Training Participant Guide
October 2019

Official IRS Training Material

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Welcome

LB&I Tax Cuts & Jobs Act Training
IRS Mission Statement

Provide America’s taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.
14 General Principles of Ethical Conduct

Please see Document 9300 for a complete list of the 14 General Principles of Ethical Conduct for Federal Employees.
Taxpayer Bill of Rights

Please see Publication 1 to read the full text of Your Rights as a Taxpayer.
LB&I Tax Cuts & Jobs Act training sessions are a large part of LB&I’s multi-pronged approach to tax reform training. This mandatory training course covers IRC § § 199A, 451, 163(j), 951A, 250, 59A, 965, 367 and 91.
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Monday - October 21, 2019
• Executive Opening, Introductions and Admin
• IRC § 199A (Qualified Business Income Deduction)

Tuesday - October 22, 2019
• IRC § 451 (Income Recognition Guidance)
• IRC § 163(j) (Limitation on Business Interest Expense)

Wednesday - October 23, 2019
• IRC § 163(j) (Limitation on Business Interest Expense) (cont’d)
• IRC § 367 & 91 (Transfer Pricing/Outbound Transfers)
Thursday - October 24, 2019
- IRC § 951A (Global Intangible Low-Taxed Income)
- IRC § 250 (Foreign Derived Intangible Income)

Tuesday - October 29, 2019
- IRC § 965 (Transition Tax)

Wednesday - October 30, 2019
- IRC § 59A (Base Erosion and Anti-abuse Tax)

Thursday – October 31, 2019
- Final Comments and Executive Closing
LB&I Training
Tax Cuts & Jobs Act (TCJA)

Limitation on Business Interest Expense Under IRC § 163(j)
Instructor Introductions
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<td>Counsel Presentation: From TCJA to Treasury Regulations</td>
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</table>
Lesson Objectives

At the end of this lesson, you will be able to:

• Compute the limitation on business interest expense under IRC § 163(j),
• Identify who is required to compute a limitation, and
• Identify unique rules applicable to different entity types.
Overview of the Limitation on Business Interest Expense Under IRC § 163(j)
At the end of Parts 1 and 2, you will be able to:

• Identify the basic formula for the limitation on business interest expense under IRC § 163(j),

• Summarize the difference between pre and post TCJA IRC § 163(j),

• Identify taxpayers that are exempt from or can elect out of the limitation on business interest expense for specific trades or businesses, and

• Identify applicable ordering rules.
Overview of IRC § 163(j)
Interest Expense Limitation

For tax years beginning after December 31, 2017, IRC § 163(j) limits business interest expense deductions. The amount of deductible business interest expense (BIE) in a taxable year cannot exceed the sum of:

1. the taxpayer’s business interest income (BII) for the year,
2. 30% of the taxpayer’s adjusted taxable income (ATI) for the year, and
3. the taxpayer’s floor plan financing interest expense for the year.
TCJA and IRC § 163(j)

TCJA amended IRC § 163(j) in several material ways:

- Applies to all taxpayers with a trade or business unless they meet certain exemptions or exceptions,
- Applies to interest paid to lenders, which are related or unrelated.
## Old vs. New IRC § 163(j)

<table>
<thead>
<tr>
<th><strong>Old IRC § 163(j)</strong></th>
<th><strong>New IRC § 163(j)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Intended to prevent earnings stripping.</td>
<td>- Intends to prevent over-reliance on debt.</td>
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<tr>
<td>- Applied only to corporations that did not meet a debt equity ratio safe harbor.</td>
<td>- Applies to all taxpayers, except small businesses and certain trades or businesses.</td>
</tr>
<tr>
<td>- <strong>Proposed regulations</strong> were issued in 1991 but never finalized.</td>
<td>- <strong>Proposed regulations</strong> were issued in Dec. 2018 and are in the process of being finalized.</td>
</tr>
</tbody>
</table>
Old vs. New IRC § 163(j)

Old IRC § 163(j)

- **Form 8926**, Disqualified Corporate Interest Expense Disallowed Under IRC § 163(j) and Related Information.
- Interest disallowed was generally carried over.
- Excess limitation amount carried forward to next year

New IRC § 163(j)

- **Form 8990**, Limitation on Business Interest Expense Under IRC § 163(j).
- Disallowed business interest carries forward to the next year.
- Interest disallowed under the old law is interest expense in the current year subject to the new limitation.
- Excess limitation does not carry forward to next year
Procedural History of the Guidance

• April 2, 2018: The IRS issued Notice 2018-28 announcing its intent to issue regulations under new section 163(j) and providing interim guidance.

• November 26, 2018: Proposed regulations under new section 163(j) and Revenue Procedure 2018-59, providing guidance for infrastructure projects, were published on IRS.GOV.


• December 28, 2018: Proposed regulations under new section 163(j) were published in the Federal Register.

• February 27, 2019: Public hearing on the proposed regulations.
Questions
Exclusions, Elections and Ordering Rules
Exclusions from IRC § 163(j)

A taxpayer is generally not subject to IRC § 163(j), if it meets:

- The **small business exemption** under IRC § 448(c), or
- It only has interest expense from one or more excepted trades or businesses.
A small business exemption taxpayer is one that:

- Is not a tax shelter (as defined in IRC § 448(d)(3)), and
- Has average annual gross receipts of $25 million or less (as adjusted for inflation) for the 3 prior tax years under the gross receipts test of IRC § 448(c).
Small Business Exemption-Gross Receipts Test of IRC § 448(c)

• The average annual gross receipts of $25 million or less for the 3 prior tax years. The $25 million is effective for 2018, and it will be adjusted for inflation to $26 million in 2019.
• The 448(c) gross receipts test applies to all taxpayers for 163(j) purposes.
• Gross receipts is reduced by returns and allowances (not COGS).
• Certain groups treated as a single person.
Small Business Exemption—
Gross Receipts Test of IRC § 448(c) (cont’d)

• Parent-Subsidiary Group
  • One or more chains of organizations connected through ownership with a common parent who owns more than 50% of at least one of the other organizations.

• Brother-Sister Group
  • 5 or fewer persons (directly or through attribution) who are individuals, estates, or trusts own more than 50% of each organization (must be identical ownership). If the brother-sister group includes at least one organization that is not a corporation, the same five or fewer people; must also together own at least 80% of each organization.
• Combined group
  
  • Group of three or more organizations, if each organization is a member of either a parent-subsidiary or brother-sister group, and at least one organization is the common parent of a parent-subsidiary group and is also a member of a brother-sister group.
Example 1 - Gross Receipts Test
Parent Subsidiary Controlled Group

Facts:

- Corporation A owns 65% of Corporation B.
- Corporation A and B do not file a Consolidated Return.
- Corporation A and B have the following gross receipts:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>Average Gross Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation A</td>
<td>15M</td>
<td>21M</td>
<td>24M</td>
<td>20M</td>
</tr>
<tr>
<td>Corporation B</td>
<td>12M</td>
<td>15M</td>
<td>21M</td>
<td>16M</td>
</tr>
<tr>
<td>Combined Gross Receipts</td>
<td>27M</td>
<td>36M</td>
<td>45M</td>
<td>36M</td>
</tr>
</tbody>
</table>
Example 1 - Gross Receipts Test
Parent Subsidiary Controlled Group (cont’d)

Result:

- A and B are members of a parent-subsidiary controlled group, and must aggregate gross receipts for purposes of IRC § 448(c) and the small business exemption in Prop. Treas. Reg. § 1.163(j)-2(d).

- A and B are considered having $36M in average annual gross receipts for 20X4.

- A and B must separately apply IRC § 163(j) to determine any limitation on the deduction for business interest expense.
**Example 2 - Gross Receipts Test**
Brother-Sister Controlled Group

**Facts:**
Individuals A, B and C own the following corporations:

<table>
<thead>
<tr>
<th></th>
<th>Corp 1</th>
<th>Corp 2</th>
<th>Corp 3</th>
<th>Identical Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual A</td>
<td>33 1/3%</td>
<td>50%</td>
<td>45%</td>
<td>33 1/3 %</td>
</tr>
<tr>
<td>Individual B</td>
<td>33 1/3%</td>
<td>25%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Individual C</td>
<td>33 1/3%</td>
<td>25%</td>
<td>45%</td>
<td>25%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>68 1/3%</td>
</tr>
</tbody>
</table>
Corporation 1, 2 and 3 have the following gross receipts:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>Average Gross Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporation 1</td>
<td>9M</td>
<td>21M</td>
<td>9M</td>
<td>13M</td>
</tr>
<tr>
<td>Corporation 2</td>
<td>12M</td>
<td>15M</td>
<td>21M</td>
<td>16M</td>
</tr>
<tr>
<td>Corporation 3</td>
<td>7M</td>
<td>7M</td>
<td>7M</td>
<td>7M</td>
</tr>
<tr>
<td>Combined Gross Receipts</td>
<td>28M</td>
<td>43M</td>
<td>37M</td>
<td>36M</td>
</tr>
</tbody>
</table>
Example 2 - Gross Receipts Test
Brother Sister Controlled Group (cont’d)

Result:

• Corporations 1, 2 and 3 are members of a brother-sister controlled group, and must aggregate gross receipts for purposes of IRC § 448(c) and the small business exemption in Prop. Treas. Reg. § 1.163(j)-2(d).

