IRC §163(j) – Limitation on Business Interest Deduction as Amended by the *Tax Cuts and Jobs Act*

Old Rule: Business interest expense was generally fully deductible and potentially limited in cases involving related or foreign parties.

New Rule: For tax years beginning after December 31, 2017, the deduction for business interest expense is limited to the sum of:

- Business interest income[1]
- 30% of adjusted taxable income[2] (not less than zero)
- Floor plan financing interest[3]

Any disallowed interest is considered paid in the following tax year and may be carried forward indefinitely.

Interest Limitation Exceptions

- Taxpayer meets $25 million gross receipts test
- Electing real property trade or business
- Electing farm business
- Regulated public utility

Pass-Through Entities: The limitation applies at the entity level, and the deduction is included in ordinary income/loss. Pass-through owners determine their limitation without regard to the pass-through income, gain, loss or deduction, except in cases where the pass-through is determined to have excess taxable income.[4]

Example 1: Corporation A has adjusted taxable income of $30,000, business interest income of $1,000 and interest expense of $12,000 with no floor plan financing interest for tax year 2018.

The 2018 limitation amount is $10,000 (($30,000 x 30%) + 1,000). Assuming it's not eligible for any of the exceptions, Corporation A deducts $10,000 of interest expense in 2018 and carries forward the $2,000 of disallowed interest to 2019.

Example 2: For 2018, BCD Partnership is a 50-50 partnership owned by Corp E and an individual. BCD isn't eligible for an exception and has ordinary income of $5,000 without considering $1,500 of business interest expense. BCD doesn't have any depreciation, amortization or depletion expenses. BCD's interest limitation in 2018 is $1,500 ($5,000 x 30%). The partnership deducts the $1,500 of business interest and reports $3,500 of ordinary income. Corp E receives a $1,750 distributive share of ordinary income from BCD. Corp E has adjusted taxable income of $1,000, including the distributive share of partnership income from BCD. Corp E has no business interest income and $3,000 of business interest expense. Corp E's interest limitation would be $0 since its adjusted taxable income, excluding its $1,750 share of BCD's income, is less than zero. Corp E would have no interest deduction in 2018. The disallowed $3,000 is carried forward to 2019.

[1] ***Business Interest Income:*** *interest includible in gross income and properly allocable to a trade or business*

[2] ***Adjusted taxable income:*** *taxable income computed without regard to any item of income, gain, deduction or loss not properly allocable to a trade or business, any business interest income or expense, net operating loss, §199A deduction and, for tax years beginning before January 1, 2022, any deduction for depreciation, amortization or depletion*

[3] ***Floor plan financing interest:*** *interest paid on indebtedness used to purchase, and secured by, motor vehicles held for sale or lease*

[4] ***Excess taxable income:*** *occurs when a pass-through entity's business interest incurred is less than the calculated limitation, the proportion of adjusted taxable income attributable to this "excess" is allowed to be included in the pass-through owner's calculation of adjusted taxable income*

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