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IRS Fact Sheet

# Questions and Answers about the limitation on the deduction for business interest expense

FS-2026-14, Aug. 2026

These frequently asked questions supersede earlier FAQs that were posted in FS-2025-09 on Dec. 23, 2025.

This Fact Sheet issues frequently asked questions about the limitation on the deduction for business interest expense.

These questions and answers are revised to:

- Address the 2017 Tax Cuts and Jobs Act and the One, Big, Beautiful Bill Act amendments to the section 163(j) limitation.
- Delete Topic D CARES Act questions and answers that are no longer applicable.
- Re-designate Topic E as new Topic D and clarify that the term “change” in new Topic D denotes specific changes to statutory language not any change to the operative effect of the statute. That is, some changes to the statutory language made by the One, Big, Beautiful Bill Act merely clarified the operation of the existing statute. To assist taxpayers, new Topic D has been revised to distinguish between substantive changes in law and clarifications of existing law.
- FS-2026-14 is current as of Aug.19, 2026 and has not been updated for any changes in law after that date.

These FAQs are being issued to provide general information to taxpayers and tax professionals as expeditiously as possible. Accordingly, these FAQs may not address any particular taxpayer’s specific facts and circumstances, and they may be updated or modified upon further review. Because these FAQs have not been published in the Internal Revenue Bulletin, they will not be relied on or used by the IRS to resolve a case. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer’s case, the law will control the taxpayer’s tax liability. Nonetheless, a taxpayer who reasonably and in good faith relies on these FAQs will not be subject to a penalty that provides a reasonable cause standard for relief, including a negligence penalty or other accuracy-related penalty, to the extent that reliance results in an underpayment of tax. Any later updates or modifications to these FAQs will be dated to enable taxpayers to confirm the date on which any changes to the FAQs were made. Additionally, prior versions of these FAQs will be maintained on IRS.gov to ensure that taxpayers, who may have relied on a prior version, can locate that version if they later need to do so.

More information about reliance is available on IRS.gov*. These FAQs were announced in IR-2026-94.*

## Background

Below are answers to some basic questions about the limitation on the deduction for business interest expense, also known as the "section 163(j) limitation." Prior to the 2017 Tax Cuts and Jobs Act (TCJA), section 163(j) of the Internal Revenue Code applied only to certain interest paid or accrued by corporations. However, the TCJA significantly changed the section 163(j) limitation. On March 27, 2020, section 163(j) was further amended by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The Treasury Department and the IRS issued final regulations under section 163(j) in Sept. 2020 and Jan. 2021. See Treasury Decisions 9905 and

9943. Additionally, the One, Big, Beautiful Bill Act (P.L. 119-21) made changes and clarifications to section 163(j).



## Topic A: General information

**Q1. What is the section 163(j) limitation on the deduction for business interest expense? (updated Aug. 19, 2026)**

A1. Generally, taxpayers can deduct interest expense paid or accrued in the taxable year. However, if the section 163(j) limitation applies, the amount of deductible business interest expense in a taxable year cannot exceed the sum of:

1. The taxpayer's business interest income for the taxable year;
2. 30% of the taxpayer's adjusted taxable income (ATI) for the taxable year; and
3. The taxpayer's floor plan financing interest expense for the taxable year.

See Topic C below for more information on calculating the limitation.

**Q2. Who is subject to the section 163(j) limitation? (updated Jan. 10, 2023)**

A2. For taxable years beginning after Dec. 31, 2017, the limitation applies to all taxpayers who have business interest expense, other than certain small businesses that meet the gross receipts test in section 448(c) ("exempt small business") (see Topic A: Q 3 and 4). The limitation does not apply to certain electing trades or businesses and certain excepted trades or businesses (see Topic B: Q 1 and 2).

**Q3. What is the gross receipts test for purposes of the section 163(j) limitation? (updated Aug. 19, 2026)**

A3. A business generally meets the gross receipts test of section 448(c) for a taxable year when it is not a tax shelter (as defined in section 448(d)(3)) and has average annual gross receipts of $25 million or less in the previous three years. The $25 million gross receipts amount is adjusted annually for inflation. The inflation adjusted gross receipts amount for 2024 is $30 million. The inflation adjusted gross receipts amount for 2025 is $31 million. The inflation adjusted gross receipts amount for 2026 is $32 million.

