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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9943]

RIN 1545-BP73

Additional Guidance Regarding Limitation on Deduction for Business Interest Expense

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide additional guidance regarding the limitation on the deduction for business interest expense under section 163(j) of the Internal Revenue Code (Code) to reflect amendments made by the Tax Cuts and Jobs Act and the Coronavirus Aid, Relief, and Economic Security Act. Specifically, the regulations address the application of the limitation in contexts involving passthrough entities, regulated investment companies (RICs), and controlled foreign corporations. The regulations also provide guidance regarding the definitions of real property development, real property redevelopment, and syndicate. The regulations affect taxpayers that have business interest expense, particularly passthrough entities, their partners and shareholders, as well as foreign corporations and their United States shareholders. The regulations also affect RICs that have business interest income, RIC shareholders that have business interest expense, and corporations that are members of a consolidated group.

DATES: Effective date: The regulations are effective on January 13, 2021.

Applicability dates: For dates of applicability, see §§1.163-15(b), 1.163(j)-1(c)(4), 1.163(j)-2(k), 1.163(j)-6, 1.163(j)-7(m), 1.163(j)-10(f), 1.469-11(a)(1) and (4), and 1.1256(e)-2(d).

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SUPPLEMENTARY INFORMATION:

Background

I. Statutory Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 163 (in particular, section 163(j)), 469, and 1256(e) of the Code. Section 163(j) was amended by Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), and the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat. 281 (March 27, 2020) (CARES Act). Section 13301(a) of the TCJA amended section 163(j) by removing prior section 163(j)(1) through (9) and adding section 163(j)(1) through (10). The provisions of section 163(j) as amended by section 13301 of the TCJA are effective for taxable years beginning after December 31, 2017. The CARES Act further amended section 163(j) by redesignating section 163(j)(10), as amended by the TCJA, as new section 163(j)(11), and adding a new section 163(j)(10) providing special rules for applying section 163(j) to taxable years beginning in 2019 or 2020.

Section 163(j) generally limits the amount of business interest expense (BIE) that can be deducted in the current taxable year (sometimes referred to in this preamble as the current year). Under section 163(j)(1), the amount allowed as a deduction for BIE is limited to the sum of (1) the taxpayer's business interest income (BII) for the taxable year; (2) 30 percent of the taxpayer's adjusted taxable income (ATI) for the taxable year (30 percent ATI limitation); and (3) the taxpayer's floor plan financing interest expense for the taxable year (in sum, the section 163(j) limitation). As further described later in this Background section, section 163(j)(10), as amended by the CARES Act, provides special rules relating to the 30 percent ATI limitation for taxable years beginning in 2019 or 2020. Under section 163(j)(2), the amount of any BIE that is not allowed as a deduction in a taxable year due to the section 163(j) limitation is treated as business interest paid in the succeeding taxable year.

The section 163(j) limitation applies to all taxpayers, except for certain small businesses that meet the gross receipts test in section 448(c) of the Code and certain trades or businesses listed in section 163(j)(7) (excepted trades or businesses). More specifically, section 163(j)(3) provides that the section 163(j) limitation does not apply to any taxpayer that meets the gross receipts test under section 448(c), other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3). Under section 163(j)(7), the excepted trades or businesses are the trade or business of providing services as an employee, electing real property businesses, electing farming businesses, and certain regulated utility businesses.

Section 163(j)(4) provides special rules for applying section 163(j) in the case of passthrough entities. Section 163(j)(4)(A) requires that the section 163(j) limitation be applied at the partnership level, and that a partner's ATI be increased by the partner's share of excess taxable income, as defined in section 163(j)(4)(C), but not by the partner's distributive share of income, gain, deduction, or loss. Section 163(j)(4)(B) provides that the amount of partnership BIE exceeding the section 163(j)(1) limitation is carried forward at the partner level as excess business interest expense (EBIE).

Section 163(j)(4)(B)(ii) provides that EBIE allocated to a partner and carried forward is available to be deducted in a subsequent year only to the extent that the partnership allocates excess taxable income to the partner. As further described later in this Background section, section 163(j)(10), as amended by the CARES Act, provides a special rule for EBIE allocated to a partner in a taxable year beginning in 2019. Section 163(j)(4)(B)(iii) provides rules for the adjusted basis in a partnership of a partner that is allocated EBIE. Section 163(j)(4)(D) provides that rules similar to the rules of section 163(j)(4)(A) and (C) apply to S corporations and S corporation shareholders.

Section 163(j)(5) and (6) define "business interest" and "business interest income," respectively, for purposes of section 163(j). Generally, these terms include interest expense and interest includible in gross income that is properly allocable to a trade or business (as defined in section 163(j)(7)) and do not include investment income or investment expense within the meaning of section 163(d). The legislative history states that "a corporation has neither investment interest nor investment income within the meaning of section 163(d). Thus, interest income and interest expense of a corporation is properly allocable to a trade or business, unless such trade or business is otherwise explicitly excluded from the application of the provision." H. Rept. 115-466, at 386, fn. 688 (2017).

Section 163(j)(8) defines ATI as the taxable income of the taxpayer (1) computed without regard to items not properly allocable to a trade or business; BIE and BII; net operating loss (NOL) deductions; deductions for qualified business income under section 199A; and deductions for depreciation, amortization, and depletion with respect to taxable years beginning before January 1, 2022, and (2) computed with such other adjustments as provided by the Secretary of the Treasury or his delegate (Secretary).

As noted previously, section 163(j)(1) includes floor plan financing interest in computing the amount of deductible business interest. Section 163(j)(9) defines "floor plan financing interest" and "floor plan financing indebtedness." These provisions allow taxpayers incurring interest expense for the purpose of securing an inventory of motor vehicles held for sale or lease to deduct the full expense without regard to the section 163(j) limitation.

Under section 163(j)(10)(A)(i), the amount of BIE that is deductible under section 163(j)(1) for taxable years beginning in 2019 or 2020 is computed using 50 percent, rather than 30 percent, of the taxpayer's ATI for the taxable year (50 percent ATI limitation). A taxpayer may elect not to apply the 50 percent ATI limitation to any taxable year beginning in 2019 or 2020, and instead apply the 30 percent ATI limitation. This election must be made separately for each taxable year. Once the taxpayer makes the election, the election may not be revoked without the consent of the Secretary. See section 163(j)(10)(A)(iii).

Sections 163(j)(10)(A)(ii)(I) and 163(j)(10)(A)(iii) provide that, in the case of a partnership, the 50 percent ATI limitation does not apply to partnerships for taxable years beginning in 2019, and the election to not apply the 50 percent ATI limitation may be made only for taxable years beginning in 2020, and may be made only by the partnership. Under section 163(j)(10)(A)(ii)(II), however, a partner treats 50 percent of its allocable share of a partnership's EBIE for 2019 as BIE in the partner's first taxable year beginning in 2020 that is not subject to the section 163(j) limitation (50 percent EBIE rule). The remaining 50 percent of the partner's allocable share of the partnership's EBIE remains subject to the section 163(j) limitation applicable to EBIE carried forward at the partner level. A partner may elect out of the 50 percent EBIE rule.

Section 163(j)(10)(B)(i) allows a taxpayer to elect to substitute its ATI for the last taxable year beginning in 2019 (2019 ATI) for the taxpayer's ATI for a taxable year beginning in 2020 (2020 ATI) in determining the taxpayer's section 163(j) limitation for the taxable year beginning in 2020.

Section 163(j)(11) provides cross-references to provisions requiring that electing farming businesses and electing real property businesses excepted from the section 163(j) limitation use the alternative depreciation system (ADS), rather than the general depreciation system, for certain types of property. The required use of ADS results in the inability of these electing trades or businesses to use the additional first-year depreciation deduction under section 168(k) for those types of property.

II. Published Guidance

On April 16, 2018, the Department of the Treasury (Treasury Department) and the IRS published Notice 2018-28, 2018-16 I.R.B. 492, which described regulations intended to be issued under section 163(j). On December 28, 2018, the Treasury Department and the IRS (1) published proposed regulations under section 163(j), as amended by the TCJA, in a notice of proposed rulemaking (REG-106089-18) (2018 Proposed Regulations) in the **Federal Register** (83 FR 67490), and (2) withdrew the notice of proposed rulemaking (1991-2 C.B. 1040) published in the **Federal Register** on June 18, 1991 (56 FR 27907 as corrected by 56 FR 40285 (August 14, 1991)) to implement rules under section 163(j) before its amendment by the TCJA. On September 14, 2020, the Treasury Department and the IRS published final regulations under section 163(j) and other sections in the **Federal Register** (85 FR 56686) (T.D. 9905) to finalize most sections of the 2018 Proposed Regulations.

Concurrently with the publication of T.D. 9905, the Treasury Department and the IRS published additional proposed regulations under section 163(j) in a notice of proposed rulemaking (REG-107911-18) in the **Federal Register** (85 FR 56846) (2020 Proposed Regulations) to provide additional guidance regarding the section 163(j) limitation in response to certain comments received in response to the 2018 Proposed Regulations and to reflect the amendments made by the CARES Act. The 2020 Proposed Regulations provided proposed rules: for allocating interest expense associated with debt proceeds of a partnership or S corporation to supplement the rules in §1.163-8T regarding the allocation of interest expense for purposes of section 163(d) and (h) and section 469 (proposed §§1.163-14 and 1.163-15); amending the definition of ATI and permitting certain RICs to pay section 163(j) interest dividends (proposed §1.163(j)-1); amending the rules for applying section 163(j)(4) to partnerships and S corporations (proposed §1.163(j)-6); re-proposing the proposed rules for applying the section 163(j) limitation to foreign corporations and United States shareholders (proposed §1.163(j)-7) and to foreign persons with effectively connected income (proposed §1.163(j)-8); amending the definition of real property trade or business (proposed §1.469-9); amending the rules for determining tax shelter status and providing guidance on the election to use 2019 ATI to determine 2020 section 163(j) limitation (proposed §§1.163(j)-2 and 1.1256(e)-2); and amending the corporate look-through rules as applicable to tiered structures (proposed §1.163(j)-10).

All written comments received in response to the 2020 Proposed Regulations are available at www.regulations.gov or upon request. After consideration of the comments received, this Treasury decision adopts most of the 2020 Proposed Regulations as revised in response to the comments, which are described in the Summary of Comments and Explanation of Revisions section. The Treasury Department and the IRS plan to finalize other portions of the 2020 Proposed Regulations separately, to allow additional time to consider the comments received.

On April 27, 2020, the Treasury Department and the IRS published Revenue Procedure 2020-22, 2020-18 I.R.B. 745, to provide the time and manner of making a late election, or withdrawing an election, under section 163(j)(7)(B) to be an electing real property trade or business or under section 163(j)(7)(C) to be an electing farming business for taxable years beginning in 2018, 2019, or 2020. Revenue Procedure 2020-22 also provides the time and manner of making or revoking elections provided by the CARES Act under section 163(j)(10) for taxable years beginning in 2019 or 2020. These elections are: (1) to not apply the 50 percent ATI limitation under section 163(j)(10)(A)(iii); (2) to use the taxpayer's 2019 ATI to calculate the taxpayer's section 163(j) limitation for any taxable year beginning in 2020 under section 163(j)(10)(B); and (3) for a partner to elect out of the 50 percent EBIE rule under section 163(j)(10)(A)(ii)(II).

Summary of Comments and Explanation of Revisions

I. Overview

The Treasury Department and the IRS received approximately 20 written comments in response to the 2020 Proposed Regulations. Most of the comments addressing the 2020 Proposed Regulations are summarized in this Summary of Comments and Explanation of Revisions section. However, comments merely summarizing or interpreting the 2020 Proposed Regulations generally are not discussed in this preamble. Additionally, comments outside the scope of this rulemaking are generally not addressed in this Summary of Comments and Explanation of Revisions section.

The Treasury Department and the IRS continue to study comments on certain issues related to section 163(j), including issues that are beyond the scope of the final regulations, and may discuss those comments if future guidance on those issues is published.

The final regulations retain the same basic structure as the 2020 Proposed Regulations, with the revisions described in this Summary of Comments and Explanation of Revisions section.

II. Notice 89-35 and Comments on and Changes to Proposed §1.163-15: Debt Proceeds Distributed From Any Taxpayer Account or From Cash

Section 1.163-15 of the 2020 Proposed Regulations supplemented the rules in §1.163-8T, temporary regulations issued prior to TCJA, regarding debt proceeds distributed from any taxpayer account or from cash proceeds. Consistent with section VI of Notice 89-35, 1989-1 C.B. 675, proposed §1.163-15 provided that taxpayers may treat any expenditure made from an account of the taxpayer, or from cash, within 30 days before or after debt proceeds are deposited in any account of the taxpayer, or received in cash, as made from such proceeds. Section 1.163-14 of the 2020 Proposed Regulations related to sections I-V of Notice 89-35. The Treasury Department and the IRS received no comments with respect to proposed §1.163-15. Accordingly, the final regulations adopt this section unchanged. Additional consideration is being given to §1.163-14, which is not being finalized in these final regulations; thus Notice 89-35 remains in effect.

III. <u>Comments on and Changes to §1.163-1: Definitions</u>

A. Adjustments to Tentative Taxable Income

Part III.A.1.a of this Summary of Comments and Explanation of Revisions section provides an overview of the negative adjustments to tentative taxable income in §1.163(j)-1(b)(1)(ii)(C) through (E) and the alternative computations for those negative adjustments in proposed §1.163(j)-1(b)(1)(iv)(B) and (E). Part III.A.1.b of this Summary of Comments and Explanation of Revisions section provides an overview of the special rules in §1.163(j)-1(b)(1)(iv)(A), (C), and (D) for the application of §1.163(j)-1(b)(1)(ii)(C) through (E). Part III.A.2 of this Summary of Comments and Explanation of Revisions section summarizes the comments received on §1.163(j)-1(b)(1)(ii)(C) through (E) and the alternative computations in proposed §1.163(j)-1(b)(1)(iv)(B) and (E). Part III.A.3 of this Summary of Comments and Explanation of Revisions section summarizes the comments received on the special rules in §1.163(j)-1(b)(1)(iv)(A), (C), and (D).

In response to comments received, the final regulations provide a number of clarifications to the ATI computation and provide new examples demonstrating their application.

1. Overview

a. Section 1.163(j)-1(b)(1)(ii)(C) through (E) and Proposed §1.163(j)-1(b)(1)(iv)(B) and (E)

Section 1.163(j)-1(b)(43) provides that tentative taxable income is the amount to which adjustments are made in computing ATI. Section 1.163(j)-1(b)(1)(i) provides for certain additions to tentative taxable income in computing ATI. For example, §1.163(j)-1(b)(1)(i)(D) provides that, subject to the rule in §1.163(j)-1(b)(1)(iii), any depreciation under section 167, section 168, or former section 168 for taxable years beginning before January 1, 2022, is added back to tentative taxable income to compute ATI. Section 1.163(j)-1(b)(1)(i)(E) and (F) provide similar rules for amortization and depletion, respectively.

Section 1.163(j)-1(b)(1)(ii) provides for certain subtractions from (or negative adjustments to) tentative taxable income in computing ATI. For example, §1.163(j)-1(b)(1)(ii)(C) provides that, if property is sold or otherwise disposed of, the greater of the allowed or allowable depreciation, amortization, or depletion of the property for the taxpayer (or, if the taxpayer is a member of a consolidated group, the consolidated group) for taxable years beginning after December 31, 2017, and before January 1, 2022 (such years, the EBITDA period), with respect to such property is subtracted from tentative taxable income. Section 1.163(j)-1(b)(1)(ii)(D) provides that, with respect to the sale or other disposition of stock of a member of a consolidated group by another member, the investment adjustments under §1.1502-32 with respect to such stock that are attributable to deductions described in §1.163(j)-1(b)(1)(ii)(C) are subtracted from tentative taxable income. Section 1.163(j)-1(b)(1)(ii)(E) provides that, with respect to the sale or other disposition of an interest in a partnership, the taxpayer's distributive share of deductions described in §1.163(j)-1(b)(1)(ii)(C) with respect to property held by the partnership at the time of such sale or other disposition is subtracted from tentative taxable income to the extent such deductions were allowable under section 704(d). See the preamble to T.D. 9905 for a discussion of the rationale for these adjustments.

The preamble to T.D. 9905 noted that, in the 2018 Proposed Regulations, §1.163(j)-1(b)(1)(ii)(C) incorporated a "lesser of" standard. In other words, the lesser of (i) the amount of gain on the sale or other disposition of property, or (ii) the amount of depreciation deductions with respect to such property for the EBITDA period, was required to be subtracted from tentative taxable income to determine ATI. As explained in the preamble to T.D. 9905, commenters raised several questions and concerns regarding this "lesser of" standard. T.D. 9905 removed the "lesser of" approach due in part to concerns that this approach would be more difficult to administer than the approach reflected in T.D. 9905.

However, the Treasury Department and the IRS recognize that, in certain cases, the "lesser of" approach might not create administrative difficulties for taxpayers. Thus, the 2020 Proposed Regulations permitted taxpayers to choose whether to compute the amount of their adjustment upon the disposition of property, member stock, or partnership interests using a "lesser of" standard. See proposed §1.163(j)-1(b)(1)(iv)(B) and (E). The Treasury Department and the IRS requested comments on the "lesser of" approach, including how such an approach should apply to dispositions of member stock and partnership interests. The comments received on the "lesser of" approach are summarized in part III.A.2 of this Summary of Comments and Explanation of Revisions section.

b. Section 1.163(j)-1(b)(1)(iv)(A) through (D)

Section 1.163(j)-1(b)(1)(iv) provides special rules for the application of §1.163(j)-1(b)(1)(ii)(C) through (E). Section 1.163(b)(1)(iv)(A)(1) provides that, for purposes of §1.163(j)-1(b)(1)(ii)(C) through (E), the term "sale or other disposition" does not include a transfer of an asset to an acquiring corporation in a transaction to which section 381(a) of the Code applies, except as otherwise provided in §1.163(j)-1(b)(1)(iv)(A).

Section 1.163(j)-1(b)(1)(iv)(A)(2) provides that, for purposes of §1.163(j)-1(b)(1)(ii)(C) and (D), the term "sale or other disposition" excludes all intercompany transactions, within the meaning of §1.1502-13(b)(1)(i). This provision reflects the general treatment of a consolidated group as a single entity for purposes of section 163(j). Section 1.163(j)-1(b)(1)(iv)(A)(3) provides that, notwithstanding any other rule in §1.163(j)-1(b)(1)(iv)(A) (including the rule regarding section 381(a) transactions), any transaction in which a member leaves a consolidated group is treated as a "sale or other disposition" for purposes of §1.163(j)-1(b)(1)(ii)(C) and (D), unless the transaction is an acquisition described in §1.1502-13(j)(5)(i)(A).

Section 1.163(j)-1(b)(1)(iv)(B) provides that, for purposes of §1.163(j)-1(b)(1)(ii)(C) through (E), the amount of a consolidated group's adjustment under §1.163(j)-1(b)(1)(ii)(C) is computed by reference to the depreciation, amortization, or depletion deductions of the group. The 2020 Proposed Regulations added §1.163(j)-1(b)(1)(iv)(B)(2) to clarify the computation under proposed §1.163(j)-1(b)(iv)(E)(1) for consolidated groups.

Section 1.163(j)-1(b)(1)(iv)(C) provides successor asset rules for certain intercompany transactions. More specifically, if deductions described in §1.163(j)-1(b)(1)(ii)(C) are allowed or allowable to a consolidated group member (S), the depreciable property or S's stock is transferred to another member (S1), and the transferor's basis in the S1 stock received in the intercompany transaction is determined, in whole or in part, by reference to its basis in the transferred property or S stock, then the S1 stock is treated as a successor asset for purposes of the negative adjustments to tentative taxable income upon the disposition of member stock.

Section 1.163(j)-1(b)(1)(iv)(D) contains anti-duplication rules. For example, §1.163(j)-1(b)(1)(iv)(D)(2) provides that depreciation, amortization, or depletion deductions allowed or allowable for a corporation for a consolidated return year of a group are disregarded in applying §1.163(j)-1(b)(1)(iv)(D) to a separate return year of that corporation. Section 1.163(j)-1(b)(1)(iv)(D)(2) also provides an example in which S deconsolidates from a consolidated group (Group 1) (thereby triggering an adjustment under §§1.163(j)-1(b)(1)(ii)(D) and 1.163(j)-1(b)(1)(iv)(A)(3)) and then sells the depreciable property. The example states that no further adjustment is required under §1.163(j)-1(b)(1)(ii)(C) upon the asset disposition with regard to the amounts included in Group 1.

2. Comments on §1.163(j)-1(b)(1)(ii)(C) through (E) and Proposed §1.163(j)-1(b)(1)(iv)(B) and (E)

a. Adoption of a "lesser of" standard

Several commenters contended that the final regulations should continue to allow taxpayers to choose whether to compute the amount of their adjustment upon the disposition of property, member stock, or partnership interests using a "lesser of" standard, as in proposed §1.163(j)-1(b)(1)(iv)(B) and (E). Commenters asserted that such an approach would ameliorate the adverse impact of the subtractions from tentative taxable income in §1.163(j)-1(b)(1)(ii)(C) through (E). One commenter further asserted that a "lesser of" option is preferable to the approach in T.D. 9905 because the latter could create an incentive for taxpayers to retain assets solely because the adverse tax consequences of disposing of the assets outweigh the cost of keeping the assets.

The Treasury Department and the IRS agree with these comments, and the final regulations retain a "lesser of" option for purposes of the negative adjustments to tentative taxable income in §1.163(j)-1(b)(1)(ii)(C) through (E). The final regulations also update the special rules in §1.163(j)-1(b)(1)(iv)(A), (C), and (D) to add cross-references to the "lesser of" computations in §1.163(j)-1(b)(1)(iv)(B) and (E).

b. Modification of the "lesser of" standard

Several commenters also recommended modifications to the "lesser of" rules in proposed §1.163(j)-1(b)(1)(iv)(B) and (E). For example, one commenter stated that the proposed "lesser of" approach is likely to be less accurate for dispositions of member stock or partnership interests than for asset dispositions because the gain prong of the "lesser of" computation in either case is based on the gain in the member stock or partnership interests, respectively, rather than on the gain that would be recognized on the sale of the underlying assets.

The Treasury Department and the IRS received recommendations regarding several alternative approaches. Under one alternative, the negative adjustment under the gain prong of the "lesser of" computation for dispositions of member stock or partnership interests would equal the amount of the negative adjustment if the assets of the subsidiary or partnership were sold. However, the commenter acknowledged that this "deemed asset sale" approach could create unnecessary administrative difficulties and lead to valuation disputes by requiring asset valuations upon dispositions of member stock or partnership interests.

Among other alternative approaches, a commenter recommended that the gain prong of the "lesser of" computation for dispositions of member stock should be based on the excess of tax depreciation over economic depreciation with respect to the underlying assets. The commenter based this approach on the theory that only stock gain that reflects non-economic depreciation should give rise to a negative basis adjustment. The commenter who recommended this approach suggested several different computational methods for this alternative approach, but acknowledged that this approach likely would not be appropriate for certain types of assets (for example, real estate or purchased goodwill) because metrics that might be used under this approach, such as earnings and profits basis or book value, would not be a good proxy for fair market value for such assets. Another commenter recommended revising the proposed "lesser of" computation for dispositions of partnership interests such that certain negative adjustments would be made at the partnership level and others would be made at the partner level.

After considering these comments, the Treasury Department and the IRS have determined that the proposed “lesser of” computations strike a proper balance between accuracy and administrability. In particular, as one commenter noted, there would be unnecessary administrative complexity under the first suggested alternative approach. This complexity includes the need for separate asset valuations that would be costly and may be subject to dispute, resulting in additional controversy between taxpayers and the IRS. The second proposed approach would require an accurate determination of economic depreciation. However, as the commenter acknowledged, there is no single, simple method for accurately determining economic depreciation. Additionally, with regard to economic depreciation, different types of assets depreciate at different rates, and some assets, such as land or certain improvements to land, may not depreciate at all. As a result, basing the gain prong of the “lesser of” computation on non-economic depreciation would create less certainty, and would not clearly be a more accurate approach, than the proposed “lesser of” standard. Requiring certain adjustments at the partner level and other adjustments at the partnership level also would add further complexity to the “lesser of” computations.

Thus, the final regulations adopt the approach in proposed §1.163(j)-1(b)(1)(iv)(B) and (E). However, the Treasury Department and the IRS acknowledge that gain on upper-tier member stock generally becomes further removed from asset gain at each additional tier within a consolidated group. Therefore, for purposes of the “lesser of” computation in §1.163(j)-1(b)(1)(iv)(E)(2), the final regulations provide that the only stock gain that is relevant is the gain that is deemed recognized on the stock of the member holding the item of property (or the stock of a successor).

The Treasury Department and the IRS appreciate the comments received on the proposed "lesser of" rules and will continue to consider these comments for purposes of potential future guidance.

c. Limitation of negative adjustments to tax benefit from adding back depreciation, amortization, and depletion deductions to tentative taxable income

The additions to tentative taxable income for depreciation, amortization, and depletion deductions during the EBITDA period (see §1.163(j)-1(b)(1)(i)(D) through (F), respectively) do not necessarily increase a taxpayer's ability to deduct BIE. For example, the taxpayer's section 163(j) limitation already may be sufficiently high to permit a deduction of all of the taxpayer's BIE even without such additions to tentative taxable income.

Commenters have stated that, in such a situation, the adjustments in §1.163(j)-1(b)(1)(ii)(C) through (E) and proposed §1.163(j)-1(b)(1)(iv)(B) and (E) could inappropriately decrease the amount of the taxpayer's BIE deduction in the year the property, member stock, or partnership interest is sold because the taxpayer derived no benefit from the adjustment under §1.163(j)-1(b)(1)(i)(D) through (F) in a prior taxable year. The commenters asserted that this detrimental outcome is inconsistent with both congressional intent and the statement in the preamble to T.D. 9905 that §1.163(j)-1(b)(1)(ii)(C) through (E) and proposed §1.163(j)-1(b)(1)(iv)(B) and (E) are intended to ensure that the positive adjustment to tentative taxable income for depreciation deductions results in a timing benefit. See part II.A.5 of the Summary of Comments and Explanation of Revisions in the preamble to T.D. 9905. Moreover, if a taxpayer that did not benefit from a positive adjustment under §1.163(j)-1(b)(1)(i)(D) through (F) were required to reduce its tentative taxable income in the year of disposition, the negative adjustment could put the taxpayer in a worse position than if the depreciation, amortization, or depletion deductions were not added back to tentative taxable income in the first place. The commenters thus recommended providing that a negative adjustment under §1.163(j)-1(b)(1)(ii)(C) through (E) and proposed §1.163(j)-

1(b)(1)(iv)(B) and (E) is required only to the extent the prior-year addback under §1.163(j)-1(b)(1)(i)(D) through (F) resulted in an increase in deductible BIE.

The Treasury Department and the IRS agree with this recommendation. Thus, the final regulations provide that a negative adjustment to tentative taxable income under §1.163(j)-1(b)(1)(ii)(C) through (E) or §1.163(j)-1(b)(1)(iv)(B) or (E) is reduced to the extent the taxpayer establishes that the additions to tentative taxable income under §1.163(j)-1(b)(1)(i)(D) through (F) in a prior taxable year did not result in an increase in the amount allowed as a deduction for BIE for such year. The final regulations also provide examples illustrating the application of this rule.

d. Capitalized depreciation

T.D. 9905 provides that, for the additions to tentative taxable income in §1.163(j)-1(b)(1)(i), amounts of depreciation, amortization, or depletion that are capitalized under section 263A of the Code (collectively, capitalized depreciation) during the taxable year are deemed to be included in the computation of the taxpayer's tentative taxable income for such year, regardless of when the capitalized amount is recovered. See §1.163(j)-1(b)(1)(iii). Thus, a taxpayer makes a positive adjustment to tentative taxable income under §1.163(j)-1(b)(1)(i)(D) through (F) when the taxpayer capitalizes the depreciation, amortization, or depletion, rather than later when the capitalized amount is recovered (for example, through cost of goods sold).

Commenters requested clarification regarding the application of §§1.163(j)-1(b)(1)(ii)(C) through (E) and 1.163(j)-1(b)(1)(iv) to capitalized depreciation. For example, commenters asked whether the adjustments in §1.163(j)-1(b)(1)(ii)(C) and proposed §1.163(j)-1(b)(iv)(B) and (E) occur upon the disposition of the depreciated property or upon the disposition of the property into which the depreciation was capitalized. A commenter asked the same question regarding the application of the successor asset rules in §1.163(j)-1(b)(1)(iv)(C). A commenter also requested clarification as to how the negative adjustments in §1.163(j)-1(b)(1)(ii)(D) and proposed §1.163(j)-1(b)(1)(iv)(E)(2) apply to capitalized depreciation because there are no basis adjustments under §1.1502-32 when depreciation is capitalized.

The Treasury Department and the IRS have determined that a negative adjustment under §1.163(j)-1(b)(1)(ii)(C) or proposed §1.163(j)-1(b)(1)(iv)(B) or (E) would be required upon the sale or other disposition of property with respect to which depreciation, amortization, or depletion was allowed or allowable during the EBITDA period, because it is the allowed or allowable depreciation, amortization, or depletion of that property that is added back to tentative taxable income. The final regulations have been modified accordingly. For the same reason, the final regulations also clarify that the successor asset rules in §1.163(j)-1(b)(1)(iv)(C) would apply if such property subsequently were transferred to another member (S1) in an intercompany transaction in which the transferor receives S1 stock. The Treasury Department and the IRS are continuing to consider how the negative adjustments in §1.163(j)-1(b)(1)(ii)(D) and proposed §1.163(j)-1(b)(1)(iv)(E)(2) apply to capitalized depreciation.

A commenter also expressed concern that, if a taxpayer does not elect to apply T.D. 9905 retroactively, then capitalized depreciation arising in taxable years beginning before November 13, 2020, would not be added back to tentative taxable income, but negative adjustments under §1.163(j)-1(b)(1)(ii)(C) through (E) still would be required for any “allowable” depreciation, including capitalized depreciation, if the relevant property, member stock, or partnership interest were disposed of in a year to which T.D. 9905 applies. The commenter thus recommended that negative adjustments under §1.163(j)-1(b)(1)(ii)(C) through (E) and proposed §1.163(j)-1(b)(1)(iv)(B) and (E) not apply to capitalized depreciation amounts that were incurred in a taxable year that began before November 13, 2020, unless the taxpayer included a positive adjustment reflecting such amounts in calculating its tentative taxable income.