• Corporation 1, 2 and 3 are considered having $36M in average annual gross receipts for 20X4.

• Corporation 1, 2 and 3 must separately apply IRC § 163(j) to determine any limitation on the deduction for business interest expense.
Excepted trades or businesses include:

- Performing services as an employee,
- An electing real property trade or business,
- An electing farming business, and
- Certain regulated utility business.
Utility businesses that meet certain rate regulation requirements, as well as many electric cooperatives, are excepted from the IRC § 163(j) limitation, without having to make an election.

Utility businesses with greater than 90% of output sold at qualifying rates are treated as wholly excepted.

Note: Excepted regulated utility trades or businesses are not eligible to take bonus depreciation for property primarily used in the excepted business. IRC § 168(k)(9)(A).
For IRC § 163(j) not to apply, the rates for furnishing or sale must be established or approved by:

- a state or political subdivision thereof,
- by any agency or instrumentality of the United States,
- by a public service or public utility commission, other similar body of any state or political subdivision thereof, or
- by the governing or rate-making body of an electric cooperative.
Elections for Real Property Trades or Businesses and Farming Businesses

- Real property trades or businesses or farming businesses can make an election out of the IRC § 163(j) business interest limitation.
- The election is irrevocable.
- Alternative depreciation system (ADS) is required for certain property. IRC §§ 163(j)(7) & 168(g), & Rev. Proc. 2019-08.
  - Taxpayer cannot take bonus depreciation.
  - Switching to ADS generally is not a change in accounting method.
Electing Real Property Trade or Businesses

- Real property trade or business means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

- Must use the ADS for any nonresidential real property, residential rental property, and qualified improvement property used in its trade or business. Not eligible for bonus depreciation under IRC § 168(k).
• Farming businesses (as defined in IRC § 263A(e)(4)) and specified agricultural and horticultural cooperatives may elect out of the IRC § 163(j) limitation.

• Examples of an electing farming business include:
  • Livestock, poultry, fish,
  • Fruit, nuts, plant nursery, and
  • A specified cooperative.
Must use ADS for any farming property the taxpayer owns with a recovery period of 10 years or more.

Not eligible for bonus depreciation under IRC § 168(k).
Questions on Forms 1120, 1120S and 1065 identify whether or not the taxpayer meets the small business exemption or only has interest from electing real property trades or businesses, electing farm businesses or certain utility businesses.

- Form 1120 Schedule K, Line 24
- Form 1120S Schedule B, Line 10
- Form 1065 Schedule B, Line 24
You can determine if your taxpayer made an election under IRC § 163(j) for any real property trade or business or any farming business by looking at:

- Form 1120 Schedule K, Line 23
- Form 1120S Schedule B, Line 9
- Form 1065 Schedule B, Line 23
**IRC § 163(j) Coordination With Other Interest Rules**

<table>
<thead>
<tr>
<th>IRC § 163(j) does not apply to deductions disallowed under:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• IRC § 264(a)</td>
</tr>
<tr>
<td>• IRC § 265</td>
</tr>
<tr>
<td>• IRC § 267A</td>
</tr>
<tr>
<td>• IRC § 279</td>
</tr>
<tr>
<td>• IRC § 163(e)(5)(A)(i)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IRC § 163(j) applies after the application of:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• IRC § 163(e)(3)</td>
</tr>
<tr>
<td>• IRC § 246A</td>
</tr>
<tr>
<td>• IRC § 263A</td>
</tr>
<tr>
<td>• IRC § 263(g)</td>
</tr>
<tr>
<td>• IRC § 267(a)(2)</td>
</tr>
<tr>
<td>• IRC § 1277</td>
</tr>
<tr>
<td>• IRC § 1282</td>
</tr>
<tr>
<td>• IRC § 163(e)(5)(A)(ii)</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>IRC § 163(j) applies before* the application of:</th>
</tr>
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<tbody>
<tr>
<td>• IRC § 465</td>
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<tr>
<td>• IRC § 469</td>
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<tr>
<td>• IRC § 461(l)</td>
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</tbody>
</table>

*The limitations are applied after IRC § 163(j), however they are still considered within the IRC § 163(j) computation of ATI.*
After determining the amount of interest expense, a taxpayer must allocate interest expense between personal, investment, and other interest expense (including business interest expense).


IRC § 163(j) only applies to the “other interest expense” category.
Other interest expense (including business interest expense) must be allocated between each activity for purposes of at risk (IRC § 465) and passive activity loss (IRC § 469) limitations.

- Applies to all taxpayers subject to IRC §§ 465 or 469.
- This is necessary to compute Adjusted Taxable Income (ATI).
Allocating Interest Expense – After 163(j) limitation determined

If there is a section 163(j) limitation, the allowable interest expense must be reallocated between each activity for purposes of at risk (IRC § 465) and passive activity loss (IRC § 469) limitations.

- The allocation method for 163(j) is different than the allocation method for purposes of at risk and passive activity loss limitations.
Ordering Rules

• Provisions that characterize interest expense as something other than business interest expense (ex: IRC § 163(d)) govern the treatment of that expense.

• IRC § 163(j) generally applies after provisions that subject interest expense to disallowance, deferral, capitalization, or other limitation.
  • But there are exceptions. For example, IRC § 163(j) applies before the loss limitation rules of IRC §§ 465 and 469. See Prop. Treas. Reg. § 1.163(j)-3 for a more complete list of exceptions.

In conclusion: IRC § 163(j) is usually at the end of the line.
Summary 1

- The amount of deductible business interest expense cannot exceed the sum of business interest income, 30% of ATI, and floor plan financing interest expense for the year.
- Post-TCJA IRC § 163(j) is applicable to all taxpayers unless certain exemptions and elections apply.
- Applicable ordering rules may apply.
Questions
Business Interest Expense and Business Interest Income
At the end of Part 3, you will be able to:

- Define interest for IRC § 163(j) purposes,
- Identify examination challenges resulting from nuances in the definition of interest,
- Explain the anti-avoidance rule, and
- Define Business Interest Income and Expense, Floor Plan Financing and describe their role in the IRC § 163(j) limitation calculation.
Business Interest Expense

Business interest expense (BIE) is:

• Any business interest paid or accrued that is properly allocable to a non-excepted trade or business; and

• Floor plan financing interest expense.

BIE does not include:

• Investment interest expense, or

• Interest expense that is allocable to an excepted trade or business.
Floor plan financing interest expense: Interest paid or accrued on floor plan financing indebtedness.

Floor plan financing indebtedness: Indebtedness that is used to finance the acquisition of motor vehicles held for sale or lease and that is secured by the acquired inventory.

Motor vehicle: A motor vehicle that is any of the following: (1) any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road; (2) a boat; (3) farm machinery or equipment.

Note: Property is ineligible for bonus depreciation if it is used in a trade or business that has floor plan financing indebtedness and the associated floor plan financing interest expense is taken into account under IRC § 163(j). IRC § 168(k)(9)(B).
Form 8990, Part I, Section I

### Computation of Allowable Business Interest Expense

Part I is completed by all taxpayers subject to section 163(j). Schedule A and Schedule B need to be completed before Part I when the taxpayer is a partner or shareholder of a pass-through entity subject to 163(j).

#### Section I—Business Interest Expense

<table>
<thead>
<tr>
<th></th>
<th>Current year business interest expense (not including floor plan financing interest expense), before the section 163(j) limitation</th>
<th></th>
<th>Disallowed business interest expense carryforwards from prior years. (Does not apply to a partnership)</th>
<th></th>
<th>Partner’s excess business interest expense treated as paid or accrued in current year (Schedule A, line 44, column (h))</th>
<th></th>
<th>Floor plan financing interest expense. See instructions</th>
<th></th>
<th>Total business interest expense. Add lines 1 through 4</th>
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<tbody>
<tr>
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Business Interest Income

- Business interest income (BII) is the amount of interest includible in the taxpayer’s gross income for the tax year which is properly allocable to a trade or business.
- BII does not include:
  - Investment interest (IRC § 163(d)), or
  - Interest income that is allocable to an excepted trade or business. (Certain regulated utilities, electing real property and farming businesses, etc.)
Proposed Regulations provide a broad definition of interest:

- Amounts paid or accrued as compensation for the use or forbearance of money under the terms of an instrument or contractual arrangement (conventional interest).
- The time value component associated with the loan transaction relating to certain swaps with significant nonperiodic payments.
- Certain amounts that are closely related to interest (interest equivalents) and affect the economic yield or cost of borrowing of a transaction involving interest.
Examples of amounts treated as interest under general tax principles include:

- Qualified stated interest
- Original issue discount (OID)
- Repurchase premium
- Deferred Payments treated as interest under section 483 (Imputed Interest)
- Amounts treated as interest under section 988
- Amounts paid or received in connection with a sale-repurchase agreement treated as indebtedness for US tax purposes (REPO’s)
Interest for Purposes of IRC § 163(j)
Interest Equivalents

Examples of other amounts that are closely related to interest (interest equivalents):

- Premium on debt instruments
- Ordinary income or loss on certain debt instruments
- Substitute interest payments (Securities Lending)
- Factoring income
- Section 1258 Gain
- Commitment fees
- Debt issuance costs
- Guaranteed payments
- Income, deduction, gain or loss from a derivative that alters the yield or effective cost of borrowing of the taxpayer. (Hedging)
Interest for purposes of IRC § 163(j)
Interest expense includes:

- Any otherwise deductible expense or loss for an amount predominantly incurred in consideration of the time value of money,
- Incurred in a transaction or series of integrated or related transactions, and
- In which the taxpayer secures the use of funds for a period of time.
- Prop. Treas. Reg. § 1.163(j)-1(b)(20)(iv)
Business Interest Income/Expense (BII and BIE)

- Means any interest includible in gross income (BII), paid or accrued (BIE) - which is properly allocable to a trade or business.

