Feedback for REG-107911-18: Rules concerning the limitation on the deduction for business interest expense

PROPOSED REGS SECTION NUMBER	SECTION TITLE	ISSUE	RECOMMENDATION	ADDITIONAL EXPLANATION /QUERIES
Prop. Regs. §1.163(j)-1[1]	**Definitions**			
Prop. Regs. §1.163(j)-1(b)	**Definitions**	Property sale adjustment required for DD&A regardless of benefit on initial addback (Prop. Regs. §1.163(j)-1(b)(iv)(E)(1))	Add the following in addition to the two items provided in the "lesser of" computation: (iii) the amount of additional business interest expense that was not disallowed as a result of the depreciation, amortization, or depletion of the property for the taxable years beginning after December 31, 2017, and before January 1, 2022, with respect to such property.	As currently written, Prop. Regs. §1.163(j)-1(b)(iv)(E)(1) requires that ATI be adjusted for DD&A in 2018-2022 when properties are sold even if the DD&A addback in those years did not increase the amount of business interest expense allowed per §163(j). Without a revision a taxpayer who did not benefit from the DD&A addback would be negatively impacted in future property sales by a forced claw-back of perceived benefit. This seems inequitable and counter to Congress' intent by allowing taxpayers to increase ATI by DD&A from the beginning.
		Stock sale adjustment required for DD&A regardless of benefit on initial addback (Prop. Regs. §1.163(j)-1(b)(iv)(E)(2))	Add the following in addition to the two items provided in the "lesser of" computation: (iii) the amount of additional business interest expense that was not disallowed as a result of the deductions described in paragraph (b)(1)(ii)(C) of this section with regard to the stock sale or disposition.	As currently written, Prop. Regs. §1.163(j)-1(b)(iv)(E)(2) requires that ATI be adjusted for DD&A in 2018-2022 related to adjustments to sales or dispositions of member stock even if the DD&A addback in those years did not increase the amount of business interest expense allowed per §163(j). Without a revision a taxpayer who did not benefit from the DD&A addback could be negatively impacted in future stock sales by a forced claw-back of perceived benefit. This seems inequitable and counter to Congress' intent by allowing

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

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				taxpayers to increase ATI by DD&A from the beginning.
		Partnership property sale adjustment required for DD&A regardless of benefit on addback (Prop. Regs. §1.163(j)-1(b)(iv)(E)(3))	Add the following in addition to the two items provided in the "lesser of" computation: (iii) the amount of additional business interest expense that was not disallowed as a result of the distributive share of deductions described in paragraph (b)(1)(ii)(C) of this section with respect to the partnership property subject to sale or disposition in a taxable year.	As currently written, Prop. Regs. §1.163(j)-1(b)(iv)(E)(3) requires that ATI be adjusted for DD&A in 2018-2022 when properties are sold even if the DD&A addback in those years did not increase the amount of business interest expense allowed per §163(j). Without a revision a taxpayer who did not benefit from the DD&A addback would be negatively impacted in future property sales by a forced claw-back of perceived benefit. This seems inequitable and counter to Congress' intent by allowing taxpayers to increase ATI by DD&A from the beginning.
		Interest dividend treatment not available to foreign investment regulated investment and money market funds (Prop. Regs. §1.163(j)-1(b)(22)(iii)(F))	Definition of interest should be extended to include earnings from foreign regulated investments and money market funds, where a taxpayer can obtain support that their income earned from such a fund is attributable to interest income earned by such a fund.	Under Prop. Regs. §1.163(j)-1(b)(22)(iii)(F), taxpayers can treat certain amounts from regulated investment companies ("RICs") as interest income for §163(j) purposes. The rationale in the Preamble hinged on the ability for a RIC to look through to the underlying investments, whereby to the extent the underlying earnings of said RICs were interest, the U.S. taxpayer, may similarly treat their earnings from the RIC as interest. This provision should be extended to include foreign regulated investment and money market funds ("Investment Funds"), where a taxpayer can obtain support that their income earned from such a fund is attributable to interest income earned by such a fund. This will ensure consistent treatment for investments in domestic and foreign regulated funds in the application of §163(j).

