



December 21, 2020

The Honorable David J. Kautter  
Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

The Honorable Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

CC:PA:LPD:PR (REG-107911-18)  
Room 5203  
Internal Revenue Service  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

**Re: Notice of Proposed Rulemaking for Rules Concerning the Limitation on the Deduction for Business Interest Expense [[REG-107911-18](#)] and Final Regulations ([T.D. 9905](#)) on International and Tax-Exempt Issues**

Dear Messrs. Kautter and Rettig:

The American Institute of CPAs (AICPA) appreciates the opportunity to provide comments on REG-107911-18 (the proposed regulations) and final regulations T.D. 9905 (the final regulations), providing rules concerning the limitation on the deduction for business interest expense after amendment of the Internal Revenue Code (IRC or Code) by the provisions commonly known as the Tax Cuts and Jobs Act (TCJA or the Act), which was enacted on December 22, 2017, and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act or the Act), which was enacted on March 27, 2020.

This letter is in response to the proposed and final regulations on section 163(j),<sup>1</sup> limitation on the deduction for business interest expense. Specifically, the AICPA submits recommendations to address the following areas:

- A. Treatment of Foreign Tax Expense
- B. Reduction of Controlled Foreign Corporation (CFC) Group Ownership Threshold to 50%
- C. Annual Election to Group CFCs
- D. Application of Ordering Rules in Section 163(j) Adjusted Taxable Income (ATI) Determinations
- E. Computation of Section 163(j) Limitation for Tax-Exempt Organizations
- F. Computation of Section 163(j) Excess Items for Tax-Exempt Partners

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<sup>1</sup> Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the Code), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

Section 163(j) limits a taxpayer's deductions for business interest expense in a tax year to the business interest income "of such taxpayer" plus 30%<sup>2</sup> of the "adjusted taxable income of such taxpayer" (plus the "floor plan financing interest of such taxpayer," if applicable).

For these purposes, "business interest" means any interest paid or accrued on indebtedness properly allocable to a trade or business, while the term "business interest income" means the amount of interest includible in the gross income of the taxpayer for the tax year that is properly allocable to a trade or business. Business interest does not include interest paid or accrued on indebtedness properly allocable to property held for investment ("investment interest" described in section 163(d)) and business interest income does not include any interest from investment property.

The term "adjusted taxable income" means the taxable income of the taxpayer computed without regard to: (i) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (ii) any business interest or business interest income; (iii) the amount of any net operating loss deduction under section 172; (iv) the amount of any deduction allowed under section 199A; and (v) in the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion.

## **A. Treatment of Foreign Tax Expense**

### Overview

Proposed Reg. §1.163(j)-7(g)(3) provides that, for purposes of computing ATI of a relevant foreign corporation, tentative taxable income of a relevant foreign corporation is determined by taking into account a deduction for foreign taxes. This rule is consistent with Treas. Reg. §1.952-2(a)(1), which provides that the taxable income of a foreign corporation for any taxable year is determined by treating the foreign corporation as a domestic corporation, and section 164(a), which allows a deduction for foreign taxes.

### Recommendation

The Department of the Treasury (Treasury) and the Internal Revenue Service (IRS or Service) should determine the ATI of a relevant foreign corporation without taking into account the deduction for foreign taxes.

### Analysis

The 163(j) limitation is based on 30% of the ATI of the entity at issue. The calculation for ATI begins with taxable income, which is then adjusted, for example, by certain depreciation and amortization, net interest expense, and other adjustments as prescribed by the Secretary.

When determining the ATI of a domestic corporation, federal taxes are not deducted (because no such deduction is allowed for regular taxable income purposes) and consequently do not reduce

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<sup>2</sup> The 2020 CARES Act amended the Code to provide that, for tax years beginning in 2019 and 2020, the 30% ATI limitation is increased to 50%, though taxpayers may elect not to have this rule apply. See IRC section 163(j)(10)(A).

the ATI of the domestic corporation. To ensure equitable treatment of domestic corporations and foreign corporations, the local country income taxes paid by the foreign corporation should not reduce a foreign corporation's ATI. The government has clear authority under section 163(j)(8)(B) to provide for this adjustment in the context of implementing section 163(j) at the foreign corporation level.

We acknowledge that this recommendation would provide for a different treatment for foreign income taxes in the context of a foreign corporation's ATI as opposed to its tested income and subpart F income, but this result is appropriate given the different policies and fundamentals of the different provisions. Specifically, our proposal offers a more accurate calculation of the pre-tax income baseline that ATI is intended to approximate in the section 163(j) context; whereas the reduction for foreign taxes for purposes of tested income of global intangible low-taxed income (GILTI) and subpart F income is statutorily mandated (see §§ 951A(c)(2)(A)(ii) and 954(b)(5)) and aligns those provisions with their deemed dividend characterization.

