Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Treatment of Corporate Taxpayers and Consolidated Groups in Proposed Guidance under section 163(j)

Dear Commissioner Rettig:

Enclosed please find comments on the treatment of corporate taxpayers and consolidated groups in the proposed guidance under section 163(j). These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Eric Solomon
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Proposed Guidance under Section 163(j) Regarding
Issues Affecting Corporate Taxpayers and Consolidated Groups

These comments (“Comments”) are submitted on behalf of the American Bar
Association Section of Taxation (the “Section”) and have not been approved by the
House of Delegates or Board of Governors of the American Bar Association.
Accordingly, they should not be construed as representing the position of the American
Bar Association.

Principal responsibility for preparing these comments was exercised by Greg
Fairbanks, Chair of the Section’s Affiliated and Related Corporations Committee (the
“Committee”). Significant contributions were made by Bryan Collins, Erik Corwin,
Jonathan Forrest, Tim Nichols, Olivia Orobona, Maury Passman, Bill Pauls, and Tom
Wessel of the Committee. The Comments have been reviewed by Lisa Zarlenga, Chair
of the Committee on Government Submissions.

Although members of the Section of Taxation may have clients who might be
affected by the federal tax principles addressed by these Comments, no member who has
been engaged by a client (or who is a member of a firm or other organization that has
been engaged by a client) to make a government submission with respect to, or otherwise
to influence the development or outcome of one or more specific issues addressed by,
these Comments has participated in the preparation of the portion (or portions) of these
Comments addressing those issues. Additionally, while the Section’s diverse membership
includes government officials, no such official was involved in any part of the drafting or
review of these Comments.

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Date: February 26, 2019
EXECUTIVE SUMMARY

These Comments are in response to proposed Regulations first released on November 26, 2018 under section 163(j) with respect to changes made by Public Law 115-97 enacted on December 22, 2017 (the “Act”). The Proposed Regulations address in part the application of the limitation on interest deductions to corporations and consolidated groups. The amendments to section 163(j) are generally applicable to tax years beginning after December 31, 2017. The Proposed Regulations are proposed to be effective when finalized, but taxpayers are generally permitted to rely on them for tax years beginning after (or ownership changes occurring in tax years beginning after) December 31, 2017, as long as taxpayers and any related parties consistently apply all of the Proposed Regulations.

The Act does not explicitly provide guidance for either corporations or, more specifically, consolidated groups. However, the legislative history of the Act does state 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.” Furthermore, for consolidated groups, the legislative history states that “[i]n the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.” Notice 2018-28 provided additional guidance consistent with the legislative history.

The Proposed Regulations address and clarify a number of issues raised by section 163(j). We commend the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) for their commitment to provide expedited guidance, and for thoughtfully addressing corporate and consolidated group-related issues. We respectfully submit these Comments and request that Treasury and the Service consider the following recommendations in the finalization of the Proposed Regulations.

1. We recommend that final Regulations reconsider the necessity of the subtractions from taxable income in computing adjusted taxable income

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2 References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated, and all “Regulation section” references are to the Treasury regulations promulgated under the Code, all as in effect on the date of these Comments.
5 Id. at 386.
(“ATI”) in Proposed Regulation section 1.163(j)-1(b)(1)(ii)(C), (D), and (E)\(^7\), as a mechanic that may not have been contemplated by Congress and in any event, would involve considerable taxpayer burden to administer.

2. We recommend that if the subtractions in Proposed Regulation section 1.163(j)-1(b)(1)(ii)(C), (D), and (E) are retained in the final Regulations, the following modifications be considered.

   a. Clarify the terms “dispositions” and “attributable” as they relate to adjustments that impact the calculation of such subtraction.

   b. Provide that a subtraction should not apply if there was no net tax benefit from the relevant depreciation, amortization, or depletion deductions resulting in increased deductibility of interest in the tax year of accrual.

   c. Address the asymmetry between dispositions of assets as compared to dispositions of member stock.

   d. Eliminate the potential for inappropriately duplicative subtraction adjustments.

3. We recommend that final Regulations revise the five-step computation in Proposed Regulation section 1.163(j)-5(b)(3)(ii) to focus less on location of interest and thus better reflect single-entity principles and the realities of modern financing arrangements.

4. We recommend that final Regulations replace the annualized approach to determining the separate return limitation year (“SRLY”) limitation on disallowed section 163(j) carryover amounts with a “Cumulative Register Approach,” as such term is defined, below, consistent with the general application of Regulation section 1.1502-21.

5. If Proposed Regulation section 1.382-2(a)(7)(ii) is retained in final regulations, we recommend that final Regulations permit taxpayers to make a closing-of-the-books election for allocating current year disallowed business interest expense (“BIE”) similar to the rules in Regulation section 1.382-6(b).

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\(^7\) Sales of depreciable property.

\(^8\) Dispositions of stock of a member of a consolidated group.

\(^9\) Dispositions of partnership interests.
6. We recommend that final Regulations address the application of section 382(e)(3) to foreign corporations treated as loss corporations with disallowed BIE carryovers.

7. We recommend that final Regulations consider providing a taxpayer election to apply an alternative ordering for section 383 purposes with respect to net operating losses (“NOLs”) that arose prior to 2018 to allow taxpayers flexibility when such attributes may be approaching the end of the carryforward period.

8. We recommend that final Regulations modify the rules set forth in Proposed Regulation section 1.163(j)-4(d)(4)(i) to incorporate successor person principles where an intercompany transfer of a partnership interest occurs.

9. We recommend that final Regulations provide that, where an intercompany transfer of a partnership interest results in a termination of the partnership, the transfer be treated as a disposition of the partnership interest by the transferor for purposes of the basis adjustment rule in section 163(j)(4)(B)(iii)(II), and that corresponding treatment be afforded to the transferee in an instance where the transferee also is a partner in the partnership prior to the intercompany transfer.

10. We recommend that Regulation section 1.1502-36 be amended to address the treatment of excess business interest expense (“EBIE”) that has been allocated to a member as a deferred deduction for purposes of determining the net inside attribute amount and for purposes of the reattribution election under Regulation section 1.1502-36(d)(6).

11. We recommend that final Regulations modify the allocation rules in Proposed Regulation section 1.163(j)-10 to permit the use of any reasonable method to allocate disallowed disqualified interest expense from years in which old section 163(j) applied.
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DISCUSSION

A. Anti “Double Benefit” Adjustment to ATI

1. Background

For purposes of computing ATI, deductions for depreciation, amortization, and depletion are added back to taxable income, but only with respect to taxable years beginning before January 1, 2022. The Proposed Regulations include additional adjustments that are intended to address the potential for a perceived “double benefit” with respect to depreciation, amortization, or depletion deductions for taxable years beginning after December 31, 2017, and before January 1, 2022. Specifically, the concern is that insofar as a taxpayer receives a benefit by adding such deductions back to taxable income to increase ATI in the year they initially accrue pursuant to section 163(j)(8)(A)(v), the taxpayer should not be able to effectively receive a second ATI benefit from such deductions when the applicable property is sold due to the increased gain that results from the property having a lower basis on account of those deductions.

To address this concern, Proposed Regulation section 1.163(j)-1(b)(1)(ii)(C) provides that, with respect to a sale or other disposition of property, there is a subtraction from taxable income in computing ATI equal to the lesser of (i) any gain recognized on

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11 Prop. Reg. § 1.163(j)-1(b)(1)(ii)(C), (D), and (E). Together, these adjustments are referred to herein as the “anti-double benefit subtractions.”
the sale or other disposition of such property, and (ii) any depreciation, amortization, or
depreciation deductions for the taxable years beginning after December 31, 2017, and before
January 1, 2022, with respect to such property. Proposed Regulation section 1.163(j)-
1(b)(1)(ii)(D) extends a similar rule to sales of consolidated group member stock. It
would require that with respect to the sale or other disposition of stock of a member of a
consolidated group, there would be a subtraction from taxable income in computing ATI
for the investment adjustments, as defined under Regulation section 1.1502-32, with
respect to such stock that are attributable to such depreciation, amortization, and
depreciation deductions. Notably, the rule requiring a subtraction from taxable income in
computing ATI in the case of a sale of consolidated group member stock does not
expressly limit the subtraction to the amount of recognized gain on the sale of the stock.\textsuperscript{13}

The Preamble to the Proposed Regulations explains that the anti-double benefit
subtractions are “for sales or dispositions of certain property for taxable years beginning
before January 1, 2022,” which suggests that these adjustments only apply in taxable
years beginning before January 1, 2022.\textsuperscript{14} However, the regulatory language does not
place a date limitation on the relevant sales or dispositions, just the depreciation
deductions, suggesting that these adjustments apply regardless of when the sale or
disposition occurs, even if many years later.\textsuperscript{15}

2. Comments and Recommendations

a. Reconsider Necessity for Adjustment

We recognize that Treasury has broad regulatory authority under section
163(j)(8)(B) to prescribe adjustments to the computation of ATI. From a policy
perspective, whether the anti-double benefit subtractions from taxable income in
computing ATI are an advisable exercise of that authority depends in significant part on
the extent of the benefit Congress intended to provide when it included the depreciation,
amortization, and depletion add-back in computing ATI for taxable years beginning after
December 31, 2017, and before January 1, 2022. Unfortunately, it is difficult to discern
Congress’ intent in this regard.

On one hand, there is no express indication in either the statute or the legislative
history that Congress was concerned about a double benefit when property subject to
depreciation, amortization, or depletion in taxable years beginning after December 31,
2017, and before January 1, 2022 is sold or otherwise disposed of. Since Congress
directly addressed the treatment of such depreciation, amortization, and depletion for ATI
purposes, but did not explicitly provide for compensating adjustments upon a sale or
other disposition of the property, one might assume that Congress thought the general
rules for determining gain or loss on property dispositions would apply and that there
would be no such adjustments to taxable income. To the extent that is correct, the anti-

\textsuperscript{13} Prop. Reg. section 1.163(j)-1(b)(1)(ii)(E) provides a rule for partnership interests that is substantially
identical to the rule for sales or dispositions of consolidated group member stock.

\textsuperscript{14} Preamble, 83 Fed. Reg. at 67,492.

\textsuperscript{15} See Prop. Reg. § 1.163(j)-1(b)(1)(ii)(C).
double benefit subtractions would actually frustrate Congressional intent by effectively clawing back, at the time of a subsequent disposition, a benefit – the ATI increase resulting from depreciation, amortization, and depletion deductions taken for taxable years beginning after December 31, 2017, and before January 1, 2022 – that Congress intended to provide.

On the other hand, Congress was legislating against the backdrop of old section 163(j), which included a definition of adjusted taxable income that was similar to new section 163(j)(8) in many respects, including providing that adjusted taxable income would be computed without regard to “any deduction allowable for depreciation, amortization, or depletion” and “with such other adjustments as the Secretary may by regulation prescribe.” Proposed Regulations issued under old section 163(j) in 1991 included subtractions from taxable income in computing ATI for: (i) with respect to any sale or disposition of property, any depreciation, amortization, or depletion deductions taken with respect to the property for taxable years beginning after July 10, 1986 (with no recognized gain limitation); (ii) with respect to the sale or disposition of stock of a consolidated group member, the investment adjustments with respect to such stock attributable to such deductions; and (iii) with respect to the sale or other disposition of a partnership interest, the taxpayer’s distributive share of such deductions with respect to property held by the partnership at the time of such sale or other disposition. Although these were only proposed Regulations – and proposed Regulations that had remained outstanding without being finalized for over 25 years at the time of enactment of the Act – it is possible Congress was cognizant of these proposed Regulations and expected that Treasury would similarly seek to use the regulatory authority in new section 163(j)(8)(B) to provide for these kinds of subtractions.

