

# CARES Act Tax Planning Implications – Business Interest Expense

**Lisa Pileggi,**  
Director-in-Charge,  
Tax Strategies

**Michael Viens,**  
Director,  
Tax Strategies

[www.kmco.com](http://www.kmco.com)

**Kreischer  
Miller**

PEOPLE | IDEAS | SOLUTIONS

# Agenda

1. History of IRC 163(j) Provisions
2. Modifications Under CARES Act
3. Planning Considerations



**Kreischer  
Miller**

# History of IRC 163(j)

---

- Prior to Tax Cuts and Jobs Act (Pre 2018 Tax Years)
  - Focused on limiting interest paid to a related party if no U.S. tax was imposed on the corresponding interest income.
- Tax Cuts and Jobs Act Modifications (Post 2017 Tax Years)
  - Expanded application to any taxpayer and potentially limits amount of business interest expense deduction.
- CARES Act Modification (2019 and 2020 Tax Years)
  - The CARES Act generally increases the interest limitation for taxable years beginning in 2019 and 2020 subject to limitations for partnerships.



PEOPLE | IDEAS | SOLUTIONS

# TCJA Provisions

---

- Generally, taxpayers can deduct interest expense paid or accrued in the taxable year. However, if section 163(j) applies, the amount of deductible business interest expense in a taxable year cannot exceed the sum of:
  - the taxpayer's business interest income for the year;
  - 30% of the taxpayer's adjusted taxable income (ATI) for the year; and
  - the taxpayer's floor plan financing interest expense for the year.



PEOPLE | IDEAS | SOLUTIONS

# Who is Subject to the Section 163(j) Limitation?

---

- For tax years beginning after 2017, the limitation applies to all taxpayers who have business interest expense, other than certain small businesses that meet the gross receipts test in section 448(c) (“exempt small business”).
- The limitation also does not apply to certain excepted trades or businesses.



PEOPLE | IDEAS | SOLUTIONS

# Gross Receipts Test

---

- A business generally meets the gross receipts test of section 448(c) when it is not a tax shelter (as defined in section 448(a)(3)) and has average annual gross receipts of \$25 million or less in the previous three years.
- For tax year 2019, the average amount is increased to \$26 million.
- The amount will be adjusted for inflation going forward.



PEOPLE | IDEAS | SOLUTIONS

# Excepted Trade or Business

---

- The trade or business of providing services as an employee;
- Certain real property trades or businesses that elect to be excepted;
- Certain farming businesses that elect to be excepted; and
- Certain regulated utility trades or businesses.



PEOPLE | IDEAS | SOLUTIONS

# Adjusted Taxable Income (“ATI”)

---

- Start with taxable income for the taxable year as if section 163(j) does not limit any interest deduction, and then add the following:
  - business interest expense;
  - net operating loss deduction;
  - deduction for qualified business income under section 199A;
  - depreciation, amortization, or depletion deduction; capital loss carrybacks or carryovers;
  - and any deduction or loss not properly allocable to a non-excepted trade or business.



PEOPLE | IDEAS | SOLUTIONS



# Adjusted Taxable Income (“ATI”)

---

Also subtract the following:

- business interest income;
- floor plan financing interest expense;
- the lesser of (i) gain realized on sale or disposition of property or (ii) deductions for depreciation, amortization or depletion taken for such property during a tax year beginning after 2017 (and similar adjustments for sales or dispositions of property held by a partnership or member of a consolidated group upon the sale or other disposition of the partnership interest or stock of the member);
- and any income or gain that is not properly allocable to a non-excepted trade or business.



PEOPLE | IDEAS | SOLUTIONS

# Adjusted Taxable Income (“ATI”)

---

- For taxable years beginning after 2021, deductions for depreciation, amortization, or depletion are not taken into account in calculating ATI.



PEOPLE | IDEAS | SOLUTIONS

# Treatment of Interest Expense That Can't Be Deducted in the Current Year

---

- The amount of business interest expense disallowed as a deduction in the current year is carried forward to the next taxable year (a “disallowed business interest expense carryforward”).
- The disallowed business interest expense carryforward may be limited in the next taxable year if the section 163(j) limitation continues to apply.



PEOPLE | IDEAS | SOLUTIONS

# Partnership 163(j) Limitation

---

- The section 163(j) limitation is applied at the partnership level.
- The amount of deductible business interest expense in a taxable year cannot exceed the sum of the partnership's business interest income, 30% of the partnership's ATI, and the partnership's floor plan financing interest expense.
- Business interest expense that may be deducted upon application of the section 163(j) limitation is taken into account in determining the non-separately stated taxable income or loss of the partnership.
- Any business interest expense of the partnership that is disallowed upon application of the section 163(j) limitation is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.
- This amount is called excess business interest expense.



PEOPLE | IDEAS | SOLUTIONS

# Partnership 163(j) Limitation

---

- A partner carries forward its share of excess business interest expense.
- In a succeeding taxable year, a partner may treat its excess business interest expense as business interest expense paid or accrued by the partner to the extent the partner is allocated excess taxable income or excess business interest income from the same partnership.
- Excess taxable income is the amount of ATI of the partnership that was in excess of what it needed to deduct its business interest expense, and excess business interest income is the amount by which business interest income exceeded business interest expense at the partnership level.