**Q4. My average annual gross receipts for years 2021-2023 were more than $30 million subjecting me to a section 163(j) interest expense limitation for the 2024 tax year. A portion of that interest expense was limited and carried forward to 2025. If my average annual gross receipts based on tax years 2022 through 2024 decrease to below $31 million, will I be subject to the section 163(j) limitation when I file for the 2025 taxable year? (updated Dec. 23, 2025)**

A4. No. Although you were subject to the section 163(j) limitation for the 2024 taxable year, the limitation does not apply to you for the 2025 taxable year. The disallowed portion of business interest expense from 2024 that is carried forward to 2025, along with the amount of 2025 business interest, will not be subject to the limitation in 2025 because your average annual gross receipts for 2022-2024 is below $31 million. Therefore, you do not need to compute the section 163(j) limitation for the 2025 taxable year.

Note: This answer assumes that you are operating only one trade or business that is not an electing or excepted trade or business, as discussed in Topic B: Q 1, 2 and 3 below.

## Topic B: Excepted trades or businesses

**Q1. Which businesses qualify as an excepted trade or business?**

A1. The following are excepted trades or businesses:

- The trade or business of providing services as an employee;
- Certain real property trades or businesses that elect to be excepted;
- Certain farming businesses that elect to be excepted; and
- Certain regulated utility trades or businesses.

**Q2. How does an eligible real property trade or business or farming business elect to be an excepted trade or business? (updated Aug. 19, 2026)**

A2. A taxpayer with an eligible real property trade or business or farming business may make an election to be an excepted trade or business by following the procedures outlined in Treas. Reg. §1.163(j)-9, including the requirement to attach a statement to a timely filed federal income tax return (including any extensions) for the taxable year of election. See also Revenue Procedures 2018-59, 2021-9, and 2026-17. An exempt small business is permitted to make an election to be an excepted trade or business even though that taxpayer is not subject to the section 163(j) limitation. See Treas. Reg. §§1.163(j)-2(d)(1) and 1.163(j)-9(b). This provision is intended to allow taxpayers who are unsure whether they qualify as an exempt small business to make a protective election without having to apply the gross receipts test described in Topic A: Q 2 and 3 above for the prior three taxable years. Once made, an election is generally irrevocable and binding on the trade or business for all succeeding years. See Treas. Reg.§1.163(j)-9 for certain circumstances where the election terminates. See also Revenue Procedure 2026-17 for certain circumstances where the election may be withdrawn. The statement making an election to be an excepted trade or business that is attached to the taxpayer's return for the taxable year of election must include the following information:

- The taxpayer's name, address, and social security number or employer identification number;
- A description of the electing trade or business, including the principal business activity code; and
- A statement that the taxpayer is making an election as a real property trade or business (under section 163(j)(7)(B) or as a farming business (under section 163(j)(7)(C)), as applicable.

**Q3. Are there any consequences I should be aware of in making an election to be an excepted trade or business? (updated Aug. 19, 2026)**

A3. Yes. If you make an election to be an excepted real property trade or business, the following assets that you hold in the electing real property trade or business must be depreciated using the alternative depreciation system (ADS) and are not eligible for a bonus depreciation deduction under section 168(k):

- Nonresidential real property;
- Residential rental property; and
- Qualified improvement property.

If you make an election to be an electing farming business, any property with a recovery period of 10 years or more that you hold in the electing farming business must be depreciated using ADS, and such property is not eligible for a bonus depreciation deduction under section 168(k).

See Revenue Procedures 2019-08, 2021-09, and 2026-17 for more information.

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# Topic C: Determining the Section 163(j) Limitation Amount

**Q1. What is considered interest for purposes of section 163(j)? (updated Jan. 10, 2023)**

A1. Treas. Reg. §1.163(j)-1(b)(22) defines the term "interest" to determine interest expense and interest income for purposes of section 163(j). In general, under Treas. Reg. §1.163(j)-1(b)(22), interest is any amount that is paid, received, or accrued as compensation for the use or forbearance of money under the terms of an instrument or contractual arrangement, including a series of transactions, that is treated as a debt instrument for purposes of section 1275(a) and Treas. Reg. §1.1275-1(d), or any amount that is treated as interest under other provisions of the Code or the regulations thereunder. Treas. Reg. §1.163(j)-1(b)(22) provides additional information on what constitutes interest for purposes of section 163(j), including anti-avoidance rules and a list of other amounts treated as interest, such as certain amounts of bond premium, factoring income, and certain dividends from regulated investment companies.