What is clear is that the anti-double benefit subtractions will involve significant administrative complexity, both for taxpayers and the Service. Specifically, taxpayers will be required to track depreciation, amortization, and depletion deductions taken during the relevant periods and their effect on the basis of assets, consolidated group member stock, and partnership interests, and to take those into account in computing ATI whenever the relevant assets, stock, or interests are disposed of, even if not disposed of until many years in the future. Particularly in the case of complex corporate structures with multiple tiers, this tracking exercise may become extremely burdensome. In addition, as further discussed below, for these adjustments to fairly serve their intended purpose, we recommend additional modifications to the Proposed Regulations that will add further complexity and tracking obligations. In light of the limited period for which such rules are currently applicable, it can reasonably be asked whether such complexity and dedication of further resources is justified.

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17 See Former Prop. Reg. § 1.163(j)-2(f)(3)(i), (ii), (iii). The preamble to those Proposed Regulations did not mention preventing a double benefit as the rationale for the ATI adjustments. Rather, it stated that “[i]n general” the purpose of the adjustments to taxable income in the Proposed Regulations was “to modify taxable income to more closely reflect the cash flow of the corporation.” The Preamble to the current section 163(j) Proposed Regulations observes that the prior Proposed Regulations were never adopted and disclaims taking a cash flow approach to the computation of ATI. See Preamble, 83 Fed. Reg. at 67,492.
Assuming, however, that Treasury and the Service retain the anti-double benefit subtractions in the final Regulations, we offer the following recommendations with respect to the proposal.

b. Clarification of Terms “Dispositions” and “Attributable”

Clarification is needed with respect to the terminology used in the rule for dispositions of consolidated group member stock. In particular, is the term “sale or other disposition” intended to apply to a transfer of stock of a member from one member of a consolidated group to another member of the group? What if a parent corporation’s stock in a subsidiary is redeemed or otherwise canceled in a transaction qualifying as a liquidation under section 332? In general, one would think that such transfers should not be considered dispositions, at least to the extent that they do not impact consolidated taxable income under Regulation section 1.1502-11, whether because the relevant transfer is a non-recognition exchange or because any gain or loss is deferred under the intercompany transaction Regulations.

Pursuant to Proposed Regulation section 1.163(j)-4(d)(iv), the starting point for determining a group’s ATI is consolidated taxable income under Regulation section 1.1502-11 without regard to any carryforwards or allowances under section 163(j). Logically, an intercompany disposition that does not impact consolidated taxable income could not result in the double benefit in computing ATI that the subtraction rule is intended to address. However, absent clarification, the “sale or other disposition” language of the Proposed Regulations might by its terms apply to such transfers and require a subtraction in computing ATI if the transferred stock’s basis includes investment adjustments attributable to depreciation, amortization, or depletion deductions for the relevant years.

There are also issues in determining the scope of the investment adjustments that are considered “attributable” to depreciation, amortization, or depletion deductions for taxable years beginning after December 31, 2017, and before January 1, 2022. For example, assume that corporation P, the parent of a consolidated group, owns all of the stock of S, which purchases asset X for $100 in 2019. X is fully depreciated pursuant to section 168(k) and the depreciation deduction results in a $100 adjustment in P’s stock in S. In 2020, P contributes the stock of S to S1, another wholly-owned subsidiary in a section 351 exchange. Assume that, consistent with the comment immediately above, the contribution is not considered a disposition of the S stock. If P later sells the S1 stock, does the anti-double benefit subtraction rule apply? As a technical matter, there has been no investment adjustment under Regulation section 1.1502-32 to P’s basis in the S1 stock for the $100 of depreciation taken with respect to X, and so arguably the subtraction rule would not apply to a sale of that stock. We expect that Treasury and the Service would intend that the subtraction rule apply in such a case, but the language of the Proposed Regulations may need to be revised to achieve that result.

In addition, it is unclear whether the investment adjustments “attributable” to the specified depreciation, amortization, and depletion deductions include only the initial reduction in basis resulting from those deductions, or whether they include as well subsequent investment adjustments that reflect the effects of those adjustments. Consider
a case in which P, the parent of a consolidated group, owns all of the stock of corporation S1, which in turn owns all of the stock of corporation S2. In 2019, S2 purchases asset X for $100 and fully depreciates that asset under section 168(k). Through its impact on S2’s income, the $100 depreciation deduction results in downward investment adjustments to the basis of S1’s stock in S2 and P’s stock in S1. In 2020, S2 sells asset X for $40, resulting in gain of $40, a subtraction from ATI in the same amount (i.e., the lesser of the gain [$40] or the prior depreciation deductions [$100]), and upward investment adjustments of $40 in the stock of both S2 and S1. In 2021, P sells its stock in S1 to an unrelated buyer. In determining the amount of the anti-double benefit subtraction in computing ATI that results from the S1 stock sale, what is the amount of the investment adjustments “attributable” to the depreciation deduction – $100, the original amount of the deduction, or $60, the net adjustment after the upward adjustment for the gain recognized when X was sold, which gain would not have been recognized but for X having been fully depreciated in the first place? The latter answer ($60) clearly seems the better of the two, as the $100 answer would result in a cumulative total of $140 of ATI subtractions, exceeding by $40 the ATI benefit originally realized by the P group from the depreciation deduction relating to the purchase of X and thereby going beyond what is required to protect against the perceived double benefit.

c. Exception for Depreciation, Amortization, or Depletion Not Resulting in an Interest Deductibility Tax Benefit

We believe that there should be no subtraction from taxable income in computing ATI to the extent that particular depreciation, amortization, or depletion deductions did not impact the amount of interest deductible in the year in which those deductions accrued. The rationale underlying these subtractions is expressly to prevent a perceived double benefit. Accordingly, the subtractions should not apply if there was no benefit in the first instance. Consider, for example, a calendar year corporation that in 2020 had ATI of $500, computed by including as an addition to its taxable income $50 of depreciation deductions with respect to property X, which was acquired and placed in service in that year. Assume further that the corporation had $100 of otherwise deductible interest expense for that year. Based on its ATI of $500, the corporation would be entitled to deduct up to $150 of interest expense for that year, and accordingly it deducts the full amount of its actual interest expense, $100. If the $50 of depreciation were not included in ATI, the corporation would be entitled to deduct up to $135 of interest expense, and hence it would still deduct the full $100 amount of its interest expense. In other words, the $50 add-back for the depreciation expense in computing the corporation’s ATI resulted in no increase in the amount of the corporation’s interest expense deductions for that year.

Now assume that in 2021 the corporation sells property X for a gain of greater than $50. Assume further that for that year the corporation would have ATI, without any anti-double benefit subtraction, of $300 and interest expense of $90. If, as required by the Proposed Regulations, the $50 is subtracted in the computation of ATI, ATI would be $250, and the corporation would be permitted to deduct only $75 of its $90 of interest.

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18 This example assumes that the recognized gain limitation on the ATI subtraction in the case of an asset sale is retained in the final Regulations.
expense, resulting a $3.15 increase in tax for 2021, and the remaining $15 of interest expense becoming a BIE carryover. On these facts, the corporation has a detriment from the subtraction in the form of an out-of-pocket tax cost even though it initially received no interest expense deduction benefit from the $50 depreciation deduction. This result cannot be squared with the anti-double benefit rationale for the subtraction, and accordingly the Proposed Regulations should be revised to require a subtraction in computing ATI in the year of disposition only to the extent the original depreciation, amortization, or depletion add-back in computing ATI for the accrual year produced a tax benefit by enabling interest expense to be deducted. While we recognize that such an approach would involve significant additional administrative complexity, requiring that ATI be reduced for depreciation, amortization, and depletion deductions that had no impact on interest deductions in the year incurred puts further pressure on the already uncertain policy justification for the anti-double benefit subtraction.

d. Address Asymmetry Between Disposition of Assets and Entity

We recommend that Treasury and the Service address the asymmetry between the rule for dispositions of assets, under which the amount of the subtraction is limited to the amount of recognized gain when a relevant asset is disposed of, and the rule for sales or other dispositions of consolidated group member stock, for which there is no such limitation – rather, in such cases, the full amount of the depreciation, amortization, or depletion deductions must be subtracted.

As an initial matter, it is difficult to see why the anti-double benefit subtraction should apply when consolidated group member stock is transferred in a nonrecognition exchange, whether within the consolidated group as discussed above or outside the group. In such a case, the transfer itself would otherwise have no impact on taxable income, and hence no impact on ATI. Accordingly, the transaction would not result in a benefit to the consolidated group in terms of increasing its ATI, thereby undermining the rationale for requiring a subtraction for depreciation, amortization, or depletion-related investment adjustments. Logically, the potential for a subtraction should be tacked to any substituted basis assets received in the non-recognition exchange, and should apply only when those assets are disposed of in a recognition exchange, although we acknowledge that additional administrative complexity would result from such a provision.

Moreover, the presence of a gain limitation in the asset sale rule and no such limitation in the stock sale rule yields discontinuities that may be difficult to justify. For example, assume P, the parent of a consolidated group, forms S in 2019 with a contribution of $200. S uses $50 to purchase assets it fully depreciates under section 168(k), resulting in an investment adjustment in P’s S stock. Assume for simplicity that S’s business otherwise generates no net taxable income in 2019 or 2020, so there are no other adjustments to the basis of P’s stock in S. On the first day of 2021, S sells all of its assets to an unrelated buyer, with $25 of the purchase price being allocated to the assets acquired and depreciated in 2019; otherwise there is no gain or loss with respect to the sale. Under the Proposed Regulations, the P group would have to subtract $25 – the lesser of the gain recognized or the 2019 depreciation deductions – from taxable income in computing its 2021 ATI. By contrast, if P were to sell the S stock, the ATI subtraction would be $50 even if the same amount of gain ($25) were recognized with respect to the
sale of the S stock that was recognized with respect to the S assets. The discrepancy in the ATI results in these two cases is hard to rationalize, and it may drive choices between sales of assets and consolidated member stock.

One possible approach to equalizing the results in these two cases would be to limit the subtraction in the stock sale case to the amount of gain inherent in the assets that originally gave rise to the depreciation, amortization, or depletion deductions. That would again involve greater administrative complexity – including the need for valuation of a consolidated group member’s assets when stock of the member is sold – and accordingly, it seems impractical.

An alternative approach to equating the results in the stock and asset sale cases would be to eliminate the recognized gain limitation in the case of an asset sale. The underlying theory for such an approach is that, upon the disposition of an asset and in the absence of any subtraction, a taxpayer would in fact benefit from the full amount of those depreciation deductions in the year of disposition ATI computation. In the example above, had there been no depreciation deductions, the taxpayer would have a $25 loss with respect to the 2019 assets. Thus, absent any subtraction, ATI would be effectively increased by $50 in the year of disposition as a result of the 2019 depreciation deductions ($25 for the recognized gain plus $25 for the foregone loss), and the full $50 amount of the depreciation deductions would have to be subtracted to eliminate the perceived “double benefit.” Creating what amounts to a full parallel ATI basis regime that would, for example, result in an ATI increase even when an asset is disposed of at no gain or a loss may have been thought to be too administratively complex, including for non-consolidated taxpayers, and perhaps also to stretch too far beyond existing principles relating to “recapture” of depreciation and other cost recovery deductions for regular tax purposes.

e. Eliminate Duplication of Anti-Duplicate Benefit Subtraction

We recommend that Treasury and the Service revise the Proposed Regulations to prevent the potential for duplication of the anti-double benefit subtraction. Consider a case in which P, the parent of a consolidated group, owns a subsidiary, S, that in 2020 acquires and places in service asset X and takes a $50 depreciation deduction with respect to it. Assume for simplicity that S’s other items for 2020 net to $0, and that the P group otherwise has positive consolidated taxable income, such that the $50 depreciation deduction results in a downward adjustment in P’s basis in the S stock. The $50 of depreciation with respect to X is added back to taxable income in computing the P

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19 In fact, absent agreement to make a section 338 election, one might expect a buyer to pay less for the stock of S than for the S assets because purchasing the stock would not result in a step-up in the basis of S’s assets.

