
IRS Issues Guidance on the Business Interest Expense Limitation

By Kenneth S. Wear, Christine M. Green / Apr 04, 2018

On April 2, the Treasury and the IRS issued Notice 2018-28 which provides guidance concerning the business interest expense limitation enacted as part of tax reform. The guidance includes the application of the rules to consolidated groups of corporations and the carryover treatment of certain disallowed interest expense incurred prior to 2018.

Under Section¹ 163(j) as amended by the Tax Cuts and Jobs Act, the deduction for business interest expense is limited for taxable years beginning after December 31, 2017 to the sum of (a) the business interest income of the taxpayer for the taxable year, (b) 30 percent of the adjusted taxable income^[2] of the taxpayer for the taxable year, and (c) the floor plan financing interest of the taxpayer for the taxable year. This limitation, however, does not apply to taxpayers with average annual gross receipts of \$25 million or less.

Notice 2018-28^[3] states that the Treasury and the IRS intend to issue proposed regulations under Section 163(j) and that taxpayers may rely on the rules provided within the Notice until such regulations are issued. The Notice provides clarification with respect to consolidated groups: the limitation on the amount allowed as a deduction for business interest expense applies at the level of a consolidated group, and the group's taxable income for purposes of calculating the limitation will be its consolidated taxable income. The Notice also states that intercompany obligations will be disregarded when calculating the limitation.

In addition to informing taxpayers that regulations under Section 163(j) concerning consolidated groups will be issued, Notice 2018-28 also provides that proposed regulations will be issued to reflect the following:

- Taxpayers with disallowed disqualified interest from the last tax year beginning before January 1, 2018 may carry such interest forward as business interest to the taxpayer's first taxable year beginning after December 31, 2017. Disqualified interest included interest paid to or, in certain circumstances, guaranteed by related parties. Deductions for such interest expense were disallowed, but could be carried forward, under prior law to the extent the interest expense exceeded 50% of the taxpayer's adjusted taxable income. Interest carried forward under the new rules will be subject to the limitations under the amended Section 163(j).
- For purposes of Section 163(j), all interest paid or accrued by a C corporation on indebtedness of such C corporation is business interest and all interest on indebtedness held by the C corporation that is includible in gross income is business interest income.
- The disallowance and carryforward of a C corporation's business interest expense under Section 163(j) will not affect whether or when such business interest expense reduces the C corporation's earnings and profits.
- For purposes of calculating a partner's (or S corporation shareholder's) annual business interest expense deduction under Section 163(j), a partner cannot include the partner's share of the partnership's business interest income except to the extent of the partner's share of the excess of the partnership's business interest income over the partnership's business interest expense. This rule is intended to prevent double counting of business interest income that was already applied in determining the partnership's own business interest expense deduction.

For questions or more information, please contact Christine M. Green, Kenneth S. Wear or another member of Clark Hill's Corporate Practice Group.

[1] Unless otherwise stated, all "Section" references herein refer to the Internal Revenue Code of 1986, as amended.

[2] Defined, generally, as EBITDA for taxable years beginning before January 1, 2022, and EBIT for taxable years beginning after December 31, 2021.

[3] Notice 2018-28 (released April 2, 2018), available at <https://www.irs.gov/pub/irs-drop/n-18-28.pdf>.