**Q2. What is business interest expense? (updated Aug. 19, 2026)**

A2. Business interest expense is any interest expense that is properly allocable to a trade or business that is not an excepted trade or business.

As discussed in Topic D: Q 1, section 163(j) applies to all business interest expense without regard to any mandatory or elective interest capitalization provisions, except for interest capitalized under section 263(g) or 263A(f). Accordingly, business interest expense excludes any interest capitalized under section 263(g) or 263A(f) and includes all other interest expense that is allocable to a trade or business that is not an excepted trade or business.

Floor plan financing interest expense is also business interest expense. See Topic C: Q 1, for what is considered interest.

See Topic C: Q 8, if you have interest expense that is allocable to both an excepted trade or business and a non-excepted trade or business.

**Q3. What is business interest income? (updated Jan. 10, 2023)**

A3. Business interest income is interest income that is includable in gross income and properly allocable to a trade or business that is not an excepted trade or business. See Topic C: Q 1, above, for what is considered interest. See Topic C: Q 8 if you have interest income that is allocable to both an excepted trade or business and a non-excepted trade or business.

**Q4. How do I calculate ATI (ATI limitation)? (updated Aug. 19, 2026)**

A4. ATI is calculated by taking the taxable income for the taxable year as if section 163(j) does not limit any interest deduction, and then adding and subtracting from that amount certain amounts for the taxable year:

Additions include, but are not limited to, business interest expense; net operating loss deduction; deduction for qualified business income under section 199A; depreciation, amortization, or depletion deduction for taxable years beginning before Jan. 1, 2022, or after Dec. 31, 2024; capital loss carrybacks or carryovers; and any deduction or loss not properly allocable to a non-excepted trade or business.

Subtractions include, but are not limited to, business interest income; floor plan financing interest expense; with respect to the sale or other disposition of property (which may take place in a taxable year beginning on or after Jan. 1, 2022), the greater of the allowed or allowable depreciation, amortization or depletion of the property for taxable years beginning before Jan. 1, 2022, or after Dec. 31, 2024; and any income or gain that is not properly allocable to a non-excepted trade or business.

Certain other adjustments to ATI apply for some types of taxpayers. See Treas. Reg. §1.163(j)-1(b)(1).

**Q5. What is floor plan financing interest expense? (updated Aug. 19, 2026)**

A5. Floor plan financing interest expense is interest paid or accrued on floor plan financing indebtedness. Floorplan financing indebtedness is indebtedness that is used to finance the acquisition of motor vehicles held for sale or lease and that is secured by the acquired inventory. For example, if you own an automobile dealership and pay interest on a loan that is secured by the dealership's office equipment, then such interest is not a floor plan financing interest expense since it is not secured by the acquired inventory.

For purposes of floor plan financing, a motor vehicle is defined as any one of the following:

- A self-propelled vehicle designed for transporting persons or property on a public street,
- A boat, and
- Farm machinery or equipment

As discussed in Topic D: Q 1, for tax years beginning after December 31, 2024, a motor vehicle, for purposes of determining whether interest is floor plan financing interest, also includes any trailer or camper which is designed to provide temporary living quarters for recreational, camping or seasonal use and is designed to be towed by, or affixed to, a motor vehicle.

**Q6. What happens to business interest expense that I cannot deduct in the current year because of the section 163(j) limitation? (updated Aug. 19, 2026)**

A6. The amount of business interest expense disallowed as a deduction in the current year under section 163(j) is carried forward to the next taxable year (a "disallowed business interest expense carryforward"). Your disallowed business interest expense carryforward may be limited in the next taxable year if the section 163(j) limitation continues to apply to you. Special rules apply to partnerships and S Corporations (see Topic C: Q 9).

**Q7. If I'm engaged in both an excepted trade or business and a non-excepted trade or business, how do I determine the section 163(j) limitation? (updated Jan. 10, 2023)**

A7. Your interest expense that is properly allocable to an excepted trade or business is not subject to the section 163(j) limitation. Similarly, the amount of your items of income, gain, deduction, or loss, including interest income that is properly allocable to an excepted trade or business, is excluded in determining the section 163(j) limitation. Therefore, you should allocate tax items between excepted and non-excepted trades or businesses in order to determine the section 163(j) limitation. Treas. Reg. §1.163(j)-10 provides special rules for allocating various tax items. You must generally compare your basis in the assets you use in your excepted trades or businesses and your basis in the assets you use in your non-excepted trades or businesses to determine what portion of interest expense and interest income to allocate to your excepted trades or businesses. In limited cases, tracing of interest expense paid on certain non-recourse debt may be available.