20 As noted above, the Proposed Regulations under old section 163(j) did not include a gain limitation with respect to the depreciation, amortization, or depletion subtraction in computing adjusted taxable income. It should be noted, however, that under old section 163(j), the adjusted taxable income computation would have been relevant to a much more limited number of taxpayers.

21 The presence of a double benefit assumes that S’s 2019 depreciation deductions resulted in an increase in the amount of the group’s interest expense deductions allowed under section 163(j) for that year.
group’s ATI for 2020. At the beginning of 2021, S sells X and realizes a gain of $50 with respect to it. Under the Proposed Regulations, the P group must subtract $50 from the group’s taxable income in computing its ATI for 2021. Now assume that, in 2022, P sells the S stock to an unrelated buyer. Does P have to again subtract $50 from its computation of the group’s ATI because the basis of the S stock includes adjustments from 2020 that are “attributable” to depreciation deductions with respect to X? As discussed above, final Regulations could address this duplicate adjustment by expressly treating the investment adjustments “attributable” to the depreciation deduction as the net investment adjustments, including both the negative adjustment for depreciation in 2020 and the positive adjustment resulting from the $50 of gain recognized in 2021.

However, consider a variation on these facts in which the order of the sales is reversed. Specifically, assume that in 2021, P sells the stock of S to P1, the parent corporation of another consolidated group, with no section 338 election. Subsequently, in 2022, S sells X and realizes a $50 gain with respect to it. Applying the Proposed Regulation, the P group would have to subtract the $50 of depreciation from its computation of its ATI for 2021 – regardless of whether S was sold at a gain or a loss. Then, upon the sale of X by S in 2022, there appears to be nothing to prevent the P1 group from having to include a second $50 subtraction in computing its ATI for 2022. This result seems particularly unfair, and it goes beyond what is required to protect against the perceived double benefit, insofar as the P1 group did not get the benefit of the add-back for the $50 of depreciation in computing its ATI for 2020.

One might question whether it is possible that the potential for duplicative subtractions from ATI could be avoided by applying Regulation section 1.1502-80(a)(2). Regulation section 1.1502-80(a)(2) provides that “[n]othing in these Regulations shall be interpreted or applied to require an adjustment, inclusion, or other item to the extent it would have the effect of duplicating any other adjustment, inclusion, or other item required under the Code or other rule of law, including other provisions of these Regulations.” However, this provision (as currently written) appears to only authorize a compensating adjustment to prevent duplication caused by the consolidated return Regulations, and the anti-double benefit subtraction rule is proposed to be located in the Regulations under section 163(j).22

To prevent these kinds of duplicative adjustments, Treasury and the Service should consider adopting in the final Regulations a rule turning off further anti-double benefit rule subtractions once a subtraction has been made from ATI with respect to depreciation deductions, whether as a result of a sale of a relevant asset or of consolidated group member stock. At a minimum, however, the final Regulations should confine any anti-double benefit subtraction to the group that received the initial benefit by adding back the depreciation, amortization, and depletion deductions to taxable income in computing ATI in the first place – i.e., the P1 group in the alternate fact pattern above should not be exposed to a potential subtraction in computing ATI if the P group has included such a subtraction upon its sale or other disposition of subsidiary stock.

22 However, we note that Treasury has broad regulatory authority under section 1502 and could amend Regulation section 1.1502-80 to address this concern.
B. Five-Step Computation

1. Background

Proposed Regulation section 1.163(j)-5(b)(3)(ii) would provide rules regarding which member’s BIE would be deducted by the consolidated group in the current taxable year. If a group’s section 163(j) limitation for the taxable year exceeds the aggregate amount of BIE, including disallowed BIE carryforwards, of all members, then each member’s BIE, including carryforwards, would be fully deducted in that year, subject to other limitations, such as section 382 and the SRLY rules. However, if the aggregate amount of BIE, including carryforwards, of all members exceeds the group’s section 163(j) limitation for the year, then five steps would need to be considered.

2. Comments and Recommendations

The operation of Proposed Regulation section 1.163(j)-5(b)(3)(ii) appears grounded in the notion that each member of a consolidated group will know with particularity its BIE for each taxable year. Unfortunately, this is not always possible under modern financing arrangements, where it is typically the case that multiple members of a consolidated group, if not all of the members of the consolidated group, will participate in the arrangement as co-obligors, guarantors, or in some similar capacity.

Moreover, the mechanism of Proposed Regulation section 1.163(j)-5(b)(3)(ii)(C)(2), which would direct that each member first deduct its current-year BIE to the extent of its business interest income (“BII”) and its floor plan financing interest expense, makes the location of BII and floor plan financing interest expense matter, without any parameters for determining the appropriate location of such income. For example, in a situation where S borrows money from outside the consolidated group and on-lends some or all of the proceeds of that external borrowing to B, which B then uses to purchase interest-bearing securities in the public market, is the BII generated by those securities attributable to B, to S, or to both B and S?

The idea that the location of BII (or floor plan financing interest expense) within a consolidated group impacts the absorption of the members’ current-year BIE or the investment adjustments made with respect to any particular member’s stock seems inconsistent with the single-entity principles adopted by the Proposed Regulations, in particular, the group’s single section 163(j) limitation and the determination of adjusted taxable income on a consolidated basis. For example, consider a situation where S1 and S2 are members of a consolidated group, each have $100 of BIE and the group has $100 of BII but no other income. If the group’s BII is located in S1, under the Proposed Regulations, its BIE is absorbed and S2’s BIE is carried forward. If instead the BII is located in S2, the opposite occurs. Finally, if the BII is located in P, the common parent, S1’s and S2’s BIE will be absorbed pro rata. This is in sharp contrast to existing consolidated return provisions, such as Regulation section 1.1502-22, where the group’s

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net capital gain/loss is determined on a consolidated basis (i.e., a member’s capital gain income is not netted with its capital losses before such amounts are combined with those of other members of the group).

In view of the difficulties associated with determining with specificity whether a member is or is not an obligor under each of the consolidated group’s financing arrangements and whether any or all of the BII of the consolidated group is attributable to any particular member, we recommend a different approach that is more consistent with single-entity principles. Specifically:

- As a starting point, a consolidated group’s current-year BIE should be determined on an aggregate basis.

- Where the aggregate amount of the consolidated group’s current-year BIE is greater than the consolidated section 163(j) limitation computed for the group, we believe it is appropriate that:
  - The consolidated group be allowed to deduct such consolidated current-year BIE to the extent of the consolidated section 163(j) limitation, subject to any other applicable limitations.
  - Each of the members of the consolidated group be allowed to take into account a proportionate amount of the consolidated group’s deduction for current-year BIE, with such proportionate amount determined by multiplying the consolidated group’s deduction for current-year BIE by an amount equal to (i) the member’s current-year BIE divided by (ii) the aggregate current-year BIE of the consolidated group. For this purpose, a member should be allowed to determine its current-year BIE in a reasonable manner that is consistently applied.
  - The consolidated group’s current-year BIE in excess of the consolidated section 163(j) limitation be carried forward by the group to the succeeding taxable year.

- Where the aggregate amount of the consolidated group’s current-year BIE is less than the consolidated section 163(j) limitation computed for the group, we believe it is appropriate that:
  - The consolidated group be allowed to deduct the entire amount of its current-year BIE, subject to any other applicable limitations.
  - Each of the members of the consolidated group be allowed to take into account a proportionate amount of the consolidated group’s deduction for current-year BIE, with such proportionate amount determined by multiplying the consolidated group’s deduction for current-year BIE by an amount equal to (i) the member’s current-year BIE divided by (ii) the aggregate current-year BIE of the consolidated group. For this purpose, and as noted above, a member should be allowed to determine its current-year BIE in a reasonable manner that is consistently applied.
The consolidated group be allowed to deduct disallowed BIE carryforwards to the extent of the remaining consolidated section 163(j) limitation in the manner contemplated by Proposed Regulation section 1.163(j)-5(b)(3)(ii)(A), (B), and (C)(4).

Overall, we believe that this approach offers sufficient flexibility and accuracy to achieve the purposes of section 163(j), is well-grounded in single-entity principles, and gives effect to the realities of modern financing arrangements.

C. Application of SRLY to Section 163(j)

1. Background

Proposed Regulation section 1.163(j)-5(d)(1) provides that the disallowed BIE carryforwards of a member arising in a SRLY that are included in the consolidated group’s BIE deduction for any taxable year may not exceed the section 163(j) limitation for that year, determined by reference only to that member’s items of income, gain, deduction, and loss for that year (the “section 163(j) SRLY limitation”). Thus, the section 163(j) SRLY limitation is calculated on an annual basis (the “Proposed Annual Approach”). Proposed Regulation section 1.163(j)-5(f) would provide that the section 163(j) SRLY limitation does not apply if it would overlap with the application of section 382, applying the principles of Regulation section 1.1502-21(g).

2. Comments and Recommendations

We agree that the application of the SRLY rules to disallowed BIE carryforwards is consistent with the policy underlying those rules (as discussed in more detail below). We further agree that the application of the overlap rule to disallowed BIE carryforwards is appropriate for the same reasons the overlap rule is applied to other attributes limited under sections 382 and 383.26

However, we believe that the Proposed Annual Approach would create potentially distortive effects, and that it would violate the neutrality principle underlying the concept of a SRLY restriction (described below) without advancing any clear section 163(j) policy. Thus, we believe that the Proposed Annual Approach should be modified to

25 In addition, under the Proposed Annual Approach, the disallowed BIE carryforwards of a member arising in a SRLY are available for deduction by the consolidated group in the current year only to the extent (i) the group has any remaining section 163(j) limitation for the current year after the deduction of current-year BIE and disallowed BIE carryforwards from earlier taxable years (taxable years that precede the year in which the member’s disallowed BIE SRLY carryforwards arose) that are permitted to be deducted in the current year, and (ii) the section 163(j) SRLY limitation for the current year exceeds the amount of the member’s BIE already deducted by the group in that year. Prop. Reg. § 1.163(j)-5(d)(2).

26 See, e.g., Preamble to Reg. § 1.1502-21, 64 Fed. Reg. 36,092, 36,094 (July 2, 1999) (“The Treasury and the IRS remain concerned about complexity in applying the current SRLY rules, particularly with respect to situations where both the SRLY rules and section 382 apply…On balance, the Treasury and the IRS believe that the simultaneous or proximate imposition of a section 382 limitation reasonably approximates a corresponding SRLY limitation. Accordingly, these regulations generally eliminate the SRLY limitation in circumstances in which its application overlaps with that of section 382.”).
include a cumulative register such as is used in the application of the SRLY limitation to NOL and capital loss carryovers (the “Cumulative Register Approach”).27 Using a Cumulative Register Approach for the section 163(j) SRLY limitation would require looking to a member’s cumulative contribution (positive and negative) to the group’s “section 163(j) capacity” (described below).

