ALSTON & BIRD

WWW.ALSTON.COM

Federal Tax ADVISORY ■

AUGUST 1, 2018

The Interest Deduction Limitation

New Section 163(j) does not seem to have caused a ripple in corporate borrowing, which is said to be at all-time highs. If public companies don't care, S corporations, partnerships, and individuals may be more likely to escape due to the Section 163(j)(3) exemption for "small business." But as usual, "small business" is a difficult definition.

Section 163(j) will not apply to any taxpayer with average annual gross receipts not exceeding $25 million for the three-tax-year period ending with the tax year that precedes the tax year at issue. Gross receipts are gross sales, investment income, and all amounts received for services. The test applies to the taxpayer, not the trade or business.

Example. High-salaried individual Jim makes $5 million in taxable compensation and sells stock for $21 million. Jim will be subject to the limitation except for the three-year averaging rule. But if the $21 million gross receipts is recurring due to investments in private equity funds, he could fall out of the exception. Of course, only his business interest expense would be affected by the limit. But his limit of deduction to 30% of his adjusted taxable income might not be so high because it would not include salary and investment income.

Also, the regulation aggregates the receipts of all persons treated as a single employer by Section 52(a) or (b), or Section 414(m) or (o). High-salaried individuals might try putting their leveraged business into a partnership, but the aggregation rule can thwart that effort to avoid the limit.

Even if Jim avoids direct involvement with Section 163(j), he can't avoid indirect involvement if he owns an interest in a partnership that incurs debt, and they all do. The partnership will include in Jim's K-1 his allocated share of deductible business interest, any nondeductible business interest, and investment interest that may be limited at Jim's level.

But Jim says he is not concerned because all of his activities are related to real estate, and real estate is exempt. Right? Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental operation, management, leasing, or brokerage trade or business can elect (irrevocably) to be excluded from Section 163(j). That definition is broad but does not cover everything touching real estate.

An election by the real estate business is required to use the real estate exemption. It carries the downside of requiring use of the alternative depreciation method. That may not be so bad, except that it means bonus depreciation cannot apply. But it would not apply anyway to most real estate; however, efforts are under way to remove that limit on bonus depreciation.

The point is that the small business exception is very useful, but it may not entirely exempt taxpayers that think they should be exempt from the interest deduction limit.

For more information, please contact Jack Cummings at 919.862.2302.

You can subscribe to future *Federal Tax* advisories and other Alston & Bird publications by completing our **publications subscription form**.

Click **here** for Alston & Bird's Tax Blog.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481
sam.kaywood@alston.com

Edward Tanenbaum
Co-Chair
212.210.9425
edward.tanenbaum@alston.com

George Abney
404.881.7980
george.abney@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

Seth M. Buchwald
404.881.7836
seth.buchwald@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Stefanie E. Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Ryan J. Kelly
202.239.3306
ryan.kelly@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Danny Reach
704.444.1272
danny.reach@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

Michael Senger
404.881.4988
michael.senger@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RALEIGH: 555 Fayetteville Street ▪ Suite 600 ▪ Raleigh, North Carolina, USA, 27601-3034 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ▪ Suite 2100 ▪ San Francisco, California, USA, 94105-0912 ▪ 415.243.1000 ▪ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, California, USA, 94303-2282 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333