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				RICs are defined as domestic corporations[2] that are registered under the Investment Company Act of 1940.[3] Foreign corporations are excluded from the definition a RIC, and therefore the aforementioned look-through treatment was not extended to non-RIC holdings, such that foreign dividends, under the current regulations, cannot be considered §163(j) 'interest dividends'. In order to bring uniformity to investments in RICs with investments in other Investment Funds, we propose the following: a. To permit U.S. entities and CFCs to treat earnings from regulated foreign Investment Funds as interest to the extent such earnings can be traced to underlying income of the Investment Fund that is interest. This would provide parity to investments in foreign Investment Funds with U.S. investments in RICs.[4] b. To expand the definition beyond RIC investment to any regulated foreign MMF that has access to underlying investment detail and require that the fund provide detail sufficient to support the determination that distributions are attributable to interest. c. Additionally, suggest that 'interest dividend' look-through treatment be permitted for Taxpayers that invest in domestic

[2] §851(a).
[3] §851(a)(1)(A).
[4] The Treasury declined to extend treatment to PFICs on the basis that they do not separately report amounts of interest income for Federal income tax purposes. If a PFIC does in fact report such amounts, we believe that the Taxpayer should be able to treat income from such PFIC as attributable to interest income.

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				or foreign regulated funds that invest all but a *de minimis* portion of their assets in interest bearing securities.
Prop. Regs. §1.163(j)-6	**Application of the business interest deduction limitation to partnerships and subchapter S Corporations**			
Prop. Reg. §1.163(j)-6(d)	Election to substitute 2019 ATI for 2020 ATI (Prop. Regs. §1.163(j)-6(d)(5))	Need for additional guidance in applying prior year ATI and the allocation of that ATI	Provide that the rules for determining the partners' allocable shares of ATI under the original "11-step approach" in final Regs. §1.163(j)-6(f) are a permissible method in applying prior year ATI and the allocation of that ATI in the case of a non-tiered partnership. Additionally, provide that a non-tiered partnership that allocates all items pro rata could take advantage of an exception (similar to the rule that allows steps 2-11 to be bypassed in Regs. §1.163(j)-6(f)(2)(ii) of the final regulations) and allocate this ATI pro rata.	The proposed regulation would appear to modify the rules for determining the partners' allocable shares of ATI under the original "11-step approach" in final Regs. §1.163(j)-6(f). This proposed regulation disregards the "11-step approach" and instead points to different mechanics of a tiered partnership allocation rule under Prop. Regs. §1.163(j)-6(j)(9). Because of the complexity of the inconsistent approach for this one-year election, additional examples of the application would be beneficial. Additionally, query whether a partnership that historically allocates all items pro rata could take advantage of an exception (similar to the exception out of the 11-step calculation, as contained in the final regulations) and allocate this ATI pro rata.
Prop. Regs. §1.163(j)-6(h)	**Basis adjustments**	Feedback request on non-liquidating partnership distribution basis	Do not require adjustments to the partners' basis in the partnership interest under Prop. Regs. §1.163(j)-6(h)(3) nor the partnership's basis in capital assets under	The current regulations only require an upward basis adjustment for a partnership's excess business interest expense either at the time a partner sells their partnership interest or on a liquidating distribution. We believe that this is a reasonable approach in most circumstances.

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		adjustments	Prop. Regs. §1.163(j)-6(h)(5) for non-liquidating distributions of a partnership with excess business interest expense, except at the election of the partner to the extent the non-liquidating distribution would trigger gain pursuant to §731(a)(1).	Using an example: If basis adjustments under Prop. Regs. §1.163(j)-6(h)(3) or (h)(5) are not required for excess business interest expense on non-liquidating distributions, if a partnership has excess ATI in the future the disallowed business interest expense may be deducted. Alternatively, if a basis adjustment under Prop. Regs. §1.163(j)-6(h)(3) or (h)(5) is required, that same interest expense will not be recoverable until such time as the capital property is sold. As such, a rule requiring a basis adjustment for non-liquidating distributions can create considerable timing distortions. This approach may be detrimental to a partner in some situations. For example: a partner's basis in the partner's partnership interest is reduced by the amount of the excess business interest expense under Prop. Regs. §1.163(j)-6(h)(2). If the partner has minimal or no remaining basis in the partnership interest, a subsequent non-liquidating distribution of money by the partnership to the partner could trigger capital gain to the partner under §731(a)(1) where the partner would have had no or reduced capital gain if the Prop. Regs. §1.163(j)-6(h)(2) basis adjustments had not been made. If upward basis adjustments under Prop. Regs. §1.163(j)-6(h)(3) are not permitted at the election of the partner in this situation, the partner would have capital gain without the benefit of the ordinary interest deduction that reduced the partner's basis in the partnership interest. In such a circumstance, a partner may prefer to elect instead to apply the basis adjustments under Prop. Regs. §1.163(j)-6(h)(3) and (h)(5) rather than recognize capital gain on a current basis and wait for the potential to take the disallowed interest deduction if and when excess ATI or excess business interest income is allocated to the partner in the future. As such, a rule not allowing for such an election could also create considerable timing