Definition of Interest for IRC § 163(j)

- Prevents businesses from financing transactions in such a way as to avoid the interest deduction limitation.
Adjusted Taxable Income (ATI)
At the end of Part 4, you will be able to:

- Define Adjusted Taxable Income (ATI), and
- Compute ATI using Form 8990.
Interest Expense Limitation - Recap

For tax years beginning after December 31, 2017, IRC § 163(j) limits business interest expense deductions. 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 year;
2. 30% of the taxpayer’s adjusted taxable income (ATI) for the year; and
3. the taxpayer’s floor plan financing interest expense for the year.
• Taxable Income (TI) follows the definition from IRC § 63 but computed without regard to the application of the IRC § 163(j) limitation.
  • Must consider almost everything including 263A, loss limitations, and GILTI.

• Special rules apply to consolidated groups, CFCs, partnerships, REITs, RICs, S corporations and tax exempt entities.

• TI computed each year for purposes of IRC § 163(j) limitation.

• No carryover of excess limitation unlike old IRC § 163(j).
Adjusted taxable income (ATI) means taxable income of the taxpayer computed \textit{without} regard to:

- Any item of income, gain, deduction, or loss which is not properly allocable to a trade or business;
- Any business interest income or business interest expense;
- Any net operating loss (IRC § 172);
- Any qualified business income deduction (IRC § 199A);
Adjusted Taxable Income (cont’d)

- For tax years beginning before 2022, any deduction for depreciation, amortization, or depletion attributable to a trade or business; and
- Adjustments described in published guidance.

Remember, TI is a comprehensive computation that includes adjustments to income for IRC §§ 263A and 267, as well as basis, at-risk and passive activity loss limitations.

- Therefore, the additions and subtractions are limited to the amount the item affects TI.
### Section II—Adjusted Taxable Income

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Additions (adjustments to be made if amounts are taken into account on line 6)</th>
</tr>
</thead>
</table>
| 6  
  Taxable income. See instructions | 7  
  Any item of loss or deduction which is not properly allocable to a trade or business of the taxpayer. See instructions |
|                                           | 8  
  Any business interest expense not from a pass-through entity. See instructions |
|                                           | 9  
  Amount of any net operating loss deduction under section 172 |
|                                           | 10 
  Amount of any qualified business income deduction allowed under section 199A |
|                                           | 11 
  Deduction allowable for depreciation, amortization, or depletion attributable to a trade or business |
|                                           | 12 
  Amount of any loss or deduction items from a pass-through entity. See instructions |
|                                           | 13 
  Other additions. See instructions |
|                                           | 14 
  Total current year partner’s excess taxable income (Schedule A, line 44, column (f)) |
|                                           | 15 
  Total current year S corporation shareholder’s excess taxable income (Schedule B, line 46, column (c)) |
|                                           | 16 
  Total. Add lines 7 through 15 |

*Amounts to be reported on Form 8990, Part II, Section IV.*
Form 8990, Part I, Section II, Taxable Income, Reductions

<table>
<thead>
<tr>
<th>Reductions (adjustments to be made if amounts are taken into account on line 6)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>17</strong> Any item of income or gain which is not properly allocable to a trade or business of the taxpayer. See instructions</td>
</tr>
<tr>
<td><strong>18</strong> Any business interest income not from a pass-through entity. See instructions</td>
</tr>
<tr>
<td><strong>19</strong> Amount of any income or gain items from a pass-through entity. See instructions</td>
</tr>
<tr>
<td><strong>20</strong> Other reductions. See instructions</td>
</tr>
<tr>
<td><strong>21</strong> Total. Combine lines 17 through 20</td>
</tr>
<tr>
<td><strong>22</strong> Adjusted taxable income. Combine lines 6, 16, and 21. (If zero or less, enter -0-)</td>
</tr>
</tbody>
</table>
### Section III—Business Interest Income

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Current year business interest income</td>
<td>[\text{Current year business interest income}]</td>
</tr>
<tr>
<td>24</td>
<td>Excess business interest income from pass-through entities</td>
<td>[\text{Excess business interest income from Schedule A, line 44, column (g), and Schedule B, line 46, column (d)}]</td>
</tr>
<tr>
<td>25</td>
<td>Total. Add lines 23 and 24</td>
<td>[\text{Total. Add lines 23 and 24}]</td>
</tr>
</tbody>
</table>

### Section IV—163(j) Limitation Calculations

#### Limitation on Business Interest Expense

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>26</td>
<td>Multiply adjusted taxable income (line 22) by 30% (0.30)</td>
<td>[\text{Multiply adjusted taxable income (line 22) by 30% (0.30)}]</td>
</tr>
<tr>
<td>27</td>
<td>Business interest income</td>
<td>[\text{Business interest income (line 25)}]</td>
</tr>
<tr>
<td>28</td>
<td>Floor plan financing interest expense</td>
<td>[\text{Floor plan financing interest expense (line 4)}]</td>
</tr>
<tr>
<td>29</td>
<td>Total. Add lines 26, 27, and 28</td>
<td>[\text{Total. Add lines 26, 27, and 28}]</td>
</tr>
</tbody>
</table>

#### Allowable Business Interest Expense

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>Total current year business interest expense deduction</td>
<td>[\text{Total current year business interest expense deduction}}]</td>
</tr>
</tbody>
</table>

### Carryforward

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>Disallowed business interest expense</td>
<td>[\text{Disallowed business interest expense. Subtract line 29 from line 5. (If zero or less, enter -0-.)}]</td>
</tr>
</tbody>
</table>
Summary 3

• ATI starts with TI computed as if the IRC § 163(j) limitation does not exist.
• Add and subtract various items from TI to compute ATI.
• ATI is one of three items added together to determine the allowable BIE.
Questions
Special Rules: Allocating between Exceptioned and Non-Excepted Trades or Businesses
At the end of Part 5, you will be able to:

• Identify the steps required before a taxpayer allocates between excepted and non-excepted trades or businesses.
• Apply basic allocation rules for excepted and non excepted trades or businesses, and
• Review the statement required to be filed with the tax return.
Allocation Rules

• The taxpayer allocates tax items between its excepted and non-excepted trades or businesses in the manner set forth in Prop. Treas. Reg. § 1.163(j)-10 to determine its IRC § 163(j) limitation.

• Allocation rules are generally broken into three categories:
  • Interest Income and interest expense are allocated based on adjusted tax basis of the assets in the trade or business.
  • Tax items other than interest income and interest expense have varying rules on how they should be allocated.
  • Interest expense from qualified nonrecourse indebtedness use direct allocation.
Before allocating between excepted and non-excepted trades or businesses, interest under IRC § 163(j), taxpayer must:

- Determine if the taxpayer meets the small business exemption.
- Determine the amount of interest expense allocated between investment, personal, and other.
- Identify excepted trades or businesses.

Limitation under IRC § 163(j) does not apply to interest expense properly allocable to an “excepted trade or business.”
Allocation Rules - General (cont’d)

• Income and expense items must be allocated to excepted and non-excepted trades or businesses.
• No allocations are necessary if all of the taxpayer’s trades or businesses are non-excepted (or excepted).
• Special rules apply to consolidated returns and controlled foreign corporations (CFCs).
Allocation Rules
Interest Income and Interest Expense

- Allocation is based on the relative amounts of a taxpayer’s adjusted tax basis in the assets used in its excepted vs. its non-excepted trades or businesses.
- A taxpayer’s adjusted tax basis in its assets is determined quarterly and averaged across the year.
- **De minimis exception**: when 90%+ of a taxpayer’s adjusted tax basis for the year is allocable to either excepted or non-excepted trades or businesses, the taxpayer treats all of its interest income and interest expense as allocable to that category of trades or businesses.
- Special rules apply when an asset is used in more than one trade or business.
### Allocation Rules
#### Interest Income and Interest Expense - Example

<table>
<thead>
<tr>
<th>Allocation Category</th>
<th>Excepted Trade or Business?</th>
<th>Average Adjusted Tax Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electing Real Property</td>
<td>Yes</td>
<td>$400</td>
</tr>
<tr>
<td>Electing Farming Business</td>
<td>Yes</td>
<td>$400</td>
</tr>
<tr>
<td>Wine Selling Business</td>
<td>No</td>
<td>$50</td>
</tr>
</tbody>
</table>

- Basis Allocable to Excepted TOB: $800
- Total Tax Basis: $850
- Percentage Allocable to Excepted TOB (800/850): 94%
Allocation Rules

Tax Items Other Than Interest Income and Expense

- Gross income (other than dividends, interest income) and deductions (other than interest expense) are allocated to the Trade or Business to which they relate.
- Special “look-through” rules for certain dividends and gain/loss from the disposition of non-consolidated C corporation stock, S corporation stock, and partnership interests.
• Expenses, losses, and deductions, other than interest, definitely related to a trade or business, within the meaning of Treas. Reg. § 1.861-8(b), would be allocable to that trade or business.