As discussed in part III.A.2.c of this Summary of Comments and Explanation of Revisions section, the final regulations adopt the recommendation that a negative adjustment to tentative taxable income under §1.163(j)-1(b)(1)(ii)(C) through (E) and proposed §1.163(j)-1(b)(1)(iv)(B) and (E) be reduced to the extent the taxpayer establishes that the additions to tentative taxable income under §1.163(j)-1(b)(1)(i)(D) through (F) in a prior taxable year resulted in no increase in deductible BIE in that year. If a taxpayer does not elect to apply T.D. 9905 retroactively, the taxpayer will have no additions to tentative taxable income under §1.163(j)-1(b)(1)(i)(D) through (F) in a prior taxable year (and, thus, no increase in deductible BIE in that year) with respect to capitalized depreciation. Because the final regulations already address the commenter's concern, the Treasury Department and the IRS have not incorporated the commenter's specific recommendation.

e. Dispositions by consolidated groups

The final regulations also revise §§1.163(j)-1(b)(1)(iv)(A)(2), 1.163(j)-1(b)(1)(iv)(B)(2), and 1.163(j)-1(b)(1)(iv)(E) to clarify that the amount of gain taken into account by a consolidated group upon a "sale or other disposition" includes the net gain the group would take into account, including as a result of intercompany transactions. One commenter contended that this clarification is needed to ensure that the amount of gain taken into account by a consolidated group for purposes of the negative adjustments in proposed §§1.163(j)-1(b)(1)(iv)(B)(2) and 1.163(j)-1(b)(1)(iv)(E) is the same regardless of whether the property, member stock, or partnership interest is sold in an intercompany transaction before leaving the group (that is, to achieve single-entity treatment of the group). For example, assume that S would recognize $100 of gain upon the sale of property to a nonmember. However, rather than sell the property directly to a nonmember, S first might sell the property to member B and recognize $60 of gain, and B then could sell the property to the nonmember and recognize an additional $40 of gain. In either case, the group would recognize a net gain of $100 in relation to the property, and that same $100 should be relevant in determining the amount of any negative adjustment to ATI.

3. Comments on §1.163(j)-1(b)(1)(iv)(A), (C), and (D)

a. Section 1.163(j)-1(b)(1)(iv)(A)

Commenters questioned why, under the rules for deconsolidating transactions in §1.163(j)-1(b)(1)(iv)(A)(3), the exception to "sale or other disposition" treatment is limited to whole-group acquisitions described in §1.1502-13(j)(5)(i)(A) and does not also include whole-group acquisitions that take the form of reverse acquisitions, as described in §1.1502-13(j)(5)(i)(B). The Treasury Department and the IRS did not intend this exception to exclude transactions described in §1.1502-13(j)(5)(i)(B), and the final regulations revise §1.163(j)-1(b)(1)(iv)(A)(3) to correct this typographical error.

The Treasury Department and the IRS received another comment regarding the exceptions to "sale or other disposition" treatment for whole-group acquisitions in §1.163(j)-1(b)(1)(iv)(A)(3) and for section 381 transactions in §1.163(j)-1(b)(1)(iv)(A)(1) (see the summary in part III.A.1.b of this Summary of Comments and Explanation of Revisions section). The commenter noted that the tax law generally treats the successor in a section 381 transaction (and the acquiring group in a whole-group acquisition) as stepping into the shoes of the acquired entity (or group). However, the commenter also noted that §1.163(j)-1(b)(1)(iv)(A) does not expressly provide that the acquiring entity (or group) steps into the shoes of the acquired entity (or group) for purposes of the negative adjustments in §§1.163(j)-1(b)(1)(ii)(C) through (E) and 1.163(j)-1(b)(1)(iv)(B) and (E). The commenter recommended clarifying this point.

The Treasury Department and the IRS agree with the commenter. Thus, the final regulations clarify this point by expressly stating that the acquiring corporation in a section 381 transaction and the surviving group in a transaction described in §1.1502-

13(j)(5)(i) is treated as a successor to the distributor or transferor corporation or the terminating group, respectively, for purposes of §§1.163(j)-1(b)(1)(ii)(C) through (E) and 1.163(j)-1(b)(1)(iv)(B) and (E) of this section.

A commenter also noted that the "lesser of" computation for dispositions of member stock in proposed §1.163(j)-1(b)(1)(iv)(E)(2) could be misconstrued as overriding the rules for negative adjustments to a group's tentative taxable income in the case of deconsolidating transactions subject to §1.163(j)-1(b)(1)(iv)(A)(3). Under this erroneous interpretation, if a sale or other disposition resulted in a deconsolidation, the "lesser of" computation would apply solely with respect to the member stock that was sold, even though the deconsolidation rules in §1.163(j)-1(b)(1)(iv)(A)(3) would treat the transaction as a disposition of all of the departing member's stock. Thus, the "lesser of" computation would not reflect the full amount of gain recognized upon the complete disposition of the departing member's stock.

The Treasury Department and the IRS did not intend the "lesser of" rule in proposed §1.163(j)-1(b)(1)(iv)(E)(2) to override the rules for deconsolidating transactions. The regulations under section 163(j) generally treat a consolidated group as a single entity; thus, the rules for deconsolidations in §1.163(j)-1(b)(1)(iv)(A)(3) treat the date of a member's deconsolidation as the appropriate time to make adjustments to tentative taxable income with regard to all of that member's stock. Thus, the final regulations clarify §1.163(j)-1(b)(1)(iv)(A)(3) to provide that any transaction in which a member leaves a consolidated group is treated as a taxable disposition of all stock of the departing member held by any member of the consolidated group for purposes of §1.163(j)-1(b)(1)(ii)(C) and (D) and §1.163(j)-1(b)(1)(iv)(B), (E)(1), and (E)(2), unless the transaction is described in §1.1502-13(j)(5)(i).

A commenter also suggested that nonrecognition transactions in which a member leaves a consolidated group should not be treated as a "sale or other disposition” for purposes of the negative adjustments in §1.163(j)-1(b)(1)(ii)(C) and (D) and proposed §1.163(j)-1(b)(1)(iv)(B) and (E). The final regulations do not accept this comment because, under the single-entity theory of consolidated groups in the section 163(j) regulations, such negative adjustments should be made when a member deconsolidates, regardless of the form of the deconsolidation transaction, other than in a whole-group acquisition described in §1.1502-13(j)(5)(i). In other words, because the section 163(j) regulations generally treat a consolidated group as a unified taxpayer, any adjustments to ATI related to property should occur when the item of property leaves the group. This result should be consistent whether the property is disposed of directly by a group member or whether the property leaves the group upon the deconsolidation of a member.

The Treasury Department and the IRS also received a comment that the gain prong of the proposed “lesser of” computation could yield unintended results for certain nonrecognition transactions. Under T.D. 9905, dispositions are treated as “sales or other dispositions” for purposes of the negative adjustments under §1.163(j)-1(b)(1)(ii)(C) through (E) unless an express exception applies. As previously discussed in this part III.A.3.a of this Summary of Comments and Explanation of Revisions section, T.D. 9905 provides exceptions for section 381 transactions and whole-group acquisitions. However, T.D. 9905 does not provide an exception to “sale or other disposition” treatment for other nonrecognition transactions, such as transactions to which section 351 or section 721 applies.

The commenter noted that the “lesser of” computations in proposed §1.163(j)-1(b)(1)(iv)(B) and (E) could be construed to suggest that a taxpayer would have no negative adjustment under these provisions if the taxpayer transferred an asset in a transaction to which section 351 or section 721 applies. The Treasury Department and the IRS did not intend the proposed “lesser of” computations to create additional exceptions to “sale or other disposition” treatment for purposes of the negative adjustments required under §1.163(j)-1(b)(1)(ii)(C) through (E). Thus, the final regulations clarify that the disposition of property, member stock, or partnership interests in a transaction other than a deconsolidation (the treatment of which is addressed in §1.163(j)-1(b)(1)(iv)(A)(3)) that is a nonrecognition transaction other than a section 381 transaction is treated as a taxable disposition for purposes of the gain prong of the “lesser of” computation.

b. Section 1.163(j)-1(b)(1)(iv)(C)

As noted in part III.A.1.b of this Summary of Comments and Explanation of Revisions section, the successor asset rules in §1.163(j)-1(b)(1)(iv)(C) apply to certain intercompany transactions. For example, assume that S (a member of the P group) acquires a depreciable asset and fully depreciates the asset under section 168(k). P then contributes its S stock to S1 (another member of the P group) in exchange for S1 stock in a transaction to which section 351 applies. In this case, the S1 stock is a successor asset to the S stock. Moreover, if P sells its S1 stock to a third party in a transaction that causes both S1 and S to deconsolidate, the transaction is treated as a taxable disposition of both the S1 stock and the S stock for purposes of §§1.163(j)-1(b)(1)(ii)(C) and (D) and 1.163(j)-1(b)(1)(iv)(B) and (E). See §1.163(j)-1(b)(1)(iv)(A)(3). In that case, both the actual sale of the S1 stock and the disposition of the S stock on its deconsolidation pursuant to §1.163(j)-1(b)(1)(iv)(A)(3) could produce negative adjustments to ATI. Application of the anti-duplication rule in §1.163(j)-1(b)(1)(iv)(D) effectively would mean that the total subtraction from ATI would equal the greater of the two stock gains (if any).

One commenter agreed with this reading of the regulations but suggested that an example would be helpful to clarify the interaction of these multiple rules. The Treasury Department and the IRS agree with this suggestion, and the final regulations include an example illustrating the operation of these rules.

c. Section 1.163(j)-1(b)(1)(iv)(D)

Commenters have stated that the anti-duplication rule in §1.163(j)-1(b)(1)(iv)(D)(2) is unclear, does not properly support the example in that paragraph, and does not take into account the exception to the deconsolidation rule in §1.163(j)-1(b)(1)(iv)(A)(3). For example, a commenter stated that it is unclear whether the operative rule, which does not reference §1.163(j)-1(b)(1)(ii)(C), actually supports the conclusion in the example, which references §1.163(j)-1(b)(1)(ii)(C). Another commenter requested clarification that the anti-duplication rule in §1.163(j)-1(b)(1)(iv)(D)(2) does not apply to a whole-group acquisition, which is not treated as a "sale or other disposition" for purposes of §1.163(j)-1(b)(1)(ii)(C) through (E). See §1.163(j)-1(b)(1)(iv)(A)(3).

The Treasury Department and the IRS agree with these comments and have revised §1.163(j)-1(b)(1)(iv)(D)(2) to clarify the application of this provision. The Treasury Department and the IRS also have clarified the application of §1.163(j)-1(b)(1)(iv)(D)(1), including by clarifying that the paragraph contains two separate rules, rather than one rule and one example.

A commenter also requested examples illustrating the application of the anti-duplication rule in §1.163(j)-1(b)(1)(iv)(D) when the taxpayer's negative adjustment under the "lesser of" computation is based on gain recognized rather than on depreciation deductions taken during the EBITDA period. The final regulations add an example to §1.163(j)-1(b)(1)(viii) to illustrate the application of this rule.

B. Dividends from Regulated Investment Company (RIC) Shares

If a RIC has certain items of income or gain, part 1 of subchapter M and other Code provisions provide rules under which a RIC may pay dividends that a shareholder in the RIC may treat in the same manner (or a similar manner) as the shareholder would treat the underlying item of income or gain if the shareholder realized it directly. Like the preamble to the 2020 Proposed Regulations, this preamble refers to this treatment as "conduit treatment." The 2020 Proposed Regulations provide rules under which a RIC that earns BII may pay section 163(j) interest dividends. The total amount of a RIC's section 163(j) interest dividends for a taxable year is limited to the excess of the RIC's BII for the taxable year over the sum of the RIC's BIE for the taxable year and the RIC's other deductions for the taxable year that are properly allocable to the RIC's BII. The 2020 Proposed Regulations provide that a RIC shareholder that receives a section 163(j) interest dividend may treat the dividend as interest income for purposes of section 163(j), subject to holding period requirements and other limitations. The Treasury Department and the IRS received one comment requesting that the proposed rules providing this treatment be finalized. These final regulations adopt those proposed rules.

A few commenters requested that conduit treatment be extended to funds other than RICs, such as foreign regulated investment funds and foreign money market funds, so that investors in those funds may treat earnings from those funds as interest income to the extent the earnings can be traced to interest income of the funds. These final regulations do not adopt these recommendations. The Treasury Department and the IRS received similar recommendations in response to the 2018 Proposed Regulations, and they were not adopted in T.D. 9905. As explained in the preamble to T.D. 9905, there are significant differences between the rules governing income inclusions in respect of passive foreign investment companies (PFICs), such as foreign money market funds, and RICs. These significant differences would require a different mechanical approach if conduit treatment were extended to PFICs and present additional policy considerations. The Treasury Department and the IRS continue to study this comment and these issues.

Another commenter requested that conduit treatment be extended to allow shareholders in real estate investment trusts (REITs) to treat REIT dividends as interest income, to the extent that the income earned by the REIT is interest income. The Treasury Department and the IRS continue to consider this comment.

IV. Comments on and Changes to Proposed §1.163(j)-6: Application of the Business Interest Expense Deduction Limitations to Partnerships and Subchapter S Corporations

A. Overview

Section 1.163(j)-6 provides rules for applying section 163(j) to partnerships, S corporations and their owners. As described in this part IV of the Summary of Explanation of Revisions section, the Treasury Department and the IRS continue to study aspects of proposed §1.163(j)-6. Accordingly, the final regulations reserve on §§1.163(j)-6(e)(6) (partnership deductions capitalized by a partner), (h)(4) (partner basis adjustments upon liquidating distributions), (h)(5) (partnership basis adjustments upon partner dispositions), (j) (tiered partnerships), and (l)(4)(iv) (S corporation deductions capitalized by an S corporation shareholder). These paragraphs of the 2020 Proposed Regulations are retained in proposed form and may be relied on to the extent provided in the Applicability Dates section of this preamble.

B. Trading Partnerships

The 2020 Proposed Regulations addressed the application of section 163(j) to partnerships engaged in a trade or business activity of trading personal property (including marketable securities) for the account of owners of interests in the activity, as described in §1.469-1T(e)(6) (trading partnership). Specifically, the 2020 Proposed Regulations included a rule requiring a partnership engaged in a trading activity (i.e., trade or business activities described in section 163(d)(5)(A)(ii) and illustrated in Revenue Ruling 2008-12, 2008-1 C.B. 520 (March 10, 2008)) to bifurcate its interest expense from the trading activity between partners that are passive investors (taxpayers that do not materially participate in the activity within the meaning of section 469) in the trading activity and all other partners, and subject only the portion of the interest expense that is allocable to the non-passive investors to limitation under section 163(j) at the partnership level. The portion of interest expense from the trading activity allocable to passive investors is subject to limitation under section 163(d) at the partner level, as provided in section 163(d)(5)(A)(ii). Accordingly, proposed §1.163(j)-1(c)(1) and (2) include rules applicable to trading partnerships that modify the definitions of BII and BIE to effectuate this bifurcation.

In addition, proposed §1.163(j)-6(d)(4) requires that a trading partnership bifurcate all of its other items of income, gain, loss and deduction from its trading activity between partners that are passive investors and all other partners. The portion of the partnership's other items of income, gain, loss or deduction from its trading activity properly allocable to the passive investors in the partnership will not be taken into account at the partnership level as items from a trade or business for purposes of applying section 163(j) at the partnership level. Instead, all such partnership items properly allocable to passive investors will be treated as items from an investment activity of the partnership, for purposes of sections 163(j) and 163(d).

As stated in the preamble to 2020 Proposed Regulations, this approach, in order to be effective, presumes that a trading partnership generally will possess knowledge regarding whether its individual partners are passive investors in its trading activity. Because no rules currently exist requiring a partner to inform the partnership whether the partner has grouped activities of the trading partnership with other activities of the partner outside of the partnership, the 2020 Proposed Regulations include a revision to the section 469 activity grouping rules to provide that any activity described in section 163(d)(5)(A)(ii) may not be grouped with any other activity of the partner, including any other activity described in section 163(d)(5)(A)(ii).

In response to the decision to bifurcate interest expenses from a trading activity, one commenter stated that the bifurcation approach was inconsistent with section 163(j)(5). According to the comment, the statute does not support the partnership having BIE for some partners and investment interest expense for others. Rather, once a partnership determines that it is investment interest expense that same interest expense cannot also be BIE of the partnership. The commenter read section 163(j) to mean that if a partnership is engaged in a trade or business that is not a passive activity and with respect to which certain owners do not materially participate, then the interest expense allocable to the partnership's trade or business is investment interest and section 163(j) does not apply to any of the interest expense.

Alternatively, the commenter recommended that, to the extent the Treasury Department and the IRS determine that materially participating partners should be subject to limitation under either section 163(d) or section 163(j), a rule similar to that for corporate partners should be adopted. Under such a rule, a trading partnership would treat all of its interest expense as investment interest expense at the partnership level with respect to all of its partners, and the interest expense allocable to a non-passive investor would be recharacterized as BIE by such non-passive investor. This approach, according to the commenter, would achieve a similar result as the proposed bifurcation approach while eliminating the administrative complexities associated with a partnership having to determine whether each of its partners is materially participating.

As stated in the preamble to the 2020 Proposed Regulations, the Treasury Department and the IRS considered treating all interest expense of a trading partnership as investment interest expense but concluded that it was inconsistent with the intent of section 163(j) to limit BIE of a partnership. The commenter's alternative approach also is inconsistent with the statute because it ignores the fact that the trading partnership is engaged in trade or business and, therefore, any BIE should be subject to section 163(j). Such an approach would further diverge from the application of section

163(j), particularly with respect to business interest carryforwards. Partnership BIE that is limited under section 163(j)(4) is carried forward by the partner as EBIE and is not treated as paid or accrued in succeeding taxable years until the partner receives ETI from the same partnership. Under the commenter's approach, the partner, if subject to section 163(j), would treat the interest expense as paid or accrued in the succeeding tax year under section 163(j)(2) without requiring an allocation of ETI or excess BII (EBII) from the partnership. The bifurcation approach in the 2020 Proposed Regulations, and in these final regulations, preserves the partnership-level application of section 163(j) for those partners who are non-passive investors in the trade or business of the partnership as well as the carryover rules applicable at the partner-level.

Another commenter suggested an alternative under which section 163(j) would be applied at the partnership level and any EBIE would be allocated to the partners. Any direct or indirect partner that is a non-passive investor in the partnership's trading activity would continue to apply the rules of section 163(j) to the EBIE received from the partnership. For partners who did not materially participate in the partnership's trading activity, any allocated EBIE from the partnership would be fully deductible subject to any partner-level section 163(d) limitation. Under this approach, any EBIE received by a passive investor would be treated as paid or accrued in the current year and not subject to the carryover rules under section 163(j)(4)(B). The Treasury Department and the IRS do not adopt this comment as the approach is inconsistent with the statutory language and intent of section 163(j)(5) because the second sentence of section 163(j)(5) specifically states that BIE shall not include investment interest expense.

Several commenters opposed the revision of the grouping rule under section 469 to prohibit the grouping of trading activities. Proposed §1.469-4(d)(6) provides that a trading activity described in section 163(d)(5)(A)(ii) may not be grouped with any other activity of the taxpayer, including another trading activity. One commenter observed that such a rule would discourage trading funds from using multiple partnerships because it may result in partners never being able to demonstrate material participation in the trading activity under the 500 hour test or any other material participation test (i.e., §1.469-5T(a)) for any one partnership, even though the partner would materially participate in a properly grouped activity. Another acknowledged the administrative burden associated with partnerships evaluating the activities of their passive partners but highlighted that partnerships were already required to collect details about partner's tax status in similar situations. A third suggested that the grouping rule could be modified to permit a partner to group activities provided the partner provides sufficient information to the partnership to enable it to identify the taxpayer as a materially participating partner.

The Treasury Department and the IRS do not adopt these recommendations because the rules under section 469 adequately address these concerns. Activity under section 469 is broadly defined to be a trade or business under section 162 and the rules further provide for grouping by a partnership or S corporation. As addressed previously, for the bifurcation method to be effective, modification of the section 469 grouping rules is necessary to avoid potential abuse and to allow the trading partnership to presume that an individual partner is a passive investor in the trading activity based solely on the partnership's understanding as to the lack of work performed in the trading activity. Additionally, if grouping were allowed, then passive partners could group their other trade or business activities, in which they materially participate, with their trading activity in order to become a material participant as to the trading activity, thus, avoiding the section 163(d) limit at the partner level. The final regulations clarify that this grouping rule applies only to individuals, estates, trusts, closely held C corporations, and personal service corporations that may directly or indirectly own interests in trading activities described in §1.469-1T(e)(6) and subject to section 163(d)(5)(ii).

One commenter observed that the proposed regulations do not discuss a tiered partnership structure with respect to the material participation rules. The Treasury Department and the IRS determined that such a rule is not needed. The bifurcation approach in proposed §1.163(j)-1(c)(1) and (2) applies where interest income or expense is allocable to one or more partners that do not materially participate (within the meaning of section 469), as described in section 163(d)(5)(A)(ii). Thus, in a tiered structure where interest is not allocable to one or more partners that do not materially participate, the rules in §1.163(j)-6(c)(1) and (2) do not apply and the interest expense is subject to the rules under section 163(j)(4).

The same commenter recommended the final regulations provide that if a partner that has EBIE ceases to materially participate in a later taxable year, the EBIE would be allowed in a later year subject to any section 163(d) limitation; and conversely, if a passive investor partner has a section 163(d) investment carryover and then materially participates in a later taxable year, the 163(d) carryover would be allowed subject to any partner-level section 163(j) limitation. In light of concerns with partners shifting between participating and not participating in the trading activity in order to unsuspend EBIE, the Treasury Department and the IRS determined that such a rule is not warranted.

One commenter requested transition relief for trading partnerships that may have relied on the statement contained in the preamble to the 2018 Proposed Regulations that the BIE of the partnership allocable to trading activity will be subject to section 163(j) at the entity level, even if the interest expense is later subject to limitation under section 163(d) at the individual partner level. Partnerships that relied on the 2018 Proposed Regulations may have allocated EBIE to partners who do not materially participate in the trading activity of the partnership. Under the final regulations, partnerships carrying on trading activities do not allocate ETI or EBII from trading activities to their partners who do not materially participate in those activities. Rather, any interest expense and all other items from such activities allocable to these partners will be treated as items derived from an investment activity of the partnership. As a result, passive investors that were previously allocated EBIE from the trading partnership generally will not be allocated any ETI or EBII from that partnership in future years against which they can offset the EBIE.

The Treasury Department and the IRS agree that relief should be accorded to partners of trading partnerships that do not materially participate in the trading activity and that relied on the statement in the preamble to the 2018 Proposed Regulations. Accordingly, a transition rule is provided in the final regulations to permit passive investors in a partnership engaged in a trading activity to deduct EBIE allocated to them from the partnership in any taxable year ending prior to the effective date of the final regulations without regard to the amount of ETI or EBII that may be allocated by the partnership to the partner in the first taxable year ending on or after the effective date of these final regulations.

For purposes of this transition rule, any EBIE that is no longer subject to disallowance under section 163(j) solely as a result of this transition rule will not be subject to limitation or disallowance under section 163(d). In such case, the partnership treated the interest expense as business interest expense for purposes of calculating its limitation under section 163(j). The treatment of interest expense by the partnership as BIE in prior years is not affected by this transition rule. Accordingly, the rule in section 163(j)(5) that interest expense cannot be treated as both BIE and investment interest expense would still apply, and the BIE of the partnership cannot be treated as investment interest expense of the partner in future years.

The commenter also observed that a corporate partner is never subject to section 163(d) regardless of material participation and requested clarification whether section 163(j) applies to a trading partnership's corporate partner at the partner or partnership level. The Treasury Department and the IRS have determined that the regulations as proposed adequately addressed this situation. Generally, a corporate partner is not a passive investor subject to section 163(d)(5)(A)(ii); therefore, the rules under proposed §1.163(j)-6(c) would not apply.

In the 2020 Proposed Regulations, the Treasury Department and the IRS requested comments regarding whether similar rules should be adopted with respect to S corporations that also may be involved in trading activities, and whether such rules would be compatible with subchapter S. One commenter recommended that the final regulations provide that an S corporation engaged in a trading activity be required to bifurcate its interest expense between shareholders who materially participate in the trading activity and shareholders who do not materially participate and apply section 163(j) to the former and section 163(d) to the latter at the S corporation level.

The Treasury Department and the IRS appreciate this recommendation but, as acknowledged by the commenter, the implementation of such a rule would require different allocations of S corporation income and other items among shareholders of the S corporation. Unlike partnerships, S corporations must allocate items pro rata to the shareholders, in accordance with their respective percentages of stock ownership in the corporation. See generally section 1377(a)(1). Therefore, with regard to S corporations, the Treasury Department and the IRS have determined that (i) section 163(d) should continue to be applied at the shareholder level, and (ii) as provided by section 163(j)(4)(A) and (D), section 163(j) should continue to be applied at the S corporation level. Consequently, the final regulations do not incorporate the commenter's recommendation.

C. Treatment of Business Interest Income and Business Interest Expense with Respect to Lending Transactions Between a Partnership and a Partner (Self-Charged Lending Transactions)

The 2020 Proposed Regulations provide that, in the case of a self-charged lending transaction between a lending partner and a borrowing partnership in which the lending partner owns a direct interest, any BIE of the borrowing partnership attributable to a self-charged lending transaction is BIE of the borrowing partnership for purposes of proposed §1.163(j)-6(n). However, to the extent the lending partner receives interest income attributable to the self-charged lending transaction and also is allocated EBIE from the borrowing partnership in the same taxable year, the lending partner may treat such interest income as an allocation of EBII from the borrowing partnership in that taxable year, but only to the extent of the lending partner's allocation of EBIE from the borrowing partnership in the same taxable year. To prevent the potential double counting of BII, the lending partner includes interest income re-characterized as EBII only once when calculating the lending partner's own section 163(j) limitation. In cases where the lending partner is not a C corporation, to the extent that any interest income exceeds the lending partner's allocation of EBIE from the borrowing partnership for the taxable year, and such interest income otherwise would be properly treated as investment income of the lending partner for purposes of section 163(d) for that year, such excess amount of interest income will continue to be treated as investment income of the lending partner for that year for purposes of section 163(d).

One commenter generally supported the approach for self-charged lending transactions provided in the 2020 Proposed Regulations and expected that many taxpayers may benefit from this rule. However, the commenter noted that the rule applies only to self-charged lending transactions where the lending partners directly own interests in the borrowing partnerships and stated that this rule is too narrow. The commenter recommended that the rule be broadened to include loans to a partnership by other members in the same consolidated group as a corporate partner. In addition, the commenter recommended that the rule for self-charged lending transactions should be expanded to include lending partners in upper-tier partnerships who make loans to lower-tier partnerships. The commenter stated that in both cases, the interest expense would ultimately flow up to the same taxpayer that recognizes the interest income.

The Treasury Department and the IRS have determined that the rule for self-charged lending transactions should be adopted in the final regulations without change. With respect to the recommendation that the self-charged lending rule should apply to indirect lenders in tiered-partnership situations, the Treasury Department and the IRS concluded that adopting a rule to allow interest income of a partner in an upper-tier partnership that lent money to a lower-tier partnership to offset EBIE that may be suspended in a lower-tier partnership would add undue complexity to these rules, and such rules would likely become more difficult to administer, particularly with respect to large and complex multi-tiered entity structures. With respect to the recommendation to extend the rule to apply to corporate partners where the lender is a member of the same consolidated group of corporations, the Treasury Department and the IRS continue to consider whether this would be appropriate for inclusion in future guidance. The Treasury Department and the IRS are also considering additional guidance that would limit the application of the self-charged interest rule to a lender that is subject to tax under section 511, due to the special rules that apply to the calculation of unrelated business taxable income under section 512. See §1.512(a)-6.

The Treasury Department and the IRS solicited comments in the 2020 Proposed Regulations regarding whether the rule for self-charged lending transactions between partnerships and lending partners (or a similar rule) should apply to, lending transactions between S corporations and lending shareholders. No comments were received in response to this solicitation. The pro rata allocation requirements applicable to S corporations make adopting rules similar to those provided for partnership self-charged lending transactions difficult to apply and could potentially impact the eligibility requirements under subchapter S. Accordingly, the final regulations do not provide such a rule.

D. CARES Act Partnership Rules

The 2020 Proposed Regulations provide special rules for partners and partnerships for taxable years beginning in 2019 or 2020 under section 163(j)(10) as enacted by the CARES Act. Proposed §1.163(j)-6(g)(4) provides that 50 percent of any EBIE allocated to a partner for any taxable year beginning in 2019 is treated as BIE paid or accrued by the partner in the partner's first taxable year beginning in 2020 (referred to in the 2020 Proposed Regulations as §1.163(j)-6(g)(4) business interest expense). The amount that is treated as BIE paid or accrued by the partner in the partner's 2020 taxable year is not subject to a section 163(j) limitation at the partner level. The 2020 Proposed Regulations further provide that if a partner disposes of its interest in the partnership in the partnership's 2019 or 2020 taxable year, the amount treated as BIE paid or accrued by the partner under proposed §1.163(j)-6(g)(4) is deductible by the partner and thus does not result in a basis increase under §1.163(j)-6(h)(3). The 2020 Proposed Regulations state that a taxpayer may elect to not have §1.163(j)-6(g)(4) apply, and provide two examples illustrating these rules in §§1.163(j)-6(o)(35) and (o)(36). The Treasury Department and the IRS specifically requested comments on these proposed rules and on whether further guidance was necessary.

One commenter agreed with the approach taken in the 2020 Proposed Regulations, but requested that the final regulations clarify that an election out of the 50 percent EBIE rule is made by a partner with respect to each partnership in which the partner holds an interest. The commenter stated that partners may have different reasons to elect out of the 50 percent EBIE rule and that by allowing partners to make the election out with respect to each partnership, partners will have greater flexibility in managing their tax consequences.

The Treasury Department and the IRS agree with this comment. Thus, the final regulations clarify that partners may elect out of the 50 percent EBIE rule on a partnership by partnership basis.

Another commenter requested confirmation with respect to an aspect of the example in §1.163(j)-6(o)(36). In the example, the partner is allocated EBIE in 2018 and 2019 and sells its partnership interest in 2019. The commenter requested confirmation that the partner would not deduct 50 percent of the EBIE since the sale of the partnership interest occurred in 2019, resulting in a gain/loss recognition event during the 2019 taxable year, and there would be no basis in the partnership for the partner to deduct 50 percent of the 2019 EBIE.

The Treasury Department and the IRS believe that the example, as drafted in the proposed regulations, represents a correct interpretation of the regulations and are therefore finalizing the example without change. However, these final regulations clarify that §1.163(j)-6(g)(4) business interest expense can be deducted by the disposing partner except to the extent that the business interest expense is negative section 163(j) expense as defined in §1.163(j)-6(h)(1) immediately before the disposition. Under the example in §1.163(j)-6(o)(36), the partner treats 50 percent of 2019 EBIE ($10 x 50%) as §1.163(j)-6(g)(4) business interest expense. Section 1.163(j)-6(g)(4) provides that if a partner disposes of a partnership interest in the partnership's 2019 or 2020 taxable year, the partner can deduct the §1.163(j)-6(g)(4) business interest expense and there is no basis increase under §1.163(j)-6(h)(3) for this amount. Thus, unless the partner elects out of the 50 percent EBIE rule, the partner would have a $25 loss (instead of a $30 loss) from the sale of its partnership interest in 2019 and $5 of deductible BIE that is not subject to a section 163(j) limitation at the partner level.

The Treasury Department and the IRS received one comment on proposed §1.163(j)-6(d)(5). This commenter stated that the proposed regulations disregard the

“11-step approach” in §1.163(j)-6(f)(2), and instead point to different mechanics of a tiered partnership allocation rule under proposed §1.163(j)-6(j)(9). The commenter recommended additional guidance and examples on the application of the proposed regulations to non-tiered partnerships and partnerships that historically allocate all items pro rata.

In light of this comment, and in light of the fact that the tiered partnership rules in the proposed regulations are not being finalized at this time, the Treasury Department and the IRS believe that a simpler method for a partnership to take into account 2019 ATI in 2020 is warranted. Therefore, these final regulations prescribe a simplified method that applies when a partnership uses its 2019 section 704 income, gain, loss, and deduction amounts in determining its 2020 allocable ATI and include an illustrative example.

