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**Business Interest Expense
Deductibility under Section 163(j)**

**An Introduction and the Related Consequences of the
Tax Cuts and Jobs Act (TCJA)**



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Agenda

- Overview
- General definitions and rules
- Excepted trades or businesses
- C corporations and consolidated groups
- Partnerships and S corporations
- Foreign corporations and foreign persons



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Overview



Overview

- Sec. 163(j) provides that the amount allowed as a deduction under [Chapter 1] for business interest expense may not exceed the sum of:
 - Business interest income for a taxable year;
 - Floor plan financing interest for such taxable year; and
 - 30% of "adjusted taxable income" for such taxable year.
- Any disallowed business interest is carried forward and treated as business interest paid or accrued in the succeeding taxable year subject to Sec. 163(j). Sec. 163(j)(2).
- Certain specified trades or businesses (excepted trades or businesses) are not subject to Sec. 163(j).



Overview (*cont.*)

- Sec. 163(j) limits the deduction of **Business Interest Expense (BIE)**.
 - BIE is interest paid or accrued on indebtedness properly allocable to a trade or business.
- The limitation includes **Business Interest Income (BII)** and **Floor Plan Financing Interest (FPFI)** (and **Adjusted Taxable Income (ATI)**).
 - BII is interest includible in gross income which is properly allocable to a trade or business.
 - FPFI is paid or accrued on debt that is: (i) used to finance the acquisition of motor vehicles held for sale or lease; and (ii) secured by the inventory so acquired.
- Property used in a trade or business with FPFI is not qualified property under Sec. 168(k) if the FPFI was taken into account.



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Overview (*cont.*)

- ATI means the taxable income of a taxpayer computed without regard to:
 - Income, gain, deduction, or loss not properly allocable to a trade or business;
 - Business interest expense and business interest income;
 - Net operating loss deduction under Sec. 172;
 - The deduction under Sec. 199A (for qualified business income); and
 - Deductions for depreciation, amortization, or depletion for taxable years beginning before Jan. 1, 2022.
- Other adjustments to ATI may be provided by the Secretary.



Overview (*cont.*)

Small business exemption:

- Sec. 163(j) limitation does not apply to any taxpayer, other than a tax shelter defined in Sec. 448(d)(3), if average annual gross receipts does not exceed \$25 million under Sec. 448(c).
- The definition of "tax shelter" under Sec. 448(d)(3) includes a "syndicate" under Sec. 1256(e)(3).
 - Generally applies to non-C corporation entities.
 - Over 35% of losses flow to limited partners or similar owners.
 - This definition can apply even if no tax planning.

Key Considerations:

- Aggregation of gross receipts is required for all persons treated as a single employer under Sec. 52(a) and (b) and Sec. 414(m) and (o).
- The definition of a tax shelter may be a trap for the unwary for taxpayers who think the Small Business Exemption may apply.
- Partnerships and S corporations that qualify for the exemption may still need to provide items relevant to Sec. 163(j) to their partners and shareholders.



Overview (*cont.*)

- On Nov. 26, 2018, the IRS issued proposed regulations under Sec. 163(j) and related provisions.
- The proposed regulations include 1.163(j)-1 through 1.163(j)-11 and proposed regulations under other Sections.
- The deadline for comments was Feb. 26, 2019.
- It is unknown when final regulations will be released.



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General definitions and rules



Interest

- The proposed regulations provide a broad definition of interest.
- The definition under Prop. Reg. § 1.163(j)-1(b)(20) consists of:
 - **Compensation for the use or forbearance of money**
 - ☐ Includes OID, qualified stated interest, repurchase premium, and imputed interest.
 - **Swaps with significant non-periodic payments.**
 - ☐ Non-cleared swap with significant non-periodic payments treated as part loan.
 - **Other amounts treated as interest.**
 - ☐ Premium, substitute interest payments, amounts from a derivative that alters the effective cost of borrowing or effective yield, certain commitment fees, debt issuance costs, guaranteed payments for the use of capital under Sec. 707(c), and factoring income.
 - **Anti-avoidance rule for expense or loss predominantly associated with the time value of money.**



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Adjusted Taxable Income (ATI)

- ATI is defined as taxable income with adjustments.
- For this purpose, taxable income means the definition in Sec. 63 (computed without regard to Sec. 163(j)).
- A deduction under Sec. 250(a)(1) is determined without regard to the taxable income limitation in Sec. 250(a)(2) and without regard to Sec. 163(j).
- Additional rules apply for determining ATI with respect to specific types of taxpayer (e.g., C corporations, RICs and REITs, S corporations, partnerships, etc.).