• Deductions related to one or more excepted or non-excepted trades or businesses are apportioned based on relative adjusted tax basis of the assets used in those trades or businesses.

• All other deductions are ratably apportioned based on gross income.
Taxpayer is required to attach a statement entitled, “Section 163(j) Asset Basis Calculations,” to its timely filed federal income tax return that includes:

- The adjusted tax basis in assets,
- Determination dates,
- The names and TINs of all entities for which basis information is being provided,
- Asset basis information for look through items, and
- Summary of the method or methods used to determine asset basis.
Failure to file the statement or filing a statement that does not comply with the requirements in the proposed regulation will permit the IRS to treat all of the taxpayer’s interest expenses as properly allocable to a non-excepted business, unless taxpayer can establish a reasonable basis for failing to comply.
Allocation Rules
Excepted vs. Non-Excepted-Example

HoldCo.

Sub 1
Electing Real Property Trade or Business

Sub 2
Non-Excepted Trade or Business

Sub 3
Regulated Utility
Facts:

• Holdco Consolidated group has $1,000,000 of conventional interest.

• The adjusted tax basis in the assets used in non-excepted trades or businesses is 40% and the adjusted tax basis in the assets used in excepted trades or businesses is 60%.
### Limitation on Business Interest Expense Under Section 163(j)

Attach to your tax return. Go to [www.irs.gov/Form8990](http://www.irs.gov/Form8990) for instructions and the latest information.

#### Part I: Computation of Allowable Business Interest Expense

Part I is completed by all taxpayers subject to section 163(j). Schedule A and Schedule B need to be completed before Part I when the taxpayer is a partner or shareholder of a pass-through entity subject to 163(j).

#### Section I—Business Interest Expense

<table>
<thead>
<tr>
<th></th>
<th>Current year business interest expense (not including floor plan financing interest expense), before the section 163(j) limitaion</th>
<th>400,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Disallowed business interest expense carryforwards from prior years. (Does not apply to a partnership)</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Partner’s excess business interest expense treated as paid or accrued in current year (Schedule A, line 44, column (h))</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Floor plan financing interest expense. See instructions</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Total business interest expense. Add lines 1 through 4</td>
<td></td>
</tr>
</tbody>
</table>

$600,000 related to excepted trades or businesses is not included on Form 8990, Line 1.
**Allocation Rules**

**Excepted vs. Non-Excepted - Example 4**

---

**U.S. Corporation Income Tax Return**

For calendar year 2018 or tax year beginning [ ] , 2018, ending [ ] , 2018.

- Go to www.irs.gov/Form1120 for instructions and the latest information.

**Total Interest Deduction:** $900,000

- **Interest from Non-Excepted TOB:** $400,000
- **Less: Disallowed Business Interest Expense:** ($100,000)
- **Plus: Interest from Excepted TOB:** $600,000

---

**Note:**

- The **Interest from Non-Excepted TOB** is $400,000.
- The **Less: Disallowed Business Interest Expense** is $100,000.
- The **Plus: Interest from Excepted TOB** is $600,000.

Thus, the **Total Interest Deduction** is calculated as follows:

\[
\text{Total Interest Deduction} = \text{Interest from Non-Excepted TOB} + \text{Interest from Excepted TOB} - \text{Disallowed Business Interest Expense}
\]

\[
\text{Total Interest Deduction} = 400,000 + 600,000 - 100,000 = 900,000
\]

---

**Form 1120**

Department of the Treasury

Internal Revenue Service

**Check if:**

- 1a Consolidated return (attach Form 851)
- b Life/nonlife consolidated return
- 2 Personal holding co. (attach Sch. PH)
- 3 Personal service corp. (see instructions)
- 4 Schedule M-3 attached

**Table:**

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>Compensation of officers</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>Salaries and wages</td>
<td>13</td>
</tr>
<tr>
<td>14</td>
<td>Repairs and maintenance</td>
<td>14</td>
</tr>
<tr>
<td>15</td>
<td>Bad debts</td>
<td>15</td>
</tr>
<tr>
<td>16</td>
<td>Rents</td>
<td>16</td>
</tr>
<tr>
<td>17</td>
<td>Taxes and licenses</td>
<td>17</td>
</tr>
<tr>
<td>18</td>
<td>Interest (see instructions)</td>
<td>18 $900,000</td>
</tr>
<tr>
<td>19</td>
<td>Charitable contributions</td>
<td>19</td>
</tr>
<tr>
<td>20</td>
<td>Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)</td>
<td>20</td>
</tr>
<tr>
<td>21</td>
<td>Depletion</td>
<td>21</td>
</tr>
<tr>
<td>22</td>
<td>Advertising</td>
<td>22</td>
</tr>
</tbody>
</table>
Excepted trade or business activity will need to be taken into consideration in the determination of:

- Form 8990, Part 1, Section II-Adjusted Taxable income, and
- Form 8990, Part I, Section III- Business Interest Income.
**Allocation Rules**

**Excepted vs. Non-Excepted-Example**

---

**Form 8990**

**Limitation on Business Interest Expense Under Section 163(j)**

- **Part I - Computation of Allowable Business Interest Expense**
  - Section I - Business Interest Expense
    1. Current year business interest expense (not including floor plan financing interest expense), before the section 163(j) limitation.
    2. Disallowed business interest expense carryovers from prior years. (Does not apply to a partnership).
    3. Partner's excess business interest expense treated as paid or accrued in current year (Schedule A, line 44, column (h)).
    4. Floor plan financing interest expense. See instructions.
    5. Total business interest expense. Add lines 1 through 4.

- **Section II - Adjusted Taxable Income**
  20. Other reductions. See instructions.
  22. Adjusted taxable income. Combine lines 6, 16, and 21. (If zero or less, enter -0-).

- **Section III - Business Interest Income**
  24. Excess business interest income from pass-through entities (total of Schedule A, line 44, column (g), and Schedule B, line 46, column (d)).

---

**For Paperwork Reduction Act Notice, see the instructions.**
Taxpayers must allocate between excepted and non-excepted trades or businesses.

Interest income and expense are allocated based on adjusted tax basis of the assets in the trades or businesses. Other tax items have varying rules.

Taxpayers are required to file a statement with their return detailing its asset basis calculations.
Questions
Special Rules: C Corporations
At the end of Parts 6 and 7, you will be able to:

- Identify special rules applicable to C corporations and consolidated groups.

- Determine correct amount of IRC § 163(j) limitation allocable to members of a consolidated group.
• All interest paid or accrued (or treated as paid or accrued) by a C corporation is business interest expense,

• All interest includible in gross income by a C corporation is business interest income,

• Except to the extent such interest expense or interest income is allocable to an excepted trade or business.
Any investment interest expense, investment interest income, or investment expenses that a partnership pays, receives, or accrues and allocates to a C corporation partner is treated by the C corporation as properly allocable to a trade or business.
Current year business interest expense is deducted before disallowed business interest expense carryforwards, which are then deducted in the order of the year in which they were incurred, starting with the earliest year, subject to certain limitations.
Questions
Special Rules: Consolidated Groups
• The IRC § 163(j) limitation is applied at the consolidated return level. A consolidated group has a single IRC § 163(j) limitation.

• A group’s current year Business Interest Expense (BIE) and Business Interest Income (BII) is the sum of the current year BIE and BII of each of its members.

• ATI is calculated using the group’s consolidated taxable income determined under Treas. Reg. § 1.1502-11, without regard to any BIE carryforwards or disallowances under IRC § 163(j).
Interest expense and interest income from intercompany obligations are not treated as business interest expense or business interest income.

For purposes of calculating ATI of the group, intercompany and corresponding items are disregarded to the extent they offset in amount.
• The group (rather than a particular member) is treated as engaged in excepted or non-excepted trades or businesses.

