



Interim Guidance Issued on New Business Interest Expense Limitations

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The IRS and the Treasury Department recently announced interim guidance to help taxpayers comply with the new business interest expense limitations under the Tax Cuts and Jobs Act (P.L. 115-97) (the [Act](#)). Notice 2018-28, published on April 2, 2018 (the [Notice](#)), provides that more comprehensive proposed regulations under new Section 163(j) of the Internal Revenue Code (the [Code](#)) are forthcoming. In addition to that announcement, the Notice addresses, among other things, (i) carryforwards of excess interest and excess limitation amounts under the prior version of Code Section 163(j) for the last taxable year before January 1, 2018; (ii) business interest and interest income of C corporations and S corporations; (iii) what effect, if any, the new Code Section 163(j) has on a C corporation's earnings and profits; and (iv) how to calculate a partner's annual deduction for business interest expense in light of the partnership's business interest expense. A brief overview of each topic is included below.

The New Section 163(j) of the Code

Code Section 163(j), as revised by the Act, limits a taxpayer's annual deduction of interest expense to the sum of: (i) business interest income, (ii) 30 percent of the taxpayer's adjusted taxable income, and (iii) the taxpayer's floor plan financing interest for the taxable year. In most cases, aside from floor plan financing, a taxpayer's limitation on net interest expense generally will be 30 percent of the taxpayer's adjusted taxable income.

New Code Section 163(j) provides exceptions to the limitations for certain taxpayers, including taxpayers with annual gross receipts under \$25 million, utilities businesses, electing real property trades or businesses, electing farming businesses, and service employees.

Carryover Items Under Pre-Act 163(j) of the Code

Pursuant to the Notice, Treasury intends to issue proposed regulations providing that excess interest can be carried forward, but excess limitation amounts cannot. Under new Code Section 163(j), taxpayers that are not able to deduct all their business interest, because of the limitation in Code Section 163(j)(1) for the last taxable year before January 1, 2018, are allowed to treat such interest as

paid or incurred in the following year, subject to the same limitations as any other business interest otherwise paid or accrued in that following year.

While excess business interest can be carried forward to the following year, taxpayers are no longer allowed to carry over any prior excess limitation amounts under proposed regulations that Treasury intends to issue. This means that if a taxpayer's calculated limitation amount is greater than the taxpayer's net business interest expense for the year, that excess limitation amount cannot be carried forward and applied in the following year's business interest expense calculation.

The Notice provides that forthcoming regulations also will address the interaction of new Code Section 163(j) and (i) the tax on base erosion payments, and (ii) proposed rules pertaining to consolidated groups.

Application to C Corporations and S Corporations

Under the Notice, Treasury announced plans to issue proposed regulations clarifying that all interest paid or accrued by a C corporation on its debt will be properly allocable to a trade or business. Consequently, all interest paid by a corporation will be business interest. Likewise, all of the corporation's interest income will be considered business interest income.

In addition, further clarification is expected from Treasury on whether and to what extent the interest expense of a partnership with a C corporation partner will be treated as non-business interest.

The Notice makes clear that the rules for C corporations regarding business interest expense and income do not apply to S corporations. Thus, an S corporation's interest expense and income are not automatically considered business interest. Instead, the rules for S corporations will likely be similar to the forthcoming proposed regulations regarding partnerships (see discussion below).

Earnings and Profits

The Notice provides that the proposed regulations will clarify that the disallowance and carry forward of a deduction under new Code Section 163(j) should have no effect on whether or when such interest expense reduces earnings and profits.

Partnerships

Finally, under the Notice, Treasury and the IRS clarify that, for purposes of calculating a partner's annual deduction for business interest expense, a partner can only include business interest income from a partnership to the extent it exceeds business interest expense of that partnership. Likewise, partners may not include their share of a partnership's floor plan financing interest in the calculation of their annual business interest expense deduction limitation. This avoids the double counting of income and expense items for purposes of the limitation.

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