**Q8. How does the section 163(j) limitation apply to partnerships and S corporations? (updated Aug. 19, 2026)**

A8. The section 163(j) limitation is applied at the partnership level. As provided in Topic A: Q 1, the amount of deductible business interest expense in a taxable year cannot exceed the sum of the partnership's business interest income, 30% of the partnership's ATI, and the partnership's floor plan financing interest expense.

Business interest expense that may be deducted upon application of the section 163(j) limitation is taken into account in determining the non-separately stated taxable income or loss of the partnership. Any business interest expense of the partnership that is disallowed upon application of the section 163(j) limitation is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership. This amount is called excess business interest expense (EBIE).

A partner carries forward its share of EBIE. In a succeeding taxable year, a partner may treat its EBIE as business interest expense paid or accrued by the partner to the extent the partner is allocated excess taxable income or excess business interest income from the same partnership. Excess taxable income is the amount of ATI of the partnership that was in excess of what it needed to deduct its business interest expense. Excess business interest income is the amount by which business interest income exceeded business interest expense at the partnership level. Excess taxable income is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership. An allocation of excess taxable income to a partner increases the partner's ATI. Similarly, an allocation of excess business interest income to a partner increases the partner's business interest income. Once EBIE is treated as business interest expense paid or accrued by the partner, such business interest expense is subject to the partner's section 163(j) limitation, if any (see Topic A: Q 1).

S corporations apply the section 163(j) limitation at the S corporation level. Any business interest expense of the S corporation that is disallowed upon application of the section 163(j) limitation is not allocated to its shareholders but is instead carried over at the S corporation level to its succeeding taxable years. An S corporation allocates any excess taxable income and excess business interest income to its shareholders on a pro-rata basis.

Treas. Reg. §1.163(j)-6 provides special rules and defined terms relating to the application of section 163(j) to partnerships and S corporations. Treas. Reg. §1.163(j)-6(f)(2) specifically sets out the steps for allocating deductible business interest expense and the section 163(j) excess items for partnerships.

**Q9. How does a partner account for business interest expense when it computes its section 704(d) basis loss limitation? (added Jan. 10, 2023)**

A9. Treas. Reg. §1.163(j)-6(h) provides for a separate section 704(d) loss class for business interest expense comprised of: deductible business interest expense and business interest expense of an exempt entity (whether allocated to the partner in the current taxable year or suspended under section 704(d) in a prior taxable year), any excess business interest expense (EBIE) allocated to the partner in the current taxable year, and any EBIE from a prior taxable year that was suspended under section 704(d) (negative section 163(j) expense).

After the partner determines the amount of the limitation apportioned to this section 704(d) loss class, any deductible business interest expense is taken into account before any EBIE or negative section 163(j) expense. See Example 7 in Treas. Reg. §1.163(j)-6(o)(7) for more information.

This provision is generally applicable for taxable years beginning on or after Nov. 13, 2020. For more information, see the applicability date in Treas. Reg. §1.163(j)-6(p).

**Q10. How does the section 163(j) limitation apply to a consolidated group of corporations? (updated Jan. 10, 2023)**

A10. The section 163(j) limitation applies at the consolidated return level, and a consolidated group has a single limitation. In calculating the limitation, a consolidated group's business interest expense and business interest income is, respectively, the sum of its members' business interest expense and business interest income. The consolidated group should calculate its ATI using the group's taxable income as determined under Treas. Reg.§1.1502-11 without regard to any carryforwards or disallowances under section 163(j).

**Q11. Does the section 163(j) limitation apply to foreign corporations? (updated Aug. 19, 2026)**

A11. Yes, the section 163(j) limitation applies to any foreign corporation whose classification is relevant under Treas. Reg. §301.7701-3(d)(1) for a taxable year other than solely pursuant to section 881 or 882. As a result, section 163(j) applies to any foreign corporation that is a controlled foreign corporation (CFC). Generally, section 163(j) applies to a CFC in the same manner as it applies to a domestic C corporation. If a CFC is a partner in a partnership, the section 163(j) limitation applies to the partnership in the same manner as if the CFC were a domestic C corporation. Treas. Reg. §1.163(j)-7 provides rules for determining the amount of ATI and calculating the limitation for CFCs.