• Special rules for allocating asset basis between members of a consolidated group can be found in Prop. Treas. Reg. § 1.163(j)-10(a)(4).
• Once a group has determined percentage allocable to excepted and non-exceptioned trades or businesses, each member will apply the same percentage regardless of whether each member actually engaged in an excepted trade or business.
Deduction of Business Interest Expense - General

- Carryforward of a consolidated group’s disallowed business interest expense includes carryforward’s from the group’s prior consolidated return year plus carryforwards from separate return years.
- All current-year business interest expense is deducted in the current year, before any carryforwards from prior years.
- Carryforwards are deducted in the order of taxable years in which they arose, beginning with the earliest year.
Allowable amount is greater than current year BIE plus carryforward of disallowed BIE from prior years:

- Each group member deducts total BIE without limitation.
- Ordering rules apply.
- Member’s may be subject to limitation under other provisions of the code. (SRLY, IRC § 381, IRC § 382 and overlap rules)
Allocation of Limitation to Group Members - Example

Facts:

- P&S are the only members of a consolidated group.
- Consolidated group has a IRC § 163(j) limitation of $200 in year 2.
- Group has $100 of Current year BIE in Year 2.
- P and S each have $50 of disallowed business interest carryforwards from year 1.
Results:

• Group will deduct the entire $100 of Current BIE.

• P and S would be allowed to each deduct their entire $50 of disallowed business interest carryforwards from year 1 in year 2.
Allocation of Limitation to Group Members 2

• Allowable amount is greater than current year BIE, but less than current year BIE plus carryforward of disallowed BIE from prior years:
  • Each member deducts its current year BIE without limitation.
  • Each group member deducts (subject to the remaining limitation) BIE carryforwards on a pro rata basis, beginning with the earliest year, based on the member’s relative share of the group’s BIE carryforwards.
Allocation of Limitation to Group Members - Example

Facts:

- P&S are the only members of a consolidated group.
- Consolidated group has a IRC § 163(j) limitation of $200 in year 2.
- Group has current year BIE in year 2 of $100.
- P has $140 of disallowed business interest carryforwards from year 1.
- S has $60 of disallowed business interest carryforwards from year 1.
Results:

- Group will deduct the entire $100 of Current BIE.
- The remaining allowable amount of $100 would be deducted on a pro-rata basis by P and S.
- P would be allowed to deduct $70 of its carryforwards \((100 \times (140/(60+140)))\)
- S would be allowed to deduct $30 of its carryforwards \((100 \times (60/(60+140)))\)
Amount allowable is less than current year BIE:

- Each group member first deducts its current year BIE up to its own BII.
- Remaining current year BIE deducted (subject to remaining limitation) on a pro rata basis, based on member’s relative share of group’s remaining current year BIE.
SRLY and IRC 382 Limitations on BIE Carryforward

- SRLY rules apply to certain BIE Carryforwards.
- Overlap Rule: The SRLY limitation does not apply to BIE carryforwards when the application of the SRLY rules results in an overlap with the application of IRC § 382.
- Consolidated IRC § 382 rules apply to members of a consolidated group following ownership changes, or members that join the group with interest expense governed by IRC § 163(j).
Summary 5

• The IRC § 163(j) limitation is applied at the consolidated return level.

• Intercompany obligations, transactions and items are disregarded for purpose of the IRC § 163(j) limitation.

• The group (rather than a particular member) is treated as engaged in excepted or non-excepted trades or businesses.

• SRLY and IRC § 382 rules may apply.
Special Rules: S Corporations and Shareholders
Objectives

At the end of Parts 8 and 9, you will be able to:

- Identify rules applicable to S corporations and partnerships,
- Identify what items pass-through to investors.
- Determine the treatment of a partnership’s excess business interest expense (EBIE), and
- Distinguish the difference in the IRC § 163(j) limitation between various types of partnerships and partners.
S Corporations

- The IRC § 163(j) limitation is applied at the S corporation level. The S corporation prepares a Form 8990, if required.

- The small business exemption can apply at the S corporation level.

- S corporations subject to IRC § 163(j) can elect into the real property trade or business or farming business exceptions, if applicable.

- Disallowed BIE is carried over by the S corporation and is treated as business interest expense paid or accrued in the following year.
Computation of ATI

• Taxable income includes both the separately and non-separately stated items of income or loss.

• Taxable income generally equals Form 1120S, Schedule K, Line 18 – Income/loss Reconciliation

• Add or subtract items from taxable income to arrive at ATI just like any other corporation.
Excess Taxable Income

- Excess taxable income (ETI) is the amount of an S corporation’s ATI that is in excess of the amount of ATI required to support the S corporation’s BIE deduction.
- This amount is computed by an S corporation and is allocated to the shareholder.
- This amount is used by the shareholder in determining their current year ATI.
**Part III S Corporation Pass-Through Items**

Part III is only completed by S corporations that are subject to section 163(j). The S corporation items below are allocated to the shareholders. See the instructions for more information.

### Excess Taxable Income

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>38</td>
<td>Subtract the sum of lines 4 and 25 from line 5. (If zero or less, enter -0-.)</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>39</td>
<td>Subtract line 38 from line 26. (If zero or less, enter -0-.)</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>40</td>
<td>Divide line 39 by line 26. Enter the result as a decimal. (If line 26 is zero, enter -0-.)</td>
<td>.</td>
<td>.</td>
</tr>
<tr>
<td>41</td>
<td>Excess Taxable Income. Multiply line 40 by line 22</td>
<td>.</td>
<td>.</td>
</tr>
</tbody>
</table>

### Excess Business Interest Income

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>42</td>
<td>Excess business interest income. Subtract the sum of lines 1, 2, and 3 from line 25. (If zero or less, enter -0-.)</td>
<td>.</td>
<td>.</td>
</tr>
</tbody>
</table>
S Corporation Shareholder

- The deductible business interest expense of the S corporation is not subject to further limitation under IRC § 163(j) by the shareholders.

- For a shareholder subject to the IRC § 163(j) limitation, the shareholder’s current year IRC §163(j) limitation computation will include the following applicable amounts from each of its S corporations that are subject to IRC § 163(j):
  - Current year excess taxable income (ETI), and
  - Current year excess business interest income (EBII).
  - These amounts will not include items from an excepted trade or business.
Form 8990, Schedule B
Summary of S Corp Shareholder’s Items

<table>
<thead>
<tr>
<th>(a) Name of S corporation</th>
<th>(b) EIN</th>
<th>(c) Current year excess taxable income</th>
<th>(d) Current year excess business interest income</th>
</tr>
</thead>
<tbody>
<tr>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>46 Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Special Rules: Partnerships and Partners
Partnerships

- The IRC § 163(j) limitation is applied at the partnership level. The partnership prepares a Form 8990, if required.

- Partnerships subject to IRC § 163(j) can elect into the real property trade or business or farming business exceptions, if applicable.
Excess Business Interest Expense (EBIE)

- The disallowed business interest expense of a partnership subject to IRC § 163(j) is termed EBIE, and is not carried forward by the partnership, but is allocated to the partners. (See line 32 of the Form 8990)

- A partner can utilize EBIE in subsequent tax years, subject to certain limitations.
The partnership completes a Form 8990 and computes the following items, if applicable:

- Total Current Year Business Interest Expense Deduction - Line 30
- Excess Business Interest Expense (EBIE) - Line 32
- Excess Business Interest Income (EBII) - Line 37
- Excess Taxable Income (ETI) - Line 36
### Part II Partnership Pass-Through Items

Part II is only completed by a partnership that is subject to section 163(j). The partnership items below are allocated to the partners and are not carried forward by the partnership. See the instructions for more information.

#### Excess Business Interest Expense

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>32</td>
<td>Excess business interest expense. Enter amount from line 31.</td>
<td></td>
</tr>
</tbody>
</table>

#### Excess Taxable Income (If you entered an amount on line 32, skip lines 33 through 37.)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td>Subtract the sum of lines 4 and 25 from line 5. (If zero or less, enter -0-.)</td>
<td></td>
</tr>
<tr>
<td>34</td>
<td>Subtract line 33 from line 26. (If zero or less, enter -0-.)</td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>Divide line 34 by line 26. Enter the result as a decimal. (If line 26 is zero, enter -0-.)</td>
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<tr>
<td>36</td>
<td>Excess Taxable Income. Multiply line 35 by line 22.</td>
<td></td>
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</tbody>
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#### Excess Business Interest Income

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Formula</th>
</tr>
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<tbody>
<tr>
<td>37</td>
<td>Excess business interest income. Subtract the sum of lines 1, 2, and 3 from line 25. (If zero or less, enter -0-.)</td>
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</tbody>
</table>
Partnership P is subject to the IRC § 163(j) limitation and has the following for the 2018 tax year:

- ATI of $100,000
- BII of $30,000
- BIE of $80,000

Compute P’s total current year business interest expense deduction and EBIE or EBII.
Example (cont’d)

- The partnership’s total current year business interest expense deduction is $60,000, which is 30% of ATI + BII ($30,000 + $30,000).

- The partnership has disallowed business interest expense, termed EBIE, of $20,000, which is the difference between BIE and current year business interest expense deduction ($80,000 − $60,000).
Allocation of Deductible BIE and IRC § 163(j) Excess Items

• After completing Form 8990, a partnership must determine how the deductible BIE and the IRC § 163(j) excess items, are allocated among the partners.