ATI

- **Additions to taxable income:**
 - Business interest expense;
 - Net operating loss deduction;
 - Deduction under Sec. 199A;
 - Deduction for capital loss carryback or carryover;
 - Deduction or loss not properly allocable to a non-excepted trade or business;
 - Excess taxable income from CFCs if there is a CFC group election; and
 - For years beginning before Jan. 1, 2022:
 - ❑ Depreciation under Sec. 167 or Sec. 168;*
 - ❑ Amortization of intangibles under Sec. 167 or Sec. 197;*
 - ❑ Other amortized expenditures (Sec. 195(b)(1)(B), 248, or 1245(a)(2)(C));* and
 - ❑ Depletion under Sec. 611.*

Key Considerations:

*Expenses capitalized to inventory under Sec. 263A are not a depreciation, amortization, or depletion deduction under the proposed regulations, and therefore are not an addition under the proposed regulations.



ATI (*cont.*)

- **Subtractions to taxable income:**
 - Business interest income;
 - Floor plan financing interest expense;
 - The lesser of: (1) any gain recognized on the sale or other disposition of property; and (2) depreciation, amortization, or depletion for taxable years after Dec. 31, 2017 and before Jan. 1, 2022, with respect to such property;
 - Certain investment adjustments under Reg. § 1.1502-32 attributable to depreciation, amortization, and depletion upon the sale or other disposition of the stock of a member of a consolidated group;
 - The taxpayer's distributive share of certain deductions of depreciation, amortization, and depletion allowable under Sec. 704(d) upon the sale or other disposition of a partnership interest;
 - Income or gain that is not properly allocable to a non-excepted trade or business; and
 - Deemed inclusions under Sec. 78, Sec. 951(a), and Sec. 951A less the deduction under Sec. 250 as computed for Sec. 163(j) purposes.

Key Considerations:

- Recapture provisions may operate similar to Sec. 1245, but taxpayers will need to allocate purchase price in detail to depreciable and amortizable assets.
- In the sale of a consolidated subsidiary, there is no look-through to the underlying assets.



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Relationship to other provisions

- Sec. 163(j) generally applies after the application of other provisions that subject interest expense to disallowance, deferral, capitalization, or other limitation.
- However, Sec. 163(j) is applied before the application of Sec. 461(l) (business losses of non-corporate taxpayers), Sec. 465 (at-risk limitation), and Sec. 469 (passive activity losses).
- Capitalized interest expense under Sec. 263A and Sec. 263(g) is not business interest expense for purposes of Sec. 163(j).
- See proposed regulations under Sec. 59A for interaction with Sec. 163(j).



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Anti-avoidance rule

- Arrangements entered into with a principal purpose of avoiding Sec. 163(j) or the regulations may be disregarded and re-characterized by the IRS to the extent necessary to carry out the purposes of Sec. 163(j). Prop. Reg. § 1.163(j)-2(h).
- The anti-avoidance rule specifically references the small business exemption but may be interpreted more broad.

Effective date of the proposed regulations

- The proposed regulations are not effective until final.
- However, the proposed regulations provide:

"taxpayers and their related parties, within the meaning of Sec. 267(b) and 707(b)(1), may apply the rules of this Sec. to a taxable year beginning after December 31, 2017, *so long as the taxpayers and their related parties consistently apply the rules of the Sec. 163(j) regulations*, and if applicable, §§ 1.263A-9, 1.381(c)(20)-1, 1.382-6, 1.383-1, 1.469-9, 1.882-5, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-91 through 1.1502-99, (to the extent they effectuate the rules of §§ 1.382-6 and 1.383-1), and 1.1504-4 to those taxable years." [Emphasis added].





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Excepted trades or businesses



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Excepted trades or businesses

- Certain specified trades or businesses (excepted trades or businesses) are not subject to Sec. 163(j).
- The term "trade or business" does not include:
 - Performing services as an employee;
 - Certain regulated public utilities; and
 - Any electing real property trade or business or any electing farming business.
- "Real Property Trade or Business" means any real property, development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business (Sec. 469(c)(7)).



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Real property trade or business

- Proposed regulations under Sec. 469 provide definitions for: (i) real property operation; and (ii) real property management.
 - The principal purpose must be the provision of the use of real property or physical space to one or more customers; and
 - The principal purpose must not be the provision of other significant or extraordinary personal services to customers in conjunction with the customers' incidental use of the real property or physical space.
- Other definitions of real property trades or businesses are reserved under the proposed regulations.



