reporting high earnings. Second, countervailing pressure from creditors similarly may be absent. Although lenders may consider reported earnings, lenders focus primarily upon the soundness of the borrowing corporation's cash flow statements, projections, and balance sheet. Thus, a privately-held corporation may not be compelled to report high earnings even if it needs to borrow. Accordingly, the pressure on accountants to understate financial income is particularly great in privately-held corporations. Even in publicly-held corporations, it is unlikely that the countervailing pressure to reflect high earnings will exactly offset the pressure placed on accountants.⁵¹ To the extent that the pressures do not completely offset, distorted financial reporting will result.

3. Compliance Problems

The BURP adjustment causes a further concern because of its compliance cost implications. Compliance costs will undoubtedly increase because corporations will be forced to maintain an additional set of books for AMT purposes. Moreover, the complexities of the AMT will cause corporations to hire additional accountants, outside experts, or both.⁵² These compliance costs may prove pro-

50. Gould, *supra* note 2, at 795. Gould stated that "[i]t is unlikely that publicly held companies will reduce the strength of their financial statements to avoid tax. Leveraged companies or companies attempting to borrow will not be able to engage in such financial reporting distortions." *Id.*

51. Committees on AMT, *supra* note 18, at 570. The Committees stated that "it seems a vain hope that the conflict between the tax incentive to report lower earnings and a purported desire to reflect higher earnings will produce an appropriate calculation of a firm's economic income." *Id.*

52. An oil and gas industry official asserted that the BURP adjustment will cause "a tremendous increase in our tax department's workload and an increase in the workload of companies that supply our data." Uhlfelder, *supra* note 40, at 942.

hibitive for smaller corporations, driving many marginal corporations out of business.⁵³

Compliance may also pose a problem for the Internal Revenue Service ("IRS") from an administrative and budgetary standpoint. The BURP adjustment may force the IRS to examine critically a corporation's financial statements and restate them in certain situations.⁵⁴ Such critical review will be time consuming and will require the IRS to thoroughly train its auditors in GAAP. Given an already overburdened audit staff and budget constraints, it is questionable whether the IRS can effectively police the BURP adjustment.⁵⁵

C. The ACE Adjustment

The ACE adjustment is equal to seventy-five percent of the difference between the corporation's AMTI and its ACE.⁵⁶ ACE is defined as the corporation's AMTI, as adjusted in accordance with

53. Feinberg & Robinson, *supra* note 2, at 36. Another commentator has stated that: Undoubtedly, small closely held corporations will have difficulty in complying with the administrative requirements underlying the several determinations that must be made and the multitude of records that must be maintained [for AMT purposes]. Moreover, even the most sophisticated corporate taxpayer may have difficulty in working with the complexities of certain concepts contained in the corporate [AMT].

Gould, *supra* note 2, at 783-84.

54. The temporary regulations for the BURP adjustment set forth rules requiring specified adjustments to net book income to prevent the omission or duplication of items of net book income. Temp. Treas. Reg. § 1.56-IT(d)(4) (1987). In addition, the temporary regulations allow the Commissioner to approve or require other adjustments to a corporation's net book income to prevent omission or duplication of items. Temp. Treas. Reg. § 1.56-IT(d)(4)(i) (1987). To the extent that the IRS exercises this authority, it will clearly require critical review of corporate financial statements.

55. The corporate AMT with the BURP adjustment:

Will require that IRS auditors become expert[s] in the rules of accounting to critically examine a [corporation's] accounting books and records Acceptance of this invitation to widespread surveillance of all documents by the IRS provokes troubling policy questions as well as practical concerns about the ability of the auditing staff to cope with the increased time demands in a time of budget crisis.

Feinberg & Robinson, *supra* note 2, at 35-36.

56. I.R.C. § 56(g)(1). The use of seventy-five percent — as opposed to fifty percent — may be due to the "inclusion of the negative adjustment for ACE and from the fact that ACE is smaller than [BURP]." Gould, *supra* note 2, at 790 n.69 (summarizing a speech by David Garlock, former Associate Legislative Counsel for the Treasury).