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				distortions.
		Treatment of basis adjustment at partnership level as non-depreciable or non-amortizable.	We support the proposed regulations, which assert that the basis adjustment should be captured as a non-depreciable or non-amortizable asset.	The regulations should mirror the spirit or intent of §163(j)(4)(B)(iii)(II), which states that "no deduction shall be allowed to the transferor or transferee for any EBIE resulting in a basis increase to a partner that disposed of its interest." In effect, by making the basis adjustment at the partnership depreciable, an item that was considered limited (nondeductible) to the partnership (and passed to the partners) would, in effect, be turned back into a valid partnership deduction, this time for depreciation. As depreciation, there would be an immediate and perhaps unintended ATI ramification starting in 2022, once depreciation is no longer allowed as an addback.
Prop. Reg. §1.163(j)-6(j)	**Tiered partnerships**	Further guidance on the treatment of UTP EBIE under the rules of Subchapter K is necessary.	More guidance is requested, in the way of detailed examples, to understand full tracking of all §704(b), tax basis and capital account adjustments required at every tiered partnership level related to EBIE from a lower-tier partnership ("LTP"), as well as new concepts such as basis and carryforward components of EBIE.	The rules under Prop. Regs. §1.163(j)-6(j)(3) provide that, under the "Entity Approach," when LTP allocates EBIE to an upper-tier partnership ("UTP"), UTP does not further allocate such EBIE to its partners, and the UTP partners' tax basis is unaffected until such time that the UTP treats said EBIE as paid or accrued. However, Prop. Regs. §1.163(j)-6(j)(2) would provide that both the UTP and any direct *or indirect partners of UTP* shall be required, for §704(b) purposes, to treat such interest expense as a nondeductible item under §705(a)(2)(B). In a multi-tiered structure, this result could result in capital disparities and create administrative burdens in tracking the partners' bases.

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Prop. Regs. §1.163(j)-7	**Application of the §163(j) limitation to foreign corporations and United States shareholder**			
Prop. Regs. §1.163(j)-7(c)	**Application of §163(j) to CFC group members of a CFC group**	Disregarded transactions of a CFC group (Prop. Regs. §1.163(j)-7(c)(2)(ii))	Add an election to disregard interest between members of the same CFC group where a CFC group election is in effect.	Disregarding interest between members of the same CFC group would add symmetry to the rules for tax consolidations provided in §1.163(j)-5. In addition, we believe that disregarding these amounts will clarify questions related to priority of deduction to a CFC. For example, the sourcing of interest income and expense matching would not be altered if CFC to CFC interest was excluded in the disallowed business interest expense amounts for allocation. Given disregarding loans between CFC groups members may cause additional complexity for some taxpayers, we request that the option to disregard loans within a CFC group be provided on an elective basis. To relieve concerns about a whipsaw effect, we suggest that the election be subject either to the existing anti-abuse rule in Prop. Regs. §1.163(j)-7(g)(4) or a new anti-abuse rule to the same effect.
Prop. Regs. §1.163(j)-7(d)	Determination of a specified group and specified group members	Ownership threshold for inclusion in CFC group	The ownership threshold for inclusion in the CFC group election should be reduced to the threshold for qualifying as a CFC.	The specified group rules require that 80% of the total value (by reference to §1504(a)(2)(B)) of an applicable CFC be owned by the specified group parent or other applicable CFCs in the specified group in order for the applicable CFC to be included in the specified group. However, that ownership threshold is incompatible with (and harder to satisfy than) the threshold for determining CFC status under §957 and ignores the realities of common control that a U.S. shareholder has over more-than-50% -owned CFCs. Accordingly, in order to alleviate the increased burden under the proposed regulations on taxpayers who must calculate and report §163j