• Worksheets A & B attached to the Form 8990 instructions contain an 11 step allocation computation per Prop.Treas. Reg. § 1.163(j)-6(f)(2). This computation is only necessary when there are special allocations.
Partner

- A partner’s share of partnership interest expense that was deductible under IRC § 163(j) at the partnership level is not subject to the limitation under IRC § 163(j) at the partner’s level.

- A partner that is allocated EBIE is required to file a Form 8990 to report the EBIE, even if the partner is not subject to IRC § 163(j) on its own interest expense.
Schedule A Summary of Partner’s
IRC § 163(j) Items

<table>
<thead>
<tr>
<th>(a) Name of partnership</th>
<th>(b) EIN</th>
<th>Excess Business Interest Expense</th>
<th>(f) Current year excess taxable income</th>
<th>(g) Current year excess business interest income</th>
<th>(h) Excess business interest expense treated as paid or accrued (lesser of (a) or (f))</th>
<th>(i) Current year excess business interest expense carryforward (f) minus (h)</th>
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Form 8990 (12-2018)
### Partner’s/Shareholder’s Special Adjustments to arrive at ATI

<table>
<thead>
<tr>
<th>Form 8990 Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td><strong>ADD</strong> Amount of any loss or deduction from a passthrough entity</td>
</tr>
<tr>
<td>13</td>
<td>Share of partner’s (or shareholder’s) ATI from passthrough entities not subject to section 163(j)</td>
</tr>
<tr>
<td>14</td>
<td>Total current year partner’s excess taxable income (Schedule A, Line 44, column (f))</td>
</tr>
<tr>
<td>15</td>
<td>Total current year shareholder’s excess taxable income (Schedule B, Line 46, column (c))</td>
</tr>
<tr>
<td>19</td>
<td><strong>SUBTRACT</strong> Amount of any income or gain items from a passthrough entity</td>
</tr>
</tbody>
</table>
Partner’s Basis

• Deductible business interest expense and excess business interest expense are subject to IRC § 704(d) basis limitation.

• A partner’s basis in its partnership interest is reduced (but not below zero) by the amount of excess business interest expense allocation from the partnership.

• If the partner disposes of the partnership interest prior to fully utilizing the EBIE, the partner’s basis is increased, immediately before such disposition, by the amount that any basis reductions exceed any amount of excess interest expense that has been treated as paid by the partner.
Ownership of Pass-through Entities Not Subject to IRC § 163(j) by Reason of the Small Business Exemption

• The owner (partner or shareholder) of a pass-through entity not subject to IRC § 163(j) by reason of the small business exemption who is subject to IRC § 163(j) at their level must include in their IRC §163(j) limitation computation their share of the pass-through’s,
  • business interest expense,
  • adjusted taxable income, and
  • business interest income
• The owner must request the pass-through entity to separately state, in sufficient detail, the items necessary to figure these amounts.
## Information Reporting Summary

### Partnership subject to section 163(j) limitation
- **Excess Business Interest Expense (EBIE)**
  - Box: 13
  - Code: K
- **Excess Taxable Income (ETI)**
  - Box: 20
  - Code: AE
- **Excess Business Interest Income (EBII)**
  - Box: 20
  - Code: AF

### S corporation subject to section 163(j) limitation
- **Excess Taxable Income (ETI)**
  - Box: 17
  - Code: AA
- **Excess Business Interest Income (EBII)**
  - Box: 17
  - Code: AB

### Corporate Partner of Partnership
- **Investment Interest Expense**
  - Box: 13
  - Code: H

(If the corporation is subject to the section 163(j) limitation, investment interest expense from a partnership is treated as business interest expense)
IRC § 163(j) contains special rules that apply to passthrough entities that differ on the treatment of business interest expense, depending upon various factors including:

- Whether the passthrough entity is subject to the IRC § 163(j) limitation.
- Whether the passthrough entity meets the small business exemption or is an excepted taxpayer, in whole or in part.
- Whether the partner or shareholder is subject to IRC § 163(j).
- Whether the partner is a corporation.
Questions
Special Rules: RIC, REIT, REMICs
Objectives

At the end of Parts 10, 11, and 12, you will be able to:

• Determine whether a REMIC, RIC or REIT is subject to the IRC § 163(j) limitation,
• Describe international provisions that may impact the IRC § 163(j) limitation, and
• Identify potential audit issues relating to the IRC § 163(j) limitation.
Real Estate Mortgage Investment Conduit (REMICs)

- Applicable rules found in IRC §§ 860A – 860G
- REMIC is not treated as carrying on a trade or business for purposes of IRC § 162 (Treas. Reg. § 1.860C-2(b)(4)).
- Business interest expense limitations do not apply to a REMIC (Prop. Treas. Reg. § 1.860C-2(b)(2)(ii)).
Regulated Investment Companies (RICs)

• Applicable rules found in IRC §§ 851–855 and IRC § 860.
• Typical RIC incurs very little interest expense.
• RIC’s income is primarily from investing in stock and securities, and may include:
  • Interest income
  • Dividend income
  • Capital gain income
• The IRC § 163(j) limitation is unlikely to impact the interest expense deductions of a typical RIC.
Real Estate Investment Trusts (REITs)

- Applicable rules found in IRC §§ 856 – 859 and IRC § 860.
- Types of REITs:
  - Mortgage REITs – assets are mortgage notes receivable that generate interest income
  - Equity REITs – assets are real property and leasehold interests that generate rental income
  - Mixed REITs - mortgage notes receivable and real property.
- REITs may be eligible for the “electing real property trade or business” exception.
- Prop. Treas. Reg. § 1.163(j)-9(g) provides a 10% safe harbor.
Special Rules: International Considerations
International Considerations

- Interaction of IRC § 163(j) with the Base Erosion Anti-Abuse Tax (BEAT) under IRC § 59A
- Application of IRC § 163(j) to foreign persons with effectively connected income (ECI)
- Application of IRC § 163(j) to controlled foreign corporations (CFCs) and United States shareholders
Interaction of IRC § 163(j) with the Base Erosion Anti-Abuse Tax (BEAT)

• § 59A covers a new minimum tax amount (added to regular income tax liability) imposed on “applicable taxpayers” that make certain “base erosion payments” to foreign related parties

• Under § 59A(c)(3), if the § 163(j) limitation applies, the reduction in the amount of interest is allocable first to interest paid or accrued to unrelated parties with respect to the taxpayer, and then pro rata to related domestic and foreign parties.

• The effect of this provision is to maximize the amount of related party interest expense to be treated as a base erosion tax benefit and potentially be subject to the BEAT minimum tax.
IRC § 163(j) Limitation Applied to Foreign Persons with Effectively Connected Income (ECI)

- IRC §163(j) applies to the interest expense of Foreign Persons with effectively connected income.
- Section 1.163(j)-8 of the proposed regulations provides the rules for determining the amount of Adjusted Taxable Income, Business Interest Income, Business Interest Expense, and Floor Plan Financing Interest Expense and calculating the IRC § 163(j) limitation for Foreign Persons with ECI.
IRC § 163(j) Limitation Applied to Controlled Foreign Corporations (CFCs)

- Section 1.163(j)-7* of the proposed regulations provide guidance on applying IRC § 163(j) rules to CFCs.
- IRC § 163(j) would apply to a CFC’s business interest expense in the same manner as those rules apply to a domestic C corporation.
- CFC group election – provides an alternative approach for computing the deduction for business interest expense of a CFC group.

* There may be potential changes in the final regulations to the proposed rules in this area
Adjusted Taxable Income (ATI) – Global Intangible Low-Taxed Income (GILTI), Subpart F and Foreign-Derived Intangible Income (FDII)

• GILTI and related IRC § 250 deduction and Subpart F Income should be excluded from US Shareholders’ ATI computed on Form 8990, Line 20 (reductions).
• Under the proposed regulations, if a CFC group election was made and the top tier CFC has excess taxable income (ETI), the US shareholder includes its ownership portion of the top-tier’s CFC ETI in its ATI calculation. See Prop. Treas. Reg. § 1.163-7(d)(1) and (2). (Form 8990, Line 15)
• The preliminary FDII deduction should be taken into account in Line 6 of Form 8990. See FDII proposed regulations for the ordering rules regarding FDII deduction and IRC §163(j).
• Proposed Regulations § 1.163(j)-7
• Proposed Regulations § 1.163(j)-8
• Proposed Regulations § 1. 250(a)-1
• Notice 2018-28, initial guidance under IRC § 163(j)
• Tax Reform webpage on IRS.gov FAQ
• IRC § 864(c) Effectively Connected Income
Part 12

Practical Application-Risk Assessing and Audit Techniques
• All taxpayers with business interest expense; a disallowed business interest expense carryforward, or current year or prior year excess business interest expense.

• Exceptions:
  • Small business taxpayers without EBIE from a partnership
  • Only have interest expense from excepted trades or businesses
**Step 1:** Determine if taxpayer is exempt from limitation.

*Exam Tip:* A taxpayer will self report if they meet the small business exemption, do not have business interest expense, or only have interest from excepted trades or businesses. The taxpayer must also not have excess business interest expense from a partnership.
Step 2: Determine if taxpayer has excepted trades or businesses.