In general, the SRLY rules are intended to provide that “the manner and extent to which a corporation’s separate tax attributes are absorbed or utilized should not vary based on whether the corporation is inside or outside a consolidated group” (the “Neutrality Principle”).28 The Service has similarly described the function of the SRLY rules as follows:

[T]he SRLY Regulations replicate, to the extent possible, separate entity treatment of the SRLY member. In other words, the SRLY Regulations were designed to produce an absorption result that varies as little as possible from the absorption that would have occurred, had the SRLY member not been acquired by the consolidated group.29

The Proposed Annual Approach would, contrary to the Neutrality Principle, routinely impose a harsher restriction on the absorption of disallowed SRLY BIE carryforwards than would be the case if such member had not been acquired by a consolidated group. The example below illustrates this point (for simplicity, assume neither S1 nor P has any BII or BIE in Years 1 or 2).

27 We note that the SRLY limitation was previously calculated on an annual basis, and that this annual approach was replaced by the cumulative register contained in the current regulations specifically because of the anomalous results of calculating the SRLY limitation on an annual basis. See Preamble to Prop. Reg. § 1.1502-21, 56 Fed. Reg. 4,228, 4,229 (Feb. 4, 1991) (“Under the present regulations, the SRLY limitation is determined separately for each member and for each year…This approach produces certain anomalous results. If the member produces income in a consolidated return year, but the group has no positive consolidated taxable income for that year (e.g., because losses of other members offset the income), the member’s SRLY losses cannot be absorbed in that year. Because the amount of the member’s contribution in one year is not carried over to later years, the SRLY losses cannot be absorbed in a later consolidated return year unless the member contributes to consolidated taxable income again in that year. Another anomaly exists because a member with SRLY losses is not treated as contributing to consolidated taxable income if the contribution consists of capital gains in a year in which the rest of the group has offsetting capital losses.”).

28 See, e.g., Preamble to Reg. § 1.1502-21, 64 Fed. Reg. at 36,093-94 (describing arguments for retention of the SRLY rules following the enactment of section 382).

29 CCA 200924042 (Jan. 30, 2009).
As shown in the example above, the Proposed Annual Approach precludes the P Group from absorbing any of S1’s disallowed SRLY BIE carryforwards in Year 1 because of the losses of P. Therefore, the Proposed Annual Approach creates a different result than would otherwise exist for S1 on a separate entity basis. However, this is the correct result for the P Group for Year 1 given Congress’s intent that the section 163(j) limitation apply at the consolidated level.

Compare, however, the Year 2 results. In Year 2, the P Group has generated sufficient ATI so as to allow it to deduct an amount of BIE (or disallowed BIE carryforwards), and as of the close of Year 2, S1 has contributed a sufficient amount of ATI to the P Group during the Year 1-2 period to justify the P Group’s use of $30 of S1’s disallowed SRLY BIE carryforwards. However, because S1 did not generate positive ATI in Year 2, the P Group would be precluded from using any of S1’s disallowed SRLY BIE carryforwards in that Year. In contrast, under the Cumulative Register Approach, the P Group would be able to deduct $30 of S1’s disallowed SRLY BIE carryforwards, equivalent to S1’s results as a single entity.

Admittedly, the Cumulative Register Approach would involve additional complexity and require the maintenance of a separate register to calculate section 163(j) capacity. However, the calculation of the cumulative register could leverage the existing SRLY limitation Regulations and the Proposed Regulations under section 163(j). For example, the section 163(j) cumulative register could, similar to Regulation section 1.1502-3(d), provide that the amount of disallowed SRLY BIE carryforwards absorbed by the group may not exceed (i) the aggregate of the member’s net contributions to section 163(j) capacity, minus (ii) the aggregate of the member’s BIE (including disallowed SRLY BIE carryforwards) absorbed in all consolidated return years (whether
or not absorbed by the member). The calculation of section 163(j) capacity in each year could be based on Proposed Regulation section 1.163(j)-2(b), modified (i) to eliminate the restriction on ATI less than zero in Proposed Regulation section 1.163(j)-2(b)(2) and (ii) to take into account only the member’s items of income, gain, deduction, and loss included in consolidated adjusted taxable income (similar to Regulation section 1.1502-21(c)(1)(i)). The amount calculated under Proposed Regulation section 1.163(j)-2(b) as modified above would represent the member’s contribution (positive or negative) to section 163(j) capacity of the group. To the extent such section 163(j) capacity is utilized to absorb BIE of the member (including disallowed SRLY BIE carryforwards), the cumulative register would be decreased.

The Preamble to the Proposed Regulation states that the annual calculation of the section 163(j) SRLY limitation is appropriate “because Congress did not retain the excess limitation carryforward provisions from old section 163(j) [and thus] allowing members to carry forward their unused section 163(j) SRLY limitation would be inconsistent with congressional intent.” 30 We believe this statement goes too far. All that the section 163(j) rules would seem to require is that the P Group (viewed as a single entity) not deduct any BIE in Year 1, and no more than $48 in Year 2 (30% of $160 of ATI). Allowing the P Group to use some amount of S1’s disallowed SRLY BIE carryforwards in Year 2 in no way represents a carryforward of unused section 163(j) limitation; rather, it is rooted in core SRLY principles. Treasury and the Service have decided for understandable reasons to impose a SRLY limitation. Allowing the P Group to use a portion of S1’s disallowed SRLY BIE carryforwards in Year 2 simply reflects the notion that S1 has contributed a sufficient amount of ATI to the P Group such that the SRLY limitation should no longer apply to that portion. This is not a carryover of S1’s unused section 163(j) limitation from Year 1, because as a member of the P Group during Year 1 S1 has no independent section 163(j) limitation. There is only a single section 163(j) limitation – that of the P Group – and the P Group’s Year 2 section 163(j) limitation would permit use of a portion of S1’s disallowed SRLY BIE carryforwards. The only relevant question is whether the P Group can use the S1 carryforwards in Year 2, when the P Group has capacity under its section 163(j) limitation, and that is a SRLY question.

Another alternative to the Proposed Annual Approach, suggested by a comment included in the Preamble, 31 is to provide that disallowed SRLY BIE carryforwards cease to be subject to a section 163(j) SRLY limitation to the extent a member’s stand-alone section 163(j) limitation exceeds the consolidated group’s section 163(j) limitation in a taxable year (the “SRLY Release Approach”). The SRLY Release Approach is similar to the treatment of built-in losses subject to a SRLY limitation under Regulation section 1.1502-15. Regulation section 1.1502-15 generally provides that a member’s recognized built-in loss ceases to be treated as arising in a SRLY to the extent that member’s SRLY


31 See Preamble, 83 Fed. Reg. at 67,502 (“The Treasury Department and the IRS request comments on the SRLY rules in proposed §1.163(j)-5(d), including whether a member’s SRLY-limited disallowed BIE carryforwards should cease to be subject to a SRLY limitation (to the extent of the member’s stand-alone section 163(j) limitation) in taxable years in which the member’s stand-alone section 163(j) limitation exceeds the consolidated group’s section 163(j) limitation.”).
limitation exceeds the consolidated group’s taxable income. The SRLY Release Approach would apply in an analogous way, releasing disallowed SRLY BIE carryforwards from the section 163(j) SRLY limitation to the extent a member’s stand-alone section 163(j) limitation exceeds the consolidated group’s section 163(j) limitation. However, while there are several variables that factor into the calculations, in general the SRLY Release Approach seems more distortive than the Cumulative Register Approach when comparing the total BIE carryforwards and other deductions of a SRLY limited member absorbed by a consolidated group to the hypothetical separate entity results of that member.

We believe that the Cumulative Register Approach, consistent with the general application of Regulation section 1.1502-21, represents the best method of applying the SRLY limitation to disallowed BIE carryforwards. However, we believe the SRLY Release Approach, which is consistent with the treatment of built-in losses under Regulation section 1.1502-15, would also be preferable to the Proposed Annual Approach.

For example, in Reg. § 1.1502-15(d), Ex. (5), in the year at issue (i) a member (T) of a consolidated group has $45 of recognized built-in loss from the sale of a non-capital asset subject to a SRLY limitation, (ii) taxable income, determined only by reference to T’s items (other than T’s $45 of built-in loss), is $25, and (iii) the consolidated group as a whole has $10 of taxable income (disregarding T’s $45 of built-in loss). This example concludes that $15 of the recognized built-in loss (i.e., the difference between the SRLY limitation of $25 and the $10 of the loss that can be used in the year based on the income of the group) is not treated as arising in a SRLY and therefore ceases to be subject to a SRLY limitation.

For example, assume S1 is acquired by P at the beginning of Year 1, S1 and P elect to file a consolidated return for that Year (creating the P Group), and S1 has $50 of SRLY limited BIE carryforwards from prior years. Assume that in Year 1 S1 has a $100 loss and P has $100 of income, and in Year 2 S1 has $100 of income and P has $0 of income/loss. Further, for simplicity, assume that ATI and taxable income are equivalent in all years and that the 80% limitation on the use of NOLs imposed by section 172(a)(2) does not apply.

If S1 had remained a separate entity, S1 could have deducted $30 of its BIE carryforwards in Year 2 ($100 ATI * 30%), and offset the remaining $70 of its Year 2 income with $70 of NOL carryforwards from Year 1. Thus, S1 would absorb $100 of its deductions within Years 1 and 2. However, in the P Group, S1’s $100 loss in Year 1 is absorbed to offset P’s $100 of Year 1 income. Under the SRLY Release Approach (or the Proposed Annual Approach), the P Group could also absorb $30 of S1’s SRLY limited BIE carryforwards in Year 2. Thus, under the SRLY Release Approach (or the Proposed Annual Approach), S1 would be able to utilize $130 of its deductions ($30 of BIE carryforward and $100 of NOLs from Year 1) in the P Group, exceeding the amount of S1’s deductions. S1 would have been able to utilize if it had remained a separate entity. This is seemingly the result the cumulative register concept is intended to prevent. Here, the Cumulative Register Approach would not allow S1 to deduct any of its BIE carryforwards in Year 2, meaning that only $100 of S1’s deductions (the $100 of NOLs in Year 1) would be absorbed in the P Group, the same net absorption as on a single-entity basis.

However, as noted above, several other variables can affect the calculations, and it is not obvious that any one method leads to the appropriate result in all cases.
D. Coordination of Section 382 and Section 163(j)

1. Background

The TCJA added section 382(d)(3) for taxable years beginning after December 31, 2017. Section 382(d)(3) provides that, for purposes of section 382, the term “pre-change loss” includes carryovers of disallowed interest described in section 163(j)(2) under rules similar to the rules in section 382(d)(1). Section 163(j)(2) provides that interest paid or accrued in a taxable year that is not allowed as a deduction pursuant to section 163(j)(1) is carried forward to the succeeding taxable year. Section 382(d)(1) treats as a pre-change loss both (i) the NOL carryforward of a loss corporation to the taxable year in which the ownership change date (“Change Date”) occurs (the “Change Year”), and (ii) the NOL carryforward for the Change Year that is allocable to the period on or before the Change Date (the “Pre-Change Period,” the period after the Change Date, the “Post-Change Period”). Section 382(k)(1) defines a “loss corporation” as a corporation entitled to use an NOL carryover or having an NOL for the Change Year. The TCJA expanded the definition of a “loss corporation” to include any corporation entitled to use a carryforward of disallowed interest described in section 163(j)(2).  

