

Publications

Proposed Corporate Minimum Tax Rules Generally Exempt Income Under Tax-Favored Benefit Plans

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The Inflation Reduction Act of 2022 (“Act”) imposed a 15% corporate minimum tax on the “adjusted financial statement income” (“AFSI”) of taxpayers with more than \$1 billion of AFSI, effective for tax years beginning after December 31, 2022. Because a corporate tax on “book income,” without adjustment, could include income and assets of tax-qualified pension and other post-retirement funds reported on a corporate taxpayer’s financial statements, the Act includes an exemption for a covered benefit plan.

Under Code section 56A, the calculation of AFSI –

- disregards costs in connection with a “covered benefit plan,” which includes Code section 401(a) defined benefit plans, qualified foreign plans (Code sec. 404A(e)), and “any other defined benefit plan which provides post-employment benefits other than pension benefits”;
- is reduced by the tax deductions allowed with respect to such covered benefit plans; and
- is increased by income that is included in the gross income of the corporation under any other income tax provisions.

While this exemption is helpful, tax practitioners have been eagerly awaiting proposed regulations that clarify a multitude of issues under the new corporate minimum tax. They got their wish on September 13 when Treasury and IRS issued hundreds of pages of proposed regulations detailing the scope of the 15% minimum tax and the required detailed calculations. 89 Fed. Reg 75062. Fortunately, it is not necessary to wade through too many of the provisions to understand how benefit plans and exempt organizations subject to the unrelated business income tax are treated. We summarize the key provisions below.

A. Exemption for Tax-Favored Benefit Plans

The proposed rules generally track the statute by providing that a taxpayer’s calculation of AFSI should –

- disregard “any amount of income, cost, expense, gain or loss that would otherwise be included in connection with any covered benefit plan.” Prop. Reg. §1.56A-13(b)(1).
- be increased by any amount of income associated with a covered benefit plan under any provision of Chapter 1 of the Code; an example would be a reversion from a qualified plan upon its termination, which is included in taxable income (and is also subject to excise tax under Code section 4980), and
- be reduced by allowable deductions, such as for pension plan contributions under section 404(a).

The term “covered benefit plan” includes –

- any defined benefit plan (other than a multiemployer plan),
- a qualified foreign plan described under Code section 404A(e), and
- any other defined benefit plan where, under the accounting standards that apply to AFS, the plan is treated as a defined benefit plan that provides post-employment benefits other than pension benefits.

The Preamble (89 Fed. Reg. at 75084) contains a few important clarifications of these principles. One clarification relates to post-employment welfare plans such as retiree medical plans. In this regard, even if the welfare benefits are in the nature of a defined contribution plan – such as a health reimbursement arrangement (“HRA”) – the associated income would be excluded because HRAs for retirees are deemed to be defined benefit plans for accounting purposes. The same would apply to retiree life insurance plans.

The Preamble also addresses trusts for Puerto Rican retirement plans. In this case, the adjustment for the income earned by the plan would apply only if the taxpayer has made a proper election under ERISA section 1022(i)(2)(A) to treat the trust as a U.S. trust. However, trusts associated with plans created or organized under other U.S. possessions (e.g., the U.S. Virgin Islands) would not qualify for this adjustment.

B. Treatment of UBTI and Tax-Exempt Entities

Another provision of the proposed regulations provides rules for adjusting the AFSI for the income of tax-exempt entities, including qualified plan trusts, and voluntary employees’ beneficiary association (“VEBA”) trusts under Code section 501(c)(9). As applied to these trusts, the tax would be appropriately adjusted to take into account only the adjusted financial statement income –

- of an unrelated trade or business (as defined in Code section 513) of such organization, taking into account the modifications under Code section 512(b) (which exclude passive investment income), and
- derived from “debt-financed property” (as defined in section 514) to the extent that income from such property is treated as “unrelated business taxable income” under section 512(b)(4).

While not expressly stated, the above formulation suggests that deemed UBTI associated with excess retiree medical assets in a VEBA similarly would not count in AFSI.

Based on the above guidance – and the fact that the threshold is \$1 billion of book income – it appears highly unlikely that the minimum tax would be payable on account of UBTI associated with such exempt trusts and organizations.

C. Next Steps

The proposed rules summarized above are generally effective for tax years ending after September 13, 2024. Reliance on the proposed rules is also permitted for the 2023 tax year, as long as the taxpayer and its controlled group (using a 50% ownership standard) apply the guidance on a consistent basis.

Comments on the proposed rules should be submitted by December 12, 2024. A public hearing is scheduled for January 16, 2025.

We expect that affected taxpayers and their tax advisors will have few concerns as they take this benefit plan guidance into account in calculating their AFSI for minimum tax purposes. However, they are likely to face considerable complexity as they struggle to comply with other aspects of this new corporate tax regime.