Exam Tip: Taxpayers electing into the real property trade or business or farming business exceptions self report the election.
Step 3: Determine if taxpayer is subject to other provisions that affect the disallowance, deferral or other limitation of interest. (Precede IRC § 163(j) limitation)

For example:
• Interest capitalized as part of self-constructed assets- IRC § 263A
• Related party interest deferral - IRC § 267(a)(2) & (3)
• Interest in Hybrid transactions/entities - IRC § 267A
Step 4: For non-C corporation taxpayers, determine if taxpayer properly allocated interest to personal, investment, and other interest.

Exam Tip: See guidance under Treasury Regulation § 1.163-8T, Notice 88-37, and Notice 89-35 for the allocation methods.
Definition of Interest

Step 5: Determine whether taxpayer included all items under the definition of interest in calculating business interest income (BII) and business interest expense (BIE) for IRC § 163(j) purposes including:

- Conventional interest
- The time value component associated with the loan transaction relating to certain swaps with significant non-periodic payments
- Other amounts that are closely related to interest (interest equivalents),
- Anti-avoidance rule

Exam tip: Request business interest workpapers.
Carryforwards

**Step 6:** Verify carryforwards.

**Exam Tip:** Carryforward - Disallowed **BIE** is treated as paid in the next year

**Exam Tip:** No Carryforward of excess income items
Step 7: Determine if taxpayer properly allocated items of income, gain, deduction, or loss between excepted and non-excepted TOBs and reported the excepted TOB assets on the ADS method of depreciation.

- Allocation rules are generally based on TP’s adjusted tax basis of the assets used in its excepted and non-excepted TOB.
- Taxpayer is required to attach a statement to its timely filed tax return.

Exam tip: Request allocation workpapers.
Step 8: Verify Taxable Income on line 6 Form 8990.

Exam tip: Determine whether taxable income is computed as though all BIE is allowable BIE.

Exam tip: Consider all other applicable limitations including basis, at-risk, passive activity loss, and excess business loss.
Step 9: Verify all additions and reductions to taxable income are included on Form 8990, Part I, Section II.

Exam Tip: Verify adjustments for pass-through entity items, GILTI and Subpart F.

Exam tip: Taxpayer may try to convert certain items from ATI into BII to increase the limitation. Ensure the amounts of interest equivalents are properly classified.
Step 10: Calculate IRC § 163(j) limitation.

Taxpayer’s deduction for BIE for a taxable year is limited to: \( \text{BII} + 30\% \text{ of ATI} + \text{Floor plan financing} \)
Step 11: Reallocate BIE to each activity if the at risk or passive activity loss limitations apply.

Exam tip: Reallocation generally required for all taxpayers except non-closely held C corporations.
Step 12: Reconcile Form 8990, Line 30, total current year business interest expense deduction, to the tax return, for example, Form 1120, Line 18.

Exam tip: Taxpayers are required to attach a schedule to Form 8990 that indicates the amount and line item on the tax return where the business interest expense is being deducted. Note: IRC §§ 465, 469 and 461(l) apply after the IRC § 163(j) limitation.
Special Entity Considerations

• Remember to refer back to the special considerations addressed for:
  • C Corporations – Part 6
  • Consolidated Returns – Part 7
  • S Corporations – Part 8
  • Partnerships – Part 9
  • RICs, REITs and REMICS – Part 10
  • International – Part 11
Resources

- IRC §§ 163(j) & 168(g)
- Proposed Treas. Regs. §1.163(j)-1 through §1.163(j)-11
- Notice 2018-28, initial guidance under section 163(j).
- Rev. Proc. 2019-08, regarding ADS depreciation
Resources (cont’d)

• IRC 163(j) Resources on the Virtual Library
• Form 8990, Limitation on Business Interest Expense Under Section 163(j)
• Instructions to Form 8990
• Pub 225, Farmer’s Tax Guide
• Pub 946, How To Depreciate Property
• Tax Reform webpage on IRS.gov
  • FAQ
Lesson Summary

You are now able to:

• Compute the limitation on business interest expense under IRC §163(j),
• Identify who is required to compute a limitation, and
• Identify unique rules applicable to different entity types.
LB&I Training
Tax Cuts & Jobs Act (TCJA)

From TCJA to Treasury Regulations
Objectives 8

- Tax Regulatory Process
  - Explain the differences between Proposed, Temporary, and Final regulations
  - Explain what a Treasury Decision (TD) is and why a TD is important
  - Describe origins of Treasury Regulations and the process of writing, review, and approval.
Three Key Government Offices Responsible for Issuing Tax Regulations

• The IRS
• The IRS Office Of Chief Counsel
• The Department Of Treasury Office of Tax Policy

Each office plays a unique role in the regulatory process as evidenced in the mission statements.
The mission of the Internal Revenue Service is to provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all. It is the duty of the IRS to correctly apply the laws enacted by Congress; to determine the reasonable meaning of various Internal Revenue Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view. IRM 32.1.1.1(1)
The mission of the Office of Chief Counsel is to serve America’s taxpayers fairly and with integrity by **providing correct and impartial interpretation** of the internal revenue laws and the highest quality legal advice and representation for the IRS. Chief Counsel’s primary means of providing correct and impartial interpretation of the internal revenue laws is through published guidance. CCDM 32.1.1.1(3)

- Primarily responsible for drafting, circulating for review and approval, and publishing of the regulations in the Code of Federal Regulations (CFR).
- The Chief Counsel Regulations Handbook – CCDM 32.1.1 contains procedures for the drafting, review, and publication process.
The Office of Tax Policy (OTP) Mission

- The Department of Treasury Office of Tax Policy assists the Secretary and is responsible for developing and implementing tax policies and programs; providing the official estimates of all Government receipts for the President's budget, fiscal policy decisions, and Treasury cash management decisions; establishing policy criteria reflected in regulations and rulings and guiding their preparation with the Internal Revenue Service; negotiating tax treaties for the United States and representing the United States in meetings and work of multilateral organizations dealing with tax policy matters; and providing economic and legal policy analysis for domestic and international tax policy decisions.
Treasury Regulations

• Treasury regulations carry the force and effect of law.
• Treasury regulations are the official Treasury interpretation of the Code.
• Section 7805 of the Code gives the Secretary of the Treasury the authority to create the necessary rules and regulations to enforce the Code. Sometimes, specific Code statutes authorize the Secretary to issue regulations.
• Regulations are issued to provide guidance on new legislation, e.g. TCJA, and on projects listed in the Priority Guidance Plan (PGP) published annually by the IRS and Treasury Department.
Types of Regulatory Projects

- Advance Notice of Proposed Rulemaking (ANPRM).
- Notice of Proposed Rulemaking (NPRM), also known as Proposed Regulation.
- Temporary Regulations (published as Treasury Decision (TD)).
- Final Regulations (published as TD).
Where Regulations are Published

- Regulations are published in the Internal Revenue Bulletin and the Federal Register (daily publication), and are annually codified in the Code of Federal Regulations (CFR, revised April 1 of each year).
- The CFR is divided into 50 titles that represent areas subject to Federal regulations.
- Title 26 of the CFR contains Internal Revenue regulations.
Advance Notice of Proposed Rulemaking (ANPRM)

- ANPRM describes a problem or situation, announces that the agency is considering regulatory action, describes the agency’s anticipated regulatory approach, and seeks input from the public about the issues, the need for regulation, and the adequacy of the agency’s proposed regulatory action. See CCDM 32.1.1.2.1

- Sometimes, instead of the ANPRM, a Notice may be published in the Internal Revenue Bulletin to indicate the intention of the Treasury Department and the IRS to issue proposed regulations. Such Notices generally describe the scope and content of the intended proposed regulations, invite comments from the public, and specify if taxpayers may rely on the Notice. It is the policy of the Department of Treasury to issue proposed regulations or other guidance within 18 months of issuing the Notice.
Proposed Regulations (NPRM)

- Announces to the public that the IRS and Treasury are considering issuing rules on matters not addressed in existing regulations or modifying regulations published in the Code of Federal Regulations (CFR).
- Contain a preamble that explains the rules, provides notice to the public about proposed rulemaking and requests public comments.
- Sets out the proposed regulatory text.
- Provides notice of public hearings of the regulations.
- Prior to adoption, may be withdrawn or modified at any time.
- Unlike Treasury Decisions (TDs), NPRMs do not have full force and legal effect unless and until they are adopted as final regulations (in the proposed or modified form).
Proposed Regulations Reliance

• Generally, taxpayers may rely on proposed regulations if there is an express statement in the preamble permitting reliance and there are no applicable final or temporary regulations.

• If there are applicable final or temporary regulations, taxpayers may rely on proposed regulations if the preamble to the proposed regulations contain an express statement permitting reliance.

• The Office of Chief Counsel ordinarily should not take any position in litigation or advice that would yield a result that would be harsher to the taxpayer than what the taxpayer would be allowed under the proposed regulations.

• The Tax Court has ruled that proposed regulations carry no more weight than a litigating position. KTA-Tator, Inc. v. Commissioner, 108 T.C. 100 (1997).
Treasury Decision (TD)

• A Treasury Decision (TD) is a document with 2 main parts:
  1) the preamble and
  2) the text of a final or temporary regulation.