Section 382 generally restricts a loss corporation’s utilization of its pre-change losses after the corporation undergoes an ownership change by limiting the amount of income earned by the corporation after the ownership change that may be offset by pre-change losses incurred prior to the ownership change. An ownership change occurs if one or more “5% shareholders” increase their ownership in the loss corporation’s stock, in the aggregate, by more than 50% during a testing period, generally the three-year period preceding a testing date.

In the event of an ownership change, a loss corporation’s utilization of its pre-change loss to offset taxable income for the Post-Change Period is limited to an annual amount of pre-change loss equal to the product of the value of the loss corporation’s equity immediately before the ownership change, multiplied by the long-term tax-exempt rate (the “section 382 limitation”). For foreign corporations, the value of such loss corporation’s equity is determined only by reference to items treated as connected with

34 Prior to the TCJA, section 382(k)(1) provided that “The term ‘loss corporation’ means a corporation entitled to use a net operating loss carryover or having a net operating loss for the taxable year in which the ownership change occurs. Except to the extent provided in regulations, such term includes any corporation with a net unrealized built-in loss.” The TCJA inserted the following sentence between the first and second sentence: “Such term shall include any corporation entitled to use a carryforward of disallowed interest described in section 381(c)(20).” Section 381(c)(20) captures “[t]he carryover of disallowed business interest described in section 163(j)(2) to taxable years ending after the date of [a section 332 liquidation] or [an acquisitive reorganization under sections 368(a)(1)(A), 368(a)(1)(C), 368(a)(1)(D), 368(a)(1)(F), and 368(a)(1)(G)].”

35 The term “5% shareholder” means any person holding five percent or more of the value of the stock of the loss corporation at any time during the testing period. See I.R.C. § 382(k)(7).


37 I.R.C. § 382(b)(1).
the conduct of a U.S. trade or business.\textsuperscript{38} The section 382 limitation does not apply to taxable income before the Change Date or to NOLs after the Change Date.\textsuperscript{39} Therefore, when an ownership change occurs on any date other than the last day of the taxable year (a “Mid-year Change”), Regulation section 1.382-6(a) provides that the loss corporation must allocate its taxable income, NOL, net capital loss, or modified capital gain net income (collectively, “Items”) for the Change Year between the Pre-Change Period and the Post-Change Period by ratably allocating an equal portion to each day in the year (the “Ratable Allocation Method”). However, under Regulation section 1.382-6(b), a loss corporation may elect to allocate its Items between the Pre-Change Period and the Post-Change Period as if the loss corporation’s books were closed on the Change Date (the “Closing-of-the-Books Method”).\textsuperscript{40} Treasury and the Service issued Proposed Regulation section 1.382-6(b)(4) to address the allocation of current year BIE (as defined in Proposed Regulation section 1.163(j)-5(a)(2)(i)) between the Pre-Change Period and the Post-Change Period. We discuss these Proposed Regulations in greater detail below.

Proposed Regulation section 1.163(j)-3 provides rules governing the interaction between the section 163(j) limitation and other provisions of the Code. In general, section 163(j) applies after the application of other Code provisions that subject interest expense to disallowance, deferral, capitalization, or other limitation.\textsuperscript{42} Thus, with regard to the interaction of the section 163(j) limitation and the section 382 limitation, the Proposed Regulations provide that disallowed interest carryforwards subject to limitation under section 382 may be deducted under section 163(j) to the extent not otherwise disallowed under section 382.

Proposed Regulation section 1.163(j)-5(e) provides cross references to various provisions governing the application of disallowed interest carryforwards and section 382. The sections below summarize the provisions most relevant to these Comments.

2. Comments and Recommendations

Section 382(k)(1) defines a loss corporation to include a corporation that has a prior year BIE being carried forward to the current year under section 163(j)(2). Thus,

\textsuperscript{38} I.R.C. § 382(e)(3). Thus, if a controlled foreign corporation within the meaning of section 957(a) (“CFC”) had stock with a total, aggregate value of $10 million but the U.S-connected assets of the CFC were 30% of the total assets of the CFC, it appears the value component may be $3 million in such circumstance, and not the full $10 million stock value.

\textsuperscript{39} I.R.C. § 382(a), (b)(3).

\textsuperscript{40} An election to use the Closing-of-the-Books Method applies only for purposes of allocating the loss corporation’s Items and therefore does not terminate the loss corporation’s taxable year as of the Change Date.

\textsuperscript{41} “Current Year BIE” is defined as BIE (as defined in Prop. Reg. § 1.163(j)-1(b)(2)) that would be deductible in the current taxable year without regard to section 163(j) and that is not a disallowed BIE carryforward from a prior taxable year.

\textsuperscript{42} Prop. Reg. § 1.163(j)-3(b)(1).
reading that section in isolation, it would not appear to apply to a corporation that has only a current year disallowed BIE.\textsuperscript{43}

The Proposed Regulations would modify the definition of a “loss corporation” to include a corporation that has a current year disallowed BIE that is allocable to the Pre-Change Period. Specifically, Proposed Regulation section 1.382-2(a)(1)(i)(A) defines a “loss corporation” as any corporation entitled to use, among other attributes, a section 382 disallowed BIE carryforward described in Proposed Regulation section 1.382-2(a)(7). This provision provides that a 382 disallowed BIE carryforward includes (i) the loss corporation’s disallowed BIE carryforward, as defined in Proposed Regulation section 1.163(j)-1(b)(9),\textsuperscript{44} including Disallowed Disqualified BIE, as of the ownership change; and (ii) the carryforward of the loss corporation’s disallowed BIE (within the meaning of Proposed Regulation section 1.163(j)-1(b)(8))\textsuperscript{45} paid or accrued (without regard to section 163(j)) in the Pre-Change Period in the year of the testing date, determined by allocating an equal portion of the disallowed BIE paid or accrued (without regard to section 163(j)) in the year of the testing date to each day in that year, regardless of whether the loss corporation has made an election to apply the Closing-of-the-Books Method under Regulation section 1.382-6(b)(2).\textsuperscript{46}

For example, if X, a calendar-year loss corporation experiences an ownership change on May 26, 2019, and has $100 of Current Year BIE, $81 which is allowable under section 163(j) and $19 which is disallowed, $32.40 of the $81 allowable Current Year BIE would be allocated to the Pre-Change Period ($81 * (146 days/365 days) = 32.40), and $48.60 would be allocated to the Post-Change Period ($81 * (219 days/365 days) = $48.60). The $19 of disallowed Current Year BIE would be allocated $7.60 to the Pre-Change Period ($19 * (146 days/365 days) = $7.60) and $11.40 to the Post-Change Period ($19 * (219 days/365 days = $11.40). The $7.60 of disallowed Current

\textsuperscript{43} However, we note that the reference in section 382(d)(3) to similar rules as in section 382(d)(1) may create confusion as such reference may give the appearance that current year disallowed BIE is a pre-change loss under such similar rules.

\textsuperscript{44} Prop. Reg. § 1.163(j)-1(b)(9) provides that the term disallowed BIE carryforward is any business BIE described in Prop. Reg. § 1.163(j)-2(c). Under that provision, a disallowed BIE carryforward is generally any BIE disallowed under section 163(j) because it exceeds the section 163(j) limitation and is therefore carried forward to the succeeding taxable year or any BIE, including carryforwards, for which a deduction was disallowed under section 163(j) immediately prior to its amendment by the TCJA (“Disallowed Disqualified BIE”).

\textsuperscript{45} Prop. Reg. § 1.163(j)-1(b)(8) provides that the term “disallowed BIE” means the amount of BIE for the taxable year that exceeds the section 163 limitation and any Disallowed Disqualified BIE.

\textsuperscript{46} The contributors to this report were divided with respect to whether Treasury and the Service should expand the definition of “loss corporation” to include a corporation that has Disallowed BIE allocable to the Pre-Change Period as described in Proposed Regulation section 1.382(a)-2(a)(7)(ii). Certain contributors believe that such an interpretation is inconsistent with the statutory language of section 382(k)(1) and, accordingly, should not be included in the final Regulations. Other contributors believe that it would be supportable to finalize Proposed Regulation sections 1.382-2(a)(1)(i)(A) and 1.382-2(a)(7)(ii) in their current form, and that doing so is appropriate from a policy standpoint.
Year BIE allocated to the Pre-Change Period would constitute a section 382 disallowed
BIE carryforward that is subject to a section 382 limitation. 47

The Preamble cites having to compute a single ATI for the Change Year, as
opposed to having to compute separate ATIs for the Pre-Change Period and the Post-
Change Period, as support for precluding a loss corporation from using the Closing-of-
the-Books Method to allocate Current Year BIE. 48 The effect of foreclosing a loss
corporation’s ability to use the Closing-of-the-Books Method, however, will be distortive
in many circumstances.

Consider the following example. P is a calendar-year loss corporation. On
September 30, 2019, P experiences an ownership change that does not create a short
taxable year. Prior to September 30, 2019, P had no debt on its books and therefore no
interest expense. Between October 1, 2019 and December 31, 2019, P engages in several
leveraged acquisitions, which caused P to have accrued $10 million of Current Year BIE
at the end of calendar-year 2019. For 2019, P has a section 163(j) limitation of $6
million. Under Proposed Regulation section 1.382-6(b)(4), $4.5 million of the $6 million
allowable Current Year BIE would be allocated to the Pre-Change Period ($6 million * (273
days/365 days) = $4.5 million), and $1.5 million would be allocated to the Post-
Change Period ($6 million * (92 days/365 days) = $1.5 million). The $4 million of
disallowed Current Year BIE would be allocated $3 million to the Pre-Change Period (4
million * (273 days/365 days) = $3 million) and $1 million to the Post-Change Period ($4
million * (92 days/365 days = $1 million), notwithstanding there was no actual interest
expense during the Pre-Change Period. The result in this example is distortive.

To mitigate the potential distortive interest results stemming from mandating that
the Ratable Allocation Method be applied to allocate Current Year BIE between the Pre-
Change Period and the Post-Change Period if the final Regulations continue to apply
section 382 to Current Year BIE, we recommend that Treasury and the Service permit
Current Year BIE to be allocated under the Ratable Allocation Method or, by election,
under a slightly modified Closing-of-the-Books Method (the “Modified Closing-of-the-
Books Method”).