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				limitations on an individual entity basis for controlled CFCs even if a CFC group election is made, the ownership threshold for inclusion in the CFC group election should be reduced to the more than 50% threshold for qualifying as a CFC.
Prop. Regs. §1.163(j)-7(e)	**Rules and procedures for treating a specified group as a CFC group**	Request for an annual grouping election	Modify the five-year election as prescribed under Prop. Regs. §1.163(j)-7(e)(5)(ii) to instead be an annual election, which is consistent with the determination of the safe harbor election under the proposed regulations and with elections made under other parts of the Code and Regulations, including the high-tax election for GILTI. Although there are cases where a CFC group election is favorable to taxpayers, it is difficult for taxpayers to forecast the impact of such an election over a five-year period, and there are situations where it may not be favorable, including as a result of factual changes and changes in law as described in the additional explanation. In order to address apparent concerns	Rationale for an annual election: • GILTI high tax exclusion election: The CFC grouping election may have a negative impact due to the interaction with the GILTI high tax exclusion election. If a GILTI high-tax exclusion election is made, making the §163(j) CFC group election may affect the interest expense apportioned to different tested units and may flip some from high-tax to not or vice versa, which could help or hurt the GILTI posture. • QBAI for GILTI: CFC Grouping Election *might* turn a tested income entity into a tested loss entity. QBAI of a tested loss entity is not included into calculations of U.S. Shareholder's NDTIR (therefore, potentially increasing the GILTI inclusion).[5] • Unintended increased limitation: If the CFC group would be limited under §163(j) with a CFC group election, making the election could result in CFCs that would otherwise be able to deduct all of their interest expense (because they have plenty of ATI on a standalone basis) being limited under §163(j). This

[5] As an example, before application of §163(j), assume a CFC had income of $100 and $101 of net business interest expense resulting in a taxable loss of $1. Under §163(j), the CFC has $100 of ATI ($1 TL + $101 interest expense), limiting interest deductions to $30 (30% of $100 ATI). This means the CFC is in a tested income position ($100 income - $30 interest = $70 TI) allowing for use of QBAI. However, a grouping election that results in no limitation (i.e., because collectively the group's interest expense is less than 30% of ATI) would flip the CFC back into a tested loss.

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			regarding inappropriate tax planning that might be facilitated by allowing annual CFC group elections, restrictions could be placed on the ability to carry forward disallowed BIE if an election is made or revoked within 60 months of a previous revocation or election, as relevant. Taxpayers should not be prevented by such concerns from making or revoking CFC group elections as needed to adjust to changing facts pertaining to their CFC groups or relevant law. If the five-year election is maintained, we recommend the regulations clarify that if an election is made for a prior tax year that the five-year clock begin for the taxable year first elected.	could result in a net cost if, for instance such a CFC has low-tax subpart F income to which disallowed interest expense would have been apportioned without the election. • Symmetry: Note that the safe harbor election provided under Prop. Regs. §1.163(j)-7(h)(1) provides electivity for a CFC group that is eligible for the safe harbor. It is an annual election and under Prop. Regs. §1.163(j)-7(j)(3)(i), if the safe harbor election is made, the U.S. shareholder is not permitted to include any CFC inclusions in determining its ATI. Certainly, the effective ability to elect in the safe harbor context provides support for making this election available more generally on an annual basis. • Precedent can also be drawn from many of the elections permitted in the Internal Revenue Code. For example, sections 47, 48, 59, and 174 permit an election to change the default status when the election is irrevocable or the ability to revoke such election is limited either by time or only with consent. We believe that the default position in this case is clearly stated as standalone CFC calculations. Being that the default answer is clear we believe that only an affirmative election should begin binding the taxpayer to a position for any period of time. • Uncertainty as to Applicable Facts and Law: A five-year election does not allow taxpayers opportunity to take into consideration potential changes with respect to underlying facts, such as acquisitions or dispositions, or even changes in law. To this latter point, the changes to remove depreciation and amortization from adjustments to ATI in 2022 may significantly change a CFC group profile, and it is difficult to predict at this time the