Unlike the BURP adjustment, the ACE adjustment can be either a positive or negative number. If the adjustment is negative, it is allowed so long as it does not generate a cumulative negative adjustment. See I.R.C. § 56(g)(2)(B). Thus, the reduction to AMTI is limited to the excess of the aggregate amount by which AMTI has been increased by the ACE adjustment in prior taxable years less the aggregate amount of reductions taken in prior years. *Id.*

Code section 56(g)(4).⁵⁷ The primary adjustments to AMTI relate to depreciation, items included for purposes of computing earnings and profits ("E & P"), items disallowed in computing E & P, and Code section 312(n) adjustments.⁵⁸

Calculation of the depreciation adjustment initially requires a corporation to divide its depreciable property into the following four categories: (1) property placed in service after 1989; (2) property to which the new accelerated cost recovery system ("ACRS") applies; (3) property to which the original ACRS system applies; and (4) property placed in service before 1981.⁵⁹ A corporation must then compute depreciation for each category based on a statutorily prescribed method.⁶⁰ Finally, depreciation for ACE purposes is determined by comparing depreciation as computed under the method specified by the statute with depreciation used for book purposes, and selecting the method which yields deductions having the smaller present value.⁶¹ Obviously, these procedures will be very difficult and time-consuming.

The difficulty and time involved are compounded by the other adjustments. The second adjustment relates to items which are excluded from gross income for AMTI purposes, but are included in determining E & P.⁶² These items are taken into account for ACE purposes, and thus AMTI must be adjusted accordingly.⁶³

Items disallowed in computing E & P represent the third adjustment.⁶⁴ In effect, items deducted in arriving at AMTI which are not deductible for computing E & P must be added back when determining ACE.⁶⁵

57. See I.R.C. § 56(g)(3). See *infra* notes 58-67 and accompanying text for a discussion of the adjustments contained in I.R.C. § 56(g)(4).

58. I.R.C. §§ 56(g)(4)(A)-(D).

59. I.R.C. § 56(g)(4)(A).

60. *Id.*

61. I.R.C. §§ 56(g)(4)(A)(i), 56(g)(4)(A)(v).

62. I.R.C. § 56(g)(4)(B)(i).

63. *Id.* An example of such an adjustment is the interest on tax-exempt bonds. The adjustment is reduced by any deduction that would have been allowable had the amount actually been includable in gross income. I.R.C. § 56(g)(4)(B)(i)(II). Thus, interest incurred to purchase tax-exempt bonds, for example, would be subtracted from the interest on the bonds in determining the adjustment. Other examples include the inside build-up in life insurance contracts reduced by premiums attributable to the insurance coverage and income on annuity contracts. I.R.C. §§ 56(g)(4)(B)(ii)-(iii); see also I.R.C. §§ 7702(g), 72(u)(2).

64. I.R.C. § 56(g)(4)(C)(i).

65. *Id.* An example of an item that must be added back is the dividends received deduction. There are special rules, however, governing certain dividends which qualify for the one-hundred percent dividend received deduction and dividends from certain section 936 corporations. I.R.C. §§ 56(g)(4)(C)(ii)-(iii); see also I.R.C. § 936.

Finally, AMTI is adjusted according to most of the E & P computational rules of Code section 312(n).⁶⁶ These rules include adjustments for construction period carrying costs, intangible drilling costs, certain amortization provisions, LIFO inventory adjustments, and installment sales.⁶⁷ As a result of the extensive and complicated adjustments required to arrive at ACE, the calculation of the corporate AMT becomes excessively burdensome.

Despite its complexity, the ACE adjustment cures two of the problems presented by the BURP adjustment. In contrast to BURP, the ACE adjustment derives from AMTI rather than financial statement income. Consequently, ACE eliminates the concerns of BURP raised by the limitations and shortcomings of GAAP, and the consequent pressure that BURP places on accountants to understate financial statement income.⁶⁸

Although the ACE adjustment eliminates some problems associated with the BURP adjustment, the ACE adjustment heightens the compliance concerns inherent in the BURP adjustment. Both BURP and ACE require one set of tax records for regular tax purposes and another set for AMT purposes; otherwise, the informational requirements for the BURP and ACE adjustments differ. Generally, to arrive at the BURP adjustment, the only additional information required (e.g., financial statement or book income) is contained in financial statements that most corporations already maintain for other purposes. This is not the case for the ACE adjustment. Instead, a corporation must independently develop the

66. I.R.C. § 56(g)(4)(D)(i). The Code, however, specifies a number of limits on the application of the section 312(n) rules. I.R.C. §§ 56(g)(4)(D)(i)(I)-(V). In addition, there is a special rule for intangible drilling costs and mineral exploration and development costs. I.R.C. § 56(g)(4)(D)(ii).