## **B. Reduction of CFC Group Ownership Threshold to 50%**

### Overview

Proposed Reg. § 1.163(j)-7(d)(2) provides rules for determining a specified group. A specified group includes one or more chains of applicable CFCs connected through stock ownership with a specified group parent, but only if the specified group parent owns stock meeting the requirements of section 1504(a)(2)(B) (pertaining to value) in at least one applicable CFC. The subsidiary stock meeting the requirements of section 1504(a)(2)(B) must be owned directly or indirectly by one or more of the other applicable CFCs or the specified group parent. Proposed Reg. § 1.163(j)-7(d)(2)(iii) defines a specified group parent as (i) a qualified U.S. person, which is defined as an individual citizen or resident of the U.S. or a U.S. corporation,<sup>3</sup> or (ii) an applicable CFC. The term applicable CFC is a CFC that has at least one U.S. shareholder that owns, within the meaning of section 958(a), stock in the CFC.<sup>4</sup>

### Recommendation

Treasury and the IRS should provide reduction in the CFC group ownership threshold from 80% of value to 50% of value and retain the reference to section 1504(a)(2)(B) for purposes of determining whether an applicable CFC is included in the specified group.

### Analysis

The 80% CFC group ownership threshold is arbitrarily high. The existing ownership threshold is inconsistent with existing CFC rules. A 50% threshold is a more administrable threshold and more closely aligns with the existing CFC rules, such as the rule for determining CFC status under section 957.

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<sup>3</sup> Prop. Reg. § 1.163(j)-7(d)(2)(iv) provides that members of a U.S. consolidated group are treated as a single qualified U.S. person.

<sup>4</sup> Treas. Reg. § 1.163(j)-1(b)(2).

Moreover, in the preamble, Treasury and the IRS determined that limiting the 80% threshold to value is appropriate to prevent taxpayers from breaking affiliation by diluting voting power below 80%. However, by applying a lower threshold for the CFC group ownership threshold, this process ought to mitigate Treasury's and the IRS's concern that taxpayers will intentionally break affiliation from a CFC group by qualifying a larger number of applicable CFCs as specified group members of a single group.

### **C. Annual Election to Group CFCs**

#### Overview

Proposed Reg. § 1.163(j)-7(e)(5)(ii) provides that a CFC group election, once made, is only revocable after a five-year period that commences at the end of the first period for which the election is in effect. Similarly, once revoked, a CFC group election cannot be made with respect to any specified period for the five years following the last day of the specified period for which the election was revoked.

Further, Treasury and the IRS requested comments regarding whether a specified group that does not make a CFC group election when it first comes into existence (or for the first specified period following 60 days after the date of publication of the Treasury decision adopting the regulations as final in the Federal Register) should not have the ability to make the CFC group election for any specified period beginning during the 60-month period following that specified period.

#### Recommendation

Treasury and the IRS should provide taxpayers who have made a group election the ability to revoke this election at any point. These taxpayers are then subject to a five-year cooling off period before having the ability to re-elect (*i.e.*, once revoked, the taxpayer cannot make the election again for five years).

The AICPA also recommends allowing an initial CFC group election at any time, and no 60-month limitation period should apply prior to the initial CFC group election.

#### Analysis

Forecasting the effect of the CFC grouping election over a five-year period is difficult for taxpayers. There are unforeseen changes in a taxpayer's facts and circumstances outside the control of the taxpayer that arise year over year and could adversely affect a prior CFC grouping election. Many of these changes have nothing to do with tax planning (*e.g.*, acquisitions and audit adjustments). The preamble indicates that Treasury and IRS are concerned about abuse with respect to providing an annual election.

Moreover, no similar concern exists for an initial CFC group election, which is why the AICPA recommends no 60-month limitation period prior to making the initial CFC group election.