Election for excepted trades or businesses

- The proposed regulations provide rules and procedures for the election for excepted real property trades or businesses or farming businesses.
- The election is generally irrevocable.
- There is a safe-harbor for the eligibility of certain REITs that hold real property for the election for a excepted real property trade or business.
- A real property trade or business is not eligible for an election if at least 80% of the business's real property is leased to a trade or business that is under common control.
 - Exception for the eligibility of certain REITs.



Allocations to an excepted trade or business

- The proposed regulations provide exclusive rules for allocating tax items between excepted trades or businesses and non-excepted trades or businesses.
- Interest expense that is properly allocable to excepted trades or businesses is not subject to Sec. 163(j).
- Other items that are properly allocable to excepted trades or businesses are excluded from the calculation of the taxpayer's Sec. 163(j) limitation.
- Property used in an excepted trade or business is not qualified property under Sec. 168(k) for bonus depreciation (Sec. 168(k)(9)).



Allocations to an excepted trade or business (*cont.*)

- Specific rules in the proposed regulations for the allocation of:
 - Gross income other than dividends and interest income;
 - Dividends;
 - Gain or loss with respect to C corporation stock, partnership interest, or S corporation stock;
 - Expenses (other than interest expense), losses, and other deductions that are definitely related to a trade or business;
 - Other deductions that are not definitely related to a trade or business;
 - Interest expense and interest income that is property allocable to a trade or business;
 - Assets used in more than one trade or business; and
 - Adjusted basis in partnership interests and stock in a non-consolidated corporation.



Allocations to an excepted trade or business (*cont.*)

- Under the proposed regulations, the allocation of interest expense and interest income to excepted and non-excepted trades or businesses is generally based on the taxpayer's adjusted basis in the assets used in such trades or businesses (or excepted trades or businesses).
- Direct allocation of interest expense is required for certain qualified nonrecourse indebtedness.
- Direct allocation of interest expense and interest income is required for certain active financing businesses.
- Disallowed business interest expense carryforwards are not re-allocated in a succeeding year.



Allocations to an excepted trade or business (*cont.*)

- The allocation rules related to interest expense and interest income require the quarterly determination of adjusted basis.
- An anti-abuse rule may apply if there is a principal purpose to artificially shift basis allocable to excepted or non-excepted trades or businesses.
- Each taxpayer making an allocation must prepare an information statement to be filed with its timely federal income tax return.
- Failure to file or comply may allow the IRS to treat all interest expense as properly allocable to a non-excepted trade or business.



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C corporations and consolidated groups



C corporations

- C corporations generally have business items.
- BIE and BII: A C corporation can only have BIE and BII for purposes of Sec. 163(j) (unless allocable to an excepted trade or business).
- ATI: A C corporation's items of income, gain, deduction, or loss are properly allocable to a trade or business for purposes of Sec. 163(j) and, thus, taken into account in determining ATI (unless allocable to an excepted trade or business).
- Corporate partners: In general, treatment extends to items allocated from a partnership to a corporate partner, with special rule for certain Sec. 951(a) and Sec. 951A(a) inclusions by a domestic partnership.



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C corporations - carryforwards

- Carryforwards: In general:
 - Sec. 163(j)(2) provides that any BIE limited under Sec. 163(j) will be carried forward as a “disallowed BIE carryforward” and treated as paid or accrued in the succeeding taxable year.
- Carryforwards: Ordering Rule for Absorption
 - The proposed regulations provide that a C corporation’s current-year BIE (i.e., interest expense deductible in current year without regard to the Sec. 163(j) limitation and carryforwards) is deducted before any carryforwards from a prior taxable year.
 - Carryforwards deducted in the order in which they arose, with the earliest taxable year first.
- Carryforwards are subject to applicable limitations (e.g., Sec. 382, SRLY).



C corporations - carryforwards as an attribute

- Sec. 381(a) transactions:
 - Sec. 381(c)(20) treats the carryover of disallowed business interest under Sec. 163(j)(2) as an item to which the acquiring corporation succeeds in a Sec. 381(a) transaction.
 - The proposed regulations (i) clarify that the carryover item includes disallowed BIE from the taxable year ending on the date of distribution or transfer, and (ii) limit the acquiring corporation's ability to use carryforwards in its first taxable year ending after the acquisition, consistent with treatment of NOL carryforwards under Treas. Reg. §§ 1.381(c)(1)-1 and -2.
- E&P adjustments:
 - The proposed regulations generally provide that a C corporation's E&P is determined without regard to BIE disallowance under Sec. 163(j). Thus, a C corporation generally must reduce its E&P by disallowed BIE.
 - ❑ Carryforwards are subject to applicable limitations (e.g., Sec. 382, SRLY).