67. See I.R.C. § 312(n). In addition to these four primary adjustments, there are three other adjustments of more limited application. The first relates to the exchange of debt pools. I.R.C. § 56(g)(4)(E). When a corporation realizes a loss on the exchange of one pool of debt obligations for another, the loss is not recognized for ACE purposes so long as the effective interest rates and maturities of the two pools are substantially the same. *Id.*

The second adjustment concerns the acquisition expenses of life insurance companies. I.R.C. § 56(g)(4)(f). Generally speaking, the acquisition expenses of life insurance companies are to be capitalized and amortized for ACE purposes in accordance with GAAP. *Id.*

The third adjustment of limited application applies to certain ownership changes. I.R.C. § 56(g)(4)(H). If a corporation experiences an ownership change within the meaning of section 382 after the enactment date of the Tax Reform Act of 1986, and the aggregate adjusted basis of its assets exceeds the net fair market value of its stock, then the adjusted basis of each asset will be limited, for ACE purposes, to its proportionate share of the value of the stock. *Id.*; see also I.R.C. § 382.

68. See *supra* notes 34-51 and accompanying text.

information for the extensive adjustments needed to determine ACE.⁶⁹ As a result, corporations will be forced to generate a third set of tax records just for ACE purposes.

Additionally, the ACE adjustment is much more complex than the BURP adjustment. With the BURP adjustment, much of the complexity revolves around the calculation of AMTI. In computing the ACE adjustment, however, determination of AMTI is at most a "half-way" point. To arrive at ACE, numerous additional computations will have to be made.⁷⁰

III. ALTERNATIVES FOR COPING WITH CORPORATE TAX AVOIDANCE

The current corporate AMT structure, including the special adjustment approach of BURP and ACE, represents only one way to address the problem of corporate tax avoidance. Less obtrusive means are also available.⁷¹ The most drastic, but nonetheless the most streamlined and logical approach, would be to eliminate the corporate minimum tax and deal directly with the problem at its source by purging the Code of tax preferences. A less dramatic proposal would eliminate the BURP and ACE adjustments from the minimum tax structure, resulting ultimately in a minimum tax based solely on tax preferences.

A. *Eliminate the Corporate Minimum Tax By Eliminating Preferences*

The corporate minimum tax represents a conceptual anomaly, rather than a structural necessity in the tax system. This complex tax exists wholly apart from the regular tax structure, and was added mainly to provide Congress with a politically palatable and

69. See *supra* notes 57-67 and accompanying text.

70. See *supra* notes 57-67 and accompanying text.

71. Arguably, the BURP and ACE adjustments could be modified to eradicate some of their inherent problems. As an example, the overall complexity of the AMT structure could be reduced slightly by basing the AMT solely on the ACE adjustment. This would eliminate the need to compute the specifically enumerated adjustments and preferences. These adjustments and preferences would not escape taxation because, with the exception of the AMT NOL deduction, they are included in the ACE adjustment. Obviously, there are other numerous possibilities for superficial modification. Realistically, however, no individual change or combination of changes is likely to cure the major defects in the BURP and ACE adjustments without attacking the basic nature of the adjustment itself. For example, the only way to eliminate most of BURP's inherent problems would be to remove its reliance on financial statement (or book) income. Yet, this reliance is the very essence of the BURP adjustment. Consequently, this Article does not consider a modified BURP or ACE adjustment as a serious alternative for coping with the problem of corporate tax avoidance.

feasible way to curb tax avoidance.⁷² Simply put, the corporate minimum tax system allows Congress to indirectly tax that which it is not willing to tax directly. However, employing this indirect approach forces Congress to forego the most logical alternative for coping with the tax avoidance problem: dealing directly with the problem by focusing on its source.