V. Comments on and Changes to Proposed §1.163(j)-7: Application of the Section 163(j) Limitation to Foreign Corporations and United States Shareholders

A. Overview

Section 1.163(j)-7 provides rules for applying section 163(j) to relevant foreign corporations and their United States shareholders (U.S. shareholders).

As described in this part V of the Summary of Comments and Explanation of Revisions section, the Treasury Department and the IRS continue to study aspects of proposed §1.163(j)-7. Accordingly, the final regulations reserve on §1.163(j)-7(c)(2)(iii) (treating a CFC group as single C corporation for purposes of allocations to an excepted trade or business) and (iv) (treating a CFC group as single taxpayer for purposes of treating amounts as interest), (f)(2) (ordering rule when a CFC group member has ECI), and (j) (computation of ATI of certain United States shareholders of applicable CFCs), and related definitions in §1.163(j)-7(k). These paragraphs of the 2020 Proposed Regulations are retained in proposed form and may be relied on to the extent provided in the Applicability Dates section.

B. Negative Adjusted Taxable Income of CFC Group Members

Proposed §1.163(j)-7(c) provided rules for applying section 163(j) to CFC group members. Proposed §1.163(j)-7(c)(2)(i) provided that a single section 163(j) limitation is computed for a specified period of a CFC group based on the sum of the current-year business interest expense, disallowed BIE carryforwards, BII, floor plan financing interest expense, and ATI of each CFC group member. For this purpose, the ATI and other items of a CFC group member were generally computed on a separate-entity basis. Proposed §1.163(j)-7(c)(2)(i).

Under the general rule of §1.163(j)-1(b)(1)(vii), ATI of a taxpayer cannot be less than zero (no-negative ATI rule). Two comments were received regarding the application of the no-negative ATI rule with respect to CFC groups and CFC group members. One of the comments stated that it is unclear how the rule applies to CFC group members. Both comments asserted that the no-negative ATI rule should apply with respect to the CFC group, rather than each separate CFC group member. As a result, the ATI of a CFC group would generally be reduced by the negative ATI of CFC group members, if any. One comment noted that consolidated groups have a single ATI amount, which takes into account losses of consolidated group members. Another comment noted that, if negative ATI of CFC group members is not taken into account, CFC group members could be required to deduct BIE in a taxable year in which the sum of the CFC group members' tested losses exceed the sum of their tested income; the comment questioned whether this result is appropriate, noting that it would often be more beneficial to carry forward the disallowed BIE to the subsequent taxable year in light of the fact that tested losses cannot be carried forward to subsequent taxable years.

The Treasury Department and the IRS agree that the ATI of CFC group members should take into account amounts less than zero for purposes of determining the ATI of a CFC group. Accordingly, the final regulations provide that the no-negative ATI rule applies with respect to the ATI of a CFC group, rather than a CFC group member.

C. Transactions Between CFC Group Members

In general, intragroup transactions are taken into account for purposes of computing a CFC group's section 163(j) limitation. However, proposed §1.163(j)-7(c)(2)(ii) provided an anti-abuse rule that disregarded an intragroup transaction between CFC group members if a principal purpose of entering into the transaction was to affect the CFC group's or a CFC group member's section 163(j) limitation by increasing or decreasing the CFC group or a CFC group member's ATI. Some comments requested a broader rule that would permit taxpayers to elect annually to disregard BII and BIE between CFC group members for purposes of applying section 163(j). The comments asserted that this election would reduce the compliance burden on taxpayers.

The final regulations do not provide an election to disregard intragroup BII and BIE. The effect of the requested election would be to allow a deduction for all intragroup BIE and to cause the section 163(j) limitation applicable to other BIE (that is, BIE with respect to debt that is not between members of a CFC group) to be determined without regard to intragroup BII. Although the requested election would not affect the total amount of deductible BIE within the CFC group, it would change the location of the deduction within the CFC group (that is, the CFC group member for which a deduction is allowed). Moving a BIE deduction from one CFC group member to another may have significant Federal income tax consequences. For example, the location of a CFC group's interest deduction can affect the amount of a CFC group member's subpart F income and tested income (or tested loss) and, therefore, the amount of a U.S. shareholder's income inclusion under section 951(a) or 951A(a), respectively. Thus, the requested election could be used to inappropriately manipulate the impact of BIE deductions within a CFC group.

However, the final regulations expand the anti-abuse rule so that it may apply not only to certain intragroup transactions that affect ATI but also to intragroup transactions entered into with a principal purpose of affecting a CFC group or a CFC group member's section 163(j) limitation by increasing the CFC group or a CFC group member's BII. This rule is intended to prevent taxpayers from artificially increasing the total amount of BII and BIE within a CFC group for a specified period in order to shift disallowed BIE from one CFC group member to another or change the timing of deductions of BIE. For example, a payment of BIE by a payor CFC group member to a payee CFC group member will generally result in an equal increase in the CFC group's section 163(j) limitation (and therefore the amount of deductible BIE) as a result of the increase in the CFC group's BII. However, the increase in the CFC group's section 163(j) limitation is not necessarily allocated to the payor. Instead, under the ordering rules of §1.163(j)-7(c)(3), the additional section 163(j) limitation would be allocated first to the payee to the extent it has BIE, and then may be allocated to other CFC group members. This type of transaction would be subject to the anti-abuse rule if it was entered into with a principal purpose of increasing the amount of BIE deductible by other CFC group members.

D. High-Tax Exceptions

1. Application of section 163(j) to Controlled Foreign Corporations with high-taxed income

One comment suggested that the Treasury Department and the IRS consider a special rule for the application of section 163(j) to CFC group members that are subject to the subpart F high-tax exception under §1.954-1(d) or the GILTI high-tax exclusion under §1.951A-2(c)(7) (together, high-tax exceptions). For example, the comment suggested a multi-step approach under which section 163(j) would first be applied to

CFC group members on a separate-entity basis for the purpose of applying the high-tax exceptions, and then ATI and BIE of CFC group members subject to the high-tax exceptions could be excluded in computing the CFC group's section 163(j) limitation.

The Treasury Department and the IRS have determined that applying section 163(j) first to each CFC group member on a separate-entity basis, then applying the high-tax exceptions, and then reapplying section 163(j) to a CFC group by excluding income eligible for the high-tax exceptions, would significantly increase the administrative and compliance burdens of section 163(j) and therefore reduce the benefits of making a CFC group election. Furthermore, such an approach would be inconsistent with the general concept and purpose of a consolidated approach to the CFC group election; for example, it would increase the relevance of the location of intragroup debt and ATI within a CFC group and could inappropriately enhance the effective foreign tax rate of such income. Accordingly, the final regulations do not adopt this recommendation.

2. Disallowed business interest expense carryforwards and the high-tax exceptions

Section 163(j) and the section 163(j) regulations generally apply to determine the deductibility of BIE of a relevant foreign corporation (which includes an applicable CFC) in the same manner as those provisions apply to determine the deductibility of BIE of a domestic C corporation. Section 1.163(j)-7(b). One comment requested that the Treasury Department and the IRS confirm that a CFC to which the high-tax exceptions apply can still have a disallowed BIE carryforward.

The high-tax exception does not modify the rules for determining the section 163(j) limitation or the amount of an applicable CFC's disallowed BIE carryforward. See part V.D.1 of this Summary of Comments and Explanation of Revisions section. Accordingly, an applicable CFC may have disallowed BIE carryforwards if the applicable CFC is subject to a high-tax exception in the taxable year(s) in which the disallowed BIE carryforwards arose.

E. Allocation of CFC Group Items to an Excepted Trade or Business

Proposed §1.163(j)-7(c)(2)(iii) provided that, for purposes of allocating items to an excepted trade or business under §1.163(j)-10, all CFC group members are treated as a single C corporation. Similarly, proposed §1.163(j)-7(c)(2)(iv) provided that, for purposes of determining whether certain amounts are treated as interest within the meaning of §1.163(j)-1(b)(22), all CFC group members are treated as a single taxpayer. Several comments addressed the method of allocating items of a CFC group member to an excepted trade or business under §1.163(j)-10. The Treasury Department and the IRS continue to study the proper method for allocating CFC group members' items to an excepted trade or business and when it is appropriate to treat a CFC group as a single entity. The Treasury Department and the IRS may address these issues in future guidance and will consider the comments at that time. Accordingly, the final regulations reserve on §1.163(j)-7(c)(2)(iii) and (iv).

F. Limitation on Pre-group Disallowed Business Interest Expense Carryforwards

1. Pre-group disallowed business interest expense carryforwards attributable to specified group members

The 2020 Proposed Regulations provided special rules relating to disallowed BIE carryforwards of a CFC group member that arose in a taxable year before it joined the CFC group (pre-group disallowed BIE carryforwards). Under proposed §1.163(j)-7(c)(3)(iv)(A)(1), a CFC group member cannot deduct pre-group disallowed BIE carryforwards in excess of the cumulative section 163(j) pre-group carryforward limitation. This limitation is determined in a manner similar to the limitation on the use of carryovers of a member of a consolidated group arising in a separate return limitation year (SRLY). See §1.1502-21(c).

One comment requested that the limitation on pre-group disallowed BIE carryforwards be removed, because it increases the compliance burden on taxpayers and any potential for loss trafficking could adequately be addressed by an anti-abuse rule. Alternatively, if this request is not adopted, the comment requested that the limitation on pre-group disallowed BIE carryforwards not apply to disallowed BIE carryforwards that arose in a taxable year in which a CFC group election was available but prior to the first taxable year for which the CFC group election was in effect. The comment asserted that applying the limitation to such carryforwards is inappropriate because there is no loss trafficking concern unless a CFC is acquired from outside the group.

The Treasury Department and the IRS have determined that it would be inappropriate for the limitation on deduction of pre-group disallowed BIE carryforwards to be replaced with an anti-abuse rule focused on loss trafficking. Loss trafficking concerns may arise anytime the ATI or BII of one CFC group member is used to allow a deduction for BIE of another CFC group member attributable to a taxable year before the other CFC group member joined the CFC group. As a result, the final regulations retain the limitation on the deduction of pre-group disallowed BIE carryforwards.

2. Application of section 382 to CFCs joining or leaving a CFC group

As a general matter, the SRLY limitations described in §§1.1502-21(c) and 1.163(j)-5(d) do not apply to a member of a consolidated group if their application would result in an overlap with the application of section 382 (SRLY overlap rule). See §§1.1502-21(g)(1) and 1.163(j)-5(f). One comment requested clarification as to whether section 382 applies to a CFC that does not have ECI. The comment generally supported the limitation on pre-group disallowed BIE carryforwards but suggested that, if section 382 applies to CFCs, a rule similar to the SRLY overlap rule should be adopted to prevent the limitation on pre-group disallowed BIE carryforwards from applying to a CFC group member if its application would result in an overlap with the application of section 382.

Section 382, by its terms, applies to the disallowed BIE carryforwards of foreign corporations regardless of whether they have ECI. However, the Treasury Department and the IRS continue to study certain aspects of the application of sections 163(j) and 382 to foreign corporations, including the possible application of a SRLY overlap rule to applicable CFCs joining or leaving a CFC group, as well as the computation of any relevant section 382(a) limitation. The Treasury Department and the IRS may address these issues in future guidance and will consider the comments at that time.

G. Specified Groups and Specified Group Members

1. The 80-percent ownership threshold

Proposed §1.163(j)-7(d) provided rules for determining a specified group and specified group members. 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) (which requires 80 percent ownership by value) in at least one applicable CFC, and stock meeting the requirements of section 1504(a)(2)(B) in each of the applicable CFCs (except the specified group parent) is owned by one or more of the other applicable CFCs or the specified group parent. Indirect ownership through a partnership or through a foreign estate or trust is taken into account for this purpose.

Some comments requested that the ownership threshold for applying this rule be reduced to 50 percent, or “more than 50 percent,” in order to make the rule consistent with the ownership rules in sections 957 and 954(d)(3). The comments asserted that a lower threshold would reduce the compliance burden of applying section 163(j) to CFCs on a separate-entity basis, would allow joint ventures to be included in the CFC group, and could prevent taxpayers from manipulating their ownership interests in order to break affiliation and exclude entities from the CFC group. One comment noted that local regulatory restrictions may prevent a U.S. shareholder from owning 80 percent of the stock in a CFC.

Another comment requested that the ownership threshold be reduced to 50 percent with respect to a CFC that has only one U.S. shareholder. The comment asserted that, if a CFC has only one U.S. shareholder, there is no concern of potentially inconsistent treatment by different shareholders and there would be no need for additional procedural requirements (for example, a requirement to provide notice to other shareholders). Alternatively, the comment suggested that a specified group parent that is a qualified U.S. person be permitted to elect to treat a CFC as a CFC group member if it meets the 50 percent (but not the 80 percent) ownership threshold, even if the specified group parent is not the sole U.S. shareholder.

The Treasury Department and the IRS have determined that it would be inappropriate to reduce the specified group ownership threshold below 80 percent. The application of section 163(j) to a CFC group is modeled on the rules for applying section 163(j) to a U.S. consolidated group under §1.163(j)-5. Accordingly, the definition of a specified group is generally consistent with the definition of an affiliated group under section 1504. In certain respects, the rules of §1.163(j)-7(c) have the effect of treating a CFC group as a single entity for purposes of section 163(j). Such treatment is not appropriate for CFCs that do not share at least 80 percent common ownership, that is, CFCs that are not highly related. Moreover, because one CFC group member's ATI and BII can be used by other CFC group members to deduct BIE, reducing the specified ownership threshold would increase the potential for one CFC group member to disproportionately benefit, or suffer a detriment, from the attributes of another CFC group member even though those CFCs are not highly related.

As an alternative, one comment requested that a U.S. shareholder be permitted to take into account its pro rata share of CFC attributes in computing the CFC group section 163(j) limitation without regard to the percentage of the U.S. shareholder's ownership interest. This approach is not adopted in the final regulations because it would require different U.S. shareholders to calculate the section 163(j) limitation differently and separately track disallowed BIE carryforwards with respect to the same CFC.

2. Clarifications to rules for determining a specified group and specified group members

The final regulations make several clarifying changes to the rules for determining a specified group and specified group members. First, the definition of specified group in §1.163(j)-7(d)(2)(i) is modified to clarify that a specified group may exist when a qualified U.S. person directly owns all of its applicable CFCs rather than owning one or more chains of applicable CFCs.

Second, the definition of specified group member in §1.163(j)-7(d)(3) is modified to clarify that there must be at least two applicable CFCs in a specified group in order for any applicable CFC to be a specified group member and for a CFC group election to be available.

Finally, the rule in §1.163(j)-7(d)(2)(vii) (concerning when a specified group ceases to exist) is modified to clarify that references to the common parent in §1.1502-75(d)(1), (d)(2)(i) through (d)(2)(ii), and (d)(3)(i) through (d)(3)(iv) are treated as references to the specified group parent. This is the case even if the specified group parent is a qualified U.S. person and therefore not included in the specified group.

H. CFC Group Election

1. Timing and revocation of the CFC group election

Proposed §1.163(j)-7(e) provided rules and procedures for treating specified group members as CFC group members and for determining a CFC group. Proposed §1.163(j)-7(e)(5) provided rules for making and revoking a CFC group election. Under the 2020 Proposed Regulations, a CFC group election could not be revoked with respect to any specified period of the specified group that begins during the 60-month period following the last day of the first specified period for which the election was made. Similarly, once revoked, a CFC group election could not be made again with respect to any specified period of the specified group that begins during the 60-month period following the last day of the first specified period for which the election was revoked. The preamble to the proposed regulations requested comments as to 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 2020 Proposed Regulations as final in the **Federal Register**) should be precluded from making the CFC group election for the following 60-month period.

Some comments requested that taxpayers be permitted to make or revoke the CFC group election on an annual basis, due to the difficulty of predicting the effect of the election five years in advance (including the potential for changes in fact or law that could interact adversely with the CFC group election). The comments noted that, although the election is favorable in most cases, it could have unfavorable consequences in some circumstances.

Some comments recommended against imposing a 60-month waiting period on specified groups for which a CFC group election is not made for the first specified period in which a specified group exists (or the specified period beginning 60 days after the regulations are finalized), because taxpayers may lack the resources or information to determine whether to make the election for the first taxable year in which it is available. Furthermore, some comments asked for clarification concerning when the 60-month period begins if a CFC group election is made or revoked with respect to a prior specified period. Finally, one comment recommended that the Treasury Department and the IRS consider providing an exception to the 60-month rule that would allow a CFC group election to be revoked when there is a "change in control." The comment did not suggest a definition of change in control.

The Treasury Department and the IRS have determined that taxpayers should not be permitted to revoke the CFC group election for a specified period beginning within 60 months after the specified period for which it is made or to make the CFC group election for a specified period beginning within 60 months after the specified period for which it is revoked. The CFC group rules are based in part on the consolidated return rules, which do not allow affiliated groups that have elected to file a consolidated return to discontinue the filing of a consolidated return without the consent of the Commissioner (which generally requires a showing of good cause). See §1.1502-75(c). In addition, if a corporation ceases to be a member of a consolidated group, that corporation generally is not permitted to rejoin the consolidated group before the 61st month beginning after its first taxable year in which it ceased to be a member of the group. Section 1504(a)(3)(A).

Moreover, an annual election would enable taxpayers to use section 163(j) to inappropriately control the timing of BIE deductions. In general, the CFC group election is intended, in large part, to reduce taxpayer burden, including compliance costs and costs that might otherwise be incurred to restructure the location of debt within a CFC group solely for purposes of section 163(j), and to permit allocation of a CFC group's section 163(j) limitation to CFC group members with BIE. The CFC group election is not intended to allow taxpayers to select the most favorable result in every taxable year.

The Treasury Department and the IRS agree that it is not necessary to impose the 60-month waiting period on specified groups that have neither made nor revoked a CFC group election. Accordingly, the final regulations do not impose a 60-month waiting period on a specified group for which a CFC group election is not made for the first specified period in which a specified group exists (or the specified period beginning

60 days after the regulations are finalized). The final regulations provide, consistent with the 2020 Proposed Regulations, that the 60-month period begins after the last day of the specified period for which the election was made or revoked. See §1.163(j)-7(e)(5). Therefore, if an election is made or revoked with respect to a specified period, the 60-month period begins to run on the day after the end of that specified period. Finally, the Treasury Department and the IRS continue to study whether an exemption to the 60-month rule for revoking a CFC group election is appropriate when the ownership of the CFC group changes but the specified group continues and, therefore, the CFC group would also otherwise continue absent an exemption.

2. Disclosure required for taxable years in which a CFC group election is in effect

Under the 2020 Proposed Regulations, a designated U.S. person makes a CFC group election by attaching a statement to its relevant Federal income tax or information return. Proposed §1.163(j)-7(e)(5)(iv). However, the 2020 Proposed Regulations did not require a statement to be filed for taxable years following the taxable year for which an election is made. In order to facilitate ongoing disclosure of the computation of the CFC group 163(j) limitation in subsequent taxable years, the final regulations provide that (in accordance with publications, forms, instructions, or other guidance) each designated U.S. person must attach a statement to its relevant Federal income tax or information return for each of its taxable years that includes the last day of a specified period of a specified group for which a CFC group election is in effect. See §1.163(j)-7(e)(6). The CFC group election remains in effect even if the required statement is not filed.

I. CFC Group Members with Effectively Connected Income

Proposed §1.163(j)-7(f) provided that if a CFC group member has income that is effectively connected with the conduct of a U.S. trade or business (ECI), then ECI items and related attributes of the CFC group member are not included in the calculation of the section 163(j) limitation of the CFC group or in the allocation of the limitation among CFC group members, but are treated as items of a separate CFC (ECI deemed corporation) that is not treated as a CFC group member. A comment requested clarification concerning the proper method for allocating assets between the CFC group member and the ECI deemed corporation, which is relevant to the allocation of BII and BIE to an excepted trade or business under §1.163(j)-10.

As discussed in part VI of this Summary of Comments and Explanation of Revisions section, the Treasury Department and the IRS continue to study the application of section 163(j) to foreign corporations with ECI. The Treasury Department and the IRS may address these issues in future guidance and will consider the comment at that time. Before the issuance of such guidance, taxpayers should use a reasonable method for allocating assets between the CFC group member and the ECI deemed corporation. The method must be consistently applied to all CFC group members and each specified period of the CFC group after the first specified period in which it is applied.

In addition, because the Treasury Department and the IRS continue to study the application of section 163(j) to foreign corporations with ECI, the final regulations reserve on §1.163(j)-7(f)(2) (ordering rule with §1.163(j)-8 when a CFC group member has ECI).

J. ATI Computation of an Applicable CFC

1. Foreign Income Taxes

The 2020 Proposed Regulations provided that, for purposes of computing the ATI of a relevant foreign corporation for a taxable year, tentative taxable income takes into account a deduction for foreign income taxes. Proposed §1.163(j)-7(g)(3). The preamble to the 2020 Proposed Regulations requested comments on whether, and the extent to which, the ATI of a relevant foreign corporation should be determined without regard to a deduction for foreign income taxes. Some comments asserted that all foreign income taxes, or foreign income taxes imposed by the country in which a CFC is organized or a tax resident, should not be taken into account as a deduction for purposes of computing a CFC's ATI. The comments asserted that not taking into account a deduction for such foreign income taxes would provide parity between CFCs and domestic corporations, which do not deduct Federal income taxes (but may deduct state and foreign taxes) in determining their ATI.

Other comments noted that, if a domestic corporation elects to claim a foreign tax credit, the deduction for foreign income taxes is disallowed under section 275(a)(4) and is not taken into account in determining the domestic corporation's ATI. Therefore, disregarding a CFC's deduction for foreign income taxes would conform the ATI of a CFC with that of a domestic corporation doing business through a foreign branch that elects to credit foreign income taxes. Another comment asserted that foreign income taxes should not be deducted to the extent a CFC's U.S. shareholders elect to credit foreign income taxes. Finally, several comments suggested that the proposed rule penalizes CFCs operating in high-tax jurisdictions.

The Treasury Department and the IRS agree that it is appropriate to determine the ATI of a relevant foreign corporation without regard to a deduction for foreign income taxes that are eligible to be claimed as a foreign tax credit. Accordingly, the final regulations provide that no deduction for foreign income taxes (within the meaning of §1.960-1(b)) is taken into account for purposes of determining the ATI of a relevant foreign corporation. Thus, regardless of whether an election is made to claim a credit for these foreign income taxes, the foreign income taxes do not reduce ATI.

2. Anti-abuse rule

Proposed §1.163(j)-7(g)(4) provided that, if certain conditions are met, when one specified group member or applicable partnership (specified borrower) pays interest to another specified group member or applicable partnership (specified lender), and the payment is BIE to the specified borrower and income to the specified lender, then the ATI of the specified borrower is increased by the amount necessary for the BIE of the specified borrower not to be limited under section 163(j). A partnership is an applicable partnership if at least 80 percent of the interests in capital or profits is owned, in the aggregate, directly or indirectly through one or more other partnerships, by specified group members of the same specified group.

The final regulations provide that, for purposes of determining whether a partnership is an applicable partnership, a partner's interests in the profits and capital of the partnership are determined in accordance with the rules and principles of §1.706-1(b)(4)(ii) through (iii).

K. Safe Harbor

Proposed §1.163(j)-7(h) provided a safe-harbor election for stand-alone applicable CFCs and CFC groups. If the safe-harbor election is in effect for a taxable year of a stand-alone applicable CFC or specified taxable year of a CFC group member, no portion of the BIE of the stand-alone applicable CFC or of each CFC group member, as applicable, is disallowed under section 163(j). The safe-harbor election is intended to reduce the compliance burden with respect to applicable CFCs that would not have disallowed BIE if they applied section 163(j) by allowing taxpayers in general to use subpart F income and GILTI items in lieu of ATI. In general, the safe-harbor election measures whether BIE is less than or equal to the sum of 30 percent of the applicable CFC's subpart F income and GILTI (not to exceed the applicable CFC's taxable income), taking into account only amounts attributable to a non-excepted trade or business.

The preamble to the 2020 Proposed Regulations requested comments on appropriate modifications, if any, to the safe-harbor election that would further the goal of reducing the compliance burden on stand-alone applicable CFCs and CFC groups that would not have disallowed BIE if they applied the section 163(j) limitation. In this regard, comments requested that the safe harbor be expanded to cover applicable CFCs and CFC groups that have BII that is greater than or equal to BIE. The comments noted that an application of section 163(j) would not disallow any BIE of an applicable CFC or CFC group that has net BII.

The Treasury Department and the IRS agree that it is appropriate for the safe-harbor to be expanded as requested because an application of section 163(j) in this case would not disallow any BIE. Accordingly, the final regulations provide that a safe-harbor election may be made with respect to a stand-alone applicable CFC or CFC group if its BIE does not exceed either (i) its BII, or (ii) 30 percent of the lesser of its eligible amount (in general, the sum of the applicable CFC's subpart F income and GILTI, taking into account only items properly allocable to a non-excepted trade or business) or its qualified tentative taxable income (that is, the applicable CFC's tentative taxable income determined by taking into account only items properly allocable to a non-excepted trade or business). Thus, under the final regulations, if either a stand-alone applicable CFC or a CFC group has BII that is greater than or equal to its BIE, it is not necessary to determine its qualified tentative taxable income or eligible amount in order to make the safe-harbor election. However, consistent with the 2020 Proposed Regulations, the election may not be made for a CFC group that has pre-group disallowed BIE carryforwards.

In addition, consistent with the changes described in part V.B of the Summary of Comments and Explanation of Revisions section (providing that negative ATI of a CFC group member is taken into account for purposes of computing the CFC group's section 163(j) limitation), the determination of the eligible amount of a stand-alone applicable CFC or a CFC group has been modified to account for tested losses, if any, of an applicable CFC. See §1.163(j)-7(h)(3). Rather than providing a formula for calculating each component of the eligible amount, the final regulations rely on existing rules under sections 951, 951A, 245A (to the extent provided in section 964(e)(4)), and 250 to determine the taxable income a domestic corporation would have had if it wholly owned the stand-alone applicable CFC or CFC group members and had no other assets or income. See §1.163(j)-7(h)(3).

L. Increase in Adjusted Taxable Income of United States Shareholders

Proposed §1.163(j)-7(j) provided rules that increase a U.S. shareholder's ATI by a portion of its specified deemed inclusions (as defined in §1.163(j)-1(b)(1)(ii)(G)). Several comments were received on these rules. The Treasury Department and the IRS continue to study the method for determining the portion of the specified deemed inclusions of a U.S. shareholder that should increase its ATI. The Treasury Department and the IRS may address this issue in future guidance and will consider the comments at that time. Accordingly, the final regulations reserve on §1.163(j)-7(j).

VI. <u>Comments on and Changes to Proposed §1.163(j)-8: Application of the Business Interest Deduction Limitation to Foreign Persons with Effectively Connected Income</u>

Proposed §1.163(j)-8 provides rules for applying section 163(j) to a nonresident alien individual or foreign corporation with ECI. The Treasury Department and the IRS continue to study methods of determining the amount of deductible BIE and disallowed business interest expense carryforwards that are allocable to ECI, such as the ATI ratio defined in proposed §1.163(j)-8(c)(1)(ii) and the interaction of proposed §1.163(j)-8 with the tiered partnership rules in proposed §1.163(j)-6(j). The Treasury Department and the IRS anticipate addressing these issues in future guidance and will consider the comments at that time. Accordingly, the final regulations continue to reserve on §1.163(j)-8.

VII. <u>Comments on and Changes to Proposed §1.469-9: Definition of Real Property Trade or Business</u>

Section 469(c)(7)(C) defines real property trade or business by reference to eleven types of trades or businesses that are not defined in the statute. The 2020 Proposed Regulations, in response to questions about the application of section 469(c)(7)(C) to timberlands, provided definitions for two terms – real property development and real property redevelopment – to further clarify what constitutes a real property trade or business.

One commenter questioned why the preamble to the 2020 Proposed Regulations references the definition of “farming” in section 464(e), when the term “farming business” in section 163(j)(7)(C) is defined by reference to section 263A(e)(4) rather than to section 464(e). The commenter further noted that a section 263A(e)(4) “farming business” excludes not only timber but also any evergreen tree which is more than 6 years old at the time severed from the roots. The commenter posited that there is no reason why such trees should be treated differently from timber for section 163(j) purposes.

The Treasury Department and the IRS have concluded that no change is required to the definition of real property trade or business and that the definitions of “real property development” and “real property redevelopment” in proposed §1.469-9(b)(2)(ii)(C) and (D) should be adopted in the final regulations without change. However, it should be noted that §1.469-9(b)(2)(i)(B) references section 464(e) to exclude farming activities from the definition of real property trade or business for purposes of section 469(c)(7)(C). In promulgating §1.469-9(b)(2)(i)(B), the Treasury Department and the IRS determined that the term “farming” as provided in section 464(e) is the most appropriate definition for purposes of section 469(c)(7). Section 464(e) generally excludes the cultivation and harvesting of trees (except those bearing fruit or nuts) from the definition of “farming.” Accordingly, the Treasury Department and the IRS note that the term “timberland” as used in §1.469-9(b)(2)(ii)(C) and (D) includes evergreen trees (including those described in section 263A(e)(4)). Therefore, to the extent the evergreen trees may be located on parcels of land covered by forest, the Treasury Department and the IRS have concluded that the business activities of cultivating and harvesting such evergreen trees may be properly considered as a component of a "real property development" or "real property redevelopment" trade or business under the final regulations, and no additional clarification is needed in this regard. To the extent that any business activities of cultivating or harvesting evergreen trees do not explicitly fall within these two definitions, then such business activities may otherwise qualify under one or more of the other terms provided in section 469(c)(7)(C). Providing a definition for any of the remaining undefined terms in section 469(c)(7)(C) is beyond the scope of the final regulations.

VIII. <u>Comments on and Changes to Proposed §1.163(j)-10</u>

A. Proposed Limitation on Corporate Look-Through Rules

For purposes of determining the extent to which a shareholder's basis in the stock of a domestic non-consolidated C corporation or CFC is allocable to an excepted or non-excepted trade or business under §1.163(j)-10, §1.163(j)-10(c)(5)(ii)(B) provides several look-through rules whereby the shareholder "looks through" to the corporation's basis in its assets.

The application of these look-through rules may produce distortive results in certain situations. For example, assume Corporation X's basis in its assets is split equally between X's excepted and non-excepted trades or businesses, and that (as a result) X has a 50 percent exempt percentage applied to its interest expense. However, rather than operate its excepted trade or business directly, X operates its excepted trade or business through a wholly owned, non-consolidated subsidiary (Corporation Y), and each of X and Y borrows funds from external lenders. Assuming for purposes of this example that neither the anti-avoidance rule in §1.163(j)-2(h) nor the anti-abuse rule in §1.163(j)-10(c)(8) applies, Y's interest expense would not be subject to the section 163(j) limitation because Y is engaged solely in an excepted trade or business. Moreover, a portion of X's interest expense also would be allocable to an excepted trade or business by virtue of the application of the look-through rule in §1.163(j)-10(c)(5)(ii)(B)(2) to X's basis in Y's stock.

The anti-avoidance rule in §1.163(j)-2(h) and the anti-abuse rule in §1.163(j)-10(c)(8) would preclude the foregoing result in certain circumstances. However, proposed §1.163(j)-10(c)(5)(ii)(D)(2) would modify the look-through rule for domestic non-consolidated C corporations and CFCs to limit the potentially distortive effect of this look-through rule on tiered structures in situations to which the anti-avoidance and anti-abuse rules do not apply. More specifically, proposed §1.163(j)-10(c)(5)(ii)(D)(2) would modify the look-through rule for non-consolidated C corporations to provide that, for purposes of determining a taxpayer's basis in its assets used in excepted and non-excepted trades or businesses, any such corporation whose stock is being looked through may not itself apply the look-through rule (Limited Look-Through Rule).

