



TaxNewsFlash

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KPMG reports: Initial analysis of regulations, guidance under section 163(j)

The U.S. Treasury Department and IRS collectively (“Treasury”) on July 28, 2020, released two sets of regulations, as well as other administrative guidance, relating to section 163(j) as amended by:

- The 2017 U.S. tax law (Pub. L. No. 115-97, enacted December 22, 2017, and often referred to as the “Tax Cuts and Jobs Act”)
- The Coronavirus Aid, Relief, and Economic Security Act (Pub. L. No. 116-136, enacted March 27, 2020, and often referred to as the “CARES Act”)

The Treasury and IRS release (collectively, the “163(j) Package”) included:

- [Final regulations \(T.D. 9905\)](#) [PDF 2.22 MB] (575 pages) relating to section 163(j) (the “Final Regulations”)
- [Proposed regulations \(REG-107911-18\)](#) [PDF 1 MB] (285 pages) relating to section 163(j) (the “2020 Proposed Regulations”)
- [Notice 2020-59](#) [PDF 126], which provides a safe harbor allowing certain businesses that manage or operate “qualified residential living facilities” to qualify as “electing real property trades or businesses” under section 163(j)(7)(B)
- A list of [“frequently asked questions” \(FAQs\)](#) regarding the aggregation rules under section 448(c)(2) that apply to the section 163(j) small business exemption

This report reviews the background of the 163(j) Package and discusses the effective and applicability dates of various rules. Links also are provided to separate Focus Reports with initial impressions and observations about certain aspects of the 163(j) Package and the application of the 163(j) Package to various business entities.

KPMG Focus Reports

- [Key concepts: Interest and adjusted taxable income](#)
- [Implications for domestic corporations](#)
- [Implications for passthrough entities](#)
- [Implications for foreign corporations](#)
- [State and local tax considerations](#)
- [Exempt and excepted businesses and entities](#)

Background

Section 163(j) was significantly altered, and its applicability was greatly expanded by, the Tax Cuts and Jobs Act. Finalization of regulations proposed by Treasury in late 2018 had been expected in early 2020 but with the enactment of the CARES Act, the scope and timing of the section 163(j) rules were revised. Now, with the release of this 163(j) Package, Treasury has provided final rules on many aspects of section 163(j), but, as will be discussed in this report, new proposed rules have once again changed significant parts of the regime and added complexity for many taxpayers. Before addressing the new guidance, a quick timeline of relevant developments to date is helpful in orienting the discussion.

The Tax Cuts and Jobs Act amended section 163(j) to disallow a deduction for business interest to the extent net business interest expense exceeds 30% of adjusted taxable income (“ATI”) plus floor plan financing interest for taxable years beginning after December 31, 2017. For this purpose, ATI equals a taxpayer’s taxable income computed without regard to (i) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business, (ii) business interest expense or business interest income, (iii) the amount of any net operating loss (“NOL”) deduction, (iv) the 20% deduction for certain passthrough income under section 199A, and (v) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion. Business interest expense that is disallowed under section 163(j) is treated as paid or accrued in the succeeding taxable year and may be carried forward indefinitely. However, unlike under the old statute, to the extent a taxpayer has excess capacity to deduct interest in a given year but does not have sufficient interest expense, section 163(j) as amended does not permit such excess limitation to be carried forward.

Treasury issued Notice 2018-28 on April 6, 2018, in which it confirmed, among other things, that the section 163(j) limitation would be applied on a consolidated group basis.

Treasury released proposed regulations (REG-106089-18) relating to section 163(j) on November 26, 2018 (the “2018 Proposed Regulations”). Read [TaxNewsFlash](#)

As indicated below, in March 2020 the CARES Act legislation made several temporary changes to section 163(j). These amendments apply to tax years beginning after December 31, 2018.

- **50% of ATI:** For tax years beginning in 2019 and 2020, the 30% limit on ATI is increased to 50%.
- **Partnerships:** The 50%-instead-of-30% ATI rule does not apply to a partnership tax year beginning in 2019, but (unless a partner otherwise elects out) for any of the partnership’s 2019 excess business interest expense that is allocated to a partner under section 163(j)(4)(B)(i)(II):
 - 50% of that excess business interest expense will be treated as business interest that is paid or accrued by the partner in its first tax year beginning in 2020 and will not subject to the limits of section 163(j)(1) and is thus deductible in such tax year (subject to any other limitations that may apply), and
 - The other 50% will be subject to the limitations of section 163(j)(4)(B)(ii) in the same manner as any other excess business interest so allocated.

- **Electing out of the 50%-of-ATI rule:** Taxpayers can elect not to have the 50%-of-ATI rule apply to any tax year. Such an election will need the Secretary's consent to be revoked. This is a partnership-level election and may be made only for tax years beginning in 2020.
- **Using 2019's ATI in 2020:** For any tax year beginning in 2020, taxpayers can elect to use their ATI from their last tax year beginning in 2019 for their ATI in the 2020 tax year. If such an election is made for a short tax year, the taxpayer's 2019 ATI will be prorated.

Treasury issued Revenue Procedure 2020-22 on April 10, 2020, in which it addressed the mechanics of the elections under section 163(j)(7)(B) (to be an electing real property trade or business) and section 163(j)(7)(C) (to be an electing farming business) for taxable years beginning in 2018, 2019, or 2020, as well as the mechanics for electing out of the CARES Act changes described above.