C corporations - carryforwards as an attribute (*cont'd*)

- Sec. 382:
 - Sec. 382(d)(3) treats a carryover of BIE as a “pre-change loss” subject to Sec. 382, under rules similar to NOLs in Sec. 382(d)(1).
 - Proposed regulations clarify the term “Sec. 382 disallowed business interest carryforward” consists of:
 - ❑ The loss corporation’s disallowed business interest expense carryforwards, including disallowed disqualified interest, as of the ownership change, and
 - ❑ The carryforward of the loss corporation’s disallowed business interest expense paid or accrued in the pre-change period (within the meaning of Treas. Reg. § 1.382-6(g)(2)), determined by allocating an equal portion of the disallowed business interest expense paid or accrued (without regard to Sec. 163(j)) to each day in the relevant taxable year, regardless of whether the loss corporation has made a closing-of-the-books election under Treas. Reg. § 1.382-6(b)(2).



C Corporations - Carryforwards as an attribute (*cont'd*)

- Sec. 383:
 - The proposed regulations would absorb pre-change losses for disallowed BIE before NOLs, and losses subject to a Sec. 382 limitation before non-limited losses of same type from same taxable year.
 - Note that specific effective date rules apply to the Sec. 382 and Sec. 383 provisions.
- SRLY:
 - In general, the Proposed Regulations apply SRLY principles to disallowed BIE arising in a separate return year, on an annual basis, and generally by reference to the member's "standalone" Sec. 163(j) limitation (with subgroup rules potentially applying).
 - ❑ Proposed §1.163(j)-5(f) would apply the principles of §1.1502-21(g) to disallowed business interest expense carryforwards when the application of the SRLY limitation would result in an overlap with the application of Sec. 382.



Consolidated groups

- **Consolidated return approach: In general**
 - The Proposed regulations apply the Sec. 163(j) limitation at the consolidated group level, with the consolidated group “generally” having a single Sec. 163(j) limitation which is then applied to a member's BIE.
 - Determine the group's Sec. 163(j) limitation
 - ☐ In general, for group's ATI, begin with consolidated taxable income (Treas. Reg. § 1.1502-11), and disregard intercompany transaction items (generally, Treas. Reg. § 1.1502-13) to the extent that such items offset in amount.
 - Identify member's with BIE and BII
 - ☐ Intercompany obligations (Treas. Reg. § 1.1502-13(g)) are disregarded in determining a member's BIE and BII (as well as a group's ATI).
 - Allocate group's Sec. 163(j) limitation to members

Example – Determination of Consolidated ATI

STI = \$50
Depreciation = \$35

U.S.
Parent

\$65 interest



STI = \$40
Depreciation = \$10

Sub

Creditor → Debtor

For simplicity, it is assumed that the debtor does not meet the small business exception as applied under Sec. 448(c) and the group does not have an excepted business.

Facts

- US Parent borrowed money from Bank.
 - US Parent has interest expense of \$65, separate taxable income (STI) of \$50, and depreciation of \$35.
 - Sub has \$40 of STI and \$10 of depreciation.

Analysis

- Under § 1.1502-11, the U.S. Parent group's consolidated taxable income is \$90.
- Under the proposed regulations, \$200 is used as the group's ATI, and the interest limitation is \$60 (\$200 x 30%).
- Disallowed interest expense = \$5 (interest expense of \$65 exceeds the limit of \$60 [\$200 x 30%]).
- U.S. Parent carries over the \$5 of disallowed BIE to the succeeding taxable year.