For example, P wholly and directly owns S1, which wholly and directly owns S2. Each of these entities is a non-consolidated C corporation to which the small business exemption does not apply. In determining the extent to which its interest expense is subject to the section 163(j) limitation, S1 may look through the stock of S2 for purposes of allocating S1's basis in its S2 stock between excepted and non-excepted trades or businesses. However, in determining the extent to which P's interest expense is subject to the section 163(j) limitation, S1 may not look through the stock of S2 for purposes of allocating P's basis in its S1 stock between excepted and non-excepted trades or businesses.

Several commenters objected to the Limited Look-Through Rule. One commenter stated that the Limited Look-Through Rule should not be finalized because it would penalize taxpayers that incur debt at the holding company level but hold excepted trade or business assets through tiers of non-consolidated subsidiaries (such as CFCs) for non-tax reasons. The commenter contended that this result is especially distortive in regulated industries, such as utilities, in which debt financing at the operating-entity level may be limited or prohibited by regulators. Another commenter noted that the Limited Look-Through Rule potentially conflicts with the single C corporation approach for CFCs under proposed §1.163(j)-7(c)(2)(iii).

The Treasury Department and the IRS remain concerned that application of the look-through rules in §1.163(j)-10 to non-consolidated C corporations may produce distortive results in certain situations. However, as stated in the preamble to the 2020 Proposed Regulations, the Treasury Department and the IRS are aware that taxpayers are organized into multi-tiered structures for legitimate, non-tax reasons and that it may be commercially difficult or impossible for taxpayers to limit or reduce the number of tiers in many cases. The Treasury Department and the IRS have therefore determined that such multi-tiered structures should be able to apply the look through rules in §1.163(j)-10. However, the Treasury Department and the IRS have also determined that the application of the look through rules in §1.163(j)-10 is inappropriate in cases where a principal purpose of a multi-tiered structure is to benefit from distortion under those rules.

Thus, the final regulations replace the Limited Look-Through Rule with an anti-abuse rule providing that, for purposes of applying the look-through rules in §1.163(j)-10(c)(5)(ii)(B) and (C) to a non-consolidated C corporation (upper-tier entity), that upper-tier entity may not apply those look-through rules to a lower-tier non-consolidated C corporation if a principal purpose for borrowing funds at the upper-tier entity level or adding an upper-tier or lower-tier entity to the ownership structure is increasing the amount of the taxpayer's basis allocable to excepted trades or businesses.

For example, P wholly and directly owns S1 (the upper-tier entity), which wholly and directly owns S2. Each of S1 and S2 is a non-consolidated C corporation to which the small business exemption does not apply, and S2 is engaged in an excepted trade or business. With a principal purpose of increasing the amount of its basis allocable to excepted trades or businesses, P has S1 (rather than S2) borrow funds from a third party. S1 may not look through the stock of S2 (and may not apply the asset basis look-through rule described in §1.163(j)-10(c)(5)(ii)(B)(2)(iv)) for purposes of P's allocation of its basis in its S1 stock between excepted and non-excepted trades or businesses; instead, S1 must treat its stock in S2 as an asset used in a non-excepted trade or business for that purpose. However, S1 may look through the stock of S2 for purposes of S1's allocation of its basis in its S2 stock between excepted and non-excepted trades or businesses.

B. 80-Percent Ownership Threshold in §1.163(j)-10(c)(7)(i)

A commenter recommended eliminating the 80-percent ownership threshold in §1.163(j)-10(c)(7)(i) for applying the look-through rules in §1.163(j)-10(c)(5)(ii) to non-consolidated C corporations. More specifically, the commenter recommended providing that interest expense allocable to an equity interest in an entity engaged in an electing real property trade or business (RPTOB) be treated as allocated to an electing RPTOB to the extent the assets of that entity are attributable to an electing RPTOB, regardless of the level of the equity interest. The commenter stated that, because a less-than-80-percent interest in a subsidiary corporation is treated as allocable to a "trade or business" for purposes of the section 163(j) limitation, it is appropriate to treat the stock of that corporation as allocable to an electing RPTOB if the subsidiary corporation is an electing RPTOB, without regard to an ownership threshold.

As stated in the preamble to the 2018 Proposed Regulations, the Treasury Department and the IRS have determined that non-consolidated entities generally should not be aggregated for purposes of applying the section 163(j) limitation. Moreover, as stated in the preamble to T.D. 9905, the Treasury Department and the IRS have determined that an 80-percent ownership threshold is appropriate for domestic non-consolidated C corporations because, unlike a partnership, a corporation generally is respected as an entity separate from its owner(s) for tax purposes and, unlike a partnership or an S corporation, a C corporation is not taxed as a flow-through entity. Thus, the final regulations do not accept the commenter's recommendation.

C. Application of Look-Through Rules to Small Businesses

Section 1.163(j)-10(c)(5)(ii)(D) provides that a taxpayer may not apply the look-through rules in §1.163(j)-10(c)(5)(ii) to a partnership, S corporation, or non-consolidated C corporation that is eligible for the small business exemption under section 163(j)(3) and §1.163(j)-2(d)(1), unless that entity elects under §1.163(j)-9 for a trade or business to be an electing RPTOB or an electing farming business. Under §1.163(j)-9(b)(2)(i), an exempt small business entity that conducts a RPTOB may make a "protective election" for its RPTOB to be an excepted trade or business.

A commenter noted that, if a taxpayer indirectly holds an interest in an electing RPTOB through an exempt upper-tier partnership that does not conduct an excepted trade or business, the taxpayer would be ineligible to allocate the taxpayer's interest expense to the electing RPTOB under T.D. 9905. To ensure that the owners of an exempt small business entity are treated consistently regardless of the entity's overall capital structure, the commenter recommended either (i) allowing the owners of an exempt small business entity to apply the look-through rules without the need for a "protective election" to be an excepted trade or business, or (ii) allowing the small business entity to elect to opt into the look-through rules.

The Treasury Department and the IRS appreciate the comments received on the application of the look-through rules to small businesses. These comments concern provisions in T.D. 9905 that were not revised in the 2020 Proposed Regulations, and the Treasury Department and the IRS have determined that addressing these comments would exceed the scope of the final regulations. However, the Treasury Department and the IRS will continue to consider these comments for purposes of potential future guidance.

D. Alternative to Asset Basis Allocation

A commenter recommended amending §1.163(j)-10 to permit taxpayers to use a fair market value allocation method when determining allocations of BIE for purposes of section 163(j). To discourage taxpayers from shifting allocation methods, the commenter recommended that a fair market value allocation election be irrevocable absent consent from the IRS.

As explained in the preamble to T.D. 9905, disputes between taxpayers and the IRS over the fair market value of an asset are a common and costly occurrence. Moreover, in the TCJA, Congress repealed the use of fair market value in the apportionment of interest expense under section 864 of the Code (see section 14502(a) of the TCJA). As noted in the preamble to T.D. 9905, Congress stated that the ability to elect to allocate interest expense under section 864 on the basis of fair market value of assets has led to inappropriate results and needless complexity. For these and other reasons, the Treasury Department and the IRS continue to believe that allocating interest expense based on relative amounts of asset basis is more appropriate than a regime based on the relative fair market value of assets. Thus, the final regulations do not accept this comment.

Applicability Dates

These final regulations apply to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. See additional discussion in part VI of the Special Analyses addressing the Congressional

Review Act.

Some provisions regarding the choice to apply the final regulations to taxable years beginning before the applicability date have changed from the 2020 Proposed Regulations. Commenters noted that these provisions in the 2020 Proposed Regulations were complicated. More specifically, in the 2020 Proposed Regulations, retroactive application of certain provisions requires application of all of the section 163(j) regulations contained in T.D. 9905, some or all of the provisions in these final regulations, and other specified provisions. Additionally, most provisions had to be applied to subsequent taxable years once applied for a taxable year (subsequent year application). As provided in this section, to simplify the applicability date provisions and provide certainty to taxpayers, these final regulations, except as otherwise described later in this **Applicability Dates** section, require taxpayers choosing to apply the final regulations to a taxable year beginning before the applicability date to apply the section 163(j) regulations contained in T.D. 9905 as modified by these final regulations, along with other specified provisions, and require subsequent year application.

Except for §§1.163-15 and 1.1256(e)-2, pursuant to section 7805(b)(7), taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules of these final regulations to a taxable year beginning after December 31, 2017,[1] and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that they consistently apply the section 163(j) regulations contained in T.D. 9905 as modified by these final regulations and, if applicable,

[1] Under the 2020 Proposed Regulations, for purposes of determining applicability dates, the term “related party” has the meaning provided in sections 267(b) and 707(b)(1). Section 267(c)(3) broadens the scope of related parties under section 267(b) by potentially treating individual partners in a partnership as related to a corporation owned by the partnership, even if the individual partners own only a small interest in the partnership. The Treasury Department and the IRS have determined that this broad scope is unnecessary in this context and may impede the ability of certain taxpayers to choose to apply the regulations to pre-applicability taxable years. Accordingly, under these final regulations, for purposes of determining applicability dates, the term “related party” is determined without regard to section 267(c)(3).

§§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.382-7, 1.383-0, 1.383-1,1.469-9, 1,469-11, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-90, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905 as modified by these final regulations to that taxable year and each subsequent taxable year.

Pursuant to section 7805(b)(7), taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may apply the provisions of §1.163-15 or 1.1256(e)-2 of the final regulations for a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that they consistently apply the rules in §1.163-15 or 1.1256(e)-2, as applicable, to that taxable year and each subsequent taxable year.

Alternatively, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may rely on the rules in the 2020 Proposed Regulations to the extent provided in the 2020 Proposed Regulations.

To the extent that a rule in the 2020 Proposed Regulations is not finalized in these final regulations, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may rely on that rule for a taxable year beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that they consistently follow all of the rules in the 2020 Proposed Regulations that are not being finalized to that taxable year and each subsequent taxable year beginning on or before the date the Treasury decision adopting that rule as final is applicable or other guidance regarding continued reliance is issued.

Statement of Availability of IRS Documents

The IRS Notices, Revenue Rulings, and Revenue Procedures cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits, including potential economic, environmental, public health and safety effects, distributive impacts, and equity. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. For purposes of E.O. 13771 this rule is regulatory.

These final regulations have been designated by the Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. OIRA has designated these regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these regulations.

A. Need for the final regulations

The Tax Cuts and Jobs Act (TCJA) substantially modified the statutory rules of section 163(j) to limit the amount of net business interest expense that can be deducted in the current taxable year. Because this limitation on deduction for business interest expense is relatively new, taxpayers would benefit from regulations that explain key terms and calculations. The Treasury Department and the IRS published proposed regulations in December 2018 (2018 Proposed Regulations) and published final regulations in September 2020 (T.D. 9905) to finalize most sections of the 2018 Proposed Regulations. Concurrently with the publication of T.D. 9905, the Treasury Department and the IRS published proposed regulations (2020 Proposed Regulations) to provide additional section 163(j) limitation guidance to T.D. 9905 in response to certain comments to the 2018 Proposed Regulations. The final regulations are needed to bring clarity to instances where the meaning of the statute was unclear and to respond to comments received on the 2020 Proposed Regulations.

B. Background and Overview

Section 163(j), substantially revised by the TCJA, provides a set of statutory rules that impose a limitation on the amount of business interest expense that a taxpayer may deduct for Federal tax purposes. This limitation does not apply to businesses with gross receipts of $25 million or less (inflation adjusted). This provision has the general effect of putting debt-financed investment by businesses on a more equal footing with equity-financed investment, a treatment that Congress believed would lead to a more efficient capital structure for firms. See Senate Budget Explanation of the Bill as Passed by SFC (2017-11-20) at pp. 163-4. Subsequently, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) amended section 163(j) to provide special rules relating to the ATI limitation for taxable years beginning in 2019 or 2020.

C. Economic Analysis

1. Baseline

In this analysis, the Treasury Department and the IRS assess the economic effects of the final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of the final regulations.

2. Summary of Economic Effects

The final regulations provide certainty and clarity to taxpayers regarding terms and calculations that are contained in section 163(j), which was substantially modified by TCJA. In the absence of this clarity, the likelihood that different taxpayers would interpret the rules regarding the deductibility of business interest expense (BIE) differently would be exacerbated. In general, overall economic performance is enhanced when businesses face more uniform signals about tax treatment. Certainty and clarity over tax treatment also reduce compliance costs for taxpayers.

For those situations where taxpayers would generally adopt similar interpretations of the statute even in the absence of guidance, the final regulations provide value by helping to ensure that those interpretations are consistent with the purpose of the statute. For example, the final regulations may specify a tax treatment that few or no taxpayers would adopt in the absence of specific guidance.

The Treasury Department and the IRS project that the final regulations will have an annual economic effect greater than $100 million ($2020) relative to the no-action baseline. This determination is based on the substantial volume of business interest payments in the economy[2] and the general responsiveness of business investment to effective tax rates,[3] one component of which is the deductibility of interest expense. Based on these two factors, even modest changes in the deductibility of interest payments (and in the certainty of that deductibility) provided by the final regulations, relative to the no-action baseline, can be expected to have annual effects greater than $100 million. This claim is particularly likely to hold for the first set of general section 163(j) guidance that is promulgated following major legislation, such as TCJA, and for other major guidance, which the Treasury Department and the IRS have determined includes the final regulations.

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[2] Interest deductions in tax year 2013 for corporations, partnerships, and sole proprietorships were approximately $800 billion.

[3] See E. Zwick and J. Mahon, "Tax Policy and Heterogeneous Investment Behavior," at American Economic Review 2017, 107(1): 217-48 and articles cited therein.

Regarding the nature of the economic effects, the Treasury Department and the IRS project that the final regulations will increase investment in the United States and increase the proportion that is debt-financed, relative to the no-action baseline. They have further determined that these effects are consistent with the intent and purpose of the statute. Because the final regulations are projected to lead to a decrease in Federal tax revenue relative to the no-action baseline, there may be an increase in the Federal deficit relative to the no-action baseline. This may lead to a decrease in investment by taxpayers not directly affected by these final regulations, relative to the no-action baseline. This effect should be weighed against the enhanced efficiency arising from the clarity and enhanced consistency with the intent and purpose of the statute provided by these regulations. The Treasury Department and the IRS have determined that the final regulations provide a net benefit to the U.S. economy relative to the no-action baseline.

The Treasury Department and the IRS have not undertaken more precise quantitative estimates of these effects because many of the definitions and calculations under section 163(j) are new and many of the economic decisions that are implicated by these final regulations involve highly specific taxpayer circumstances. The Treasury Department and the IRS do not have readily available data or models to estimate with reasonable precision the types and volume of different financing arrangements that taxpayers might undertake under the final regulations versus the no-action baseline.

In the absence of such quantitative estimates, the Treasury Department and the IRS have undertaken a qualitative analysis of the economic effects of the final regulations relative to the no-action baseline and relative to alternative regulatory approaches. This analysis is presented in Part I.C.3 of this Special Analyses.

No comments on the economic analysis of the 2020 Proposed Regulations were received.

3. Economic Effects of Specific Provisions

a. Definition of Interest

T.D. 9905 set forth several categories of amounts and transactions that generate interest for purposes of section 163(j). The final regulations provide further guidance on the definition of interest relevant to the calculation of interest expense and interest income. In particular, the final regulations provide rules under which the dividends paid by a regulated investment company (RIC) that earns net business interest income (BII) (referred to as section 163(j) interest dividends) are to be treated as interest income by the RIC's shareholders. That is, under the final regulations, certain interest income earned by the RIC and paid to a shareholder as a dividend is treated as if the shareholder earned the interest income directly for purposes of section 163(j).

These final regulations clarify that reported dividends paid by RICs can include designations of BII for the purposes of the section 163(j) limitation. This clarification makes clear that investment through RICs is treated, for purposes of the section 163(j) limitation, similarly to investment through other possible debt instruments. To the extent that taxpayers believed, in the absence of the final regulations, that dividends paid by RICs are not treated as BII for the purposes of the section 163(j) limitation, then taxpayers may respond to the final regulations by increasing investment in RICs. The Treasury Department and the IRS have determined that this treatment is consistent with the intent and purpose of the statute.

Affected Taxpayers. The Treasury Department and the IRS have determined that the rules regarding section 163(j) interest dividends will potentially affect approximately 10,000 RICs. The Treasury Department and the IRS do not have readily available data on the number of RIC shareholders that would receive section 163(j) interest dividends that the shareholder could treat as BII for purposes of the shareholder's section 163(j) limitation. They further do not have data on the volume of dividends that would be eligible for this treatment.

b. Provisions related to Partnerships

i. Trading Partnerships

Section 163(j) limits the deductibility of interest expense at the partnership level. The final regulations address commenter concerns about the interaction between this section 163(j) limitation and the section 163(d) partner level limitation on interest expense that existed prior to TJCA. Under logic described in the preamble to the 2018 Proposed Regulations, section 163(j) limitations would apply at the partnership level while section 163(d) limitations would apply at the partner level and these tests would be applied independently. Commenters suggested and the Treasury Department and the IRS have agreed that the correct interpretation of the statute is to exempt interest expense that is limited at the partner level by section 163(d) from the partnership-level section 163(j) limitation in accordance with the language of section 163(j)(5).

The final regulations provide that interest expense at the partnership level that is allocated to non-materially participating partners subject to section 163(d) is not included in the section 163(j) limitation calculation of the partnership. Generally, the section 163(d) limitation is more generous than the section 163(j) limitation. Relative to the 2018 Proposed Regulations, this change may encourage these partners to incur additional interest expense because they will be less likely to be limited in their ability to use it to offset other income. Commenters argued that exempting from section 163(j) any interest expense allocated to non-materially participating partners subject to section 163(d) will treat this interest expense in the same way as the interest expense generated through separately managed accounts, which are not subject to section 163(j) limitations.

The Treasury Department and the IRS project that the final regulations will result in additional investment in trading partnerships and generally higher levels of debt in any given trading partnership relative to the 2018 Proposed Regulations. Because investments in trading partnerships may be viewed as economically similar to investments in separately managed accounts arrangements, they further project that the final regulations, by making the tax treatments of these two arrangements generally similar, will improve U.S. economic performance relative to the no-action baseline.

Number of Affected Taxpayers. The Treasury Department and the IRS have determined that the rules regarding trading partnerships will potentially affect approximately 275,000 partnerships, not including their partners. This number was reached by determining, using data for the 2017 taxable year, the number of Form 1065 and Form 1065-B filers that (1) completed Schedule B to Form 1065 and marked box b, c, or d in question 1 to denote limited partnership, limited liability company, or limited liability partnership status; and (2) have a North American Industry Classification System (NAICS) code starting with 5231 (securities and commodity contracts intermediation and brokerage), 5232 (securities and commodity exchanges), 5239 (other financial investment activities), or 5259 (other investment pools and funds).

Additionally, the Treasury Department and the IRS have determined that the rules regarding publicly traded partnerships will potentially affect approximately 80 partnerships, not including their partners. This number was reached by determining, using data for the 2017 taxable year, the number of Form 1065 and 1065-B filers with gross receipts exceeding $25 million that answered “yes” to question 5 on Schedule B to Form 1065 denoting that the entity is a publicly traded partnership. The Treasury Department and the IRS do not have readily available data on the number of filers that are tax shelters that are potentially affected by these provisions.

ii. Self-charged Lending

The 2018 Proposed Regulations requested comments on the treatment of lending transactions between a partnership and a partner (self-charged lending transactions). Suppose that a partnership receives a loan from a partner and allocates the resulting interest expense to that partner. Prior to TCJA, the interest income and interest expense from this loan would net precisely to zero on the lending partner's tax return. Under section 163(j) as revised by TCJA, however, the partnership's interest expense deduction may now be limited. Therefore, in absence of specific regulatory guidance, the lending partner may receive interest income from the partnership accompanied by less-than-fully-offsetting interest expense. Instead, the lending partner would receive excess business interest expense (EBIE), which would not be available to offset his personal interest income. This outcome has the effect of increasing the cost of lending transactions between partners and their partnerships relative to otherwise similar financing arrangements.

To avoid this outcome, the final regulations treat the lending partner's interest income from the loan as excess business interest income (EBII) from the partnership, but only to the extent of the partner's share of any EBIE from the partnership for the taxable year. This allows the interest income from the loan to be offset by the EBIE. The business interest expense (that is, BIE) of the partnership attributable to the lending transaction will thus be treated as BIE of the partnership for purposes of applying section 163(j) to the partnership.

The Treasury Department and the IRS expect that the final regulations will lead a higher proportion of self-charged lending transactions in partnership financing, relative to the no-action baseline. In a self-charged lending transaction, the lending partner is on both sides of the transaction. It is the lender and, through the partnership, the borrower. Because of this, debt from self-charged lending transactions is generally viewed as less risky than traditional debt, as both the lender and the borrower are incentivized to repay the loan without default. Therefore, the Treasury Department and the IRS believe that the better policy choice is to not subject self-charged lending transactions to section 163(j). The Treasury Department and the IRS further project that the final regulations will increase the proportion of partnership financing that is debt-financed relative to the no-action baseline. The Treasury Department and the IRS have determined that these effects are consistent with the intent and purpose of the statute.

Number of Affected Taxpayers. The Treasury Department and the IRS do not have readily available data to determine the number of taxpayers affected by rules regarding self-charged interest because no reporting modules currently connect these payments by and from partnerships.

c. Provisions related to Controlled Foreign Corporations (CFCs)

i. How to Apply Section 163(j) when CFCs have shared ownership

T.D. 9905 clarified that section 163(j) and the section 163(j) regulations generally apply to determine the deductibility of a CFC's BIE for tax purposes in the same manner as these provisions apply to a domestic corporation. The final regulations provide additional rules and guidance as to how section 163(j) applies to CFCs, including when CFCs have shared ownership and are eligible to be members of CFC groups.

The Treasury Department and the IRS considered three options with respect to the application of section 163(j) to CFC groups. The first option was to apply the 163(j) limitation to CFCs on a stand-alone basis, regardless of whether CFCs have shared ownership. However, if section 163(j) were applied on a stand-alone basis, business interest deductions of individual CFCs might be limited by section 163(j) even when, if calculated on a group basis, business interest deductions would not be limited. Taxpayers could restructure or "self-help" to mitigate the effects of the section 163(j) limitation. Such an option would lead to restructuring costs for the taxpayer (relative to the third option, described later) with no corresponding economically productive activity.

The second option, which was proposed in the 2018 Proposed Regulations, was to allow an election to treat related CFCs in a similar manner as partnerships with respect to their U.S. shareholders. Under this option, while the section 163(j) rules would still be computed at the individual CFC level, the business interest expense of each CFC group member that was subject to section 163(j) was limited to its share of the net business interest expense of the CFC group, and the "excess taxable income" of a CFC could be passed up from lower-tier CFCs to upper-tier CFCs and U.S. shareholders in the same group. Excess taxable income is the amount of income by which a CFC's ATI exceeds the threshold amount of ATI below which there would be disallowed BIE.

Comments to the 2018 Proposed Regulations suggested that computing a section 163(j) limitation for each CFC and rolling up CFC excess taxable income would be burdensome for taxpayers, especially since some multinational organizations have hundreds of CFCs. In addition, comments noted that the ability to pass up excess taxable income would encourage multinational organizations to restructure such that CFCs with low interest payments and high ATI are lower down the ownership chain and CFCs with high interest payments and low ATI are higher up in the chain of ownership. Similar to the first option, this restructuring would impose costs on taxpayers without any corresponding productive economic activity.

The third option, which is adopted by the Treasury Department and the IRS in the final regulations, was to allow taxpayers to elect to apply the section 163(j) rules to CFC groups on an aggregate basis, similar to the rules applicable to U.S. consolidated groups. This option was suggested by many comments and is the approach taken in the final regulations. Under this option, a single section 163(j) limitation is computed for a CFC group by summing the items necessary for this computation (for example, current-year BIE and ATI) across all CFC group members. The CFC group's limitation is then allocated to each CFC member using allocation rules similar to those that apply to U.S. consolidated groups.

The choice to use the consolidated approach versus the stand-alone entity approach may affect the amount of interest that can be deducted. The amount of interest that can be deducted may affect the amount of subpart F income and tested income for purposes of determining the amount of inclusions under sections 951 and 951A. However, the consolidated approach applies only for purposes of computing the section 163(j) limitation and not for purposes of applying any other Code provision, such as section 951 or 951A.

This option reduces the compliance burden on taxpayers in comparison to applying the section 163(j) rules on an individual CFC basis and calculating the excess taxable income to be passed up from lower-tier CFCs to higher-tier CFCs. In comparison to the first and second options, this option also removes the incentive for taxpayers to undertake costly restructuring, since the location of interest payments and ATI among CFC group members will not affect the interest disallowance for the group. The Treasury Department and the IRS have not estimated this difference in compliance costs because they do not have readily available data or models to do so.

The final regulations also set out a number of rules to govern membership in a CFC group. These rules specify which CFCs can be members of the same CFC group, how CFCs with U.S. effectively connected income (ECI) should be treated, and the timing for making or revoking a CFC group election. These rules provide clarity and certainty to taxpayers regarding the CFC group election for section 163(j). In the absence of these regulations, taxpayers may make financing decisions or undertake restructuring based on differential interpretations of the appropriate tax treatment, an outcome that is generally inefficient relative to decisions based on the more uniform interpretation provided by the final regulations.

Number of Affected Taxpayers. The set of taxpayers affected by this rule includes any taxpayer with ownership in a CFC that is a member of a CFC group that has average gross receipts over a three-year period in excess of $25 million. The Treasury Department and the IRS estimate that there are approximately 7,500 taxpayers with two or more CFCs based on counts of e-filed tax returns for tax years 2015-2017. This estimate includes C corporations, S corporations, partnerships, and individuals with CFC ownership.

ii. Foreign income taxes and ATI of a CFC

The 2020 Proposed Regulations provided that the ATI of a CFC is determined by taking into account a deduction for foreign income taxes. The preamble to the 2020 Proposed Regulations requested comments on whether, and the extent to which, the ATI of a CFC should be determined without regard to a deduction for foreign income taxes. The final regulations provide that the ATI of a CFC is determined without regard to a deduction for foreign income taxes that are eligible to be claimed as a foreign tax credit. Thus, regardless of whether an election is made to claim a credit for these foreign income taxes, the foreign income taxes do not reduce ATI.

The Treasury Department and the IRS considered three options, based on comments received, in determining the extent to which foreign income taxes paid by a CFC should be taken into account in determining its ATI. The first option would not take into account a deduction for foreign income taxes imposed by the national government of the country in which a CFC is organized or a tax resident, but would take into account a deduction for taxes imposed by sub-national levels of government. This would result in treating a CFC in an analogous manner to a domestic corporation, which does not deduct Federal income taxes (but may deduct state and foreign taxes) in determining its ATI. However, this option would result in the ATI of a CFC being determined in a different manner than the ATI of a domestic corporation doing business through a foreign branch that elects to credit foreign income taxes (as discussed in the next option). Furthermore, this option would increase (relative to the next option) the administrative and compliance burdens of taxpayers required to determine which foreign income taxes paid by a CFC are imposed by a national government and which are imposed by sub-national levels of government.

The second option considered would not take into account foreign income taxes for which an election is made to claim a foreign tax credit. This option would conform the ATI of a CFC with that of a domestic corporation doing business through a foreign branch. If a domestic corporation doing business through a foreign branch elects to claim a foreign tax credit, the deduction for foreign income taxes is disallowed under section 275(a)(4) and is not taken into account in determining the domestic corporation's ATI. However, unlike a foreign branch that has a single owner, a CFC may have multiple shareholders. Because the election to credit foreign income taxes is made at the shareholder-level, this option would require a CFC to determine which of its shareholders elects to credit foreign income taxes, thereby increasing the administrative and compliance burdens. Furthermore, some shareholders of a CFC may elect to credit foreign income taxes, while other shareholders of the CFC may not elect or may not be eligible to elect a credit (for example, because the shareholder is a foreign corporation). Since the section 163(j) limitation is determined at the CFC-level, rather than on a shareholder-by-shareholder basis, this option could result in one shareholder being affected by the election of an unrelated shareholder of the same CFC, an outcome that would generally lead to economically inefficient decision-making.

The third option, which is adopted by the Treasury Department and the IRS in the final regulations, does not take into account a deduction for foreign income taxes that are eligible to be claimed as a foreign tax credit for purposes of calculating a CFC's ATI, regardless of whether the CFC's U.S. shareholders have made an election to claim a foreign tax credit. Relative to the first and second options, this option minimizes the administrative and compliance burden of determining ATI of a CFC, and also results in the greatest amount of ATI and section 163(j) limitation. In addition, this option does not treat CFCs located in high-tax countries differently than CFCs located in low-tax countries. Otherwise similar CFCs will have similar ATIs regardless of their foreign income taxes. In this way, the rule does not penalize U.S. shareholders of CFCs with high foreign taxes.

Number of Affected Taxpayers. The population of affected taxpayers includes any taxpayer that is a U.S. shareholder of a CFC. The Treasury Department and the IRS estimate that there are approximately 10,000 to 11,000 affected taxpayers based on a count of e-filed tax returns for tax years 2015-2017. These counts include C corporations, S corporations, partnerships, and individuals with CFC ownership that meet a $25 million three-year average gross receipts threshold. The Treasury Department and the IRS do not have readily available data on the number of filers that are tax shelters that are potentially affected by these provisions.

d. Election to use 2019 ATI to determine 2020 section 163(j) limitation for consolidated groups

The final regulations provide that if a taxpayer filing as a consolidated group elects to substitute its 2019 ATI for its 2020 ATI, that group can use the consolidated group ATI for the 2019 taxable year, even if membership of the consolidated group changed in the 2020 taxable year. For example, suppose consolidated group C has three members in the 2019 taxable year, P, the common parent of the consolidated group, and S1 and S2, which are both wholly owned by P. In the 2019 taxable year, each member of consolidated group C had $100 of ATI on a stand-alone basis, and that consolidated group C had $300 of ATI. In the 2020 taxable year, consolidated group C sells all of the stock of S2 and acquires all of the stock of a new member, S3. In the 2019 taxable year, S3 had $50 in ATI on a stand-alone basis. Under the final regulations, consolidated group C may elect to use $300 in ATI from 2019 as a substitute for its ATI in the 2020 taxable year.

The Treasury Department and the IRS considered as an alternative basing the 2019 ATI on the membership of the consolidated group in the 2020 taxable year. In the example in the previous paragraph, this approach would subtract out the $100 in ATI from S2 and add the $50 in ATI from S3, for a total of $250 in 2019 ATI that could potentially be substituted for 2020 ATI for consolidated group C. This approach would add burden to taxpayers relative to the final regulations by requiring additional calculations and tracking of ATI on a member-by-member basis to determine the amount of 2019 ATI that can be used in the 2020 taxable year without providing any general economic benefit.

In addition, the 2019 tax year will have closed for most taxpayers by the time the final regulations will be published. This implies that a final rule based on the consolidated group composition in the 2019 taxable year to calculate the amount of 2019 ATI that can be used in the 2020 taxable year will, relative to the alternative approach of using the composition in the 2020 taxable year, reduce the incentive for taxpayers to engage in costly mergers, acquisitions, or divestures to achieve a favorable tax result for those taxpayers for whom the 2020 taxable year has not closed by the time the final regulations are published.