Under the Modified Closing-of-the-Books Method, the Current Year BIE would
be allocated between the Pre-Change Period and the Post-Change Period as if the loss
corporation’s books were closed on the Change Date (“Step 1”). The disallowed Current
Year BIE would then be allocated between the Pre-Change Period and the Post-Change
Period in proportion to the Current Year BIE allocated to the Pre-Change Period and the
Post-Change Period in Step 1 (“Step 2”). In the example above, under the Modified
Closing-of-the-Books Method, all $10 million of the Current Year BIE would be
allocated to the Post-Change Period in Step 1 and all $4 million of disallowed Current
Year BIE would be allocated to the Post-Change Period ($4 million * ($10 million / $10

47 See Prop. Reg. § 1.382-6(b)(4)(ii), Ex.
48 We note that the complexity of these calculations may be avoided if final Regulations were to eliminate
the expanded definition of “loss corporation” in Reg. § 1.382-2(a)(7)(ii).
Thus, none of the $4 million of disallowed Current Year BIE would constitute a 382 disallowed BIE carryforward.49

Finally, we note that the Proposed Regulations may have an unintended consequence for CFCs that are impacted by section 382 but do not have income effectively connected to a U.S. trade or business. The shareholders of CFCs are potentially subject to taxation under GILTI or Subpart F. Section 163(j) applies to all taxpayers, including CFCs, and the disallowed BIE amounts affect current year determinations of tax as well as generate a carryover attribute that is a loss attribute under section 382(d)(3).50 CFCs likewise may be affected by a section 382 ownership change. Ordinarily, the effect of either a direct or indirect ownership change with respect to the stock of a CFC is limited to the extent the CFC has a U.S. federal loss attribute (NOLs, general business credits, etc.). To the extent the CFC has income effectively connected with a U.S. trade or business, such CFC may be reporting NOL carryovers on its Form 1120F. If a change in ownership occurs, section 382(e)(3) states that the pre-change value of a foreign corporation is determined by reference only to “items treated as connected with the conduct of a trade or business in the United States.” Such provision makes sense to match up the limitation on the U.S. attribute to the relative stock value of the CFC attributable to its U.S. activities.

However, the above rubric breaks down when section 163(j) is involved and the Code and Proposed Regulation appear to reach an onerous result that does not appear to be intended. Many CFCs will not be engaged in the conduct of a U.S. trade or business. However, such CFCs may nevertheless have Subpart F and GILTI inclusion calculations that may be impacted by section 163(j), notwithstanding application of Proposed Regulation section 1.163(j)-7 if such CFC elects group treatment and additional issues raised therefrom. If a section 382 ownership change occurs, a plain reading of the statute appears to limit pre-ownership change disallowed BIE carryforwards to $0.

For example, assume that a CFC experiences a section 382 ownership change on December 31, 2018 when its stock is worth $10 million and carries forward a section 382 disallowed BIE of $1 million into 2019. If the CFC has no U.S. trade or business, such 382 disallowed BIE carryforward would have a $0 section 382 limitation. On the other hand, if 30% of the CFC’s business was a U.S. trade or business, the stock value appears

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49 Using the same example, but instead of P accruing all $10 million of the Current Year BIE between October 1, 2019, and December 31, 2019, P accrues $6 million of Current Year BIE between January 1, 2019, and September 30, 2019 (the Change Date) and $4 million of Current Year BIE between October 1, 2019, and December 31, 2019. Under the Modified Closing-of-the-Books Method, the Current Year BIE would be allocated between the Pre-Change Period and the Post-Change Period as if P’s books were closed on the September 30 Change Date (i.e., Step 1). P would have $6 million of Current Year BIE allocated to the Pre-Change Period and $4 million allocated to the Post-Change Period. The disallowed Current Year BIE of $4 million would then be allocated $2.4 million to the Pre-Change Period ($4 million * ($6 million / $10 million)) and $1.6 million to the Post-Change Period ($4 million * ($4 million / $10 million)). Thus, $2.4 million of disallowed Current Year BIE would constitute a section 382 disallowed BIE carryforward.

50 Disallowed BIE amounts appear to carry forward no differently for CFCs than any other taxpayer and are not disregarded by Regulation section 1.952-2(c)(5) in the computation of the CFC’s income (as they are neither a capital loss nor net operating loss).
to be $3 million, resulting in a positive section 382 limitation. This result appears incongruous.

We recommend that Treasury and the Service address the impact of section 382(e)(3) to foreign corporations treated as loss corporations with disallowed BIE carryovers. One approach would be to provide that for disallowed BIE carryovers of a foreign corporation, the value of such corporation is the total stock value. If a foreign corporation had both disallowed BIE carryovers and other U.S. federal income tax loss attributes, the residual value above and beyond the value otherwise attributed to items connected to the conduct of a U.S. trade or business would be considered only for determining value for the section 382 limitation applicable to section 163(j) carryovers.

E. Ordering Rules Under Section 383

1. Background

In general, the Proposed Regulations provide that C corporations and consolidated groups are to deduct current year BIE prior to the utilization of any disallowed BIE carryforwards.\(^{51}\) In addition, disallowed BIE carryforwards that can be deducted in a taxable year are to be utilized in the order of the taxable years in which they arose, beginning with the earliest such year.\(^{52}\)

With respect to section 382 or SRLY-limited disallowed BIE carryforwards, Proposed Regulation section 1.383-1(d)(1)(ii) prioritizes the absorption of section 382 limited disallowed BIE carryforwards, over those that are not so limited, in determining which carryforwards are to be used where both arose in the same taxable year. SRLY-limited disallowed BIE carryforwards are deducted on a pro rata basis with non-SRLY limited disallowed BIE carryforwards from taxable years ending on the same date.\(^{53}\)

2. Comments and Recommendations

We believe these ordering rules are appropriate, and they generally parallel the ordering rules applicable with respect to NOLs subject to section 382 or SRLY limitations, which provide a reasonable model given the parallel policies underlying the loss limitation rules and the Congressional decision to subject disallowed BIE carryforwards to section 382. Thus, we agree with the rule in Proposed Regulation section 1.383-1(d)(1)(ii) as both appropriate and consistent with the policy implicit in the current section 383 Regulations and in section 382(1)(2)(B) as to NOLs.\(^{54}\) We also agree that the pro rata utilization rule for SRLY-limited and non-SRLY-limited disallowed BIE

\(^{51}\) Prop. Reg. § 1.163(j)-5(b)(2), (3).

\(^{52}\) Id.


carryforwards from the same taxable year is appropriate given that such a rule currently applies with respect to NOLs.\textsuperscript{55}

There is an aspect of the section 383 ordering rules that warrants a further comment. The current rules in Regulation section 1.383-1(d)(2) generally provide that capital losses are absorbed before NOLs, which acknowledges that the carryforward period for capital losses generally is shorter than that for NOLs. This rule may be taxpayer favorable or unfavorable, depending on whether the NOLs are approaching the end of their carryforward period, but this ordering rule is appropriate in the majority of cases given the neutrality policies underlying section 382.\textsuperscript{56} The Proposed Regulations would prioritize the use of disallowed BIE carryforwards over NOLs, which the Preamble justifies on the basis that “taxpayers must calculate their current-year income or loss in order to determine whether and to what extent they can use an NOL in that year, and deductions for BIE, including carryforwards from prior taxable years, factor into the calculation of current-year income or loss.”\textsuperscript{57} This is understandable and does provide a modicum of simplicity, but at a cost – by placing the utilization of pre-2018 NOLs with a short remaining carryforward period behind disallowed BIE carryforwards with an unlimited carryforward period, the rule may well cause the NOLs to expire without use, which is inconsistent with the neutrality principle underlying section 382.

We believe that Treasury and the Service should consider whether it is appropriate to allow taxpayers to elect an alternative ordering rule, at least with respect to NOLs that arose prior to 2018. Such a rule would add a modest amount of complexity, although we note this is very similar to the complexity potentially created by the statutory enactment of taxable income limitations in sections 163(j), 170, 172 and 250. At the same time, we appreciate that the policy argument in favor of such a rule is counter-balanced, in part, by the recognition that in the absence of the new section 163(j) limitations, taxpayers would have deducted their BIE and thus reduced their capacity to absorb NOLs.

\textsuperscript{55} See Reg. § 1.1502-21(c)(1)(iii), Ex. 2(iv).

\textsuperscript{56} See Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514) (1987), at p. 296 (the section 382 rules are “intended to approximate the results that would occur if a loss corporation's assets were combined with those of a profitable corporation in a partnership. This treatment can be justified on the ground that the option of contributing assets to a partnership is available to a loss corporation. In such a case, only the loss corporation's share of the partnership's income could be offset by the corporation's NOL carryforward. Presumably, except in the case of tax-motivated partnership agreements, the loss corporation's share of the partnership's income would be limited to earnings generated by the assets contributed by the loss corporation.”); Staff of the U.S. Committee on Finance, United States Senate, The Reform and Simplification of the Income Taxation of Corporations (1983), at pp. 67-68 (“The goal of the proposal is to provide, so far as it possible, neither incentives nor disincentives for sales or corporate businesses that have incurred unused tax losses and credits. . . . The proposal is primarily intended to permit a loss corporation, in the hands of new owners, to use its net operating loss carryovers approximately to the same extent, as to both amount and timing, as it could have used them had there been no change in ownership and had it invested its assets in activities generating income that would otherwise have been taxable.”).

\textsuperscript{57} Preamble, 83 Fed. Reg. at 67,524.
F. Partnership Issues in Consolidation

1. Background

Proposed Regulation section 1.163(j)-4(d)(4)(i) would provide that the transfer of a partnership interest in an intercompany transaction (presumably as defined in Regulation section 1.1502-13) that does not result in the termination of the partnership is treated as a disposition for purposes of the basis adjustment rule in section 163(j)(4)(B)(iii)(II), regardless of whether the transfer is one in which gain or loss is recognized. Two examples – Examples 18 and 19 – also would be added to Regulation section 1.1502-13(c)(7)(ii) to illustrate the application of this rule. As described in the Preamble, Treasury and the Service initially have determined that intercompany transfers of partnership interests should be treated as dispositions for purposes of section 163(j)(4) for two primary reasons:

The Treasury Department and the IRS have determined that intercompany transfers of partnership interests should be treated as dispositions for purposes of section 163(j)(4) because dispositions are broadly defined in section 163(j)(4)(B)(iii)(II), and because ignoring intercompany transfers of partnership interests for purposes of section 163(j)(4) would be inconsistent with the view that an entity whose owners are all members of the same consolidated group can be a partnership.\(^{58}\)

Additionally, Proposed Regulation section 1.163(j)-4(d)(4)(ii) would provide that a member’s allocation of EBIE, i.e., excess business interest expense, from a partnership, and the resulting decrease in basis in the partnership interest under section 163(j)(4)(B) is not a noncapital, nondeductible expense for purposes of Regulation section 1.1502-32(b)(3)(iii). Similarly, an increase in a member’s basis in a partnership interest under section 163(j)(4)(B)(iii)(II) to reflect EBIE not deducted by the consolidated group would not be treated as tax-exempt income for purposes of Regulation section 1.1502-32(b)(3)(ii). As discussed in the Preamble, Treasury and the Service intend for these rules to ensure that the allocations and basis adjustments under Proposed Regulation section 1.163(j)-6 would not result in investment adjustments within the consolidated group.\(^{59}\) Treasury and the Service believe that this result is appropriate because the application of the rules of Proposed Regulation section 1.163(j)-6 does not result in a net reduction in the tax attributes of the member partner; rather, “there is an exchange of one type of attribute for another (EBIE allocated from the partnership vs. basis in the partnership interest).”\(^{60}\)


\(^{59}\) Id.

\(^{60}\) Id.
2. Comments and Recommendations

a. The Application of Successor Principles to an Intercompany Transfer of a Partnership Interest and the Impact on S’s Unused EBIE

As an initial matter, we urge Treasury and the Service to give further consideration to the rule set forth in Proposed Regulation section 1.163(j)-4(d)(4)(i), as illustrated by Examples 18 and 19 in the proposed amendment to Regulation section 1.1502-13(c)(7)(ii). Proposed Regulation section 1.163(j)-4(d)(4)(i) would provide that the transfer of a partnership interest in any intercompany transaction that does not result in the termination of the partnership would be treated as a disposition for purposes of the basis adjustment rule in section 163(j)(4)(B)(iii)(II).