PEOPLE | IDEAS | SOLUTIONS

# Partnership 163(j) Limitation

---

- Excess taxable income is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.
- An allocation of excess taxable income to a partner increases the partner's ATI.
- Similarly, an allocation of excess business interest income to a partner increases the partner's business interest income.
- Once excess business interest expense is treated as business interest expense paid or accrued by the partner, such business interest expense is subject to the partner's section 163(j) limitation, if any.



PEOPLE | IDEAS | SOLUTIONS

# S Corporation 163(j) Limitation

---

- S corporations apply the section 163(j) limitation at the S corporation level.
- Any business interest expense of the S corporation that is disallowed upon application of the section 163(j) limitation is not allocated to its shareholders, but is instead carried over at the S corporation level to its succeeding taxable years.
- An S corporation allocates any excess taxable income and excess business interest income to its shareholders on a pro-rata basis.



PEOPLE | IDEAS | SOLUTIONS

# CARES Act Modifications

---

- For taxpayers generally, the CARES Act increases the 30% ATI limitation to 50% of ATI for taxable years beginning in both 2019 and 2020.
- Taxpayers may elect to use 2019 ATI in determining the section 163(j) limitation for any taxable year beginning in 2020.
- Taxpayers can elect to keep the limitation at 30% of ATI for a taxable year, but would need consent to revoke such an election for the taxable year, once made.



PEOPLE | IDEAS | SOLUTIONS



# CARES Act Partnership Modification

---

- For partnerships, the CARES Act increases the ATI limitation to 50% only for taxable years beginning in 2020.
- Half of a partnership's excess business interest expense allocated to a partner for a 2019 taxable year can automatically be treated as deductible interest expense in the partner's first taxable year beginning in 2020.
- The other half allocated to the partner is treated as it normally would be.
- Partners can elect out of treating half of 2019 EBIE as automatically deductible in 2020.
- Partnerships, rather than partners, are entitled to elect out of the increase in the ATI limitation for 2020.



PEOPLE | IDEAS | SOLUTIONS

# Planning Considerations

---

Consider interaction with other CARES Act modifications; for example, technical correction relating to Qualified Improvement Property, which makes such cost eligible for bonus depreciation.

*If QIP is material, increase in 163(j) ATI limitation from 30% to 50% may be neutralized by decrease in taxable income arising from bonus depreciation. Bonus depreciation in acquisition year will increase ATI in future years.*



PEOPLE | IDEAS | SOLUTIONS

# Planning Considerations

---

Consider late election as qualified real property trade or business or revocation of an election that was made.

Taxpayers now have until October 15, 2021, to amend 2018 and 2019 returns to reflect the change in elections. See Rev. Proc. 2020-22.

*Many taxpayers with QIP placed in service during 2018 or 2019 chose to make the real property trade or business election due to the minimal difference between GDS and ADS depreciation for QIP. Now may be the appropriate time to reevaluate.*



PEOPLE | IDEAS | SOLUTIONS

# Planning Considerations

---

Consider election to use 2019 ATI for 2020.

*Operating results for 2020 may be negatively impacted by pandemic conditions. PPP loan forgiveness may have interesting implications if proposals to negate the IRS ruling that costs aren't deductible proceed. 2020 tax deferral planning potentially becomes more interesting.*



PEOPLE | IDEAS | SOLUTIONS

# Planning Considerations

---

Consider potential state tax ramifications.

*Some states, but not all, conform to Federal tax provisions. How will decisions made in planning for CARES Act modifications to IRC 163(j) impact state income tax liabilities?*



PEOPLE | IDEAS | SOLUTIONS

# Planning Considerations

---

Consider possibility of higher tax rates on the horizon.

*Some planning decisions need to be addressed relatively quickly due to filing deadlines. Others can be delayed to await possible developments in possible further tax legislation initiatives and/or election results. Will tax rates go up near term and, if so, would interest expense deductions be more valuable in the future?*



PEOPLE | IDEAS | SOLUTIONS

# Contact the Presenters at [kmiller@kmco.com](mailto:kmiller@kmco.com)

---



**Lisa G. Pileggi**  
**Director, Tax Strategies**

As the Director-in-Charge of Kreischer Miller’s Tax Strategies practice, Lisa provides strategic leadership and management of the group, including recruiting, training, team member development, and serving as a resource on technical matters. She is a trusted advisor to her clients, providing tax and business advisory services for a broad range of privately-held businesses including real estate developers and investors, construction contractors, manufacturers, and distributors.



**Michael Viens**  
**Director, Tax Strategies**

As a Director in Kreischer Miller’s Tax Strategies practice, Mike provides assistance to corporate, partnership/limited liability company, and trust entities as well as individuals in connection with tax filings, examinations, and federal, state, and local tax planning. Mike’s background includes assisting clients with formation of businesses, raising capital, credit relationships, and executive compensation, as well as the sale, merger and other transfers of ownership interests.



PEOPLE | IDEAS | SOLUTIONS

# About Kreischer Miller

---

Kreischer Miller is an accounting, tax, and business advisory firm that has been serving clients since 1975. We've built our firm to respond to the unique needs of growth-oriented private companies, helping you smoothly transition through growth phases, business cycles, and ownership changes. The companies we work with need to be able to quickly adapt and respond to changing market opportunities and challenges. That's why our focus is on being responsive, decisive, and forward-thinking. We're up to the challenge—always looking at the road ahead, not in the rear-view mirror. **Learn more at [www.kmco.com](http://www.kmco.com).**



PEOPLE | IDEAS | SOLUTIONS