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				potential implications. The potential impact of unanticipated law changes is even more significant.
Prop. Regs. §1.163(j)-7(g)	**Computation of CFC ATI**	Request to add back foreign taxes to CFC ATI (Prop. Regs. §1.163(j)-7(g)(3))	Modify regulations to state that ATI is not reduced by taxes imposed on the net income of a CFC by the jurisdiction in which it is incorporated or in which it is otherwise a tax resident.	The Preamble to the proposed regulations requests comments regarding adjusting ATI for foreign taxes. In the case of CFCs, it is appropriate to determine CFC ATI without reduction for foreign income taxes in order to ensure that CFCs are on a par with domestic corporations in determining the §163(j) limitation. The ATI of a domestic corporation is not reduced by U.S. federal income tax, as federal income taxes are not deductible in determining U.S. federal taxable income. To achieve parity with the domestic application of §163(j), in the CFC context, the ATI should similarly not be reduced for the CFC's national income taxes, i.e., income taxes imposed by the country in which the CFC is organized or tax resident. To note, while §951A(c)(2)(A)(ii) with cross reference to §954(b)(5) details the required deductions to achieve the net foreign income inclusion in the U.S., the aim of ATI in the §163(j) context is not to determine the ATI inclusion itself but to determine the level of BIE that is available to offset such an inclusion. If a CFC's foreign taxes reduce its ATI, then CFCs are effectively subject to a lower than 30 percent limitation relative to domestic corporations. Finally, deducting foreign taxes from a CFC's ATI penalizes taxpayers with CFCs in high-tax jurisdictions. For example, assume a CFC has $100 of adjusted taxable income, and $30 of net business interest expense. Foreign country taxes CFC's income at a 20% rate. Accordingly, CFC has $70 of pre-tax income on which it pays $14

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				of foreign taxes. If CFC's $14 deduction for foreign taxes were to reduce its ATI, then CFC would only have $86 of ATI, which would mean that only $25.8 of the net business interest expense could be deducted, leaving CFC with $4.2 of excess interest expense. On the same facts, a domestic corporation would have $4.2 greater limitation and thus no excess interest expense. (This example assumes neither the domestic corporation nor the foreign corporation pays any state or local taxes, which would reduce ATI.)
Prop. Regs. §1.163(j)-7(h)	Election to apply safe-harbor	Eligibility for safe-harbor election	Taxpayers should be able to utilize the safe-harbor election when an applicable CFC or CFC group has business interest income that exceeds its business interest expense.	Prop. Regs §1.163(j)–7(h) provides a safe harbor election that applies if an applicable CFC or CFC group's business interest expense does not exceed 30% (or 50% for specified periods of a CFC group beginning in 2019 or 2020) of the lesser of (i) qualified tentative taxable income for the applicable CFC or CFC group (as applicable), and (ii) eligible amount(s) of the applicable CFC or CFC group. Generally, eligible amounts consist of subpart F income and GILTI inclusions. Treasury explained in the Preamble to the proposed regulations that the safe harbor election "is intended to reduce the compliance burden on applicable CFCs that would not have disallowed [business interest expense] if they applied the section 163(j) calculation." If an applicable CFC or CFC group has business interest income in excess of its business interest expense, there would not be any disallowed business interest expense under §163(j). However, as currently drafted the safe harbor election would not cover all such instances, meaning that the commendable goal of reducing the compliance burden on taxpayers would not be achieved in those cases. Accordingly, the recommendation to expand