Number of Affected Taxpayers. The Treasury Department and the IRS estimate that approximately 34,000 corporate taxpayers filed a consolidated group tax return for tax year 2017. This represents an upper-bound of the number of taxpayers affected by the final rule as not all consolidated groups would need to calculate the amount of section 163(j) interest limitation in tax years 2019 and 2020.

II. Paperwork Reduction Act

The collection of information in the final regulations has been submitted to the OMB for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C.

3507(d)) (PRA). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by section 6103 of the Code.

iv. Collections of Information

The collections of information subject to the PRA in the final regulations are in §§1.163(j)-6(d)(5), 1.163(j)-6(g)(4), 1.163(j)-7(e)(5)(iv), 1.163(j)-7(e)(6), and 1.163(j)-7(h)(5).

The collections of information in §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4) are required to make two elections relating to changes made to section 163(j) by the CARES Act. The election under §1.163(j)-6(d)(5) is for a passthrough taxpayer to use the taxpayer's ATI for the last taxable year beginning in 2019 as its ATI for any taxable year beginning in 2020, in accordance with section 163(j)(10)(B). The election under §1.163(j)-6(g)(4) relates to EBIE of a partnership for any taxable year beginning in 2019 that is allocated to a partner. Section 163(j)(10)(A)(ii)(II) provides that, unless the partner elects out, in 2020, the partner treats 50 percent of the EBIE as not subject to the section 163(j) limitation. If the partner elects out, the partner treats all EBIE as subject to the same limitations as other EBIE allocated to the partner.

Revenue Procedure 2020-22 describes the time and manner for making these elections. For both elections, taxpayers make the election by timely filing a Federal income tax return or Form 1065, including extensions, an amended Federal income tax return, amended Form 1065, or administrative adjustment request, as applicable. More specifically, taxpayers complete the Form 8990, "Limitation on Business Interest Expense under Section 163(j)," using the taxpayer's 2019 ATI and/or not applying the rule in section 163(j)(10)(ii)(II), as applicable. No formal statements are required to make these elections. Accordingly, the reporting burden associated with the collections of information in §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4) will be reflected in the IRS Form 8990 PRA Submissions (OMB control number 1545-0123).

The collections of information in §1.163(j)-7 are required for taxpayers (1) to make or revoke an election under §1.163(j)-7(e)(5)(iv) to apply section 163(j) to a CFC group (CFC group election) and to file an annual information statement to demonstrate how the CFC group calculated its section 163(j) limitation under §1.163(j)-7(e)(6) (annual information statement), or (2) to make an annual election to exempt a CFC or CFC group from the section 163(j) limitation under §1.163(j)-7(h)(5) (safe-harbor election). The CFC group election or revocation of the CFC group election are made by attaching a statement to the US shareholder's annual return. Similarly, the annual information statement must be attached to the US shareholder's annual return. The CFC group election remains in place until revoked and may not be revoked for any period beginning before 60 months following the period for which it is initially made. The safe-harbor election is made on an annual basis.

Under §1.964-1(c)(3)(i), to make an election on behalf of a foreign corporation, the controlling domestic shareholder provides a statement with its return and notice of the election to the minority shareholders under §1.964-1(c)(3)(ii) and (iii). See also §1.952-2(b)-(c). These collections are necessary to ensure that the election is properly effectuated, and that taxpayers properly report the amount of interest that is potentially subject to the limitation.

B. Future Modifications to Forms to Collect Information

At this time, the Treasury Department and the IRS are considering modifications to the Form 8990, "Limitation on Business Interest Expense IRC 163(j)," with regard to the elections under section 163(j)(10) regarding the election under §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4), the CFC group election, annual information statement, and safe-harbor election. Any modifications to Form 8990 would not be effective until the form cycle for the 2021 taxable year. For the PRA, the reporting burden of Form 8990 is associated with OMB control number 1545-0123. In the 2018 Proposed Regulations, Form 8990 was estimated to be required by fewer than 92,500 taxpayers.

If an additional information collection requirement is imposed through these regulations in the future, for purposes of the PRA, any reporting burden associated with these regulations will be reflected in the aggregated burden estimates and the OMB control numbers for general income tax forms or the Form 8990, “Limitation on Business Interest Expense Under Section 163(j)”.

The forms are available on the IRS website at:

<table>
<tr><th>Form</th><th>OMB Number</th><th>IRS Website Link</th><th>Status</th></tr>
<tr><td rowspan="2">Form 1040</td><td>1545-0074</td><td>https://www.irs.gov/pub/irs-pdf/f1040.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i1040gi.pdf)</td><td>Published in the Federal Register on 10/30/2020. Public comment period ends 12/29/2020.</td></tr>
<tr><td colspan="3">Link: https://www.federalregister.gov/documents/2020/10/30/2020-24139/proposed-extension-of-information-collection-request-submitted-for-public-comment-comment-request</td></tr>
<tr><td>Form 1120</td><td rowspan="3">1545-0123</td><td>https://www.irs.gov/pub/irs-pdf/f1120.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i1120.pdf)</td><td rowspan="3">Published in the Federal Register on 11/3/2020. Public comment period ends January 4, 2021.</td></tr>
<tr><td>Form 1120S</td><td>https://www.irs.gov/pub/irs-pdf/f1120s.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i1120s.pdf)</td></tr>
<tr><td>Form 1065</td><td>https://www.irs.gov/pub/irs-pdf/f1065.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i1065.pdf)</td></tr>
</table>

Form 1120- REIT		https://www.irs.gov/pub/irs-pdf/f1120rei--2018.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i1120rei.pdf)	
Form 8990		https://www.irs.gov/pub/irs-pdf/f8990_accessible.pdf (Instructions: https://www.irs.gov/pub/irs-pdf/i8990.pdf)	
	Link: https://www.federalregister.org/documents/2020/11/03/2020-24251/proposed-collection-comment-request-for-forms-1065-1066-1120-1120-c-1120-f-1120-h-1120-nd-1120-s		

In addition, when available, drafts of IRS forms are posted for comment at https://apps.irs.gov/app/picklist/list/draftTaxForms.htm. IRS forms are available at https://www.irs.gov/forms-instructions. Forms will not be finalized until after they have been approved by OMB under the PRA.

C. Burden Estimates

The following estimates for the collections of information in the final regulations are based on the most recently available Statistics of Income (SOI) tax data.

For the collection of income in §1.163(j)-6(d)(5), where a passthrough taxpayer elects to use the taxpayer's ATI for the last taxable beginning in 2019 as the taxpayer's ATI for any taxable year beginning in 2020, the most recently available 2017 SOI tax data indicates that, on the high end, the estimated number of respondents is 49,202. This number was determined by examining, for the 2017 tax year, Form 1065 and Form 1120-S filers with greater than $26 million in gross receipts that have reported interest expense, and do not have an NAICS code that is associated with a trade or business that normally would be excepted from the section 163(j) limitation.

For the collection of information under §1.163(j)-6(g)(4), in which a partner elects out of treating 50 percent of any EBIE allocated to the partner in 2019 as not subject to a limitation in 2020, the Treasury Department and the IRS estimate that only taxpayers that actively want to reduce their deductions will make this election. The application of the base erosion minimum tax under section 59A depends, in part, on the amount of a taxpayer's deductions. Accordingly, the Treasury Department and the IRS estimate that taxpayers that are subject to both the base erosion minimum tax under section 59A and section 163(j) are the potential filers of this election. Using the 2017 SOI tax data, the Treasury Department estimates that 1,182 firms will make the election. This estimate was determined by examining three criteria: first, the number of taxpayers subject to section 59A, namely, C corporations with at least $500,000,000 in gross receipts, second, the portion of those taxpayers that do not have an NAICS code associated with a trade or business that is generally not subject to the section 163(j) limitation (2211 (electric power generation, transmission and distribution), 2212 (natural gas distribution), 2213 (water, sewage and other systems), 111 or 112 (farming), 531 (real property)), and, third, the portion of taxpayers satisfying the first two criteria that received a Form K-1, "Partner's Share of Income, Deductions, Credits, etc."

The reporting burdens associated with the information collections in §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4) are included in the aggregated burden estimates for OMB control numbers 1545-0074 in the case of individual filers and 1545-0123 in the case of business filers. The overall burden estimates associated with those OMB control numbers are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be created or revised as a result of the information collections in these regulations. No burden estimates specific to §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4) of the final regulations are currently available.

The Treasury Department and the IRS request comments on all aspects of the forms that reflect the information collection burdens related to the final regulations, including estimates for how much time it would take to comply with the paperwork burdens related to the forms described and ways for the IRS to minimize the paperwork burden.

For the collections of information in §1.163(j)-7, namely the CFC group election and annual statement, and the safe-harbor election, and the corresponding notice under §1.964-1(c)(3)(iii), the most recently available 2017 SOI tax data indicates that, on the high end, the estimated number of respondents is 4,980 firms. This number was determined by examining, for the 2017 tax year, Form 1040, Form 1120, Form 1120-S, and Form 1065 filers with greater than $26 million in gross receipts that filed a Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, where an interest expense amount was reported on Schedule C of the Form 5471.

The estimated number of respondents that could be subject to the collection of information for the CFC group or safe-harbor election is 4,980. The estimated annual burden per respondent/recordkeeper varies from 0 to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes. The estimated total annual reporting and/or recordkeeping burden is 1,245 hours (4,980 respondents * 15 minutes). The estimated annual cost burden to respondents is $95 per hour. Accordingly, we expect the total annual cost burden for the CFC group election and safe-harbor election statements to be $118,275 (4,980 * .25 * $95).

III. Regulatory Flexibility Act

It is hereby certified that the final regulations will not have a significant economic impact on a substantial number of small entities.

This certification can be made because the Treasury Department and the IRS have determined that the number of small entities that are affected as a result of the regulations is not significant. These rules do not disincentivize taxpayers from their operations, and any burden imposed is not significant because the cost of implementing the rules, if any, is low.

As discussed in the 2018 Proposed Regulations, section 163(j) provides exceptions for which many small entities will qualify. First, under section 163(j)(3), the limitation does not apply to any taxpayer, other than a tax shelter under section 448(a)(3), which meets the gross receipts test under section 448(c) for any taxable year. A taxpayer meets the gross receipts test under section 448(c) if the taxpayer has average annual gross receipts for the 3-taxable year period ending with the taxable year that precedes the current taxable year that do not exceed $26,000,000. The gross receipts threshold is indexed annually for inflation. Because of this threshold, the Treasury Department and the IRS project that entities with 3-year average gross receipts below $26 million will not be affected by these regulations except in rare cases.

Section 163(j) provides that certain trades or businesses are not subject to the limitation, including the trade or business of performing services as an employee, electing real property trades or businesses, electing farming businesses, and certain utilities as defined in section 163(j)(7)(A)(iv). Under the 2018 Proposed Regulations, taxpayers that otherwise qualified as real property trades or businesses or farming businesses that satisfied the small business exemption in section 448(c) were not eligible to make an election to be an electing real property trade or business or electing farming business. Under T.D. 9905, however, those taxpayers are eligible to make an election to be an electing real property trade or business or electing farming business. Additionally, T.D. 9905 provides that certain utilities not otherwise excepted from the limitation can elect for a portion of their non-excepted utility trade or business to be excepted from the limitation. Any economic impact on any small entities as a result of the requirements in the final regulations, not just the requirements that impose a PRA burden, is not expected to be significant because the cost of implementing the rules, if any, is low.

The Treasury Department and the IRS do not have readily available data on the number of filers that are tax shelters, as defined in section 448(a)(3), that are potentially affected by these provisions. As described in more detail earlier in this preamble, the final regulations cover several topics, including, but not limited to, self-charged interest, the treatment of section 163(j) in relation to trader funds, the impact of section 163(j) on publicly traded partnerships, and the application of section 163(j) to United States shareholders of controlled foreign corporations.

The Treasury Department and the IRS do not have readily available data to determine the number of taxpayers affected by rules regarding self-charged interest because no reporting modules currently connect these payments by and from partnerships. Additionally, the Treasury Department and the IRS do not have readily available data to determine the number of taxpayers affected by rules regarding debt proceeds distributed from a taxpayer account or from cash. However, the rules do not impose a significant paperwork or implementation cost burden on taxpayers. Under Notice 89-35, taxpayers have been required to maintain books and records to properly report the tax treatment of interest. The rules in §1.163-15 are a finalization of the rules in section VI of Notice 89-35, which extends the period in §1.163-8T(c)(4)(iii)(B) from 15 to 30 days to determine whether debt proceeds have been distributed from a particular account.

As shown in the following table, the Treasury Department and the IRS estimate that approximately 276 trading partnerships will be affected by these rules. The table was calculated using data for the 2018 taxable year, the number of Form 1065 and Form 1065-B filers, with more than $26 million in gross receipts but less than the amount considered to be a small entity for purposes of this Regulatory Flexibility Act analysis, that (1) completed Schedule B to Form 1065 and marked box b, c, or d in question 1 to denote limited partnership, limited liability company or limited liability partnership status; and (2) have a North American Industry Classification System (NAICS) code starting with 5231 (securities and commodity contracts intermediation and brokerage), 5232 (securities and commodity exchanges), 5239 (other financial investment activities) or 5259 (other investment pools and funds).

Form 1065 and 1065-B Filers + NAICS Codes + Gross Receipts Range + Schedule B, Question 1 Box b, c, or d Marked		
NAICS Code (description)	**Gross Receipts Range**	**Schedule B, Question 1 Box b, c or d**
5231 (securities and commodity contracts intermediation and brokerage)	>$26M but not more than $41.5M	22
5232 (securities and commodity exchanges)	>$26M but not more than $41.5M	0
6239 (other financial investment activities)	>$26M but not more than $41.5M	242
5259 (other investment pools and funds)	>$26M but not more than $35M	12
	TOTAL	**276**

Additionally, the Treasury Department and the IRS have determined that the rules regarding publicly traded partnerships might affect approximately 71 taxpayers. This number was reached by determining, using data for the 2018 taxable year, the number of Form 1065 and 1065-B filers with gross receipts exceeding $25 million that answered “yes” to question 5 on Schedule B to Form 1065 denoting that the entity is a publicly traded partnership.

As noted earlier, the final regulations do not impose any new collection of information on these entities. These final regulations actually assist small entities in meeting their filing obligations by providing definitive advice on which they can rely.

For the section 163(j)(10) elections for passthrough taxpayers under final §§1.163(j)-6(d)(5) and 1.163(j)-6(g)(4), most small taxpayers do not need to make the elections because, as discussed above, they are not subject to the section 163(j) limitation. For small taxpayers that are subject to the limitation, the cost to implement the election is low. Pursuant to Revenue Procedure 2020-22, these passthrough taxpayers simply complete the Form 8990 as if the election has been made. Accordingly, the burden of complying with the elections, if needed, is no different than for taxpayers who do not make the elections.

The persons potentially subject to final §1.163(j)-7 are U.S. shareholders of one or more CFCs for which BIE is reported, and that (1) have average annual gross receipts for the 3-taxable year period ending with the taxable year that precedes the current taxable year exceeding $26,000,000, and (2) want to make the CFC group election or safe-harbor election. Section 1.163(j)-7 of the final regulations requires such taxpayers to attach a statement to their return providing basic information regarding the CFC group or standalone CFC.

As discussed in the PRA section of this preamble, the reporting burden for both statements is estimated at 0 to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes for all affected entities, regardless of size. The estimated monetized burden for compliance is $95 per hour.

Accordingly, the Secretary certifies that the rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), the notice of proposed rulemaking preceding this final rule was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business. No comments on the notice were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. These final regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These final regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

VI. Congressional Review Act

The Administrator of OIRA has determined that this is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (CRA). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the **Federal Register**.

Notwithstanding this requirement, section 808(2) of the CRA allows agencies to dispense with the requirements of section 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule determines. Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

These final regulations resolve ambiguity with respect to the statute and certain aspects of the 2020 Proposed Regulations, prevent abuse through the application of several anti-abuse rules, and grant taxpayer relief that would not be available based solely on the statute. Following the amendments to section 163(j) by the TCJA, the Treasury Department and the IRS published the proposed regulations to provide certainty to taxpayers. In particular, as demonstrated by the wide variety of public comments in response to the proposed regulations received after the publication of the final regulations, taxpayers continue to express uncertainty regarding the proper application of the statutory rules and the final regulations under section 163(j). This uncertainty extends to the application of a number of important temporary provisions in section 163(j) enacted as part of the CARES Act that were intended to provide relief for taxpayers impacted by COVID-19. The final regulations provide rules that are relevant to the application of these taxpayer-favorable provisions. Certainty with respect to these temporary provisions is essential so that taxpayers can accurately model the impact of these provisions on their liquidity in order to make timely informed business decisions during the limited periods in which these provisions are in place. Furthermore, in order to make informed business decisions, taxpayers will need to consider the potentially complex interaction of these temporary provisions, and section 163(j) more generally, with other Code provisions (for example, sections 59A, 172, and 250), which further heightens the need for prompt guidance. Consistent with Executive Order 13924 (May 19, 2020), the Treasury Department and the IRS have therefore determined that an expedited effective date of the final regulations would “give businesses… the confidence they need to re-open by providing guidance on what the law requires.” 85 FR 31353-4. Accordingly, the Treasury Department and the IRS have determined that the rules in this Treasury decision will take effect on the date it is filed with the Office of the **Federal Register** for public inspection.

Drafting Information

The principal authors of these regulations are Susie Bird, Charlie Gorham, Nathaniel Kupferman, Jaime Park, Sophia Wang, and James Williford (Income Tax & Accounting), Vishal Amin, Brian Choi, Jacob Moore, Adrienne M. Mikolashek, and William Kostak (Passthroughs and Special Industries), Azeka J. Abramoff and Raphael J. Cohen (International), Russell G. Jones and John B. Lovelace (Corporate), and William Blanchard, Michael Chin, Steven Harrison, and Pamela Lew (Financial Institutions & Products). Other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at https://www.irs.gov.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 – INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.163-15 is added to read as follows:

§1.163-15 Debt Proceeds Distributed from Any Taxpayer Account or from Cash.

(a) In general. Regardless of paragraphs (c)(4) and (5) of §1.163-8T, in the case of debt proceeds deposited in an account, a taxpayer that is applying §1.163-8T or §1.163-14 may treat any expenditure made from any account of the taxpayer, or from cash, within 30 days before or 30 days after debt proceeds are deposited in any account of the taxpayer as made from such proceeds to the extent thereof. Similarly, in the case of debt proceeds received in cash, a taxpayer that is applying §1.163-8T or §1.163-14 may treat any expenditure made from any account of the taxpayer, or from cash, within 30 days before or 30 days after debt proceeds are received in cash as made from such proceeds to the extent thereof. For purposes of this section, terms used have the same meaning as in §1.163-8T(c)(4) and (5).

(b) Applicability date. This section applies to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in this section to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in this section to that taxable year and each subsequent taxable year.

Par. 3. Section 1.163(j)-0 is amended by:

1. Adding entries for §§ 1.163(j)-1(b)(1)(iv)(A)(4) and 1.163(j)-1(b)(1)(iv)(B)(1) and (*2*).

2. Revising the entry for §1.163(j)-1(b)(1)(iv)(C).

3. Adding entries for §1.163(j)-1(b)(1)(iv)(E) through (G).

4. Revising the entries for §1.163(j)-1(b)(22)(iii)(F) and (b)(35).

5. Adding entries for §§1.163(j)-1(c)(4), 1.163(j)-2(b)(3)(i) through (iv), and 1.163(j)-2(d)(3).

6. Revising the entries for §§1.163(j)-2(k) and 1.163(j)-6(c)(1) through (3).

7. Adding entries for §§1.163(j)-6(c)(4), 1.163(j)-6(d)(3) through (5), 1.163(j)-6(e)(5) and (6), 1.163(j)-6(f)(1)(iii), 1.163(j)-6(g)(4), and 1.163(j)-6(l)(4)(iv).

8. Revising the entries for §§1.163(j)-6(n) and (p), 1.163(j)-7(c) through (f) and (h) through (m).

9. Adding entries for §1.163(j)-7(g)(3) and (4).

10. Revising the entries for §§1.163(j)-10(c)(5)(ii)(D) and 1.163(j)-10(f).

The revisions and additions read as follows:

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* * * * *

Par. 4. Section 1.163(j)-1 is amended by:

1. In paragraph (b)(1)(iv)(A)(1), adding the text “and paragraphs (b)(1)(iv)(B) and (E)” after the text “paragraphs (b)(1)(ii)(C), (D), and (E)”.

2. Revising paragraphs (b)(1)(iv)(A)(2) and (3).

3. Adding paragraph (b)(1)(iv)(A)(4).

4. Revising paragraphs (b)(1)(iv)(B), (C), and (D).

5. Adding paragraphs (b)(1)(iv)(E), (F), and (G).

6. Revising paragraphs (b)(1)(viii)(A) through (D).

7. Adding paragraph (b)(1)(viii)(E).

8. Adding paragraphs (b)(22)(iii)(F) and (b)(35).

9. In paragraph (c)(1), removing “paragraphs (c)(2) and (3)” from the first sentence and adding “paragraphs (c)(2), (3), and (4)” in its place.

10. Adding paragraph (c)(4).

The revisions and additions read as follows:

§1.163(j)-1 Definitions.

* * * * *

(b) * * *

(1) * * *

(iv) * * *

(A) * * *

(2) Intercompany transactions. For purposes of paragraphs (b)(1)(ii)(C) and (D) and paragraphs (b)(1)(iv)(B) and (b)(1)(iv)(E)(1) and (2) of this section, the term sale or other disposition excludes all intercompany transactions, within the meaning of §1.1502-13(b)(1)(i), to the extent necessary to achieve single-entity taxation of the consolidated

group.

(3) Deconsolidations. Notwithstanding any other rule in this paragraph (b)(1)(iv)(A), any transaction in which a member (S) leaves a consolidated group (selling group), including a section 381(a) transaction described in paragraph (b)(1)(iv)(A)(1) of this section, is treated as a taxable disposition of all S stock held by any member of the selling group for purposes of paragraphs (b)(1)(ii)(C) and (D) and paragraphs (b)(1)(iv)(B) and (b)(1)(iv)(E)(1) and (2) of this section, unless the transaction is described in §1.1502-13(j)(5)(i). Following S's deconsolidation, any subsequent sales or dispositions of S stock by the selling group do not trigger further adjustments under paragraphs (b)(1)(ii)(C) and (D) and paragraphs (b)(1)(iv)(B) and (b)(1)(iv)(E)(1) and (2) of this section. If a transaction is described in §1.1502-13(j)(5)(i), the transaction is not treated as a sale or other disposition for purposes of paragraphs (b)(1)(ii)(C) and (D) and paragraphs (b)(1)(iv)(B) and (b)(1)(iv)(E)(1) and (2) of this section. See also the successor rules in paragraph (b)(1)(iv)(C) of this section.

(4) Nonrecognition transactions. The disposition of property, member stock (other than in a deconsolidation described in paragraph (b)(1)(iv)(A)(3) of this section), or partnership interests in a nonrecognition transaction, other than a section 381(a) transaction described in paragraph (b)(1)(iv)(A)(1) of this section, is treated as a taxable disposition of the property, member stock, or partnership interest disposed of for purposes of paragraph (b)(1)(iv)(E)(1)(i), (b)(1)(iv)(E)(2)(i), and (b)(1)(iv)(E)(3)(i) of this section, respectively. For example, if a taxpayer transfers property to a wholly owned, non-consolidated subsidiary, the transfer of the property is treated as a taxable disposition for purposes of paragraph (b)(1)(iv)(E)(1)(i) of this section notwithstanding the application of section 351.

(B) Deductions by members of a consolidated group--(1) In general. If paragraph (b)(1)(ii)(C), (D), or (E) of this section applies to adjust the tentative taxable income of a consolidated group, and if the consolidated group does not use the alternative computation method in paragraph (b)(1)(iv)(E) of this section, the amount of the adjustment under paragraph (b)(1)(ii)(C) of this section equals the greater of the allowed or allowable depreciation, amortization, or depletion of the property, as provided under section 1016(a)(2), for the consolidated group for the taxable years beginning after December 31, 2017, and before January 1, 2022, with respect to such property.

(2) Application of the alternative computation method. If paragraph (b)(1)(ii)(C), paragraph (b)(1)(ii)(D), or paragraph (b)(1)(ii)(E) of this section applies to adjust the tentative taxable income of a consolidated group, and if the consolidated group uses the alternative computation method in paragraph (b)(1)(iv)(E) of this section, the amount of the adjustment computed under paragraph (b)(1)(iv)(E)(1)(i), paragraph (b)(1)(iv)(E)(2)(i), or paragraph (b)(1)(iv)(E)(3)(i) of this section must take into account the net gain that would be taken into account by the consolidated group, including from intercompany transactions, determined by treating the sale or other disposition as a taxable transaction (see paragraphs (b)(1)(iv)(A)(3) and (4) of this section regarding deconsolidations and certain nonrecognition transactions, respectively).

(C) Successor rules--(1) Successor assets. This paragraph (b)(1)(iv)(C)(1) applies if deductions described in paragraph (b)(1)(ii)(C) of this section are allowed or allowable to a consolidated group member (S) and either the depreciable property or S's stock is subsequently transferred to another member (S1) in an intercompany transaction in which the transferor receives S1 stock. If this paragraph (b)(1)(iv)(C)(1) applies, and if the transferor's basis in the S1 stock received in the intercompany transaction is determined, in whole or in part, by reference to its basis in the depreciable property or the S stock, the S1 stock received in the intercompany transaction is treated as a successor asset for purposes of paragraph (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section. Thus, except as otherwise provided in paragraph (b)(1)(iv)(D) of this section, the subsequent disposition of either the S1 stock or the S stock (or both) may require the application of the adjustment rules of paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section.

(2) Successor entities. The acquiring corporation in a section 381(a) transaction to which the exception in paragraph (b)(1)(iv)(A)(1) of this section applies is treated as a successor to the distributor or transferor corporation for purposes of paragraphs (b)(1)(ii)(C) through (E) and (b)(1)(iv)(B) and (E) of this section. Therefore, for example, in applying paragraphs (b)(1)(ii)(C) through (E) and (b)(1)(iv)(B) and (E) of this section, the acquiring corporation is treated as succeeding to the allowed or allowable items of the distributor or transferor corporation. Similarly, the surviving group in a transaction described in §1.1502-13(j)(5)(i) to which the exception in paragraph (b)(1)(iv)(A)(3) of this section applies is treated as a successor to the terminating group for purposes of paragraphs (b)(1)(ii)(C) through (E) and (b)(1)(iv)(B) and (E) of this section.

(D) Anti-duplication rule--(1) In general. The aggregate of the subtractions from tentative taxable income of a consolidated group under paragraphs (b)(1)(ii)(C) through (E) or paragraphs (b)(1)(iv)(E)(1) through (3) of this section with respect to an item of property (including with regard to dispositions of successor assets described in paragraph (b)(1)(iv)(C)(1) of this section) cannot exceed the aggregate amount of the consolidated group members' deductions described in paragraph (b)(1)(ii)(C) of this section with respect to such item of property. In addition, once an item of property is no longer held by any member of a consolidated group (whether or not an adjustment to the tentative taxable income of the group is made under paragraph (b)(1)(ii)(C) of this section with respect to the direct or indirect disposition of that property), no further adjustment to the group's tentative taxable income is made under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section in relation to the same property with respect to any subsequent stock disposition.

(2) Adjustments following deconsolidation. If a corporation (S) leaves a consolidated group (Group 1) in a transaction that requires an adjustment under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section, no further adjustment is required under paragraph (b)(1)(ii)(C) or (E) or paragraph (b)(1)(iv)(E) of this section in a separate return year (as defined in §1.1502-1(e)) of S with respect to depreciation, amortization, or depletion deductions allowed or allowable to Group 1. See paragraph (b)(1)(iv)(A) of this section for special rules regarding the meaning of the term "sale or other disposition" for purposes of the adjustments required under paragraphs (b)(1)(ii)(C) through (E) and paragraphs (b)(1)(iv)(B) and (E) of this section. For example, assume that S deconsolidates from Group 1 in a transaction not described in §1.1502-13(j)(5)(i) after holding property for which depreciation, amortization, or depletion deductions were allowed or allowable in Group 1. On the deconsolidation, S and Group 1 would adjust tentative taxable income with regard to that property. See paragraphs (b)(1)(iv)(A)(3), (b)(1)(ii)(D), and (b)(1)(iv)(E)(2) of this section. If, following the deconsolidation, S sells the property referred to in the previous sentence, no subtraction from tentative taxable income is made under paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section during S's separate return year with regard to the amounts included in Group 1. See paragraphs (b)(1)(iv)(A)(3), (b)(1)(ii)(D), and (b)(1)(iv)(E)(2) of this section.

(E) Alternative computation method. If paragraph (b)(1)(ii)(C), (D), or (E) of this section applies to adjust the tentative taxable income of a taxpayer, the taxpayer may compute the amount of the adjustments required by such paragraph using the formulas in paragraph (b)(1)(iv)(E)(1), (2), and (3) of this section, respectively, provided that the taxpayer applies such formulas to all dispositions for which an adjustment is required under paragraph (b)(1)(ii)(C), (D), or (E) of this section. For special rules regarding the treatment of deconsolidating transactions and nonrecognition transactions, see paragraph (b)(1)(iv)(A)(3) and (4) of this section, respectively. For special rules regarding the application of the formulas in paragraph (b)(1)(iv)(E)(1), (2), and (3) of this section by consolidated groups, see paragraph (b)(1)(iv)(B)(2) of this section.

(1) Alternative computation method for property dispositions. With respect to the sale or other disposition of property, the lesser of:

(i) Any gain recognized on the sale or other disposition of such property by the taxpayer (or, if the taxpayer is a member of a consolidated group, the consolidated group); and

(ii) The greater of the allowed or allowable depreciation, amortization, or depletion of the property, as provided under section 1016(a)(2), for the taxpayer (or, if the taxpayer is a member of a consolidated group, the consolidated group) for the taxable years beginning after December 31, 2017, and before January 1, 2022, with respect to such property.

(2) Alternative computation method for dispositions of member stock. With respect to the sale or other disposition by a member of a consolidated group of stock of another member for whom depreciation, amortization, or depletion was allowed or allowable with regard to an item of property (or stock of any successor to that member), the lesser of:

(i) Any gain recognized on the sale or other disposition of such stock; and

(ii) The investment adjustments under §1.1502-32 with respect to such stock that are attributable to deductions described in paragraph (b)(1)(ii)(C) of this section. The investment adjustments referred to in this paragraph (b)(1)(iv)(E)(2)(ii) include investment adjustments replicated in stock of members that are successor entities.

(3) Alternative computation method for dispositions of partnership interests. With respect to the sale or other disposition of an interest in a partnership, the lesser of:

(i) Any gain recognized on the sale or other disposition of such interest; and

(ii) The taxpayer's (or, if the taxpayer is a consolidated group, the consolidated group's) distributive share of deductions described in paragraph (b)(1)(ii)(C) of this section with respect to property held by the partnership at the time of such sale or other disposition to the extent such deductions were allowable under section 704(d).