If a CFC group election is in effect, a single section 163(j) limitation is computed for the CFC group under rules provided in Treas. Reg. §1.163(j)-7(c). In addition, if a CFC or CFC group is eligible for a safe-harbor election, none of the CFC's or CFC group members' business interest expense is disallowed in a taxable year for which the election is made. See Revenue Procedure 2026-17 for additional information.

Section 163(j) also applies to any foreign corporation (or other foreign person) that is engaged in a U.S. trade or business. Prop. Reg. §1.163(j)-8 provides rules for determining the amount of ATI and calculating the limitation for the foreign corporation (or other foreign person). In the case of a foreign corporation engaged in a U.S. trade or business, the proposed regulations coordinate the application of section 163(j) with the rules for allocating interest expense to income effectively connected with a U.S. trade or business.

## Topic D: One, Big, Beautiful Bill Act changes and clarifications

**NOTE**: The use of the term "change" in this Topic D is intended to reference changes to the underlying statutory language and not to indicate any change in the operative effect of the applicable law. This Topic has been revised (from that appearing in FS 2025-09) to distinguish between substantive changes in law and clarifications of existing law.

**Q1. What changes and clarifications were made under the One, Big, Beautiful Bill Act? (updated Aug. 19, 2026)**

A1. Taxpayers should be aware of four changes and clarifications made by the One, Big, Beautiful Bill Act regarding section 163(j).

First, for tax years beginning after Dec. 31, 2024, the One, Big, Beautiful Bill Act amended section 163(j) to add back deductions for depreciation, amortization, or depletion to taxable income when calculating ATI. For taxable years beginning after Dec. 31, 2021, and before Jan. 1, 2025, these amounts were not allowed to be added back to taxable income in calculating ATI. See Topic C: Q 4 for more information on how to calculate ATI.

Second, for tax years beginning after Dec. 31, 2024, the One, Big, Beautiful Bill Act revised the definition of a motor vehicle, for purposes of determining whether interest is floor plan financing interest, so that it includes any trailer or camper which is designed to provide temporary living quarters for recreational, camping or seasonal use and is designed to be towed by, or affixed to, a motor vehicle. See Topic C: Q

6 for more information.

Third, the One, Big, Beautiful Bill Act clarified that, except for interest that is capitalized under sections 263(g) or 263A(f), section 163(j) applies to all business interest expense regardless if any portion would otherwise be deducted or capitalized under a mandatory or elective interest capitalization provision. Accordingly, business interest expense excludes any interest capitalized under section 263(g) or 263A(f) and includes all other business interest expense. These clarifications do not reflect a change in Treasury and IRS position. See Topic C: Q 2 for more details. See also Treas. Reg. § 1.163(j)-3(b).

Fourth, for tax years beginning after Dec. 31, 2025, the One, Big, Beautiful Bill Act amended section 163(j) to exclude a U.S. shareholder's CFC income inclusion items under sections 951(a), 951A(a), and 78 (including associated portions of deductions) from the computation of ATI. As a result of this change, a U.S. shareholder will no longer be allowed to increase its ATI by a portion of CFC income inclusions. Accordingly, the proposed regulations under Treas. Reg. § 1.163(j)-7(j) that were issued in September 2020 are no longer consistent with current law and taxpayers can no longer rely on them for tax years beginning after Dec. 31, 2025.

The Department of Treasury and the IRS plan to issue guidance that addresses these changes and clarifications to section 163(j).

**Q2. What effect do changes and clarifications made under the One, Big, Beautiful Bill Act have on elections to be an excepted trade or business? (updated Aug. 19, 2026)**

A2. The One, Big, Beautiful Bill Act did not change or otherwise clarify the rules for making an election to be treated as an excepted trade or business under Treas. Reg. sections 1.163(j)-9 and 1.163(j)-1(b)(15)(iii). However, Revenue Procedure 2026-17 provides transition guidance for taxpayers who previously made these elections but now want to withdraw them in light of the One, Big, Beautiful Bill Act changes to sections 163(j)(8) and 168(k). See Topic B: Q 1, 2 & 3 for more information about electing trades or businesses.

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