## **D. Application of Ordering Rules in Section 163(j) ATI Determinations**

### Overview

In the preamble to the final regulations issued on September 14, 2020,<sup>5</sup> Treasury and the IRS state that, “further study is required to determine the appropriate rule for coordinating sections 250(a)(2), 163(j), and other Code provisions (such as sections 170(b)(2) and 172(a)(2)) that limit the availability of deductions based, directly or indirectly, upon a taxpayer’s taxable income (taxable income-based provisions).” Further, as noted in the preamble to the final regulations, commenters observed “that [the] proposed rule [in the 2018 proposed regulations] results in a lower ATI and section 163(j) limitation for the taxpayer than if the limitation in section 250(a)(2) were taken into account ... [and] that the rationale for this approach (which does not reflect the taxpayer’s actual taxable income) is unclear, and they recommend that this provision be withdrawn or made elective for taxpayers. ... Therefore, the final regulations do not contain the rule in proposed §1.163(j)-1(b)(37)(ii). Until such additional guidance is effective, taxpayers may choose any reasonable approach (which could include an ordering rule or the use of simultaneous equations) for coordinating taxable income-based provisions as long as such approach is applied consistently for all relevant taxable years.”

Proposed Reg. § 1.163(j)-1(b)(37)(ii), issued on December 28, 2018,<sup>6</sup> introduced the coordination rule with respect to sections 163(j) and 250(a)(1). The regulation states, “if for a taxable year a taxpayer is allowed a deduction under section 250(a)(1) that is properly allocable to a non-excepted trade or business, then taxable income for the taxable year is determined without regard to limitations in section 250(a)(2). For this purpose, the amount of the deduction allowed under 250(a)(1), without regard to the limitation in section 250(a)(2), is determined without regard to the application of section 163(j) and the section 163(j) regulations.”

To determine the limitations, one would need to understand the coordination requirements of each section to understand the ordering (*i.e.*, an ordering rule). Based on the aforesaid provisions of Prop. Reg. § 1.163(j)-1(b)(37)(ii), the section 250(a)(1) deduction is applied prior to the limitation on the deduction for section 163(j) and the section 163(j) regulations. Taxpayers with a significant section 250(a)(1) deduction would have greatly reduced ATI for purposes of the section 163(j) deduction. A taxpayer with a properly allocable section 250(a)(1) deduction is precluded from the taxable income limitations of section 250(a)(2), which would erode the ATI for purposes of computing the deduction under section 163(j) and the regulations therein. Per section 172(a)(2)(B)(ii)(I), the deduction allowed for net operating losses (NOLs) is determined using taxable income without regard to section 250. Additionally, the section 250(a)(2)(A)(ii) taxable income limitation is computed without regard to the section 250 deduction but after the application of sections 163(j) and 172(a). Since the section 250 deduction is determined without regard to section 163(j) and the regulations therein, there is no circularity as the taxable income limitation of section 250(a)(2) is not applied. However, the coordination for sections 172(a)(2) and 250(a)(1) are dependent on consideration of the other deduction which will create circularity. The ordering rules, as stated for these three provisions, will negatively affect taxpayers entitled to a deduction under section 250(a)(1) that is properly allocated to a non-excepted trade or business resulting in

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<sup>5</sup> TD 9905.

<sup>6</sup> REG-106089-18.

the erosion of the amount of ATI available for the limitation on the deduction for section 163(j) and the regulations therein.

### Recommendation

Treasury and the IRS should allow any reasonable method, including simultaneous equations. The AICPA also recommends, to the extent that an ordering rule is retained, application of the limitation under section 250(a)(2) if a taxpayer has a section 250(a)(1) deduction. This process would establish a more harmonious coordination with the other sections while not eroding the taxpayer's overall deductions.

### Analysis

Given the numerous Code sections that have taxable income based limitations (*e.g.*, sections 163(j), 170(b)(2), 246(b), 613A(d), and 1503(d)), we agree with the Treasury and IRS position to reserve on the ordering rule until a further study has been completed.

Our primary recommendation is for Treasury and the IRS to finalize the current state of allowing taxpayers to choose reasonable methods, including simultaneous equations. The provisions at issue are already complicated and cumbersome, and it would benefit tax administration to allow taxpayers to choose a reasonable method rather than forced into additional time-consuming and complex formulas. As evidenced by the comments and Treasury and the IRS' most recent response, there is no clear "right answer" on this point, and thus no significant purpose served by attempting to prioritize the ordering of one provision over another.