(F) Cap on negative adjustments--(1) In general. A subtraction from (or negative adjustment to) tentative taxable income that is required under paragraph (b)(1)(ii)(C), (D), or (E) or paragraph (b)(1)(iv)(B) or (E) of this section is reduced to the extent the taxpayer establishes that the positive adjustments to tentative taxable income under paragraphs (b)(1)(i)(D) through (F) of this section in a prior taxable year did not result in an increase in the amount allowed as a deduction for business interest expense for such year. The extent to which the positive adjustments under paragraphs (b)(1)(i)(D) through (F) of this section resulted in an increase in the amount allowed as a deduction for business interest expense in a prior taxable year (such amount of positive adjustments, the negative adjustment cap) is determined after taking into account all other adjustments to tentative taxable income under paragraph (b)(1)(i) and (ii) of this section for that year, as established through books and records. The amount of the negative adjustment cap for a prior taxable year is reduced in future taxable years to the extent of negative adjustments under paragraphs (b)(1)(ii)(C) through (E) and paragraphs (b)(1)(iv)(B) and (E) of this section with respect to the prior taxable year.

(2) Example. A is a calendar-year individual taxpayer engaged in a trade or business that is neither an excepted trade or business nor eligible for the small business exemption. A has no disallowed business interest expense carryforwards. In 2021, A has $100x of business interest expense, no business interest income or floor plan financing interest expense, and $400x of tentative taxable income. After taking into account the adjustments to tentative taxable income under paragraph (b)(1)(i) and (ii) of this section other than positive adjustments under paragraphs (b)(1)(i)(D) through (F) of this section, A has tentative taxable income of $450x. A increases its tentative taxable income by $30x (from $450x to $480x) under paragraph (b)(1)(i)(D) of this section to reflect $30x of depreciation deductions with respect to Asset Y in 2021. Thus, for 2021, A would have a section 163(j) limitation of $135x ($450x x 30 percent) without regard to adjustments under paragraphs (b)(1)(i)(D) through (F) of this section. After the application of paragraph (b)(1)(i)(D) of this section, A has a section 163(j) limitation of $144x ($480x x 30 percent). In 2022, A sells Asset Y at a gain of $50x. Under

paragraph (b)(1)(iv)(F)(1) of this section, A is not required to reduce its tentative taxable income in 2022 under paragraph (b)(1)(ii)(C) through (E) or paragraph (b)(1)(iv)(E) of this section. As established by A, the $30x addition to tentative taxable income under paragraph (b)(1)(i)(D) of this section resulted in no increase in the amount allowed as a deduction for business interest expense in 2021.

(G) Treatment of depreciation, amortization, or depletion capitalized under section 263A. Paragraphs (b)(1)(ii)(C) through (E) of this section and this paragraph (b)(1)(iv) apply with respect to the sale or other disposition of property to which paragraph (b)(1)(iii) of this section applies. For example, if a taxpayer with depreciable machinery capitalizes the depreciation into inventory under section 263A, paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E) of this section (and, if the taxpayer is a consolidated group, paragraph (b)(1)(iv)(B) of this section) applies upon the disposition of the machinery, subject to the cap in paragraph (b)(1)(iv)(F) of this section. Similarly, the successor asset rules in paragraph (b)(1)(iv)(C)(1) of this section would apply if the depreciable machinery subsequently were transferred to another member (S1) in an intercompany transaction in which the transferor received S1 stock.

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(viii) * * *

(A) Example 1--(1) Facts. In 2021, A purchases a depreciable asset (Asset X) for $30x and fully depreciates Asset X under section 168(k). For the 2021 taxable year, A establishes that its ATI before adding back depreciation deductions with respect to Asset X under paragraph (b)(1)(i)(D) of this section is $130x, and that its ATI after adding back depreciation deductions with respect to Asset X under paragraph (b)(1)(i)(D) of this section is $160x. A incurs $45x of business interest expense in 2021. In 2024, A sells Asset X to an unrelated third party for $25x.

(2) Analysis. A’s section 163(j) limitation for 2021 is $48x ($160x × 30 percent). Thus, all $45x of A’s business interest expense incurred in 2021 is deductible in that year. Under paragraph (b)(1)(ii)(C) of this section, A must subtract $30x from its tentative taxable income in computing its ATI for its 2024 taxable year. Alternatively, under paragraph (b)(1)(iv)(E)(1) of this section, A must subtract $25x (the lesser of $30x or $25x ($25x - $0x)) from its tentative taxable income in computing its ATI for its 2024 taxable year. However, the negative adjustments under paragraphs (b)(1)(ii)(C) and (b)(1)(iv)(E)(1) of this section are both subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Under that paragraph, A’s negative adjustment under either paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section is capped at $20x, or $150x (the amount of ATI that A needed in order to deduct all $45x of business interest expense in 2021) minus $130x (the amount of A’s tentative taxable

income in 2021 before adding back any amounts under paragraph (b)(1)(i)(D) through (F) of this section). As established by A, the additional $10x ($30x - $20x) of depreciation deductions that were added back to tentative taxable income in 2021 under paragraph (b)(1)(i)(D) of this section did not increase A's business interest expense deduction for that year.

(3) Transfer of assets in a nonrecognition transaction to which section 381 applies. The facts are the same as in paragraph (b)(1)(viii)(A)(1) of this section, except that, rather than sell Asset X to an unrelated third party in 2024, A merges with and into an unrelated third party in 2024 in a transaction described in section 368(a)(1)(A) in which no gain is recognized. As provided in paragraph (b)(1)(iv)(A)(1) of this section, the merger transaction is not treated as a ''sale or other disposition'' for purposes of paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section. Thus, no adjustment to tentative taxable income is required in 2024 under paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section.

(4) Transfer of assets in a nonrecognition transaction to which section 351 applies. The facts are the same as in paragraph (b)(1)(viii)(A)(1) of this section, except that, rather than sell Asset X to an unrelated third party in 2024, A transfers Asset X to B (A's wholly owned subsidiary) in 2024 in a transaction to which section 351 applies. The section 351 transaction is treated as a "sale or other disposition" for purposes of paragraphs (b)(1)(ii)(C) and (b)(1)(iv)(E)(1) of this section, and it is treated as a taxable disposition for purposes of paragraph (b)(1)(iv)(E)(1) of this section. See paragraph (b)(1)(iv)(A)(1) and (4) of this section. However, the negative adjustments under paragraphs (b)(1)(ii)(C) and (b)(1)(iv)(E)(1) of this section are both subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Thus, A must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year.

(B) Example 2--(1) Facts. In 2021, S purchases a depreciable asset (Asset Y) for $30x and fully depreciates Asset Y under section 168(k). P reduces its basis in its S stock by $30x under §1.1502-32 to reflect S's depreciation deductions with respect to Asset Y. For the 2021 taxable year, the P group establishes that its ATI before adding back S's depreciation deductions with respect to Asset Y under paragraph (b)(1)(i)(D) of this section is $130x, and that its ATI after adding back S's depreciation deductions with respect to Asset Y under paragraph (b)(1)(i)(D) of this section is $160x. The P group incurs $45x of business interest expense in 2021. In 2024, P sells all of its S stock to an unrelated third party at a gain of $25x.

(2) Analysis. The P group's section 163(j) limitation for 2021 is $48x ($160x × 30 percent). Thus, all $45x of the P group's business interest expense incurred in 2021 is deductible in that year. Under paragraph (b)(1)(ii)(D) of this section, the P group must subtract $30x from its tentative taxable income in computing its ATI for its 2024 taxable year. Alternatively, under paragraph (b)(1)(iv)(E)(2) of this section, the P group must subtract $25x (the lesser of $30x or $25x) from its tentative taxable income in computing its ATI for its 2024 taxable year. However, the negative adjustments under paragraphs (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section are both subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Under that paragraph, the P group's negative adjustment under either paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section is capped at $20x, or $150x (the amount of ATI the P group needed in order to deduct all $45x of business interest expense in 2021) minus $130x (the amount of the P group's tentative taxable income in 2021 before

adding back any amounts under paragraph (b)(1)(i)(D) through (F) of this section). As established by the P group, the additional $10x ($30x - $20x) of depreciation deductions that were added back to tentative taxable income in 2021 under paragraph (b)(1)(i)(D) of this section did not increase the P group's business interest expense deduction for that year.

(3) Disposition of less than all member stock. The facts are the same as in paragraph (b)(1)(viii)(B)(1) of this section, except that, in 2024, P sells half of its S stock to an unrelated third party. The results are the same as in paragraph (b)(1)(viii)(B)(2) of this section. See paragraph (b)(1)(iv)(A)(3) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year. No further adjustment under paragraphs (b)(1)(ii)(C) and (D) or paragraphs (b)(1)(iv)(E)(1) and (2) of this section is required if P subsequently sells its remaining S stock or if S subsequently disposes of Asset Y. See paragraphs (b)(1)(iv)(A)(3) and (b)(1)(iv)(D) of this section.

(4) Intercompany transfer; disposition of successor assets--(i) Adjustments in 2024. The facts are the same as in paragraph (b)(1)(viii)(B)(1) of this section, except that, rather than sell all of its S stock to an unrelated third party in 2024, P transfers all of its S stock to T in 2024 in a transaction to which section 351 applies and, in 2025, P sells all of its T stock to an unrelated third party at a gain of $40x. As provided in paragraph (b)(1)(iv)(A)(2) of this section, P's intercompany transfer of its S stock to T is not a ''sale or other disposition'' for purposes of paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section. Thus, no adjustment to tentative taxable income is required in 2024 under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section.

(ii) Adjustments in 2025. Pursuant to paragraph (b)(1)(iv)(C)(1) of this section, P's stock in T is treated as a successor asset for purposes of paragraph (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section. Moreover, P's sale of its T stock causes both T and S to deconsolidate. Thus, under paragraph (b)(1)(iv)(A)(3) of this section, the transaction is treated as a taxable disposition of all of the T stock and all of the S stock held by all members of the P group. Under the anti-duplication rule in paragraph (b)(1)(iv)(D) of this section, the total amount of gain recognized for purposes of paragraph (b)(1)(iv)(E)(2)(i) of this section is $40x, the greater of the gain on the disposition of the T stock ($40x) or on the disposition of the S stock ($25x). However, the negative adjustments under paragraph (b)(1)(iv)(E)(2) of this section are subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2025 taxable year.

(5) Alternative computation and non-deconsolidating disposition of member stock. The facts are the same as in paragraph (b)(1)(viii)(B)(1) of this section, except that, in 2024, P sells just ten percent of its S stock to an unrelated third party at a gain of $2.5x. Under paragraph (b)(1)(iv)(E)(2) of this section, the lesser of P's gain recognized on the sale of the S stock ($2.5x) and the investment adjustments under §1.1502-32 with respect to the S stock P sold ($3x) is $2.5x, an amount less than the $20x limitation under paragraph (b)(1)(iv)(F) of this section. Thus, the P group must subtract $2.5x from its tentative taxable income in computing its ATI for its 2024 taxable year.

(6) Non-deconsolidating disposition of member stock followed by asset disposition. The facts are the same as in paragraph (b)(1)(viii)(B)(5) of this section,

except that, in 2025, S sells Asset Y to an unrelated third party for a gain of $20x. Under paragraph (b)(1)(iv)(E)(1) of this section, the amount of the adjustment in 2025 is the lesser of two amounts. The first amount is the amount of S's gain recognized on the sale of Asset Y ($20x). See paragraph (b)(1)(iv)(E)(1)(i) of this section. The second amount is the amount of depreciation with respect to Asset Y (see paragraph (b)(1)(iv)(E)(1)(ii) of this section), reduced by the amount of depreciation previously taken into account in the computation under paragraph (b)(1)(iv)(E)(2)(ii) of this section ($30x - $3x, or $27x). See paragraph (b)(1)(iv)(D)(1) of this section. Thus, the amount of the adjustment under paragraphs (b)(1)(iv)(D) and (b)(1)(iv)(E)(1) of this section is $20x. In turn, this amount is subject to the negative adjustment cap under paragraph (b)(1)(iv)(F), which, after accounting for the negative adjustment on the earlier sale of S stock in 2024, is $17.5x ($20x - $2.5x). Accordingly, the P group must subtract $17.5x from its tentative taxable income in computing its ATI for its 2025 taxable year.

(C) Example 3--(1) Facts. The facts are the same as in paragraph (b)(1)(viii)(B)(1) of this section, except that, in 2024, S sells Asset Y to an unrelated third party for $25x and, in 2025, P sells all of its S stock to an unrelated third party at a gain of $25x.

(2) Analysis. The results are the same as in paragraph (b)(1)(viii)(B)(2) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year. P's sale of all of its S stock in 2025 is a ‘‘sale or other disposition'' for purposes of paragraph (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section. However, pursuant to paragraph (b)(1)(iv)(D)(1) of this section, no further adjustment to the P group's tentative taxable income is required in 2025 under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section.

(3) Disposition of S stock prior to S's asset disposition. The facts are the same as in paragraph (b)(1)(viii)(C)(1) of this section, except that, in 2024, P sells all of its S stock to an unrelated third party at a gain of $25x and, in 2025, S sells Asset Y to an unrelated third party for $25x. The results are the same as in paragraph (b)(1)(viii)(B)(2) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year. Pursuant to paragraph (b)(1)(iv)(D)(2) of this section, no adjustment to the acquiring group's tentative taxable income is required in 2025 under paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section.

(4) Deconsolidation of S in nonrecognition transaction. The facts are the same as in paragraph (b)(1)(viii)(C)(3) of this section, except that, rather than sell all of its S stock to an unrelated third party, P causes S to merge with and into an unrelated third party in a transaction described in section 368(a)(1)(A). As provided in paragraph (b)(1)(iv)(A)(3) of this section, the merger transaction is treated as a taxable disposition of all of P's stock in S for purposes of paragraphs (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section because S leaves the P group. Thus, the results are the same as in paragraph (b)(1)(viii)(C)(3) of this section.

(D) Example 4--(1) Facts. P wholly owns T, which wholly owns S. In 2021, S purchases a depreciable asset (Asset Z) for $30x and fully depreciates Asset Z under section 168(k). T reduces its basis in its S stock, and P reduces its basis in its T stock, by $30x under §1.1502-32 to reflect S's depreciation deductions with respect to Asset Z. For the 2021 taxable year, the P group establishes that its ATI before adding back S's depreciation deductions with respect to Asset Z under paragraph (b)(1)(i)(D) of this section is $130x, and that its ATI after adding back S's depreciation deductions with respect to Asset Z under paragraph (b)(1)(i)(D) of this section is $160x. The P group incurs $45x of business interest expense in 2021. In 2024, T sells all of its S stock to an unrelated third party at a gain of $25x. In 2025, P sells all of its T stock to an unrelated third party at a gain of $40x.

(2) Analysis. The results are the same as in paragraph (b)(1)(viii)(B)(2) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year. Pursuant to paragraph (b)(1)(iv)(D)(1) of this section, no negative adjustment to the P group's tentative taxable income is required in 2025 under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section.

(3) Disposition of T stock in 2024. The facts are the same as in paragraph (b)(1)(viii)(D)(1) of this section, except that, in 2024, P sells all of its T stock to another consolidated group at a gain of $40x and, in 2025, T sells all of its S stock to an unrelated party at a gain of $25x. Whereas the transaction described in paragraph (b)(1)(viii)(B)(4) of this section is treated as a taxable disposition of both the T stock and the S stock, only the actual disposition of the T stock in the transaction described in this paragraph (b)(1)(viii)(D)(3) is treated as a taxable disposition for purposes of paragraphs (b)(1)(ii)(D) and (b)(1)(iv)(E)(2) of this section. See paragraph (b)(1)(iv)(A)(3) of this section. However, the results are the same as in paragraph (b)(1)(viii)(B)(2) and (b)(1)(viii)(B)(4) of this section because of the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Thus, the P group must subtract $20x from its tentative taxable income in computing its ATI for its 2024 taxable year. Pursuant to paragraph (b)(1)(iv)(D) of this section, no negative adjustment to the acquiring group's tentative taxable income is required in 2025 under paragraph (b)(1)(ii)(D) or paragraph (b)(1)(iv)(E)(2) of this section.

(E) Example 5--(1) Facts. In 2021, A purchases Assets X and Y for $30x and $80x, respectively, and fully depreciates each asset under section 168(k). For the 2021 taxable year, A establishes that its ATI before adding back depreciation deductions with respect to Assets X and Y under paragraph (b)(1)(i)(D) of this section is $150x, and that its ATI after adding back depreciation deductions with respect to Assets X and Y under paragraph (b)(1)(i)(D) of this section is $260x. A incurs $75x of business interest expense in 2021. In 2024, A sells Assets X and Y to an unrelated third party for $40x and $90x, respectively.

(2) Analysis. A's section 163(j) limitation for 2021 is $78x ($260x × 30 percent). Thus, all $75x of A's business interest expense incurred in 2021 is deductible in that year. Under paragraph (b)(1)(ii)(C) of this section, A must subtract $110x ($30x + $80x) from its tentative taxable income in computing its ATI for its 2024 taxable year. Alternatively, under paragraph (b)(1)(iv)(E)(1) of this section, A must subtract $30x with respect to Asset X (the lesser of $30x or $40x ($40x - $0x)), and $80x with respect to Asset Y (the lesser of $80x or $90x ($90x - $0x)), from its tentative taxable income in computing its ATI for its 2024 taxable year. However, the negative adjustments under paragraphs (b)(1)(ii)(C) and (b)(1)(iv)(E)(1) of this section are both subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Under that paragraph, A's negative adjustment in 2024 under either paragraph (b)(1)(ii)(C) ($110x) or paragraph (b)(1)(iv)(E)(1) (also $110x) of this section is limited to $100x. This amount equals $250x (the amount of ATI that A needed in order to deduct all $75x of business interest expense in 2021) minus $150x (the amount of A's tentative taxable

income in 2021 before adding back any amounts under paragraph (b)(1)(i)(D) through (F) of this section). As established by A, the additional $10x ($110x - $100x) of depreciation deductions that were added back to tentative taxable income in 2021 under paragraph (b)(1)(i)(D) of this section did not increase A's business interest expense deduction for that year.

(3) Sale of assets in different taxable years. The facts are the same as in paragraph (b)(1)(viii)(E)(1) of this section, except that A sells Asset Y to an unrelated third party for $90x in 2025. Under paragraph (b)(1)(ii)(C) of this section, A must subtract $30x from its tentative taxable income in computing its ATI for its 2024 taxable year. Alternatively, under paragraph (b)(1)(iv)(E)(1) of this section, A must subtract $30x (the lesser of $30x or $40x ($40x - $0x)) from its tentative taxable income in computing its ATI for its 2024 taxable year. Because A's negative adjustment cap for its 2021 taxable year is $100x (see paragraph (b)(1)(viii)(E)(2) of this section), A's negative adjustment in 2024 of $30x is not reduced under paragraph (b)(1)(iv)(F) of this section. In 2025, A must subtract $80x from its tentative taxable income under paragraph (b)(1)(ii)(C) of this section in computing its ATI. Alternatively, under paragraph (b)(1)(iv)(E)(1) of this section, A must subtract $80x (the lesser of $80x or $90x ($90x - $0x)) from its tentative taxable income in computing its ATI for its 2025 taxable year. However, the negative adjustments under paragraphs (b)(1)(ii)(C) and (b)(1)(iv)(E)(1) of this section are both subject to the negative adjustment cap in paragraph (b)(1)(iv)(F) of this section. Moreover, A's negative adjustment cap for its 2021 taxable year is reduced from $100x to $70x to reflect A's $30x negative adjustment in 2024. See paragraph (b)(1)(iv)(F) of this section. Thus, A's negative adjustment for 2025 under either paragraph (b)(1)(ii)(C) or paragraph (b)(1)(iv)(E)(1) of this section is reduced from $80x to $70x. As established by A, the additional $10x ($110x - $100x) of depreciation deductions that were added back to tentative taxable income in 2021 under paragraph (b)(1)(i)(D) of this section did not increase A's business interest expense deduction for that year.

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(22) * * *

(iii) * * *

(F) Section 163(j) interest dividends--(1) In general. Except as otherwise provided in this paragraph (b)(22)(iii)(F), a section 163(j) interest dividend is treated as interest income.

(2) Limitation on amount treated as interest income. A shareholder may not treat any part of a section 163(j) interest dividend as interest income to the extent the amount of the section 163(j) interest dividend exceeds the excess of the amount of the entire dividend that includes the section 163(j) interest dividend over the sum of the conduit amounts other than interest-related dividends under section 871(k)(1)(C) and section

163(j) interest dividends that affect the shareholder's treatment of that dividend.

(3) Conduit amounts. For purposes of paragraph (b)(22)(iii)(F)(2) of this section, the term conduit amounts means, with respect to any category of income (including tax-exempt interest) earned by a RIC for a taxable year, the amounts identified by the RIC (generally in a designation or written report) in connection with dividends of the RIC for that taxable year that are subject to a limit determined by reference to that category of income. For example, a RIC's conduit amount with respect to its net capital gain is the amount of the RIC's capital gain dividends under section 852(b)(3)(C).

(4) Holding period. Except as provided in paragraph (b)(22)(iii)(F)(5) of this section, no dividend is treated as interest income under paragraph (b)(22)(iii)(F)(1) of this section if the dividend is received with respect to a share of RIC stock--

(i) That is held by the shareholder for 180 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 361-day period beginning on the date which is 180 days before the date on which the share becomes ex-dividend with respect to such dividend; or

(ii) To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(5) Exception to holding period requirement for money market funds and certain regularly declared dividends. Paragraph (b)(22)(iii)(F)(4)(i) of this section does not apply to dividends distributed by any RIC regulated as a money market fund under 17 CFR 270.2a-7 (Rule 2a-7 under the 1940 Act) or to regular dividends paid by a RIC that declares section 163(j) interest dividends on a daily basis in an amount equal to at least 90 percent of its excess section 163(j) interest income, as defined in paragraph (b)(35)(iv)(E) of this section, and distributes such dividends on a monthly or more frequent basis.

* * * * *

(35) Section 163(j) interest dividend. The term section 163(j) interest dividend means a dividend paid by a RIC for a taxable year for which section 852(b) applies to the RIC, to the extent described in paragraph (b)(35)(i) or (ii) of this section, as applicable.

(i) In general. Except as provided in paragraph (b)(35)(ii) of this section, a section 163(j) interest dividend is any dividend, or part of a dividend, that is reported by the RIC as a section 163(j) interest dividend in written statements furnished to its shareholders.

(ii) Reduction in the case of excess reported amounts. If the aggregate reported amount with respect to the RIC for the taxable year exceeds the excess section 163(j) interest income of the RIC for such taxable year, the section 163(j) interest dividend is--

(A) The reported section 163(j) interest dividend amount; reduced by

(B) The excess reported amount that is allocable to that reported section 163(j) interest dividend amount.

(iii) Allocation of excess reported amount--(A) In general. Except as provided in paragraph (b)(35)(iii)(B) of this section, the excess reported amount, if any, that is allocable to the reported section 163(j) interest dividend amount is that portion of the excess reported amount that bears the same ratio to the excess reported amount as the reported section 163(j) interest dividend amount bears to the aggregate reported amount.

(B) Special rule for noncalendar year RICs. In the case of any taxable year that does not begin and end in the same calendar year, if the post-December reported amount equals or exceeds the excess reported amount for that taxable year, paragraph (b)(35)(iii)(A) of this section is applied by substituting “post-December reported amount” for “aggregate reported amount,” and no excess reported amount is allocated to any dividend paid on or before December 31 of such taxable year.

(iv) Definitions. The following definitions apply for purposes of this paragraph (b)(35):

(A) Reported section 163(j) interest dividend amount. The term reported section 163(j) interest dividend amount means the amount of a dividend distribution reported to the RIC's shareholders under paragraph (b)(35)(i) of this section as a section 163(j) interest dividend.

(B) Excess reported amount. The term excess reported amount means the excess of the aggregate reported amount over the RIC's excess section 163(j) interest income for the taxable year.

(C) Aggregate reported amount. The term aggregate reported amount means the aggregate amount of dividends reported by the RIC under paragraph (b)(35)(i) of this section as section 163(j) interest dividends for the taxable year (including section 163(j) interest dividends paid after the close of the taxable year described in section 855).

(D) Post-December reported amount. The term post-December reported amount means the aggregate reported amount determined by taking into account only dividends paid after December 31 of the taxable year.

(E) Excess section 163(j) interest income. The term excess section 163(j) interest income means, with respect to a taxable year of a RIC, the excess of the RIC's business interest income for the taxable year over the sum of the RIC's business interest expense for the taxable year and the RIC's other deductions for the taxable year that are properly allocable to the RIC's business interest income.

(v) Example--(A) Facts. X is a domestic C corporation that has elected to be a RIC. For its taxable year ending December 31, 2021, X has $100x of business interest income (all of which is qualified interest income for purposes of section 871(k)(1)(E)) and $10x of dividend income (all of which is qualified dividend income within the meaning of section 1(h)(11) and would be eligible for the dividends received deduction under section 243, determined as described in section 854(b)(3)). X has $10x of business interest expense and $20x of other deductions. X has no other items for the taxable year. On December 31, 2021, X pays a dividend of $80x to its shareholders, and reports, in written statements to its shareholders, $71.82x as a section 163(j) interest dividend; $10x as dividends that may be treated as qualified dividend income or as dividends eligible for the dividends received deduction; and $72.73x as interest-related dividends under section 871(k)(1)(C). Shareholder A, a domestic C corporation, meets the holding period requirements in paragraph (b)(22)(iii)(F)(4) of this section with respect to the stock of X, and receives a dividend of $8x from X on December 31, 2021.

(B) Analysis. X determines that $18.18x of other deductions are properly allocable to X's business interest income. X's excess section 163(j) interest income under paragraph (b)(35)(iv)(E) of this section is $71.82x ($100x business interest income – ($10x business interest expense + $18.18x other deductions allocated) = $71.82x). Thus, X may report up to $71.82x of its dividends paid on December 31, 2021, as section 163(j) interest dividends to its shareholders. X may also report up to $10x of its dividends paid on December 31, 2021, as dividends that may be treated as qualified dividend income or as dividends that are eligible for the dividends received deduction. X determines that $9.09x of interest expense and $18.18x of other deductions are properly allocable to X's qualified interest income. Therefore, X may report up to $72.73x of its dividends paid on December 31, 2021, as interest-related dividends under section 871(k)(1)(C) ($100x qualified interest income - $27.27x deductions allocated = $72.73x). A treats $1x of its $8x dividend as a dividend eligible for the dividends received deduction and no part of the dividend as an interest-related dividend under section 871(k)(1)(C). Therefore, under paragraph (b)(22)(iii)(F)(2) of this section, A may treat $7x of the section 163(j) interest dividend as interest income for purposes of section 163(j) ($8x dividend - $1x conduit amount = $7x limitation).

* * * * *

(c) * * *

(4) Paragraphs (b)(1)(iv)(A)(2) through (4), (B) through (G), (b)(22)(iii)(F), and (b)(35). Paragraphs (b)(1)(iv)(A)(2) through (4), (b)(1)(iv)(B) through (G), (b)(22)(iii)(F), and (b)(35) of this section apply to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in paragraphs (b)(1)(iv)(A)(2) through (4), (b)(1)(iv) (B) through (G), (b)(22)(iii)(F), and (b)(35) of this section to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in the section 163(j) regulations contained in T.D. 9905 (§§1.163(j)-0

through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.382-7, 1.383-0, 1.383-1, 1.469-9, 1.469-11, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905, as modified by T.D. 9943, to that taxable year and all subsequent taxable years.

Par. 5. Section 1.163(j)-2 is amended by:

1. Adding paragraphs (b)(3)(iii) and (iv) and (d)(3).

2. Redesignating paragraph (k) as paragraph (k)(1).

3. Adding a new subject heading for paragraph (k).

4. Revising the subject heading of newly redesignated paragraph (k)(1).

5. Adding paragraph (k)(2).

The revisions and additions read as follows:

§1.163(j)-2 Deduction for business interest expense limited.

* * * * *

(b) * * *

(3) * * *

(iii) Transactions to which section 381 applies. For purposes of the election described in paragraph (b)(3)(i) of this section, and subject to the limitation in paragraph (b)(3)(ii) of this section, the 2019 ATI of the acquiring corporation in a transaction to which section 381 applies equals the amount of the acquiring corporation's ATI for its last taxable year beginning in 2019.

(iv) Consolidated groups. For purposes of the election described in paragraph (b)(3)(i) of this section, and subject to the limitation in paragraph (b)(3)(ii) of this section, the 2019 ATI of a consolidated group equals the amount of the consolidated group's ATI for its last taxable year beginning in 2019.

* * * * *

(d) * * *

(3) Determining a syndicate's loss amount. For purposes of section 163(j), losses allocated under section 1256(e)(3)(B) and §1.448-1T(b)(3) are determined without regard to section 163(j). See also §1.1256(e)-2(b).

* * * * *

(k) Applicability dates.

(1) In general.* * *

(2) Paragraphs (b)(3)(iii), (b)(3)(iv), and (d)(3). Paragraphs (b)(3)(iii) and (iv) and (d)(3) of this section apply to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in paragraphs (b)(3)(iii), (b)(3)(iv), and (d)(3) of this section to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in paragraphs (b)(3)(iii) and (iv) of this section and the rules in the section 163(j) regulations contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.382-7, 1.383-0, 1.383-1, 1.469-9, 1.469-11, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905

as modified by T.D. 9943, for that taxable year and for each subsequent taxable year.

Par. 6. Section 1.163(j)-6 is amended by:

1. Adding paragraphs (c)(1) and (2).

2. Redesignating paragraph (c)(3) as paragraph (c)(4).

3. Adding new paragraph (c)(3) and paragraphs (d)(3) through (5) and (e)(5).

4. Adding paragraphs (f)(1)(iii) and (g)(4).

5. Adding paragraph (n).

6. Adding paragraphs (o)(24) through (26), reserved paragraphs (o)(27). through (33), and paragraphs (o)(34) through (36).

7. Redesignating paragraph (p) as paragraph (p)(1), revising the subject heading of paragraph (p), and adding a subject heading for newly designated paragraph (p)(1).

8. Adding paragraph (p)(2).

The revisions and additions read as follows:

<u>§1.163(j)-6 Application of the section 163(j) limitation to partnerships and subchapter S corporations.</u>

* * * * *

(c) * * *

(1) <u>Modification of business interest income for partnerships</u>. The business interest income of a partnership generally is determined in accordance with §1.163(j)-1(b)(4). However, to the extent that interest income of a partnership that is properly allocable to trades or businesses that are per se non-passive activities is allocated to partners that do not materially participate (within the meaning of section 469), as described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii), such interest income shall not be considered business interest income for purposes of determining the section 163(j) limitation of a partnership pursuant to §1.163(j)-2(b). A per se non-passive activity is an activity that is not treated as a passive activity for purposes of

section 469 regardless of whether the owners of the activity materially participate in the activity.

(2) Modification of business interest expense for partnerships. The business interest expense of a partnership generally is determined in accordance with §1.163(j)-1(b)(3). However, to the extent that interest expense of a partnership that is properly allocable to trades or businesses that are per se non-passive activities is allocated to partners that do not materially participate (within the meaning of section 469), as described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii), such interest expense shall not be considered business interest expense for purposes of determining the section 163(j) limitation of a partnership pursuant to §1.163(j)- 2(b).

(3) Transition rule. With respect to a partner in a partnership engaged in a trade or business described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii), if such partner had been allocated EBIE from the partnership with respect to the trade or business described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii) in any prior taxable year in which the partner did not materially participate, such partner may treat such excess business interest expense not previously treated as paid or accrued under §1.163(j)-6(g)(2) as paid or accrued by the partner in the first taxable year ending on or after the effective date of the final regulations and not subject to further limitation under section 163(j) or 163(d).