While we tend to agree with the sentiment expressed in the Preamble that dispositions are broadly defined in section 163(j)(4)(B)(iii)(II), Treasury and the Service also have broad authority under section 1502 to draft Regulations in the consolidated return context that are different from the provisions of Chapter 1 that would apply if the corporations filed separate returns. Furthermore, we do not believe that continuing to give effect to EBIE previously allocated to a member of a consolidated group in certain instances involving that member’s transfer of the relevant partnership interest in an intercompany transaction would be akin to “ignoring intercompany transfers of partnership interests for purposes of section 163(j)(4).” Rather, we think that the analysis lends itself to the conclusion that not every type of intercompany transaction in which a partnership interest is transferred is best treated as a disposition for purposes of section 163(j)(4)(B)(iii)(II).

In this instance, we believe that the successor principles that pervade both Regulation section 1.1502-13 and Regulation section 1.1502-21 provide a sound basis for differentiating a transfer of a partnership interest by the selling member, i.e., S, to the buying member, i.e., B, in an intercompany sale – such as the one described in Example 18 in the proposed amendment to Regulation section 1.1502-13(c)(7)(ii).

61 Specifically, section 1502 directs that, in carrying out the mandate of that provision, “the Secretary may prescribe rules that are different from the provisions of chapter 1 that would apply if such corporations filed separate returns.”

62 See, e.g., Reg. § 1.1502-13(j)(2) (describing instances in which a member may be treated as a successor to another member); see also Reg. § 1.1502-13(j)(1) (describing instances in which an asset may be treated as a successor to another asset); Reg. § 1.1502-13(j)(5) (describing instances in which a surviving group may be treated as succeeding to a terminating group for purposes of applying Reg. § 1.1502-13 to the intercompany transactions of the terminating group); Reg. § 1.1502-13(j)(6) (describing instances in which the common parent is only the remaining member of the group but nevertheless may succeed to the treatment of the terminating group for purposes of applying Reg. § 1.1502-13).

63 See, e.g., Reg. § 1.1502-21(f)(1) (providing that, for purposes of Reg. § 1.1502-21, and as the context may require, a reference to a corporation, member, common parent, or subsidiary includes a reference to a successor or predecessor, as defined in Reg. § 1.1502-1(f)(4)).

64 Cf. Reg. § 1.1502-13(c)(7)(ii), Ex. (9) (describing consequences arising from an intercompany sale of a partnership interest).
from a transfer of such partnership interest by S to B by way of an intercompany transaction in which B is treated as a successor to S. Using the successor person rule of Regulation section 1.1502-13(j)(2) as a potential guide, B may constitute a successor to S in a transaction:

- To which section 381(a) applies;\(^65\)
- In which substantially all of S’s assets, including the partnership interest, are transferred to B in a complete liquidation;\(^66\) or
- In which B’s basis in the partnership interest is determined (directly or indirectly, in whole or in part) by reference to the basis of S.\(^67\)

Where B constitutes a successor to S, we think it appropriate to continue to give effect to single-entity treatment with respect to the unused EBIE of S. Accordingly, consistent with the single-entity treatment generally applied in respect of the consolidated application of section 163(j), we recommend an approach that treats B as stepping into the shoes of S with respect to the partnership interest and the unused EBIE previously allocated to S from that partnership for purposes of section 163(j)(4)(B)(iii)(II).\(^68\)

We believe that this approach gives full effect to generally applicable consolidated return principles and directs a conclusion that the requisite connection between the corporate partner to which EBIE previously was allocated and the partnership from which the allocation was made has been preserved, thus calling off the need to treat such a transaction as a disposition for purposes of section 163(j)(4)(B)(iii)(II).\(^69\)

As for the intercompany accounting for the transfer of the partnership interest from S to B in a situation where B constitutes a successor to S, we offer the following recommendations:

- If S recognizes no gain or loss on the intercompany transfer of the partnership interest to B, we think it appropriate for B’s corresponding items with respect to the transferred partnership interest, including the EBIE of S to which B succeeds, to be taken into account by B in the normal course under Regulation section 1.1502-13(c)(2)(i). Moreover,


\(^{66}\) See Reg. § 1.1502-13(j)(2)(i)(B). In such an instance, section 381 might not apply, for example, because the requirements of section 332 are not satisfied. Note that the application of successor treatment to a non-section 381 transaction originates in former Temp. Reg. § 1.1502-13T(c) (1994).

\(^{67}\) See Reg. § 1.1502-13(j)(2)(i)(C); cf. Reg. § 1.1502-1(f)(4)(ii) (defining predecessor and successor in a similar fashion). Such a transaction would include an intercompany transaction to which section 351 applies, where B’s asset basis is determined under section 362.

\(^{68}\) Example 19 in the proposed amendment to Reg. § 1.1502-13(c)(7)(ii) would need to be revised to reflect this approach.

\(^{69}\) The necessity of maintaining a connection between the corporate partner and the partnership also supports the vitality of the last sentence of Prop. Reg. § 1.163(j)-4(d)(4)(i), which provides that a change in status of a member (becoming or ceasing to be a member) is not treated as a disposition for purposes of section 163(j)(4)(B)(iii)(II).
because S does not have an intercompany item on account of the intercompany transfer of the partnership interest, we think it appropriate that no redeterminations be made under Regulation section 1.1502-13(c) with respect to S, if S remains in existence following the intercompany transaction, in an instance where B takes into account a corresponding item with respect to the transferred partnership interest.\footnote{70}

- If S recognizes gain or loss on the intercompany transfer of the partnership interest to B, and that amount is deferred under Regulation section 1.1502-13, we think it appropriate to give effect to the matching rule of Regulation section 1.1502-13(c) upon the occurrence of an allocation of excess taxable income from the partnership to B and, as a result, B’s taking into account the EBIE of S to which B succeeded. Specifically, where S recognizes gain,\footnote{71} we think it appropriate that (i) a subsequent allocation of excess taxable income to B be given effect for purposes of applying section 163(j)(4)(B)(ii)(I) to B; and (ii) S’s gain be taken into account to reflect the difference for the year between B’s corresponding item and B’s recomputed corresponding item. Alternatively, where S recognizes loss,\footnote{72} we think it appropriate that the same analysis apply.

- A rule similar to Regulation section 1.1502-13(g)(3)(i)(C) could be used to backstop the integrity of these outcomes.\footnote{73}

\footnote{70} However, upon the occurrence of a subsequent transaction involving S’s transfer of B’s stock, e.g., a taxable sale of B’s stock to an unrelated third party, we believe that it would be appropriate to redetermine a portion of any gain recognized by S on account of that transaction to be excluded from gross income to the extent of the unused EBIE to which B succeeded and that otherwise had been reflected in a lesser basis in the partnership interest transferred by S to B in the earlier intercompany transaction. Overall, we believe that this outcome is consistent with the asserted purpose of Prop. Reg. \S{} 1.163(j)-4(d)(4)(ii), as there would have been no downward adjustment in the basis of S’s stock on account of S’s receipt of an allocation of EBIE from the partnership.

\footnote{71} For example, S may recognize gain with respect to the transferred partnership interest in an intercompany transaction to which section 351 applies where B transfers money or other property, in addition to B stock, to S.

\footnote{72} For example, S could recognize loss with respect to the transferred partnership interest in a situation where S makes a liquidating distribution to B that is subject to the general rule of section 336(a).

\footnote{73} In this regard, Reg. \S{} 1.1502-13(g)(3)(i)(C) provides as follows:

If an assignment or extinguishment of an intercompany obligation in an intercompany transaction is otherwise excepted from the definition of triggering transaction under paragraph (g)(3)(i)(B)(1), (2), (5), or (6) of this section (and not also under paragraph (g)(3)(i)(B)(3) or (4) of this section), and the assignment or extinguishment is engaged in with a view to shift items of built-in gain, loss, income, or deduction from the obligation from one member to another member in order to secure a tax benefit (as defined in paragraph (g)(2)(v) of this section) that the group or its members would not otherwise enjoy in a consolidated or separate return year, then the assignment or extinguishment will be a triggering transaction to which paragraph (g)(3)(ii) of this section applies.
For example, assume (i) S and B are members of a consolidated group, (ii) S owns all of the stock of B, (iii) S also owns an interest in PS1, a partnership for U.S. federal tax purposes, with a $70 basis and $100 fair market value, and (iv) S previously has been allocated $20 of EBIE from PS1. In Year 1, S transfers the PS1 interest to B in an intercompany transaction to which section 351 applies in exchange for B stock and $10 cash. Accordingly, S recognizes gain of $10 under section 351(b) with respect to the PS1 interest that is deferred under Regulation section 1.1502-13, and S takes a $70 basis in the B stock received under section 358. B takes an $80 basis in the PS1 interest under section 362 and also succeeds to the $20 of unused EBIE previously allocated to S. In Year 2, B receives an allocation of $10 of excess taxable income from PS1. With respect to Year 2, our recommended approach would yield the following outcomes.

- If S and B were divisions of a single corporation, the single entity would take into account $10 of EBIE under section 163(j)(4)(B)(ii)(I) upon receiving the $10 allocation of excess taxable income from PS1. Furthermore, the single entity’s basis in the PS1 interest would be increased by $10. Conversely, on a separate entity basis, B would take into account $10 of EBIE under section 163(j)(4)(B)(ii)(I) upon receiving the $10 allocation of excess taxable income from PS1, and B’s basis in the PS1 interest would be increased by $10.

- Pursuant to Regulation section 1.1502-13(c)(2)(i), B gives effect to the $10 allocation of excess taxable income under section 163(j)(4)(B)(ii)(I) and treats $10 of the EBIE to which B succeeded as BIE paid or accrued by B in Year 2. Furthermore, B’s basis in the PS1 interest is increased by $10 to $90.

- Pursuant to Regulation section 1.1502-13(c)(2)(ii), S takes its $10 gain into account to reflect the difference in the consolidated return year between B’s corresponding item taken into account for the year, i.e., the $10 of excess taxable income and $10 of EBIE, and the recomputed corresponding item for the year, i.e., the $10 of excess taxable income and $10 of EBIE. Thus, no amount of S’s gain with respect to the PS1 interest is taken into account with respect to Year 2.

As a further example, assume (i) S and B are members of a consolidated group, (ii) B owns all of the stock of S, (iii) S owns an interest in PS1, a partnership for U.S. federal tax purposes, with a $70 basis and $50 fair market value, and (iv) S previously has been allocated $20 of EBIE from PS1. In Year 1, S transfers the PS1 interest to B in an intercompany transaction that is treated as a complete liquidation to which section 381 does not apply. Accordingly, S recognizes a loss of $20 under section 336(a) with respect to the PS1 interest that is deferred under Regulation section 1.1502-13, and B succeeds to this deferred loss under Regulation section 1.1502-13(j)(2)(ii). In turn, B takes a $50 basis in the PS1 interest under section 334(a) and also succeeds to the $20 of unused EBIE previously allocated to S. In Year 2, B receives an allocation of $10 of excess taxable income from PS1. With respect to Year 2, our recommended approach would yield the following outcomes:

- If S and B were divisions of a single corporation, the single entity would take into account $10 of EBIE under section 163(j)(4)(B)(ii)(I) upon receiving the
$10 allocation of excess taxable income from PS1. Furthermore, the single entity’s basis in the PS1 interest would be increased by $10. Conversely, on a separate entity basis, B would take into account $10 of EBIE under section 163(j)(4)(B)(ii)(I) upon receiving the $10 allocation of excess taxable income from PS1, and B’s basis in the PS1 interest would be increased by $10.