Congress could cure the tax avoidance problem by eliminating the various deductions, credits, and exclusions which originally generated the tax avoidance problem. Such an across-the-board cutback in tax preferences was proposed by Fortney H. Stark, a member of the Ways and Means Committee,⁷³ and was the approach taken by the Treasury in a 1984 report to President Reagan.⁷⁴ The Treasury's plan embodied in the report did not provide for a corporate minimum tax because it attacked the problem of tax avoidance directly by proposing the elimination of most tax preferences. Congress, however, rejected the plan as politically infeasible.⁷⁵

B. *A Minimum Tax Based Solely on Preferences*

The elimination of the corporate minimum tax is not likely to occur because of political factors. Therefore, the next best alternative would be for Congress to eliminate the BURP and ACE adjustments from the corporate minimum tax structure. The primary goal in developing the corporate minimum tax was to pre-

72. See, e.g., Shaviro, *Perception, Reality and Strategy: The New Alternative Minimum Tax*, 66 TAXES 91, 93 (1988) ("[the minimum tax has] greater political appeal . . . than proposals for the direct reduction of preferences"); Aaron & Galper, *The Politics of Tax Reform*, 30 TAX NOTES 49, 49 (1986) ("[v]igorous, intelligent, and well-paid lobbyists beset members of Congress with arguments that one particular tax provision or another is vital to the nation and that the campaign contributions over which the lobbyist has influence are vital to that member's reelection"); Haskell, *Tax Reform*, 35 TAX NOTES 301, 302 (1987) (implying that Congress failed to reduce or eliminate tax preferences due to pressure placed on it by various industries); Brannon, *The Corporate Minimum Tax*, 30 TAX NOTES 269, 269 (1986) ("[t]he root of the problem is that Congress feels slightly uncomfortable with some of the preference items in current law [, but] [t]here is not enough reform muscle to repeal these provisions"); Sunley, *Thinking About Senator Packwood's Alternative Minimum Tax for Corporations*, 31 TAX NOTES 395, 398 (1986) ("[f]or members [of Congress] who oppose tax incentives, it is an indirect way of [cutting back] on them. For members who favor tax incentives, it is a way of preserving them for many taxpayers while at the same time giving the members a possible response when constituents ask why certain profitable companies are permitted to pay little or no U.S. income tax.").

73. Brannon, *supra* note 72, at 269.

74. 2 The Treasury Department Report to the President, *Tax Reform for Fairness, Simplicity, and Economic Growth* 131-32 (1984).

75. See *supra* note 72 and accompanying text.

vent corporations from eliminating or dramatically reducing their income tax liabilities through the use of tax preferences.⁷⁶ The BURP and ACE adjustments represent Congress' indirect and extremely complex techniques for attaining that goal.

A simpler and more direct means exists for achieving the corporate minimum tax's main objective; specifically, the minimum tax base could be redefined to include whatever preferences are necessary to ensure that profitable corporations pay their fair share of income taxes. To implement this approach, Congress could modify the current AMT structure by eliminating the BURP and ACE adjustments from the AMTI base, and replacing them with specific, appropriate preferences. Alternatively, Congress could utilize an add-on minimum tax structure by expanding the prior add-on minimum tax base through the addition of selected preferences. Under either option, corporations would incur a minimum tax to the extent they utilize tax preferences.

There are, however, practical difficulties with a minimum tax based solely on tax preferences. In establishing the BURP and ACE adjustments, Congress rejected a minimum tax derived entirely from tax preferences.⁷⁷ Congress concluded that such a system failed to define a comprehensive income base and inadequately measured economic income.⁷⁸

Congress' conclusions are questionable. A minimum tax based solely on tax preferences would define a broad base of income as long as all significant exclusions, deductions, and credits were included in the minimum tax base. Likewise, the inclusion of all significant preferences in the minimum tax base would result in a fairly accurate measurement of economic income. Admittedly, a minimum tax based entirely on tax preferences would result in a lengthy list of items for inclusion in the minimum tax base. Nonetheless, this approach is simple and direct, in dramatic contrast to the special adjustment approach of BURP and ACE.

IV. CONCLUSION

Congress could completely remedy the corporate tax avoidance problem if it repealed the corporate minimum tax and dealt directly with the source of the problem by eliminating the various tax preferences contained in the Code. This approach is the most logi-

76. See SENATE REPORT, *supra* note 3, at 519; HOUSE REPORT, *supra* note 3, at 306-07.

77. *Id.*

78. SENATE REPORT, *supra* note 3, at 519; HOUSE REPORT, *supra* note 3, at 306-07.

cal and direct solution to the tax avoidance problem. Unfortunately, due to political factors, the direct approach is probably not feasible.

The next best alternative would be for Congress to eliminate the BURP and ACE adjustments from the minimum tax structure. In place of BURP and ACE, Congress could add additional appropriate preferences to the minimum tax base. This would ensure that corporations pay their fair share of income taxes. In contrast to the BURP and ACE adjustments, such an approach would provide a relatively simple and direct solution to the problem of corporate tax avoidance.