* * * * *

(d) * * *

(3) Section 743(b) adjustments and publicly traded partnerships. Solely for purposes of §1.163(j)-6, a publicly traded partnership, as defined in §1.7704-1, shall treat the amount of any section 743(b) adjustment of a purchaser of a partnership unit that relates to a remedial item that the purchaser inherits from the seller as an offset to the related section 704(c) remedial item. For this purpose, §1.163(j)-6(e)(2)(ii) applies.

See Example 25 in paragraph (o)(25) of this section.

(4) Modification of adjusted taxable income for partnerships. The adjusted taxable income of a partnership generally is determined in accordance with §1.163(j)-1(b)(1). However, to the extent that the items comprising the adjusted taxable income of a partnership that are properly allocable to trades or businesses that are per se non-passive activities are allocated to partners that do not materially participate (within the meaning of section 469), as described in section 163(d)(5)(A)(ii), such partnership items shall not be considered adjusted taxable income for purposes of determining the section 163(j) limitation of a partnership pursuant to §1.163(j)-2(b).

(5) Election to use 2019 adjusted taxable income for taxable years beginning in 2020. In the case of any taxable year beginning in 2020, a partnership may elect to apply this section by substituting its adjusted taxable income for the last taxable year beginning in 2019 for the adjusted taxable income for such taxable year (post-election ATI or 2019 ATI). See §1.163(j)-2(b)(4) for the time and manner of making or revoking this election. An electing partnership determines each partner's allocable ATI (as defined in paragraph (f)(2)(ii) of this section) by using the partnership's 2019 section 704 income, gain, loss, and deduction as though such amounts were recognized by the partnership in 2020. See Example 34 in paragraph (o)(34) of this section.

(e) * * *

(5) Partner basis items, remedial items, and publicly traded partnerships. Solely for purposes of §1.163(j)-6, a publicly traded partnership, as defined in §1.7704-1, shall either allocate gain that would otherwise be allocated under section 704(c) based on a partner's section 704(b) sharing ratios, or, for purposes of allocating cost recovery deductions under section 704(c), determine a partner's remedial items, as defined in §1.163(j)-6(b)(3), based on an allocation of the partnership's asset basis (inside basis) items among its partners in proportion to their share of corresponding section 704(b)

items (rather than applying the traditional method, described in §1.704-3(b)). See Example 24 in paragraph (o)(24) of this section.

(f) * * *

(1) * * *

(iii) Exception applicable to publicly traded partnerships. Publicly traded partnerships, as defined in §1.7704-1, do not apply the rules in paragraph (f)(2) of this section to determine a partner's share of section 163(j) excess items. Rather, publicly traded partnerships determine a partner's share of section 163(j) excess items by applying the same percentage used to determine the partner's share of the corresponding section 704(b) items that comprise ATI.

* * * * *

(g) * * *

(4) Special rule for taxable years beginning in 2019 and 2020. In the case of any excess business interest expense of a partnership for any taxable year beginning in 2019 that is allocated to a partner under paragraph (f)(2) of this section, 50 percent of such excess business interest expense (§1.163(j)-6(g)(4) business interest expense) is treated as business interest expense that, notwithstanding paragraph (g)(2) of this section, is paid or accrued by the partner in the partner's first taxable year beginning in 2020. Additionally, §1.163(j)-6(g)(4) business interest expense is not subject to the section 163(j) limitation at the level of the partner. For purposes of paragraph (h)(1) of this section, any §1.163(j)-6(g)(4) business interest expense is, similar to deductible business interest expense, taken into account before any excess business interest expense. This paragraph applies after paragraph (n) of this section. If a partner disposes of a partnership interest in the partnership's 2019 or 2020 taxable year, §1.163(j)-6(g)(4) business interest expense is deductible by the partner (except to the extent that the business interest expense is negative section 163(j) expense as defined

in §1.163(j)-6(h)(1) immediately prior to the disposition) and thus does not result in a basis increase under paragraph (h)(3) of this section. See Example 35 and Example 36 in paragraphs (o)(35) and (o)(36), respectively, of this section. A partner may elect to not have this provision apply with respect to each partnership interest held by the partner on an interest by interest basis. The rules and procedures regarding the time and manner of making, or revoking, such an election are provided in Revenue Procedure 2020-22, 2020-18 I.R.B. 745, and may be further modified through other guidance (see §§601.601(d) and 601.602 of this chapter).

* * * * *

(n) Treatment of self-charged lending transactions between partnerships and partners. In the case of a lending transaction between a partner (lending partner) and partnership (borrowing partnership) in which the lending partner owns a direct interest (self-charged lending transaction), any business interest expense of the borrowing partnership attributable to the self-charged lending transaction is business interest expense of the borrowing partnership for purposes of this section. If in a given taxable year the lending partner is allocated excess business interest expense from the borrowing partnership and has interest income attributable to the self-charged lending transaction (interest income), the lending partner is deemed to receive an allocation of excess business interest income from the borrowing partnership in such taxable year. The amount of the lending partner's deemed allocation of excess business interest income is the lesser of such lending partner's allocation of excess business interest expense from the borrowing partnership in such taxable year or the interest income attributable to the self-charged lending transaction in such taxable year. To prevent the double counting of business interest income, the lending partner includes interest income that was treated as excess business interest income pursuant to this paragraph (n) only once when calculating its own section 163(j) limitation. To the extent an amount of interest income received by a lending partner is attributable to a self-charged lending transaction, and is deemed to be an allocation of excess business interest income from the borrowing partnership pursuant to this paragraph (n), such an amount of interest income will not be treated as investment income for purposes of section 163(d). In cases where the lending partner is not a C corporation, to the extent that any interest income exceeds the lending partner's allocation of excess business interest expense from the borrowing partnership for the taxable year, and such interest income otherwise would be properly treated as investment income of the lending partner for purposes of section 163(d) for that year, such excess amount of interest income will continue to be treated as investment income of the lending partner for that year for purposes of section 163(d). See Example 26 in paragraph (o)(26) of this section.

(o) * * *

(24) Example 24--(i) Facts. On January 1, 2020, L and M form LM, a publicly traded partnership (as defined in §1.7704-1), and agree that each will be allocated a 50 percent share of all LM items. The partnership agreement provides that LM will make allocations under section 704(c) using the remedial allocation method under §1.704-3(d). L contributes depreciable property with an adjusted tax basis of $4,000 and a fair market value of $10,000. The property is depreciated using the straight-line method with a 10-year recovery period and has 4 years remaining on its recovery period. M contributes $10,000 in cash, which LM uses to purchase land. Except for the depreciation deductions, LM's expenses equal its income in each year of the 10 years commencing with the year LM is formed. LM has a valid section 754 election in effect.

(ii) Section 163(j) remedial items and partner basis items. LM sells the asset contributed by L in a fully taxable transaction at a time when the adjusted basis of the property is $4,000. Under §1.163(j)-6(e)(2)(ii), solely for purposes of §1.163(j)-6, the tax gain of $6,000 is allocated equally between L and M ($3,000 each). To avoid shifting built-in gain to the non-contributing partner (M) in a manner consistent with the rule in section 704(c), a remedial deduction of $3,000 is allocated to M (leaving M with no net tax gain), and remedial income of $3,000 is allocated to L (leaving L with total tax gain of $6,000).

(25) Example 25--(i) Facts. The facts are the same as Example 24 in paragraph (o)(24) of this section except the property contributed by L had an adjusted tax basis of zero. For each of the 10 years following the contribution, there would be $500 of section 704(c) remedial income allocated to L and $500 of remedial deductions allocated to M with respect to the contributed asset. A buyer of M's units would step into M's shoes with respect to the $500 of annual remedial deductions. A buyer of L's units would step into L's shoes with respect to the $500 of annual remedial income and would have an annual section 743(b) deduction of $1,000 (net $500 of deductions).

(ii) Analysis. Pursuant to §1.163(j)-6(d)(2)(ii), solely for purposes of §1.163(j)-6, a buyer of L's units immediately after formation of LM would offset its $500 annual section 704(c) remedial income allocation with $500 of annual section 743(b) adjustment (leaving the buyer with net $500 of section 743(b) deduction). As a result, such buyer would be in the same position as a buyer of M's units. Each buyer would have net deductions of $500 per year, which would not affect ATI before 2022.

(26) Example 26--(i) Facts. X and Y are partners in partnership PRS. In Year 1, PRS had $200 of excess business interest expense. Pursuant to §1.163(j)-6(f)(2), PRS allocated $100 of such excess business interest expense to each of its partners. In Year 2, X lends $10,000 to PRS and receives $1,000 of interest income for the taxable year (self-charged lending transaction). X is not in the trade or business of lending money. The $1,000 of interest expense resulting from this loan is allocable to PRS's trade or business assets. As a result, such $1,000 of interest expense is business interest expense of PRS. X and Y are each allocated $500 of such business interest expense as their distributive share of PRS's business interest expense for the taxable year. Additionally, in Year 2, PRS has $3,000 of ATI. PRS allocates the items comprising its $3,000 of ATI $0 to X and $3,000 to Y.

(ii) Partnership-level. In Year 2, PRS's section 163(j) limit is 30 percent of its ATI plus its business interest income, or $900 ($3,000 x 30 percent). Thus, PRS has $900 of deductible business interest expense, $100 of excess business interest expense, $0 of excess taxable income, and $0 of excess business interest income. Pursuant to §1.163(j)-6(f)(2), $400 of X's allocation of business interest expense is treated as deductible business interest expense, $100 of X's allocation of business interest expense is treated as excess business interest expense, and $500 of Y's allocation of business interest expense is treated as deductible business interest expense.

(iii) Lending partner. Pursuant to §1.163(j)-6(n), X treats $100 of its $1,000 of interest income as excess business interest income allocated from PRS in Year 2. Because X is deemed to have been allocated $100 of excess business interest income from PRS, and excess business interest expense from a partnership is treated as paid or accrued by a partner to the extent excess business interest income is allocated from such partnership to a partner, X treats its $100 allocation of excess business interest expense from PRS in Year 2 as business interest expense paid or accrued in Year 2. X, in computing its limit under section 163(j), has $100 of business interest income ($100 deemed allocation of excess business interest income from PRS in Year 2) and $100 of business interest expense ($100 allocation of excess business interest expense treated as paid or accrued in Year 2). Thus, X's $100 of business interest expense is deductible business interest expense. At the end of Year 2, X has $100 of excess business interest expense from PRS ($100 from Year 1). X treats $900 of its $1,000 of interest income as investment income for purposes of section 163(d).

(27) – (33) [Reserved]

(34) Example 34--(i) Facts. X and Y are equal partners in partnership PRS. Further, X and Y share the profits of PRS equally. In 2019, PRS had ATI of $100. Additionally, in 2019, PRS had $100 of section 704(b) income which was allocated $50 to X and $50 to Y (PRS did not have any section 704(c) income in 2019). In 2020, PRS's only items of income, gain, loss or deduction was $1 of trade or business income, which it allocated to X pursuant to section 704(c).

(ii) Partnership-level. In 2020, PRS makes the election described in §1.163(j)-6(d)(5) to use its 2019 ATI in 2020. As a result, PRS has $100 of ATI in 2020. PRS does not have any business interest expense. Therefore, PRS has $100 of excess taxable income in 2020.

(iii) Partner-level allocations. PRS allocates its $100 of excess taxable income to X and Y pursuant to §1.163(j)-6(f)(2). To determine each partner's share of the $100 of excess taxable income, PRS must determine each partner's allocable ATI (as defined in §1.163(j)-6(f)(2)(ii)). Because PRS made the election described in §1.163(j)-6(d)(5), PRS must determine the allocable ATI of each of its partners pursuant to paragraph (d)(5). Specifically, PRS determines each partner's share of allocable ATI based on PRS's 2019 section 704 income, gain, loss, and deduction. PRS had $100 of section 704(b) income in 2019 which was allocated $50 to X and $50 to Y. Therefore, in 2020, X and Y are both allocated $50 of excess taxable income (50% x $100).

(35) Example 35--(i) Facts. X, a partner in partnership PRS, was allocated $20 of excess business interest expense from PRS in 2018 and $10 of excess business interest expense from PRS in 2019. In 2020, PRS allocated $16 of excess taxable income to X.

(ii) Analysis. X treats 50 percent of its $10 of excess business interest expense allocated from PRS in 2019 as §1.163(j)-6(g)(4) business interest expense. Thus, $5 of §1.163(j)-6(g)(4) business interest expense is treated as paid or accrued by X in 2020 and is not subject to the section 163(j) limitation at X's level. Because X was allocated $16 of excess taxable income from PRS in 2020, X treats $16 of its $25 of excess business interest expense as business interest expense paid or accrued pursuant to §1.163(j)-6(g)(2). X, in computing its limit under section 163(j) in 2020, has $16 of ATI (as a result of its allocation of $16 of excess taxable income from PRS), $0 of business interest income, and $16 of business interest expense ($16 of excess business interest expense treated as paid or accrued in 2020). Pursuant to §1.163(j)-2(b)(2)(i), X's section 163(j) limit in 2020 is $8 ($16 x 50 percent). Thus, X has $8 of business interest expense that is deductible under section 163(j). The $8 of X's business interest expense not allowed as a deduction ($16 business interest expense subject to section 163(j), less $8 section 163(j) limit) is treated as business interest expense paid or accrued by X in 2021. At the end of 2020, X has $9 of excess business interest expense from PRS ($20 from 2018, plus $10 from 2019, less $5 treated as paid or accrued pursuant to §1.163(j)-6(g)(4), less $16 treated as paid or accrued pursuant to §1.163(j)-6(g)(2)).

(36) Example 36--(i) Facts. X is a partner in partnership PRS. At the beginning of 2018, X's outside basis in PRS was $100. X was allocated $20 of excess business interest expense from PRS in 2018 and $10 of excess business interest expense from PRS in 2019. X sold its PRS interest in 2019 for $70.

(ii) Analysis. X treats 50 percent of its $10 of excess business interest expense allocated from PRS in 2019 as §1.163(j)-6(g)(4) business interest expense. Thus, $5 of §1.163(j)-6(g)(4) business interest expense is treated as paid or accrued by X in 2020 and is not subject to the section 163(j) limitation at X's level. Pursuant to paragraph (h)(3) of this section, immediately before the disposition, X increases the basis of its PRS interest from $70 to $95 (add back of $20 of EBIE from 2018 and $5 of remaining

EBIE from 2019). Thus, X has a $25 section 741 loss recognized on the sale ($70 - $95).

(p) Applicability dates.

(1) In general.* * *

(2) Paragraphs (c)(1) and (2), (d)(3) through (5), (e)(5), (f)(1)(iii), (g)(4), (n), and (o)(24) through (29), and (34) through (36). Paragraphs (c)(1) and (2), (d)(3) through (5), (e)(5), (f)(1)(iii), (g)(4), (n), and (o)(24) through (29), and (34) through (36) of this section apply to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in paragraphs (c)(1) and (2), (d)(3) through (5), (e)(5), (f)(1)(iii), (g)(4), (n), and (o)(24) through (29), and (34) through (36) to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.382-7, 1.383-0, 1.383-1, 1.469-9, 1.469-11, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905 as modified by T.D. 9943, for that taxable year and for each subsequent taxable year.

Par. 7. Section 1.163(j)-7 is amended by revising paragraph (a), adding paragraphs (c) through (f), (g)(3) and (4), (h), (k), and (l), and revising paragraph (m) to read as follows:

§1.163(j)-7 Application of the section 163(j) limitation to foreign corporations and United

States shareholders.

(a) Overview. This section provides rules for the application of section 163(j) to relevant foreign corporations and United States shareholders of relevant foreign corporations. Paragraph (b) of this section provides the general rule regarding the application of section 163(j) to a relevant foreign corporation. Paragraph (c) of this section provides rules for applying section 163(j) to CFC group members of a CFC group. Paragraph (d) of this section provides rules for determining a specified group and specified group members. Paragraph (e) of this section provides rules and procedures for treating a specified group member as a CFC group member and for determining a CFC group. Paragraph (f) of this section provides rules regarding the treatment of a CFC group member that has ECI. Paragraph (g) of this section provides rules concerning the computation of ATI of an applicable CFC. Paragraph (h) of this section provides a safe harbor that exempts certain stand-alone applicable CFCs and CFC groups from the application of section 163(j) for a taxable year. Paragraphs (i) and (j) of this section are reserved. Paragraph (k) of this section provides definitions that apply for purposes of this section (see also §1.163(j)-1 for additional definitions). Paragraph (l) of this section provides examples illustrating the application of this section.

* * * * *

(c) Application of section 163(j) to CFC group members of a CFC group--(1) Scope. This paragraph (c) provides rules for applying section 163(j) to a CFC group and a CFC group member. Paragraph (c)(2) of this section provides rules for computing a single section 163(j) limitation for a specified period of a CFC group. Paragraph (c)(3) of this section provides rules for allocating a CFC group's section 163(j) limitation to CFC group members for specified taxable years. Paragraph (c)(4) of this section provides currency translation rules. Paragraph (c)(5) of this section provides special rules for specified periods beginning in 2019 or 2020.

(2) Calculation of section 163(j) limitation for a CFC group for a specified period--(i) In general. A single section 163(j) limitation is computed for a specified period of a CFC group. For purposes of applying section 163(j) and the section 163(j) regulations, the current-year business interest expense, disallowed business interest expense carryforwards, business interest income, floor plan financing interest expense, and ATI of a CFC group for a specified period equal the sums of each CFC group member's respective amounts for its specified taxable year with respect to the specified period. A CFC group member's current-year business interest expense, business interest income, floor plan financing interest expense, and ATI for a specified taxable year are generally determined on a separate-company basis. For purposes of determining the ATI of a CFC group, §1.163(j)-1(b)(1)(vii) (providing that ATI cannot be less than zero) applies with respect to the ATI of the CFC group but not the ATI of any CFC group member.

(ii) Certain transactions between CFC group members disregarded. Any transaction between CFC group members of a CFC group that is entered into with a principal purpose of affecting a CFC group or a CFC group member's section 163(j) limitation by increasing or decreasing a CFC group or a CFC group member's ATI or business interest income for a specified taxable year is disregarded for purposes of applying section 163(j) and the section 163(j) regulations.

(3) Deduction of business interest expense--(i) CFC group business interest expense--(A) In general. The extent to which a CFC group member's current-year business interest expense and disallowed business interest expense carryforwards for a specified taxable year that ends with or within a specified period may be deducted under section 163(j) is determined under the rules and principles of §1.163(j)-5(a)(2) and (b)(3)(ii), subject to the modifications described in paragraph (c)(3)(i)(B) of this section.

(B) Modifications to relevant terms. For purposes of paragraph (c)(3)(i)(A) of this section, the rules and principles of §1.163(j)-5(b)(3)(ii) are applied by—

(1) Replacing "§1.163(j)-4(d)(2)" in §1.163(j)-5(a)(2)(ii) with "§1.163(j)-7(c)(2)(i)";

(2) Replacing the term "allocable share of the consolidated group's remaining section 163(j) limitation" with "allocable share of the CFC group's remaining section 163(j) limitation";

(3) Replacing the terms "consolidated group" and "group" with "CFC group";

(4) Replacing the term "consolidated group's remaining section 163(j) limitation" with "CFC group's remaining section 163(j) limitation";

(5) Replacing the term "consolidated return year" with "specified period";

(6) Replacing the term "current year" or "current-year" with "current specified period" or "specified taxable year with respect to the current specified period," as the context requires;

(7) Replacing the term "member" with "CFC group member"; and

(8) Replacing the term "taxable year" with "specified taxable year with respect to a specified period."

(ii) Carryforwards treated as attributable to the same taxable year. For purposes of applying the principles of §1.163(j)-5(b)(3)(ii), as required under paragraph (c)(3)(i) of this section, CFC group members' disallowed business interest expense carryforwards that arose in specified taxable years with respect to the same specified period are treated as disallowed business interest expense carryforwards from taxable years ending on the same date and are deducted on a pro rata basis, under the principles of §1.163(j)-5(b)(3)(ii)(C)(3), pursuant to paragraph (c)(3)(i) of this section.

(iii) Multiple specified taxable years of a CFC group member with respect to a specified period. If a CFC group member has more than one specified taxable year (each year, an applicable specified taxable year) with respect to a single specified period of a CFC group, then all the applicable specified taxable years are taken into account for purposes of applying the principles of §1.163(j)-5(b)(3)(ii), as required under paragraph (c)(3)(i) of this section, with respect to the specified period. The portion of the section 163(j) limitation allocable to disallowed business interest expense carryforwards of the CFC group member that arose in taxable years before the first applicable specified taxable year is prorated among the applicable specified taxable years in proportion to the number of days in each applicable specified taxable year.

(iv) Limitation on pre-group disallowed business interest expense carryforward--

(A) General rule--(1) CFC group member pre-group disallowed business interest expense carryforward. This paragraph (c)(3)(iv) applies to pre-group disallowed business interest expense carryforwards of a CFC group member. The amount of the pre-group disallowed business interest expense carryforwards described in the preceding sentence that may be included in any CFC group member's business interest expense deduction for any specified taxable year under this paragraph (c)(3) may not exceed the aggregate section 163(j) limitation for all specified periods of the CFC group, determined by reference only to the CFC group member's items of income, gain, deduction, and loss, and reduced (including below zero) by the CFC group member's business interest expense (including disallowed business interest expense carryforwards) taken into account as a deduction by the CFC group member in all specified taxable years in which the CFC group member has continuously been a CFC group member of the CFC group (cumulative section 163(j) pre-group carryforward limitation).

(2) Subgrouping. In the case of a pre-group disallowed business interest expense carryforward, a pre-group subgroup is composed of the CFC group member with the pre-group disallowed business interest expense carryforward (the loss member) and each other CFC group member of the loss member's CFC group (the

current group) that was a member of the CFC group in which the pre-group disallowed business interest expense carryforward arose and joined the specified group of the current group at the same time as the loss member. A CFC group member that is a member of a pre-group subgroup remains a member of the pre-group subgroup until its first taxable year during which it ceases to be a member of the same specified group as the loss member. For purposes of this paragraph (c), the rules and principles of §1.163(j)-5(d)(1)(B) apply to a pre-group subgroup as if the pre-group subgroup were a SRLY subgroup.

(3) Transition rule. Solely for purposes of paragraph (c)(3)(iv)(A)(2) of this section, a CFC group includes a group of applicable CFCs for which a CFC group election was made under guidance under section 163(j) published on December 28, 2018. Therefore, if the requirements of paragraph (c)(3)(iv)(A)(2) of this section are satisfied, a group of applicable CFCs described in the preceding sentence may be treated as a pre-group subgroup.

(B) Deduction of pre-group disallowed business interest expense carryforwards. Notwithstanding paragraph (c)(3)(iv)(A)(1) of this section, pre-group disallowed business interest expense carryforwards are available for deduction by a CFC group member in its specified taxable year only to the extent the CFC group has remaining section 163(j) limitation for the specified period after the deduction of current-year business interest expense and disallowed business interest expense carryforwards from earlier taxable years that are permitted to be deducted in specified taxable years of CFC group members with respect to the specified period. See paragraph (c)(3)(i) of this section and §1.163(j)-5(b)(3)(ii)(A). Pre-group disallowed business interest expense carryforwards are deducted on a pro rata basis (under the principles of paragraph (c)(3)(i) of this section and §1.163(j)-5(b)(3)(ii)(C)(4)) with other disallowed business interest expense carryforwards from taxable years ending on the same date.

(4) Currency translation. For purposes of applying this paragraph (c), items of a CFC group member are translated into a single currency for the CFC group and back to the functional currency of the CFC group member using the average exchange rate for the CFC group member's specified taxable year. The single currency for the CFC group may be the U.S. dollar or the functional currency of a plurality of the CFC group members.

(5) Special rule for specified periods beginning in 2019 or 2020—(i) 50 percent ATI limitation applies to a specified period of a CFC group. In the case of a CFC group, §1.163(j)-2(b)(2) (including the election under §1.163(j)-2(b)(2)(ii)) applies to a specified period of the CFC group beginning in 2019 or 2020, rather than to a specified taxable year of a CFC group member. An election under §1.163(j)-2(b)(2)(ii) for a specified period of a CFC group is not effective unless made by each designated U.S. person. Except as otherwise provided in this paragraph (c)(5)(i), the election is made in accordance with Revenue Procedure 2020-22, 2020-18 I.R.B. 745. For purposes of applying §1.964-1(c), the election is treated as if made for each CFC group member.

(ii) Election to use 2019 ATI applies to a specified period of a CFC group—(A) In general. In the case of a CFC group, for purposes of applying paragraph (c)(2) of this section, an election under §1.163(j)-2(b)(3)(i) is made for a specified period of a CFC group beginning in 2020 and applies to the specified taxable years of each CFC group member with respect to such specified period, taking into account the application of paragraph (c)(5)(ii)(B) of this section. The election under §1.163(j)-2(b)(3)(i) does not apply to any specified taxable year of a CFC group member other than those described in the preceding sentence. An election under §1.163(j)-2(b)(3)(i) for a specified period of a CFC group is not effective unless made by each designated U.S. person. Except as otherwise provided in this paragraph (c)(5)(ii)(A), the election is made in accordance with Revenue Procedure 2020-22, 2020-18 I.R.B. 745. For purposes of applying

§1.964-1(c), the election is treated as if made for each CFC group member.

(B) Specified taxable years that do not begin in 2020. If a specified taxable year of a CFC group member with respect to the specified period described in paragraph (c)(5)(ii)(A) of this section begins in 2019, then, for purposes of applying paragraph (c)(2) of this section, §1.163(j)-2(b)(3) is applied to such specified taxable year by substituting “2018” for “2019” and “2019” for “2020.” If a specified taxable year of a CFC group member with respect to the specified period described in paragraph (c)(5)(ii)(A) of this section begins in 2021, then, for purposes of applying paragraph (c)(2) of this section, §1.163(j)-2(b)(3) is applied to such specified taxable year by substituting “2020” for “2019” and “2021” for “2020.”

(d) Determination of a specified group and specified group members--(1) Scope. This paragraph (d) provides rules for determining a specified group and specified group members. Paragraph (d)(2) of this section provides rules for determining a specified group. Paragraph (d)(3) of this section provides rules for determining specified group members.

(2) Rules for determining a specified group--(i) Definition of a specified group. Subject to paragraph (d)(2)(ii) of this section, the term specified group means one or more applicable CFCs or chains of applicable CFCs connected through stock ownership with a specified group parent (which is included in the specified group only if it is an applicable CFC), but only if--

(A) The specified group parent owns directly or indirectly stock meeting the requirements of section 1504(a)(2)(B) in at least one applicable CFC; and

(B) Stock meeting the requirements of section 1504(a)(2)(B) in each of the applicable CFCs (except the specified group parent) is owned directly or indirectly by one or more of the other applicable CFCs or the specified group parent.

(ii) Indirect ownership. For purposes of applying paragraph (d)(2)(i) of this section, stock is owned indirectly only if it is owned under section 318(a)(2)(A) through a partnership or under section 318(a)(2)(A) or (B) through an estate or trust not described in section 7701(a)(30).

(iii) Specified group parent. The term specified group parent means a qualified U.S. person or an applicable CFC.

(iv) Qualified U.S. person. The term qualified U.S. person means a United States person described in section 7701(a)(30)(A) or (C). For purposes of this paragraph (d), members of a consolidated group that file (or that are required to file) a consolidated U.S. Federal income tax return are treated as a single qualified U.S person and individuals described in section 7701(a)(30)(A) whose filing status is married filing jointly are treated as a single qualified U.S. person.

(v) Stock. For purposes of this paragraph (d)(2), the term stock has the same meaning as “stock” in section 1504 (without regard to §1.1504-4, except as provided in paragraph (d)(2)(vi) of this section) and all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(vi) Options treated as exercised. For purposes of this paragraph (d)(2), options that are reasonably certain to be exercised, as determined under §1.1504-4(g), are treated as exercised. For purposes of this paragraph (d)(2)(vi), options include call options, warrants, convertible obligations, put options, and any other instrument treated as an option under §1.1504-4(d), determined by replacing the term “a principal purpose of avoiding the application of section 1504 and this section” with “a principal purpose of avoiding the application of section 163(j).”

(vii) When a specified group ceases to exist. The principles of §1.1502-75(d)(1), (d)(2)(i) and (ii), and (d)(3)(i) through (iv) apply for purposes of determining when a specified group ceases to exist. Solely for purposes of applying these principles, references to the common parent are treated as references to the specified group parent and each applicable CFC that is treated as a specified group member for a taxable year with respect to a specified period is treated as affiliated with the specified group parent from the beginning to the end of the specified period, without regard to the beginning or end of its taxable year.

(3) Rules for determining a specified group member. If two or more applicable CFCs are included in a specified group on the last day of a taxable year of each applicable CFC that ends with or within a specified period, then each applicable CFC is a specified group member with respect to the specified period for its entire taxable year ending with or within the specified period. If only one applicable CFC is included in a specified group on the last day of its taxable year that ends with or within the specified period, it is not a specified group member. If an applicable CFC has multiple taxable years that end with or within a specified period, this paragraph (d)(3) is applied separately to each taxable year to determine if the applicable CFC is a specified group member for such taxable year.

(e) Rules and procedures for treating a specified group as a CFC group--(1) Scope. This paragraph (e) provides rules and procedures for treating a specified group member as a CFC group member and for determining a CFC group for purposes of applying section 163(j) and the section 163(j) regulations.

(2) CFC group and CFC group member--(i) CFC group. The term CFC group means, with respect to a specified period, all CFC group members for their specified taxable years.

(ii) CFC group member. The term CFC group member means, with respect to a specified taxable year and a specified period, a specified group member of a specified group for which a CFC group election is in effect. However, notwithstanding the prior sentence, a specified group member is not treated as a CFC group member for a taxable year of the specified group member beginning before January 1, 2018.

(3) Duration of a CFC group. A CFC group continues until the CFC group election is revoked, or there is no longer a specified period with respect to the specified group. A failure to provide the information described in paragraph (e)(6) of this section does not terminate a CFC group election.

(4) Joining or leaving a CFC group. If an applicable CFC becomes a specified group member for a specified taxable year with respect to a specified period of a specified group for which a CFC group election is in effect, the CFC group election applies to the applicable CFC and the applicable CFC becomes a CFC group member. If an applicable CFC ceases to be a specified group member for a specified taxable year with respect to a specified period of a specified group for which a CFC group election is in effect, the CFC group election terminates solely with respect to the applicable CFC.

(5) Manner of making or revoking a CFC group election--(i) In general. An election is made or revoked under this paragraph (e)(5) (CFC group election) with respect to a specified period of a specified group. A CFC group election remains in effect for each specified period of the specified group until revoked. A CFC group election that is in effect with respect to a specified period of a specified group applies to each specified group member for its specified taxable year that ends with or within the specified period. The making or revoking of a CFC group election is not effective unless made or revoked by each designated U.S. person.

(ii) Revocation by election. A CFC group election cannot be revoked with respect to any specified period beginning before 60 months following the last day of the specified period for which the election was made. Once a CFC group election has been revoked, a new CFC group election cannot be made with respect to any specified period beginning before 60 months following the last day of the specified period for which the election was revoked.

(iii) Timing. A CFC group election must be made or revoked with respect to a specified period of a specified group no later than the due date (taking into account extensions, if any) of the original Federal income tax return for the taxable year of each designated U.S. person in which or with which the specified period ends.

(iv) Election statement. To make or revoke a CFC group election for a specified period of a specified group, each designated U.S. person must attach a statement to its relevant Federal income tax or information return in accordance with publications, forms, instructions, or other guidance. The statement must include the name and taxpayer identification number of all designated U.S. persons, a statement that the CFC group election is being made or revoked, as applicable, the specified period for which the CFC group election is being made or revoked, and the name of each CFC group member and its specified taxable year with respect to the specified period. The statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(v) Effect of prior CFC group election. A CFC group election is made solely pursuant to the provisions of this paragraph (e)(5), without regard to whether a CFC group election described in guidance under section 163(j) published on December 28, 2018, was in effect.