The Final Regulations and the 2020 Proposed Regulations were published on the IRS website on July 28, 2020, which has become a common practice by Treasury of late. The relevance of the publication venue is that effective dates and other administrative law matters are generally based on the display or publication of regulations by the Federal Register, so the effective dates of the rules will not be tied to the July 28 date.

Effective dates

Final Regulations

The Final Regulations generally will be applicable to taxable years beginning on or after the date 60 days after the date of publication of the Final Regulations in the Federal Register.

KPMG observation

The Final Regulations do not apply to tax years beginning in 2019 and there is no requirement for taxpayers to adopt or apply any of the new rules for 2019 (and even 2020 in many cases). Nonetheless, taxpayers do have the option to apply the Final Regulations retroactively and in some instances such application could prove to be a net benefit to taxpayers.

2020 Proposed Regulations

The 2020 Proposed Regulations generally are proposed to apply to taxable years beginning on or after the date 60 days after the date the Treasury Decision adopting the 2020 Proposed Regulations as final regulations is published in the Federal Register.

Retroactive application and reliance

Final Regulations

Taxpayers and related parties (determined under sections 267(b) and 707(b)(1)) generally will have the discretion to apply the Final Regulations retroactively to a taxable year beginning after December 31, 2017, and before the date 60 days after the date of publication of the Final Regulations in the Federal Register but must apply the Final Regulations on a consistent basis.

Notwithstanding the foregoing, the interest anti-avoidance rules in Reg. § 1.163(j)-1(b)(22)(iv) of the Final Regulations will be applicable to transactions entered into on or after the date of publication of the Final Regulations in the Federal Register. In addition, the rules for swaps with significant nonperiodic payments provided in Reg. § 1.163(j)-1(b)(22)(ii) will have a delayed applicability date, applying to

notional principal contracts entered into on or after the date 365 days after the date of publication of the Final Regulations in the Federal Register (although taxpayers and related parties may choose to apply such rules to notional principal contracts entered into before that date).

Alternatively, taxpayers may choose to rely on the 2018 Proposed Regulations for tax years beginning before the Final Regulations are applicable but must apply the 2018 Proposed Regulations on a consistent basis. Taxpayers who choose to rely on the 2018 Proposed Regulations may nonetheless choose to apply Reg. § 1.163(j)-1(b)(1)(iii) in the Final Regulations (relating to depreciation, amortization, or depletion capitalized under section 263A) to taxable years beginning after December 31, 2017.

2020 Proposed Regulations

With respect to effective dates and reliance for the 2020 Proposed Regulations, the preamble to the 2020 Proposed Regulations does not conform with the regulation language in a number of instances. The discussion below is based on the regulation language, but the seeming conflicts might indicate that there could be further changes to the effective dates and reliance language upon publication in the Federal Register, or later.

With certain exceptions and caveats as noted below, taxpayers and their related parties (determined under sections 267(b) and 707(b)(1)) may rely on the proposed rules in the 2020 Proposed Regulations for any taxable year beginning after December 31, 2017, and before the date 60 days after the date of publication of the Treasury Decision adopting the 2020 Proposed Regulations as final regulations in the Federal Register.

The text of certain of the 2020 Proposed Regulations provides that taxpayers who choose to apply the proposed rules before they are finalized must apply them consistently (and in certain cases consistent with other related regulations). The following 2020 Proposed Regulations have such requirements:

- Prop. Reg. § 1.163-14;
- Prop. Reg. § 1.163(j)-1(b)(1)(iv)(B) and (E);
- Prop. Reg. § 1.163(j)-1(b)(22)(iii)(F);
- Prop. Reg. § 1.163(j)-1(b)(35)
- Prop. Reg. § 1.163(j)-6 (which does not contain effective date language but the Preamble suggests that it may be applied before finalized if it is applied consistently)
- Prop. Reg. § 1.163(j)-10(c)(5)(ii)(D)(2)
- Prop. Reg. § 1.469-4(d)(6)
- Prop. Reg. § 1.469-9(b)(2)(ii)(A) and (B)
- Prop. Reg. § 1.1256(e)-2

There are no consistency requirements in the text of the following 2020 Proposed Regulations:

- Prop. Reg. § 1.163-15
- Prop. Reg. § 1.163(j)-2(b)(3)(iii)-(iv)
- Prop. Reg. § 1.163(j)-2(d)(3)

The rules with respect to the applicability of and reliance on Prop. Reg. §§ 1.163(j)-7 and -8 (relating to international provisions) are complex. Prop. Reg. § 1.163(j)-7 is generally applicable for tax years beginning on or after 60 days after the date the final regulations adopting the proposed rules are published in the Federal Register. Taxpayers can generally choose to apply Prop. Reg. § 1.163(j)-7 retroactively if they also 1) elect to apply Prop. Reg. § 1.163(j)-8 retroactively and 2) apply the Final Regulations to the desired year, including by electing to apply the Final Regulations retroactively. Corresponding rules apply to Prop. Reg. § 1.163(j)-8.

Comment period and hearing

Written comments or requests for a public hearing must be submitted within 60 days after the date of filing of the 2020 Proposed Regulations for public inspection with the Office of the Federal Register.

Contact us

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