Consolidated groups

- Departing Members: A departing member may retain its current-year BIE (through the date of departure) and carryforwards, to the extent not used by the consolidated group for the taxable year including the departure date, or otherwise reduced (e.g., under Treas. Reg. § 1.1502-36). The remaining attributes would be carried forward to the member's first separate return year.
- Basis Adjustments: In general, stock basis adjustments apply under Treas. Reg. § 1.1502-32, at the time disallowed BIE is absorbed by the group.
 - Note that the preamble explicitly makes this point, but that Prop. Reg. § 1.163(j)-4(d)(3) simply includes a cross-reference to Treas. Reg. § 1.1502-32(b).
- Treas. Reg. § 1.1502-36: A disallowed BIE is treated as a deferred deduction under Treas. Reg. § 1.1502-36 and, thus, may be reduced or reattributed under Treas. Reg. § 1.1502-36(d) (addressing a duplicative loss in loss member stock and inside tax attributes, upon a transfer of such stock).
- Special rules apply to intercompany transfers of partnership interests.
- Special transition rules apply to members joining a consolidated group, for effective date purposes.



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Partnerships and S corporations



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Partnerships

- Generally, the Sec. 163(j) limitation is applied at the partnership level.
- The allowable business interest expense is taken into account in determining non-separately stated taxable income or loss of the partnership.
- Any disallowed business interest expense is allocated to each partner as "excess business interest expense" in the same manner as the non-separately stated taxable income or loss of the partnership. See proposed regulations for specific allocation methodology.
- The partnership's ATI includes adjustments for Sec. 734(b), but do not include adjustments for Sec. 743(b), built-in loss under Sec. 704(c), and Sec. 704(c) remedial allocations (items not included are included in the partner's ATI)



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Partnerships (*cont.*)

- Partners carry forward their share of excess business interest expense.
- Partners may treat excess business interest expense in the following year as business interest expense paid or accrued to the extent the partner is allocated excess taxable income or excess business interest income from the same partnership.
- The adjusted basis of a partner's partnership interest is reduced by the amount of disallowed business interest allocated to such partner.
- If a partner disposes of a partnership interest, the adjusted basis of the partner is increased immediately before the disposition by the amount of the excess.



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Partnerships (*cont.*)

- The adjusted taxable income of each partner of a partnership is determined *without* regard to any items of income, gain, deduction, or loss of such partnership.
- The allocation of "excess taxable income" to a partner increases the partner's adjusted taxable income.
- The allocation of "excess business interest" to a partner increases the partner's business interest income.
- There is an 11 step process promulgated in Treas. Reg. 1.163(j)-6(f) that must be followed in order to properly allocate Sec. 163(j) excess items in the same manner as non-separately state taxable income or loss of the partnership.
- Sec. 163(j) excess items include: Excess business interest income, excess business interest expense, excess taxable income.



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Partnerships (*cont.*)

- Gain or loss from a disposition of the partner's partnership interest is included in the partner's ATI depending on the underlying assets of the partnership.
- Proposed regulations left several key areas unaddressed, including:
 - Partnership mergers and divisions;
 - Self-charged lending transactions between partners and partnerships; and
 - Tiered partnerships.



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S corporations

- The Sec. 163(j) limitation is applied at the S corporation level, and any deduction allowed for business interest expense is taken into account in non-separately stated taxable income or loss. Prop. Reg. § 1.163(j)-6(1)(1).
- Deductible interest expense is not subject to Sec. 163(j) at the shareholder-level but retains its character as business interest expense for other purposes (e.g., Sec. 469).
- For purposes of determining the S corporation's ATI, the taxable income of the S corporation is determined under Sec. 1363(b) with modifications.



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S corporations (*cont.*)

- Disallowed business interest expense is treated differently than partnerships in that it is carried forward to the S corporation's succeeding taxable year. Prop. Reg. § 1.163(j)-6(1)(5).
- S corporations are subject to:
 - The same ordering rules as a C corporation that is not member of a consolidated group; and
 - The limitation under Sec. 382.
- The accumulated adjustment account of an S corporation is adjusted for business interest expenses in the year that it is deductible under the Sec. 163(j) limitation.



S corporations (*cont.*)

- The limitation of an S corporation shareholder does not include any item of the S corporation except excess business interest income and excess taxable income of the S corporation. Prop. Reg. § 1.163(j)-6(1)(4).
- Gain or loss of a shareholder from the disposition of stock is included in the shareholder's ATI if the S Corporation only owns non-excepted trade or business assets (the allocation rules apply if the S Corporation owns both excepted and non-excepted trade or business assets.). Prop. Reg. § 1.163(j)-6(1)(4).
- An S corporation shareholder's adjusted basis in its S corporation stock is reduced, but not below zero, when disallowed business interest expense carryforward becomes deductible under Sec. 163(j). Prop. Reg. § 1.163(j)-6(1)(6).
- If a qualified subchapter S subsidiary election terminates, any disallowed business interest expense carryforward attributable to its activities at the time of the termination remains with the parent S corporation. Prop. Reg. § 1.163(j)-6(1)(8).