If Treasury and the IRS disagree with this suggestion and determine that the tax community is better served through a specific and uniform rule, we note our concerns with the 2018 proposed rule. As currently construed, the proposed ordering rule does not treat all taxpayers equally because it would reduce the limitation on the section 163(j) deduction to the extent a taxpayer has a section 250(a)(1) deduction. For example for taxpayers whose international footprint is derived from sales that originate in the U.S. for foreign consumption or use (*i.e.*, foreign-derived intangible income (FDII)) and if the taxpayer's foreign sales exceed U.S. sales, the 2018 proposed ordering rule would first apply the section 250(a)(1) deduction for foreign sales against the domestic sales deductions. For taxpayers with significant foreign transactions (*i.e.*, FDII or GILTI), the rules in Prop. Reg. § 1.163(j)-1(b)(37)(ii) remove the taxable income limitation under section 250(a)(2) to the extent the section 250(a)(1) deduction is properly allocable to a non-excepted trade or business. This removal allows a taxpayer to maximize its section 250 deduction prior to considering the section 163(j) calculation. If finalized, this rule could adversely affect taxpayers with smaller section 250(a)(1) benefits and with more significant annual interest expense amounts, and may cause certain taxpayers to be forced to indefinitely defer some or all of their business interest expense deduction.

## **E. Computation of Section 163(j) Limitation for Tax-Exempt Organizations**

### Overview

The final regulations provide that all interest expense and all interest income of a taxpayer that is a C corporation is treated as properly allocable to a trade or business and that, for purposes of computing ATI, all items of income, gain, deduction, or loss of a taxpayer that is a C corporation are treated as properly allocable to a trade or business.<sup>7</sup> The final regulations also provide that these rules apply to a tax-exempt corporation that is subject to unrelated business income tax (UBIT) “only with respect to that corporation's items of income, gain, deduction, or loss that are taken into account in computing the corporation's unrelated business taxable income, as defined in section 512.”<sup>8</sup>

Neither the final regulations under section 163(j) nor the final regulations under section 512(a)(6) address how the limitation under section 163(j) is properly computed and applied in the context of a tax-exempt organization with more than one trade or business that must, under section 512(a)(6), separately compute unrelated business taxable income (UBTI) for each trade or business.

### Recommendation

Treasury and the IRS should provide guidance that a tax-exempt organization with more than one trade or business should compute one section 163(j) limitation for the organization as a whole, based on the business interest income and ATI of the organization collectively. Moreover, in computing the section 163(j) limitation, the organization should take into account all items of income, gain, deduction, or loss that are taken into account in computing the corporation's UBTI, but without applying section 512(a)(6).

The AICPA also recommends that when applying the section 163(j) limitation to interest expense deducted in computing UBTI, a tax-exempt organization should have the ability to allocate the limitation among its separate trades or businesses using any reasonable method. For example, a tax-exempt organization could allocate the limitation to each trade or business based on the percentage of the organization's total interest expense incurred by each trade or business.

Finally, the regulations should confirm that interest expense that a tax-exempt trust pays or incurs that is properly allocable to property held for investment (that is, which is investment interest described in section 163(d)) is not limited by section 163(j), even if the regulations under section 512(a)(6) treat a tax-exempt trust's investment activities as a trade or business.

### Analysis

Section 163(j) provides for one limitation for the taxpayer as whole, based on the aggregate business interest income “of such taxpayer” plus 30% of the aggregate ATI “of such taxpayer.” Neither section 163(j) nor section 512(a)(6) provide support for a taxpayer establishing multiple section 163(j) limitations for separate trades or businesses. Indeed, the final regulations provide

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<sup>7</sup> Treas. Reg. § 1.163(j)-4(b)(1)-(2).

<sup>8</sup> Treas. Reg. § 1.163(j)-4(b)(5).

for multiple entities in a consolidated group having a single section 163(j) limitation, calculated on a consolidated basis, by using the consolidated group's taxable income to compute ATI and summing up each member's current-year business interest expense and business interest income.<sup>9</sup>

In computing its aggregate section 163(j) limitation for the taxpayer as a whole, the organization should, as the final regulations under section 163(j) indicate, take into account only items of income, gain, deduction, or loss that are taken into account in computing the organization's UBTI. However, in doing so, the organization should not apply section 512(a)(6), meaning that items of income, gain, deduction or loss from trades or businesses with a loss should have consideration when computing the section 163(j) limitation. Taking into account items for businesses with a loss is necessary to avoid over-stating the ATI and thereby artificially increasing the section 163(j) limitation, which would allow more interest deductions than reasonably permissible. Such an approach is also similar to that taken under the final regulations for computing UBTI for purposes of the public support test.<sup>10</sup> Moreover, if the methodology for computing the section 163(j) limitation only took into account items from trades or businesses with positive UBTI ("gain silos") and the resulting section 163(j) limitation were then applied to limit the interest deductions taken in a loss silo to result in that silo becoming a gain silo (meaning it should have been taken into account in computing the overall 163(j) limitation in the first place), the entire computation would break down.