• A TD adds new text to, removes, or revises text published in the CFR.

• The preamble contains summary, background, explanations of provisions, addresses comments received from the public, and includes reasons for regulatory decisions made. It, also, states the applicability and effective date provisions.

• A TD is legal authority and is binding on taxpayers as well as the IRS, unless invalidated. CCDM 32.1.1.2.5

• When regulations are codified in the CFR, only the text of the final or temporary regulations is included. The preamble is not included in the CFR. You can find the preamble, by referring to the TD, which is noted at the end of the regulation text.
Temporary Regulations

- Temporary regulations provide immediate guidance prior to publication of final regulations.

  - A temporary regulation is generally effective when published in the Federal Register (before the Administrative Procedures Act (APA) notice-and-comment process).
  - Temporary regulations must be published with a cross-referencing NPRM to provide the public notice and comment.
  - Temporary regulations are issued if there is “good cause” to issue regulations with immediate effect without notice and comment.
  - Temporary regulations are effective until superseded by final regulations. In no event, may a temporary regulation remain effective for more than 3 years (for temporary regulations issued after 11/20/88). Sec. 7805(e).
  - Temporary regulations are given the same weight as final regulations. Robinson v. Commissioner, 119 T.C. 44 (2002).
    - Courts defer to temporary regulations unless they conflict with, or are an unreasonable interpretation of, the underlying statute.
Final Regulations

Issued after APA notice-and-comment process.

• The preamble of a final regulation cites to the underlying NPRM and other rulemaking history, discusses and analyzes public comments received and explains the agency’s final decision.

• A final regulation is preceded by an NPRM.
There are two types of regulations:

- **Legislative Regulations**: when Congress simply provides an end result, without any guidance as to how to achieve the desired result or when a statutory provision does not provide adequate authority for the regulatory action taken. CCDM 32.1.1.2.7

- **Interpretative Regulations**: issued by an agency to advise the public of the agency’s construction of the statutes it administers. If Congress provided specific rules and merely left gaps to fill, regulations filling those gaps are considered interpretative. Most IRS/Treasury regulations are considered interpretative because the underlying statute implemented by the regulation contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute.

The APA requires agencies to follow notice-and-comment process for legislative rules and exempts interpretative rules from the notice-and-comment process. This distinction is of little significance.
APA Notice-and-Comment Process - Treasury Policy Statement

• Treasury issued a Policy Statement on the Tax Regulatory Process on March 5, 2019 (the Statement).
• The Statement reiterates our commitment to the notice-and-comment process established by the APA.
• Although the APA notice-and-comment process does not apply to interpretive rules, the Statement provides that we will continue to adhere to our long standing practice of using notice-and-comment process for such regulations.
• Notice-and-comment process allows the public to participate in the rulemaking process before any final rule becomes effective and ensures that all views are adequately considered. It also enables the public to apprise the government of relevant information.
• Public comments may be submitted in writing or provided at a public hearing as requested in the NPRM.
Other Relevant Federal Administrative Law Applicable to Tax Regulations

- **Paperwork Reduction Act (PRA).** Requires Federal agencies to obtain OMB approval before enforcing any "collection of information" requirement.
- **Administrative Procedure Act (APA).** 5 USC 553 provides procedural requirements for issuing regulations.
- **Executive Order 12866 and Executive Order 13563.**
- **Regulatory Flexibility Act (RFA).** Enacted to ensure that agency regulations and collection of information requirements are appropriate in scope for the businesses, organizations, and governmental jurisdiction regulated.
- **Sections 7805(e) and (f).** Section 7805(e) provides rules for temporary regulations. Section 7805(f) provides that a final regulation, not superseding an NPRM, must be submitted to the Chief Counsel for Advocacy of the SBA for comment at least 4 weeks before the date of publication.
- **Congressional Review Act/Small Business Regulatory Enforcement Fairness Act.** The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) added the Congressional Review Act (CRA). The CRA provides that temporary and final rules cannot become effective until the issuing agency submits a report to the House of Representatives, the Senate, and the Comptroller General of the General Accountability Office.
Drafting Process

- Associate Office opens regulation project, see CCDM 32.1.2
- Members of the drafting team are identified
  - Associate Chief Counsel (docket attorney, branch reviewer, front officer reviewer), OTP attorney-advisor, and may include staff from Operating Division (Practice Network) or Division Counsel
- It is a collaborative process
- Drafting team coordinates as appropriate with other divisions, agencies, etc.
- Drafting team considers administrability both from the client perspective and from the taxpayer perspective
The "green" circulation draft is a draft approved for distribution outside of the drafting team to other Counsel and IRS offices that may be affected or have interest in the regulation, for their review and comment.

Circulation drafts are reviewed and approved by, or on behalf of, the initiating Associate Chief Counsel prior to circulation (pre-green circulation).

Generally, 14 calendar days to provide comments

Includes the Executive Summary
Review Process –
Pink Circulation (CCDM 32.1.6.8)

- After receiving and incorporating comments to the extent possible on the green circulation package, the drafting team prepares a final draft for approval (the "pink" or "signature package," see CCDM 32.1.6.8 for further discussion of the signature package).

- All regulation projects, including ANPRMs, must be approved by the Chief Counsel, the Commissioner, and the Assistant Secretary of the Treasury (OTP).
Clearance Process

Prior to publication, regulations must be reviewed and approved by the following offices:

1. Associate Chief Counsel Office
2. Chief Counsel
3. Operating Division Commissioners
4. Deputy Commissioner for Services and Enforcement
5. Treasury (OTP), OMB, and OIRA if regulations are deemed economically significant
6. Other agencies if the regulations are inter-agency (for example, IRS and Social Security Administration).
DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 502

[TD 9636]

RIN 1545–BE18

Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance on the application of sections 162(a) and 263(a) of the Internal Revenue Code (Code) to amounts paid to acquire, produce, or improve tangible property. The final regulations clarify and expand the standards in the current regulations under sections 162(a) and 263(a). These final regulations replace and remove temporary regulations under sections 162(a) and 263(a) and withdraw proposed regulations that cross referenced the text of those temporary regulations. This document also contains final regulations under section 162(1)(c) and 263(a).

11, 1.263(a)–1, 1.263(a)–2, 1.263(a)–3, and 1.263(a)–6, Merrill D. Feldstein or Alan S. Williams, Office of Associate Chief Counsel (Income Tax and Accounting), (202) 622–4950 (not a toll-free call); Concerning §§ 1.165–2, 1.167(a)–4, 1.167(a)–7, 1.167(a)–8, 1.168(i)–7, 1.263A–1, and 1.1016–3, Kathleen Reed or Patrick Clinton, Office Associate Chief Counsel (Income Tax and Accounting), (202) 622–4930 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2248. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

The collection of information in this regulation is in §§ 1.263(a)–1(f)(5), 1.263(a)–3(h)(6), and 1.263(a)–3(n)(2). This information is required in order for

Background

Section 263(a) provides that no deduction is allowed for (1) any amount paid out for new buildings or permanent improvements or betterments made to increase the value of any property or estate, or (2) any amount expended in restoring property or in making good the exhaustion thereof for which an allowance has been made. Final regulations previously issued under section 263(a) provided that capital expenditures included amounts paid or incurred to (1) add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or (2) adapt the property to a new or different use. However, those regulations also provided that amounts paid or incurred for incidental repairs and maintenance of property within the meaning of section 162 and § 1.162–4 of the Income Tax Regulations are not capital expenditures under § 1.263(a)–1.

The determination of whether an expense may be deducted as a repair or must be capitalized generally requires an examination of all of a taxpayer's particular facts and circumstances. Moreover, the subjective nature of the existing standards described above has resulted in considerable controversy between taxpayers and the IRS over
to taxable years beginning on or after January 1, 2012. The IRS and the Treasury Department received numerous written comments in response to the 2011 temporary and proposed regulations and held a public hearing on May 9, 2012. After considering these comments and the statements at the public hearing, the IRS and the Treasury Department published Notice 2012–73 (2012–51 IRB 713), on November 20, 2012, announcing that, to assist taxpayers in their transitions to the 2011 temporary regulations and final regulations, the IRS and the Treasury Department would change the

**Explanation of Provisions**

**I. Overview**

Section 263(a) generally requires the capitalization of amounts paid to acquire, produce, or improve tangible property. Section 162 allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including the costs of certain supplies, repairs, and maintenance. These final regulations provide a general framework for distinguishing capital expenditures from supplies, repairs, maintenance, and other deductible business expenses for property subject to section 168. Instead, to address significant changes in this area, revised regulations under section 168 are being proposed concurrently with these final regulations (and appear in the Proposed Rules section of this issue of the Federal Register).

**II. Materials and Supplies Under § 1.162–3**

Responding to generally favorable comments on the treatment of materials and supplies in the 2011 temporary regulations, the final regulations retain the framework and many of the rules set forth in the 2011 temporary regulations.
Thank you for your participation!