(6) Annual information reporting. Each designated U.S. person must attach a statement to its relevant Federal income tax or information return for each taxable year in which a CFC group election is in effect that contains information concerning the computation of the CFC group's section 163(j) limitation and the application of paragraph (c)(3) of this section to the CFC group in accordance with publications, forms, instructions, or other guidance.

(f) Treatment of a CFC group member that has ECI--(1) In general. If a CFC group member has ECI in its specified taxable year, then for purposes of section 163(j) and the section 163(j) regulations--

(i) The items, disallowed business interest expense carryforwards, and other attributes of the CFC group member that are ECI are treated as items, disallowed business interest expense carryforwards, and attributes of a separate applicable CFC (such deemed corporation, an ECI deemed corporation) that has the same taxable year and shareholders as the applicable CFC; and

(ii) The ECI deemed corporation is not treated as a specified group member for the specified taxable year.

(2) [Reserved].

(g) * * *

(3) Treatment of certain foreign income taxes. For purposes of computing the ATI of a relevant foreign corporation for a taxable year, no deduction is taken into account for any foreign income tax (as defined in §1.960-1(b), but substituting the phrase “relevant foreign corporation” for the phrase “controlled foreign corporation”).

(4) Anti-abuse rule--(i) In general. If a specified group member of a specified group or an applicable partnership (specified lender) includes an amount (payment amount) in income and such amount is attributable to business interest expense incurred by another specified group member or an applicable partnership of the specified group (specified borrower) during its taxable year, then the ATI of the specified borrower for the taxable year is increased by the ATI adjustment amount if--

(A) The business interest expense is incurred with a principal purpose of reducing the Federal income tax liability of any United States shareholder of a specified group member (including over other taxable years);

(B) Absent the application of this paragraph (g)(4), the effect of the specified borrower treating all or part of the payment amount as disallowed business interest expense would be to reduce the Federal income tax liability of any United States shareholder of a specified group member; and

(C) Either no CFC group election is in effect with respect to the specified group or the specified borrower is an applicable partnership.

(ii) ATI adjustment amount--(A) In general. For purposes of this paragraph (g)(4), the term ATI adjustment amount means, with respect to a specified borrower and a taxable year, the product of 3 1/3 and the lesser of the payment amount or the disallowed business interest expense, computed without regard to this paragraph (g)(4).

(B) Special rule for taxable years or specified periods beginning in 2019 or 2020. For any taxable year of an applicable CFC or specified taxable year of a CFC group member with respect to a specified period for which the section 163(j) limitation is determined based, in part, on 50 percent of ATI, in accordance with §1.163(j)-2(b)(2), paragraph (g)(4)(ii)(A) of this section is applied by substituting “2” for “3 1/3.”

(iii) Applicable partnership. For purposes of this paragraph (g)(4), the term applicable partnership means, with respect to a specified group, a partnership in which at least 80 percent of the interests in profits or capital is owned, directly or indirectly through one or more other partnerships, by specified group members of the specified group. For purposes of this paragraph (g)(4)(iii), a partner’s interest in the profits of a partnership is determined in accordance with the rules and principles of §1.706-1(b)(4)(ii) and a partner’s interest in the capital of a partnership is determined in accordance with the rules and principles of §1.706-1(b)(4)(iii).

(h) Election to apply safe-harbor--(1) In general. If an election to apply this paragraph (h)(1) (safe-harbor election) is in effect with respect to a taxable year of a stand-alone applicable CFC or a specified taxable year of a CFC group member, as applicable, then, for such year, no portion of the applicable CFC’s business interest expense is disallowed under the section 163(j) limitation. This paragraph (h) does not apply to excess business interest expense, as described in §1.163(j)-6(f)(2), until the taxable year in which it is treated as paid or accrued by an applicable CFC under §1.163(j)-6(g)(2)(i). Furthermore, excess business interest expense is not taken into account for purposes of determining whether the safe-harbor election is available for a stand-alone applicable CFC or a CFC group until the taxable year in which it is treated as paid or accrued by an applicable CFC under §1.163(j)-6(g)(2)(i).

(2) Eligibility for safe-harbor election--(i) Stand-alone applicable CFC. The safe-harbor election may be made for the taxable year of a stand-alone applicable CFC only if, for the taxable year, the business interest expense of the applicable CFC is less than or equal to either--

(A) The business interest income of the applicable CFC; or

(B) 30 percent of the lesser of the eligible amount or the qualified tentative taxable income of the applicable CFC.

(ii) CFC group. The safe-harbor election may be made for the specified period of a CFC group only if, for the specified period, no CFC group member has any pre-group disallowed business interest expense carryforward and the business interest expense of the CFC group for the specified period is less than or equal to either--

(A) The business interest income of the CFC group; or

(B) 30 percent of the lesser of the eligible amount or the qualified tentative taxable income of the CFC group.

(iii) Currency translation. For purposes of applying this paragraph (h), BII, BIE, and qualified tentative taxable income of a stand-alone applicable CFC or a CFC group must be determined using the U.S. dollar. If BII, BIE, or any items of income, gain, deduction, or loss that are taken into account in computing qualified tentative taxable income are maintained in a currency other than the U.S. dollar, then those items must be translated into the U.S. dollar using the average exchange rate for the taxable year or the specified taxable year, as applicable.

(3) Eligible amount--(i) Stand-alone applicable CFC. The eligible amount of a stand-alone applicable CFC for a taxable year is the sum of the amounts a domestic corporation would include in gross income under sections 951(a)(1)(A) and 951A(a), reduced by any deductions that would be allowed under section 245A (by reason of section 964(e)(4)) or section 250(a)(1)(B)(i), determined as if the domestic corporation has a taxable year that ends on the last date of the taxable year of the stand-alone applicable CFC, it wholly owns the stand-alone applicable CFC throughout the CFC's taxable year, it does not own any assets other than stock in the stand-alone applicable CFC, and it has no other items of income, gain, deduction, or loss.

(ii) CFC group. The eligible amount of a CFC group for a specified period is the sum of the amounts a domestic corporation would include in gross income under sections 951(a)(1)(A) and 951A(a), reduced by any deductions that would be allowed under section 245A (by reason of section 964(e)(4)) or section 250(a)(1)(B)(i), determined as if the domestic corporation has a taxable year that is the specified period, it wholly owns each CFC group member throughout the CFC group member's specified taxable year, it does not own any assets other than stock in the CFC group members, and it has no other items of income, gain, deduction, or loss.

(iii) Additional rules for determining an eligible amount. For purposes of paragraphs (h)(3)(i) and (ii) of this section, the amounts that would be included in gross income of a United States shareholder under sections 951(a)(1)(A) and 951A(a), and any corresponding deductions that would be allowed under section 245A (by reason of section 964(e)(4)) or section 250(a)(1)(B)(i), are determined by taking into account any elections that are made with respect to the applicable CFC(s), including under §1.954-1(d)(5) (relating to the subpart F high-tax exception) and §1.951A-2(c)(7)(viii) (relating to the GILTI high-tax exclusion). These amounts are also determined without regard to any section 163(j) limitation on business interest expense and without regard to any disallowed business interest expense carryovers. In addition, those amounts are determined by only taking in account items of the applicable CFC(s) that are properly allocable to a non-excepted trade or business under §1.163(j)-10.

(4) Qualified tentative taxable income. The term qualified tentative taxable income means, with respect to a taxable year of a stand-alone applicable CFC, the applicable CFC's tentative taxable income, and with respect to a specified period of a CFC group, the sum of each CFC group member's tentative taxable income for the specified taxable year; provided that for purposes of this paragraph (h)(4), tentative taxable income is determined by taking into account only items properly allocable to a non-excepted trade or business under §1.163(j)-10.

(5) Manner of making a safe-harbor election--(i) In general. A safe-harbor election is an annual election made under this paragraph (h)(5) with respect to a taxable year of a stand-alone applicable CFC or with respect to a specified period of a CFC group. A safe-harbor election that is made with respect to a specified period of a CFC group is effective with respect to each CFC group member for its specified taxable year. A safe-harbor election is only effective if made by each designated U.S. person with respect to a stand-alone applicable CFC or a CFC group. A safe-harbor election is made with respect to a taxable year of a stand-alone applicable CFC, or a specified period of a CFC group, no later than the due date (taking into account extensions, if any) of the original Federal income tax return for the taxable year of each designated U.S. person, respectively, in which or with which the taxable year of the stand-alone applicable CFC ends or the specified period of the CFC group ends.

(ii) Election statement. To make a safe-harbor election, each designated U.S. person must attach to its relevant Federal income tax return or information return a statement that includes the name and taxpayer identification number of all designated

U.S. persons, a statement that a safe-harbor election is being made pursuant to §1.163(j)-7(h) and a calculation that substantiates that the requirements for making the election are satisfied, and the taxable year of the stand-alone applicable CFC or the specified period of the CFC group, as applicable, for which the safe-harbor election is being made in accordance with publications, forms, instructions, or other guidance. In the case of a CFC group, the statement must also include the name of each CFC group member and its specified taxable year that ends with or within the specified period for which the safe-harbor election is being made. The statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(6) Special rule for taxable years or specified periods beginning in 2019 or 2020. In the case of a stand-alone applicable CFC, for any taxable year beginning in 2019 or 2020, paragraph (h)(2)(i) of this section is applied by substituting "50 percent" for "30 percent." In the case of a CFC group, for any specified period beginning in 2019 or 2020, paragraph (h)(2)(ii)(A) of this section is applied by substituting "50 percent" for "30 percent."

* * * * *

(k) Definitions. The following definitions apply for purposes of this section.

(1) Applicable partnership. The term applicable partnership has the meaning provided in paragraph (g)(4)(iii) of this section.

(2) Applicable specified taxable year. The term applicable specified taxable year has the meaning provided in paragraph (c)(3)(iii) of this section.

(3) ATI adjustment amount. The term ATI adjustment amount has the meaning provided in paragraph (g)(4)(ii) of this section.

(4) - (5) [Reserved].

(6) CFC group. The term CFC group has the meaning provided in paragraph (e)(2)(i) of this section.

(7) CFC group election. The term CFC group election means the election described in paragraph (e)(5) of this section.

(8) CFC group member. The term CFC group member has the meaning provided in paragraph (e)(2)(ii) of this section.

(9) [Reserved].

(10) Cumulative section 163(j) pre-group carryforward limitation. The term cumulative section 163(j) pre-group carryforward limitation has the meaning provided in paragraph (c)(3)(iv)(A)(1) of this section.

(11) Current group. The term current group has the meaning provided in paragraph (c)(3)(iv)(A)(2) of this section.

(12) Designated U.S. person. The term designated U.S. person means—

(i) With respect to a stand-alone applicable CFC, each controlling domestic shareholder, as defined in §1.964-1(c)(5)(i) of the applicable CFC; or

(ii) With respect to a specified group, the specified group parent, if the specified group parent is a qualified U.S. person, or each controlling domestic shareholder, as defined in §1.964-1(c)(5)(i), of the specified group parent, if the specified group parent is an applicable CFC.

(13) ECI deemed corporation. The term ECI deemed corporation has the meaning provided in paragraph (f)(1)(i) of this section.

(14) Effectively connected income. The term effectively connected income (or ECI) means income or gain that is ECI, as defined in §1.884-1(d)(1)(iii), and deduction or loss that is allocable to, ECI, as defined in §1.884-1(d)(1)(iii).

(15) Eligible amount. The term eligible amount has the meaning provided in paragraph (h)(3)(i) of this section.

(16) Former group. The term former group has the meaning provided in paragraph (c)(3)(iv)(A)(2) of this section.

(17) Loss member. The term loss member has the meaning provided in paragraph (c)(3)(iv)(A)(2) of this section.

(18) Payment amount. The term payment amount has the meaning provided in paragraph (g)(4)(i) of this section.

(19) Pre-group disallowed business interest expense carryforward. The term pre-group disallowed business interest expense carryforward means, with respect to a CFC group member and a specified taxable year, any disallowed business interest expense carryforward of the CFC group member that arose in a taxable year during which the CFC group member (or its predecessor) was not a CFC group member of the CFC group.

(20) Qualified tentative taxable income. The term qualified tentative taxable income has the meaning provided in paragraph (h)(4) of this section.

(21) Qualified U.S. person. The term qualified U.S. person has the meaning provided in paragraph (d)(2)(iv) of this section.

(22) Relevant period. The term relevant period has the meaning provided in paragraph (c)(3)(iv)(A)(2) of this section.

(23) Safe-harbor election. The term safe-harbor election has the meaning provided in paragraph (h)(1) of this section.

(24) Specified borrower. The term specified borrower has the meaning provided in paragraph (g)(4)(i) of this section.

(25) Specified group. The term specified group has the meaning provided in paragraph (d)(2)(i) of this section.

(26) Specified group member. The term specified group member has the meaning provided in paragraph (d)(3) of this section.

(27) Specified group parent. The term specified group parent has the meaning provided in paragraph (d)(2)(iii) of this section.

(28) Specified lender. The term specified lender has the meaning provided in paragraph (g)(4)(i) of this section.

(29) Specified period--(i) In general. Except as otherwise provided in paragraph (k)(29)(ii) of this section, the term specified period means, with respect to a specified group--

(A) If the specified group parent is a qualified U.S. person, the period ending on the last day of the taxable year of the specified group parent and beginning on the first day after the last day of the specified group's immediately preceding specified period; or

(B) If the specified group parent is an applicable CFC, the period ending on the last day of the specified group parent's required year described in section 898(c)(1), without regard to section 898(c)(2), and beginning on the first day after the last day of the specified group's immediately preceding specified period.

(ii) Short specified period. A specified period begins no earlier than the first date on which a specified group exists. A specified period ends on the date a specified group ceases to exist under paragraph (d)(2)(vii) of this section. If the last day of a specified period, as determined under paragraph (k)(29)(i) of this section, changes, and, but for this paragraph (k)(29)(ii), the change in the last day of the specified period would result in the specified period being longer than 12 months, the specified period ends on the date on which the specified period would have ended had the change not occurred.

(30) Specified taxable year. The term specified taxable year means, with respect to an applicable CFC that is a specified group member of a specified group and a specified period, a taxable year of the applicable CFC that ends with or within the specified period.

(31) Stand-alone applicable CFC. The term stand-alone applicable CFC means any applicable CFC that is not a specified group member.

(32) Stock. The term stock has the meaning provided in paragraph (d)(2)(v) of

this section.

(l) Examples. The following examples illustrate the application of this section. For each example, unless otherwise stated, no exemptions from the application of section 163(j) are available, no foreign corporation has ECI, and all relevant taxable years and specified periods begin after December 31, 2020.

(1) Example 1. Specified taxable years included in specified period of a specified group--(i) Facts. As of June 30, Year 1, USP, a domestic corporation, owns 60 percent of the common stock of FP, which owns all of the stock of FC1, FC2, and FC3. The remaining 40 percent of the common stock of FP is owned by an unrelated foreign corporation. FP has a single class of stock. FP acquired the stock of FC3 from an unrelated person on March 22, Year 1. The acquisition did not result in a change in FC3's taxable year or a close of its taxable year. USP's interest in FP and FP's interest in FC1 and FC2 has been the same for several years. USP has a taxable year ending June 30, Year 1, which is not a short taxable year. Each of FP, FC1, FC2, and FC3 are applicable CFCs. Pursuant to section 898(c)(2), FP and FC1 have taxable years ending May 31, Year 1. Pursuant to section 898(c)(1), FC2 and FC3 have taxable years ending June 30, Year 1.

(ii) Analysis--(A) Determining a specified group and specified period of the specified group. Pursuant to paragraph (d) of this section, FP, FC1, FC2, and FC3 are members of a specified group, and FP is the specified group parent. Because the specified group parent, FP, is an applicable CFC, the specified period of the specified group is the period ending on June 30, Year 1, which is the last day of FP's required year described in section 898(c)(1), without regard to section 898(c)(2), and beginning on July 1, Year 0, which is the first day following the last day of the specified group's immediately preceding specified period (June 30, Year 0). See paragraph (k)(29)(i)(B) of this section.

(B) Determining the specified taxable years with respect to the specified period. Pursuant to paragraph (d)(3) of this section, because each of FP and FC1 are included in the specified group on the last day of their taxable years ending May 31, Year 1, and such taxable years end with or within the specified period ending June 30, Year 1, FP and FC1 are specified group members with respect to the specified period ending June 30, Year 1, for their entire taxable years ending May 31, Year 1, and those taxable years are specified taxable years. Similarly, because each of FC2 and FC3 are included in the specified group on the last day of their taxable years ending June 30, Year 1, and such taxable years end with or within the specified period ending June 30, Year 1, FC2 and FC3 are specified group members with respect to the specified period ending June 30, Year 1, for their entire taxable years ending June 30, Year 1, and those taxable years are specified taxable years. The fact that FC3 was acquired on March 22, Year 1, does not prevent FC3 from being a specified group member with respect to the specified period for the portion of its specified taxable year before March 22, Year 1.

(2) Example 2. CFC groups--(i) Facts. The facts are the same as in Example 1 in paragraph (l)(1)(i) of this section except that, in addition, a CFC group election is in place with respect to the specified period ending June 30, Year 1.

(ii) Analysis. Because a CFC group election is in place for the specified period ending June 30, Year 1, pursuant to paragraph (e)(2)(ii) of this section, each specified group member is a CFC group member with respect to its specified taxable year ending with or within the specified period. Accordingly, FP, FC1, FC2, and FC3 are CFC group members with respect to the specified period ending June 30, Year 1, for their specified taxable years ending May 31, Year 1, and June 30, Year 1, respectively. Pursuant to paragraph (e)(2)(i) of this section, the CFC group for the specified period ending June 30, Year 1, consists of FP, FC1, FC2, and FC3 for their specified taxable years ending May 31, Year 1, and June 30, Year 1, respectively. Pursuant to paragraph (c)(2) of this section, a single section 163(j) limitation is computed for the specified period ending June 30, Year 1. That section 163(j) calculation will include FP and FC1's specified taxable years ending May 31, Year 1, and FC2 and FC3's specified taxable years ending June 30, Year 1.

(3) Example 3. Application of anti-abuse rule--(i) Facts. USP, a domestic corporation, owns all of the stock of CFC1 and CFC2. Thus, USP is the specified group parent of a specified group, the specified group members of which are CFC1 and CFC2. USP has a calendar year taxable year. All specified group members also have a calendar year taxable year and a functional currency of the U.S. dollar. CFC1 is organized in, and a tax resident of, a jurisdiction that imposes no tax on certain types of income, including interest income. With respect to Year 1, USP expects to pay no residual U.S. tax on its income inclusion under section 951A(a) (GILTI inclusion amount) and expects to have unused foreign tax credits in the category described in section 904(d)(1)(A). A CFC group election is not in effect for Year 1. With a principal purpose of reducing USP's Federal income tax liability in subsequent taxable years, on January 1, Year 1, CFC1 loans $100x to CFC2. On December 31, Year 1, CFC2 pays interest of $10x to CFC1 and repays the principal of $100x. Absent the application of paragraph (g)(4)(i) of this section, all $10x of CFC2's interest expense would be disallowed business interest expense and, therefore, CFC2 would have $10x of disallowed business interest expense carryforward to Year 2. In Year 2, CFC2 disposes of one of its businesses at a substantial gain that gives rise to tested income (within the meaning of section 951A(c)(2)(A) and §1.951A-2(b)(1)). As a result of the gain being included in the ATI of CFC2, absent the application of paragraph (g)(4)(i) of this section, CFC2 would be allowed to deduct the entire $10x of disallowed business interest expense carryforward and therefore reduce the amount of its tested income. Also, USP would pay residual U.S. tax on its GILTI inclusion amount in Year 2, without regard to the application of paragraph (g)(4)(i) of this section.

(ii) Analysis. The $10x of business interest expense paid in Year 1 is a payment amount described in paragraph (g)(4)(i) of this section because it is between specified group members, CFC1 and CFC2. Furthermore, the requirements of paragraphs (g)(4)(i)(A), (B), and (C) of this section are satisfied because the $10x of business interest expense is incurred with a principal purpose of reducing USP's Federal income tax liability; absent the application of paragraph (g)(4)(i) of this section, the effect of CFC2 treating the $10x of business interest expense as disallowed business interest expense in Year 1 would be to reduce USP's Federal income tax liability in Year 2; and no CFC group election is in effect with respect to the specified group in Year 1. Because the requirements of paragraphs (g)(4)(i)(A), (B), and (C) of this section are satisfied, CFC2's ATI for Year 1 is increased by the ATI adjustment amount, or $33.33x, which is the amount equal to 3 1/3 multiplied by $10x (the lesser of the payment amount of $10x and the disallowed business interest expense of $10x). As a result, the $10x of business interest expense is not disallowed business interest expense of CFC2 in Year

1, and therefore does not give rise to a disallowed business interest expense carryforward to Year 2.

(m) Applicability dates--(1) General applicability date. Except as provided in paragraph (m)(2) of this section, this section applies for a taxable year of a foreign corporation beginning on or after November 13, 2020.

(2) Exception. Paragraphs (a), (c)(1), (c)(2)(i) and (ii), and (c)(3) through (5), (d), (e), (f)(1), (g)(3) and (4), (h), and (k)(1) through (3), (6) through (8), and (10) through (32) of this section apply for a taxable year of a foreign corporation beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

(3) Early application--(i) Rules for paragraphs (b) and (g)(1) and (2) of this section. Taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in paragraphs (b) and (g)(1) and (2) of this section for a taxable year beginning after December 31, 2017, and before November 13, 2020, provided that those taxpayers and their related parties consistently apply all of those rules and the rules described in paragraph (m)(4) of this section for that taxable year. If a taxpayer and its related parties apply the rules described in paragraph (m)(4) of this section, as contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020), they will be considered as applying the rules described in paragraph (m)(4) of this section for purposes of this paragraph (m)(3)(i).

(ii) Rules for certain other paragraphs in this section. Taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in paragraphs (a), (c)(1), (c)(2)(i) and (ii), and (c)(3) through (5), (d), (e), (f)(1), (g)(3) and (4), (h), and (k)(1) through (3), (6) through (8), and (10) through (32) of this section for a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER**

DATE OF PUBLICATION IN THE FEDERAL REGISTER], provided that those taxpayers and their related parties consistently apply all of those rules and the rules described in paragraph (m)(4) of this section for that taxable year and for each subsequent taxable year. If a taxpayer and its related parties apply the rules described in paragraph (m)(4) of this section, as contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021),they will be considered as applying the rules described in paragraph (m)(4) of this section for purposes of this paragraph (m)(3)(ii).

(4) Additional rules that must be applied consistently. The rules described in this paragraph (m)(4) are the section 163(j) regulations and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.382-7, 1.383-0, 1.383-1, 1.469-9, 1.469-11, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-36, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1) and 1.1504-4.

(5) Election for prior taxable years and specified periods. Notwithstanding paragraph (e)(5)(iii) or (h)(5)(i) of this section, in the case of a specified period of a specified group or a taxable year of a stand-alone applicable CFC that ends with or within a taxable year of a designated U.S. person ending before November 13, 2020, a CFC group election or a safe-harbor election may be made on an amended Federal income tax return filed on or before the due date (taking into account extensions, if any) of the original Federal income tax return for the first taxable year of each designated U.S. person ending on or after November 13, 2020.

Par. 8. Section 1.163(j)-10 is amended by:

1. Redesignating paragraph (c)(5)(ii)(D) as paragraph (c)(5)(ii)(D)(1).

2. Adding a subject heading for paragraph (c)(5)(ii)(D).

3. Adding paragraph (c)(5)(ii)(D)(2).

4. Redesignating paragraph (f) as paragraph (f)(1).

5. Adding a subject heading for paragraph (f).

6. Revising the subject heading for redesignated paragraph (f)(1).

7. Adding paragraph (f)(2).

The revisions and additions read as follows:

§1.163(j)-10 Allocation of interest expense, interest income, and other items of expense and gross income to an excepted trade or business.

* * * * *

(c) * * *

(5) * * *

(ii) * * *

(D) Limitations on application of look-through rules. * * *

(2) Limitation on application of look-through rule to C corporations. Except as provided in §1.163(j)-9(h)(4)(iii) and (iv) (for a REIT or a partnership making the election under §1.163(j)-9(h)(1) or (7), respectively), for purposes of applying the look-through rules in paragraph (c)(5)(ii)(B) and (C) of this section to a non-consolidated C corporation (upper-tier entity), that upper-tier entity may not apply these look-through rules to a lower-tier non-consolidated C corporation if a principal purpose for borrowing funds at the upper-tier entity level or adding an upper-tier or lower-tier entity to the ownership structure is increasing the amount of the taxpayer's basis allocable to excepted trades or businesses. For example, P wholly and directly owns S1 (the upper-tier entity), which wholly and directly owns S2. Each of S1 and S2 is a non-consolidated C corporation to which the small business exemption does not apply, and S2 is engaged in an excepted trade or business. With a principal purpose of increasing the amount of basis allocable to its excepted trades or businesses, P has S1 (rather than S2) borrow funds from a third party. S1 may not look through the stock of S2 (and may

not apply the asset basis look-through rule described in paragraph (c)(5)(ii)(B)(2)(iv) of this section) for purposes of P's allocation of its basis in its S1 stock between excepted and non-excepted trades or businesses; instead, S1 must treat its stock in S2 as an asset used in a non-excepted trade or business for that purpose. However, S1 may look through the stock of S2 for purposes of S1's allocation of its basis in its S2 stock between excepted and non-excepted trades or businesses.

* * * * *

(f) Applicability dates.

(1) In general. * * *

(2) Paragraph (c)(5)(ii)(D)(2). The rules contained in paragraph (c)(5)(ii)(D)(2) of this section apply for taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers may choose to apply the rules in paragraph (c)(5)(ii)(D)(2) of this section to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in the section 163(j) regulations as contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.383-0, 1.383-1, 1.469-9, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905 as modified by T.D. 9943, to that taxable year and each subsequent taxable year.

Par. 9. Section 1.469-4 is amended by adding paragraph (d)(6) to read as follows:

§1.469-4 Definition of activity.

* * * * *

(d) * * *

(6) <u>Activities described in section 163(d)(5)(A)(ii)</u>. With respect to any taxpayer that is an individual, trust, estate, closely held C corporation or personal service corporation, an activity described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii) that involves the conduct of a trade or business which is not a passive activity of the taxpayer and with respect to which the taxpayer does not materially participate may not be grouped with any other activity or activities of the taxpayer, including any other activity described in §1.469-1T(e)(6) and subject to section 163(d)(5)(A)(ii).

* * * * *

Par. 10. Section 1.469-9 is amended by adding paragraphs (b)(2)(ii)(A) and (B) to read as follows:

<u>§1.469-9 Rules for certain rental real estate activities</u>.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) <u>Real property development</u>. The term <u>real property development</u> means the maintenance and improvement of raw land to make the land suitable for subdivision, further development, or construction of residential or commercial buildings, or to establish, cultivate, maintain or improve timberlands (that is, land covered by timber-producing forest). Improvement of land may include any clearing (such as through the mechanical separation and removal of boulders, rocks, brush, brushwood, and underbrush from the land); excavation and gradation work; diversion or redirection of creeks, streams, rivers, or other sources or bodies of water; and the installation of roads (including highways, streets, roads, public sidewalks, and bridges), utility lines, sewer and drainage systems, and any other infrastructure that may be necessary for subdivision, further development, or construction of residential or commercial buildings, or for the establishment, cultivation, maintenance or improvement of timberlands.

(B) Real property redevelopment. The term real property redevelopment means the demolition, deconstruction, separation, and removal of existing buildings, landscaping, and infrastructure on a parcel of land to return the land to a raw condition or otherwise prepare the land for new development or construction, or for the establishment and cultivation of new timberlands.

* * * * *

Par. 11. Section 1.469-11 is amended by revising paragraphs (a)(1) and (4) to read as follows:

§1.469-11 Applicability date and transition rules.

(a) * * *

(1) The rules contained in §§1.469-1, 1.469-1T, 1.469-2, 1.469-2T, 1.469-3, 1.469-3T, 1.469-4, but not §1.469-4(d)(6), 1.469-5 and 1.469-5T, apply for taxable years ending after May 10, 1992. The rules contained in §1.469-4(d)(6) apply for taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in §1.469-4(d)(6) to a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in the section 163(j) regulations as contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective

November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.383-0, 1.383-1, 1.469-9, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4 contained in T.D. 9905 as modified by T.D. 9943, to that taxable year and each subsequent taxable year.

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(4) The rules contained in §1.469-9(b)(2), other than paragraphs (b)(2)(ii)(A) and (B), apply to taxable years beginning on or after November 13, 2020. Section 1.469-9(b)(2)(ii)(A) and (B) applies to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in §1.469-9(b)(2), other than paragraphs (b)(2)(ii)(A) and (B), to a taxable year beginning after December 31, 2017, and on or before November 13, 2020 and may choose to apply the rules in §1.469-9(b)(2)(ii)(A) and (B) to taxable years beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules in the section 163(j) regulations contained in T.D. 9905 (§§1.163(j)-0 through 1.163(j)-11, effective November 13, 2020) as modified by T.D. 9943 (effective January 13, 2021), and, if applicable, §§1.263A-9, 1.263A-15, 1.381(c)(20)-1, 1.382-1, 1.382-2, 1.382-5, 1.382-6, 1.383-0, 1.383-1, 1.469-9, 1.704-1, 1.882-5, 1.1362-3, 1.1368-1, 1.1377-1, 1.1502-13, 1.1502-21, 1.1502-79, 1.1502-91 through 1.1502-99 (to the extent they effectuate the rules of §§1.382-2, 1.382-5, 1.382-6, and 1.383-1), and 1.1504-4, contained in T.D. 9905 as modified by T.D. 9943, to that taxable year and each subsequent taxable year.

* * * * *

Par. 12. Section 1.1256(e)-2 is added to read as follows:

§1.1256(e)-2 Special rules for syndicates.

(a) Allocation of losses. For purposes of section 1256(e)(3), syndicate means any partnership or other entity (other than a corporation that is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocated to limited partners or limited entrepreneurs (within the meaning of section 461(k)(4)).

(b) Determination of loss amount. For purposes of section 1256(e)(3), the amount of losses to be allocated under paragraph (a) of this section is calculated without regard to section 163(j).

(c) Example. The following example illustrates the rules in this section:

(1) Facts. Entity is an S corporation that is equally owned by individuals A and B. A provides all of the goods and services provided by Entity. B provided all of the capital for Entity but does not participate in Entity's business. For the current taxable year, Entity has gross receipts of $5,000,000, non-interest expenses of $4,500,000, and interest expense of $600,000.

(2) Analysis. Under paragraph (b) of this section, Entity has a net loss of $100,000 ($5,000,000 minus $5,100,000) for the current taxable year. One half (50 percent) of this loss is allocated to B, a limited owner. Therefore, for the current taxable year, Entity is a syndicate within the meaning of section 1256(e)(3)(B).

(d) Applicability date. This section applies to taxable years beginning on or after **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. However, taxpayers and their related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), may choose to apply the rules in this section for a taxable year beginning after December 31, 2017, and before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided that those taxpayers and their related parties consistently apply all of the rules of this section to that taxable year and each subsequent taxable year.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: December 30, 2020.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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