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Partnerships and S corporations not subject to Sec. 163(j)

- Small Business Exemption: Prop. Reg. § 1.163(j)-6(m).
 - If a partnership or S corporation is not subject to Sec. 163(j) by reason of the Small Business Exemption, it does not calculate the Sec. 163(j) limitation.
 - If a partner or S corporation shareholder is allocated business interest expense of an exempt entity, that allocated business interest expense is subject to the partner's or S corporation shareholder's Sec. 163(j) limitation.
 - Contrary to the general rule, a partner or S corporation shareholder includes items (including business interest income) from an exempt entity when calculating its Sec. 163(j) limitation.
- Excepted Trade or Business: Prop. Reg. § 1.163(j)-6(m).
 - If a partnership or S corporation is not subject to Sec. 163(j) because it has an excepted trade or business, it does not apply the Sec. 163(j) limitation to business interest expense that is allocable to such excepted trade or business.
 - If a partner or S corporation shareholder is allocated an item allocable to excepted trade or business, that item is excluded from the partner's or S corporation shareholder's Sec. 163(j) deduction calculation.



Partnerships and S corporations not subject to Sec. 163(j) (*cont.*)

- If a partnership allocates excess business interest expense to one or more of its partners, and in a succeeding taxable year becomes not subject to Sec. 163(j), the excess business interest expense from prior taxable years is treated as paid or accrued by the partner in such succeeding taxable year. Prop. Reg. § 1.163(j)-6(m)(3).
- If an S corporation has a disallowed business interest expense carryforward for a taxable year, and in the succeeding taxable year becomes not subject to Sec. 163(j), then such disallowed business interest expense carryforward:
 - Continues to be carried forward at the S corporation level;
 - Is no longer subject to Sec. 163(j); and
 - Is taken into account in determining the non-separately stated taxable income or loss the S corporation. Prop. Reg. § 1.163(j)-6(m)(4).



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Foreign corporations and foreign persons



Foreign corporations and foreign persons

Prop. Reg. § 1.163(j)-7

Rules related to the application of Sec. 163(j) to an "Applicable CFC."

- General rule – Sec. 163(j) applies in the same manner it does to a U.S. C corporation
- Alternative method that allows for "CFC group election"
- Rules for computation of adjusted taxable income of U.S. shareholders
- Effect on earnings and profits

Prop. Reg. § 1.163(j)-8

Rules related to the application of Sec. 163(j) to effectively connected income.

- Coordination with Treas. Reg. § 1.882-5
- Modified definition of ATI
- Ordering rules



Foreign corporations and foreign persons (*cont.*)

General Rule under Prop. Reg. § 1.163(j)-7

- Applies to an Applicable CFC in the same manner as it applies to a domestic C corporation.
- Limits interest expense deduction for Subpart F, GILTI tested income/loss and effectively connected income.
- Applicable CFC: A CFC described in Sec. 957, but only if the foreign corporation has at least one U.S. shareholder that owns, within the meaning of Sec. 958(a), stock of the foreign corporation.
- All members of a consolidated group filing a consolidated tax return are treated as a single taxpayer.



Foreign corporations and foreign persons (*cont.*)

Alternative to General Rule under Prop. Reg. § 1.163(j)-7

- The proposed regulations allow an election for an alternative method of computing an Applicable CFCs Sec. 163(j) limitation.
- Applies to Applicable CFCs that are members of a CFC group (special rules for partnerships).
- All members of the CFC group must make the election.
- Although an Applicable CFC with ECI cannot make the election, its ownership in a lower-tier Applicable CFC may be relevant in determining members of a CFC group.
- Special rules for financial entities.



Foreign corporations and foreign persons (*cont.*)

Alternative to General Rule under Prop. Reg. § 1.163(j)-7

- If a CFC Group Election is made, then the portion of the CFC Group member's interest expense that is subject to the Sec. 163(j) limitation is equal to the member's allocable share of the group's Applicable Net Business Interest Expense.
- Carryforwards are allowed at a member level.
- If members only have debt with other CFC members in the group, then no Sec. 163(j) limitation.
- Beneficial for CFC Groups with intercompany loans, but also in other situations as well.
- Special rules apply to determine year for calculation when more than one U.S. owner ("Majority U.S. shareholder taxable year" rule).
- US shareholder may include excess taxable income in Adjusted Taxable Income.



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Thank you