Once a tax-exempt organization computes its section 163(j) limitation, it will need to apply the limitation in computing UBTI, which, for tax-exempt organizations with more than one trade or business, will mean applying the limitation to interest deductions that could potentially be taken into consideration when separately computing UBTI for separate trade or business silos. The limitation by its terms applies to the organization as a whole; there is not a reason to apply the limitation to one silo rather than another. Consequently, organizations should have the ability to apply the limitation on an overall approach and use a reasonable method to allocate the interest expense to its trade or business silos. This combination approach also treats a tax-exempt organization subject to UBIT more on par with regular taxable C corporations.

Finally, section 163(j) clarifies that the limitation does not apply to interest paid or accrued on indebtedness properly allocable to property held for investment (*i.e.*, investment interest described in section 163(d)). While the final regulations under section 163(j) provide that all interest expense of a taxpayer that is a C corporation is treated as properly allocable to a trade or business and thus not investment interest described in section 163(d), no such rule applies to trusts. As a result, interest expense incurred by tax-exempt trusts that is properly allocable to property held for investment is not limited by section 163(j). We request confirmation of this result.

## **F. Computation of Section 163(j) Excess Items for Tax-Exempt Partners**

### Overview

Section 163(j) is applied to partnership business indebtedness at the partnership level. To the extent a partnership's business interest deduction is limited, it must allocate the deferred business

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<sup>9</sup> Treas. Reg. § 1.163(j)-4(d)(2).

<sup>10</sup> Treas. Reg. §§ 1.170A-9(f)(7)(v), 1.509(a)-3(a)(3)(i), (4).



interest (“excess business interest expense” or EBIE) to the partners, which reduces the partners’ bases in their partnership interests. Section 163(j)(4) provides that EBIE is then treated as paid or accrued by the partner to the extent the partner is allocated “excess taxable income” (ETI) from the partnership. ETI is ATI of the partnership in excess of the amount the partnership requires to deduct its own interest under section 163(j). To the extent EBIE is treated as paid or accrued by a partner, such EBIE is subject to a section 163(j) limitation at the partner level. Under the final regulations, EBIE is also treated as paid or accrued by a partner to the extent the applicable partnership allocates excess business interest income (EBII) (business interest income of the partnership in excess of the amount the partnership requires to deduct its own interest under section 163(j)) to the partner.

As noted above, the final regulations further provide that the rules applicable to C corporations under Treas. Reg. § 1.163(j)-4(b) apply to a tax-exempt corporation that is subject to UBIT “only with respect to that corporation's items of income, gain, deduction, or loss that are taken into account in computing the corporation's unrelated business taxable income, as defined in section 512.”<sup>11</sup> The regulations do not clarify whether this general principle also applies to EBIE, ETI, and EBII, items that are covered in the rules applicable to partnerships set forth in Treas. Reg. § 1.163(j)-6. In other words, the regulations do not state whether EBIE, ETI, and EBII are separately computed for partners that are tax-exempt corporations based solely on items of income, gain, deduction, or loss that are taken into account in computing the partners’ UBTI derived from the partnership. The regulations also do not address tax-exempt partners that are trusts. As a result, tax-exempt partners have not received information on their Schedules K-1 stating the amount of their EBIE, ETI, and EBII attributable to UBTI.

### Recommendation

Treasury and the IRS should clarify, in the final regulations, whether EBIE, ETI, and EBII are separately computed for tax-exempt partners (considering both corporations and trusts) based solely on items of income, gain, deduction, or loss that are taken into account in computing partners’ UBTI derived from the partnership and also what information is required for tax-exempt partners on the Schedule K-1.

### Analysis

Section 6031(d) requires partnerships to furnish the necessary information on Schedule K-1 to enable each partner to compute its UBTI from the partnership. However, there is currently a lack of guidance on how partnerships should compute EBIE, ETI, and EBII for tax-exempt partners. Providing additional guidance will allow for account administrability for both partnerships and their tax-exempt partners.

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<sup>11</sup> Treas. Reg. § 1.163(j)-4(b)(5).

The Honorable David J. Kautter  
The Honorable Charles P. Rettig  
December 21, 2020  
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prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact David Sites, Chair, AICPA International Tax Technical Resource Panel, at (202) 861-4104 or [David.Sites@us.gt.com](mailto:David.Sites@us.gt.com); Amy Miller, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or [Amy.Miller@aicpa-cima.com](mailto:Amy.Miller@aicpa-cima.com); or me at (612) 397-3071 or [Chris.Hesse@claconnect.com](mailto:Chris.Hesse@claconnect.com).

Sincerely,



Christopher W. Hesse, CPA  
Chair, AICPA Tax Executive Committee

cc:

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