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				the application of the safe harbor election to instances where business interest income exceeds business interest expense would make the safe harbor election a more effective tool to further the goal of reducing the compliance burden on taxpayers.
Prop. Regs. §1.163(j)-7(j)	**Rules regarding the computation of ATI of certain United States shareholders of applicable CFCs**		A U.S. Shareholder should be required to deduct CFC interest expense only once in calculating its ATI.	Treasury and the IRS have repeatedly expressed concerns about double-counting income when allowing U.S. shareholders to include CFC ETI amounts in the shareholders' ATI. The corollary to not increasing ATI twice by the same income is not decreasing ATI twice for the same deductions. However, as drafted, Prop. Regs. §1.163(j)-7(j) effectively deducts interest expense twice against the same earnings in calculating U.S. shareholders' ATI additions from CFCs, leading to an artificially lower ATI for the U.S. shareholders. For example, consider a situation where USP, a domestic corporation, wholly owns foreign corporation CFC. In 2020, CFC pays $100 of interest expense and earns $500 of gross income, such that USP takes into account $400 as GILTI. CFC therefore has $500 of ATI and $300 of ETI (calculated as ATI multiplied by the percentage of unused section 163(j) limitation, or $500 * ($250 - $100)/$250, assuming a 50% section 163(j) limitation under CARES). USP's inclusion is $400 before applying section 250, and $200 after applying section 250. Under Prop. Regs. § 1.163(j)-7(j), USP includes in ATI the product of $200 and $300/$500, or $120. Thus, CFC's interest expense is taken into account twice, first in USP's inclusion of $200 and then again in CFC's ETI of only $300. There are several possible ways to avoid decreasing a U.S. shareholder's ATI twice for the same interest expense. One approach would be to use the framework of the U.S. shareholder ATI calculation in the 2018 proposed

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				regulations, which allowed a U.S. shareholder to increase its ATI by the lower of the shareholder's inclusion with respect to a CFC group and the eligible ETI of such CFCs. The details of calculating the eligible ETI of a CFC group would, of course, need to be adjusted for the consolidated group approach of the new proposed regulations for CFC groups. However, the general framework of the 2018 proposed regulations would avoid decreasing a U.S. shareholder's ATI twice for CFC interest expense deductions by not combining CFC ETI and U.S. shareholder inclusions in the same calculation. This approach would likely be the simplest way to avoid deducting CFC interest expense twice against the same earnings for calculating a U.S. shareholder's ATI. An alternative approach would be to determine a U.S. shareholder's ATI increase by multiplying the ratio of CFC ETI over ATI ("CFC ETI ratio") by a number that does not include any CFC interest expense deductions, such as by multiplying CFC ETI ratio by (i) a modified calculation of the U.S. shareholder's CFC inclusion that adds back CFC interest expense deductions or (ii) instead of the U.S. shareholder's CFC inclusion, a modified version of CFC ATI that takes into account only deductions like the §250 deduction that are not also made in calculating CFC ETI. Alternatively, the CFC ETI ratio could be modified to back out CFC interest expense deductions, such as through multiplying CFC ETI by an inclusion ratio that takes into account how much interest expense the CFC has. Each of these alternative approaches would likely require balancing different factors and would likely be more complicated than the 2018 proposed regulations' framework. Furthermore, in each of these

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				alternatives, the U.S. shareholder's ATI addition would need to be limited to the U.S. shareholder's CFC inclusion (as under the 2018 proposed regulations' framework).
		ATI of U.S. shareholders and CFCs	Primary request is for foreign income taxes to not reduce a CFC's ATI (see -7(g) comment above) Alternatively, a U.S. shareholder's ATI should be permitted to include its eligible foreign income taxes attributable to an applicable CFC.	If the request to include foreign income taxes in a CFC's ATI (comments in Prop Regs. §1.163(j)-7(g)) are not accepted, we alternatively propose to include eligible foreign income taxes from CFCs in calculating a US shareholder's ATI. While we leave methodology of determining eligible foreign tax amounts to be determined by the Treasury, we note that analogous guidance may be found in the foreign tax credit context; whereby, a U.S. shareholder electing to claim foreign tax credits, includes foreign taxes associated with §§951 and 951A inclusions in income under §78. Accordingly, §78 deems a dividend to a U.S. shareholder such that the amount of foreign taxes is not deducted from U.S. shareholder's taxable income. This allows for tax assessment on the full amount and to reduce the resulting U.S. tax liability by the foreign tax credit. Not allowing foreign taxes to increase either CFC's ATI or the U.S. shareholder's ATI could create unintended consequences to either dis-incentivize taxpayers from loaning to high tax foreign jurisdictions and favoring putting financing activity in low tax jurisdictions to avoid the consequence of reducing ATI.