- Pursuant to Regulation section 1.1502-13(c)(2)(i), B gives effect to the $10 allocation of excess taxable income under section 163(j)(4)(B)(ii)(I) and treats $10 of the EBIE to which B succeeded as business interest expense paid or accrued by B in Year 2. Furthermore, B’s basis in the PS1 interest is increased by $10 to $60.

- Pursuant to Regulation section 1.1502-13(c)(2)(ii), B (as successor to S) takes the $20 loss into account to reflect the difference in the consolidated return year between B’s corresponding item taken into account for the year, i.e., the $10 of excess taxable income and $10 of EBIE, and the recomputed corresponding item for the year, i.e., the $10 of excess taxable income and $10 of EBIE. Thus, no amount of S’s loss with respect to the PS1 interest is taken into account with respect to Year 2.

Where B does not constitute a successor to S on account of the intercompany transaction in which S transfers the partnership interest to B, we believe that the approach of Proposed Regulation section 1.163(j)-4(d)(4)(i) has merit, as that approach is consistent with section 163(j)(4)(B)(iii)(II). Alternatively, we believe that the stepping into the shoes approach that we have recommended in the successor context also has merit in this context, as that approach is consistent with the single-entity treatment generally applied in respect of the consolidated application of section 163(j).

b. Contemplated Application of Regulation Section 1.1502-13(c) to an Intercompany Transfer of a Partnership Interest in a

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74 In such an instance, we believe that Example 18 in the proposed amendment to Regulation section 1.1502-13(c)(7)(ii) offers a useful guide to the contemplated outcome where S recognizes loss on the intercompany sale of the PS1 interest to B. That said, we recommend that a further example be developed to reflect a situation where S recognizes gain on the intercompany sale of the PS1 interest to B. In such a situation, we recommend that (i) B’s corresponding items with respect to the transferred partnership interest (for example, where B is allocated excess taxable income from the partnership in a succeeding taxable year) be taken into account by B in the normal course under Regulation section 1.1502-13(c)(2)(i), and (ii) S’s gain be taken into account and redetermined to be tax-exempt income to the extent of the difference in the consolidated return year between B’s corresponding item taken into account for the year, i.e., the excess taxable income allocated by PS1 to B, and the recomputed corresponding item for the year, i.e., the excess taxable income allocated by PS1 to B less the EBIE that would have continued to exist and, correspondingly, would have been treated as business interest expense paid or accrued in that year if S and B were divisions of a single corporation.
Nonrecognition Transaction that Constitutes a Disposition for Purposes of Section 163(j)(4)(B)(iii)(II)

Notwithstanding our preceding recommendation, we recognize that Treasury and the Service have requested comments concerning whether, if an intercompany transfer of a partnership interest in a nonrecognition transaction constitutes a disposition for purposes of section 163(j)(4)(B)(iii)(II), how should Regulation section 1.1502-13(c) apply to such a transfer if there is excess taxable income in a succeeding taxable year? In such an instance, S has no intercompany item arising from the intercompany transaction involving the transfer of the partnership interest to B, and B takes a carryover basis in the partnership interest, which amount would reflect the application of section 163(j)(4)(B)(iii)(II). This paradigm is described in Example 19 in the proposed amendment to Regulation section 1.1502-13(c)(7)(ii).

Where an intercompany transfer of a partnership interest in a nonrecognition transaction constitutes a disposition for purposes of section 163(j)(4)(B)(iii)(II), we recommend that the basis increase experienced by S under section 163(j)(4)(B)(iii)(II) with respect to the transferred partnership interest be given its proper effect as a permanent adjustment in the basis of S’s partnership interest for which an economic outlay has been made, with such transaction occurring immediately before the intercompany transfer. Under this approach, we think it appropriate for B’s corresponding items with respect to the transferred partnership interest (for example, where B is allocated excess taxable income from the partnership in a succeeding taxable year) to be taken into account by B in the normal course under Regulation section 1.1502-13(c)(2)(i). Moreover, because S does not have an intercompany item on account of the intercompany transfer of the partnership interest, we think it appropriate that no redeterminations be made under Regulation section 1.1502-13(c) with respect to S, if S remains in existence following the intercompany transaction, in an instance where B takes into account a corresponding item with respect to the transferred partnership interest.

If our preceding recommendation were to be adopted in the final Regulations, this question would be rendered moot. In any event, given the context of the question, and in view of Example 19 in the proposed amendment to Reg. § 1.1502-13(c)(7)(ii), we have taken this question to refer to an instance in which no gain or loss is recognized in an intercompany transaction that otherwise qualifies for tax-free treatment, for example, under section 351. Cf. Reg. § 1.1502-13(f)(3) (providing rules for the treatment of boot in intercompany reorganizations).

Although we have taken this question to refer to an instance in which no gain or loss is recognized in an intercompany transaction that otherwise qualifies for tax-free treatment, if S were to recognize gain on the intercompany transfer of the partnership interest to B – for example, S may recognize gain with respect to the transferred partnership interest in an intercompany transaction to which section 351 applies where B transfers money or other property, in addition to B stock, to S – and that amount is deferred under Regulation section 1.1502-13, we recommend that (i) B’s corresponding items with respect to the transferred partnership interest (for example, where B is allocated excess taxable income from the partnership in a succeeding taxable year) be taken into account by B in the normal course under Regulation section 1.1502-13(c)(2)(i), and (ii) S’s gain be taken into account and redetermined to be tax-exempt income to the extent of the difference in the consolidated return year between B’s corresponding item taken into account for the year, i.e., the excess taxable income allocated by PS1 to B, and the recomputed corresponding item for the year, i.e., the excess taxable income allocated by PS1 to B less the EBIE that
c. Consequences Arising from a Partnership’s Termination on Account of an Intercompany Transfer of a Partnership Interest

As a general rule, a partnership terminates for federal income tax purposes if its operations are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. Although terminations caused by lack of business activity are rare, a partnership will terminate when the business ceases to operate in partnership form. A business is no longer operating in partnership form when only one partner remains (operating as a sole proprietor) or when the business incorporates. A partnership also may terminate where there is a merger of two or more partnerships or a division of an existing partnership. A partnership that has not terminated will be treated as continuing.

Proposed Regulation section 1.163(j)-4(d)(4)(iii) is intended to address a situation involving an intercompany transfer of a partnership interest that results in a termination of the partnership. In view of the apparent need to maintain a connection between the corporate partner to which EBIE previously was allocated and the partnership from which the allocation was made, it seems to us a difficult proposition to give continuing effect to unused EBIE where the relevant partnership is treated as terminating for U.S. federal income tax purposes. That said, we believe that proper effect should be given to the economic outlay reflected in the form of any EBIE previously allocated to S or B by the partnership. In order to accomplish this objective, we recommend that Treasury and the Service consider the following approaches to addressing a situation involving an intercompany transfer of a partnership interest that results in a termination of the partnership:

- With respect to the transferor of the partnership interest, i.e., S, we believe it appropriate to treat the intercompany transfer as a disposition of the partnership interest by S for purposes of the basis adjustment rule in section 163(j)(4)(B)(iii)(II). In such an instance, pertinent authorities would direct that S be treated as transferring its partnership interest to B. Given this paradigm, we recommend that the basis increase experienced by S under section 163(j)(4)(B)(iii)(II) with respect to the transferred partnership interest be given its proper effect as a permanent adjustment in the basis of S’s partnership interest for which an economic outlay has been made, with such transaction occurring immediately before the intercompany transfer.

- With respect to the transferee of the partnership interest, i.e., B, pertinent authorities would direct that, where B also is a partner in the partnership prior

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would have continued to exist and, correspondingly, would have been treated as BIE paid or accrued in that year if S and B were divisions of a single corporation.

77 See I.R.C. § 708(b)(1); see also Reg. § 1.708-1(b)(1)(i).

78 See Reg. § 1.708-1(c)(1), (d)(1).

79 See I.R.C. § 708(a); Reg. § 1.708-1(a).

to the intercompany transfer, B be viewed as (i) receiving a distribution of assets from the terminating partnership with respect to its partnership interest and (ii) purchasing the partnership’s assets that had been deemed distributed to S. Given this paradigm, we believe that two potential outcomes are worthy of further consideration in this instance:

- Under the first alternative, B would take into account the unused EBIE that previously had been allocated to B by the partnership as BIE paid or accrued by B in the taxable year in which the partnership terminates in accordance with section 163(j)(4)(B)(ii)(I). This outcome is driven by B’s deemed receipt of a distribution of the assets in respect of which the partnership otherwise could have generated excess taxable income that it then could have allocated to B.

- Under the second alternative, B would give effect to the economic outlay represented by the unused EBIE previously allocated to B by increasing B’s adjusted basis in the partnership interest immediately before the intercompany transfer. This outcome presumably would impact the basis of the assets deemed received by B in that deemed distribution, as B’s basis in the assets received in the deemed liquidation of B’s partnership interest would be determined under section 732(b).

**d. Considerations Surrounding Loss Duplication upon the Disposition of Stock of a Member Holding a Partnership Interest**

The last sentence of Proposed Regulation section 1.163(j)-4(d)(4)(i) would provide that a change in status of a member (becoming or ceasing to be a member) is not treated as a disposition for purposes of section 163(j)(4)(B)(iii)(II). Accordingly, our expectation is that, in such an instance, the member joining or departing the consolidated group would continue to take into account the EBIE previously allocated to it by the partnership because the requisite connection between the corporate partner and the partnership would remain intact. Furthermore, pursuant to Proposed Regulation section 1.163(j)-4(d)(4)(ii), no downward adjustment would have been reflected in the basis of a departing member’s stock for any EBIE previously allocated to such member by the relevant partnership, although a downward adjustment would have been reflected in the corporate partner’s basis in the partnership interest on account of the receipt of that allocation of EBIE.

With respect to the results provided by Proposed Regulation section 1.163(j)-4(d)(4)(ii), Treasury and the Service explained in the Preamble that those results are “appropriate because the application of the Proposed Regulation section 1.163(j)-6 rules

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81 See, e.g., Rev. Rul. 99-6, 1999-1 C.B. 432 (Situation 1).
82 Id.
does not result in a net reduction in the tax attributes of the member partner; rather, there is an exchange of one type of attribute for another (EBIE allocated from the partnership vs. basis in the partnership interest). As relevant to this conclusion, Treasury and the Service requested comments as to whether additional rules are needed to prevent loss duplication upon the disposition of stock of a member holding a partnership interest.

In general, Regulation section 1.1502-36 provides rules to eliminate non-economic losses and duplicated losses in the event that there is a transfer of loss shares of a member of a consolidated group. Among other effects, the rules of Regulation section 1.1502-36 may eliminate or otherwise reduce attributes, including deferred deductions (as defined in Regulation section 1.1502-36(f)(2)), of the member whose loss shares are transferred. A proposed amendment to Regulation section 1.1502-36(f)(2) would treat disallowed EBIE under section 163(j) as a deferred deduction. Thus, this proposed amendment would cause disallowed EBIE under section 163(j) to be taken into account in the determination of the net inside attribute amount for purposes of applying Regulation section 1.1502-36(c) and (d), and, furthermore, may result in such amount being reduced under Regulation section 1.1502-36(d) (as a result of being treated as a Category C attribute) or reattributed pursuant to an election under Regulation section 1.1502-36(d)(6)(i).

In keeping with the proposed amendment to the definition of deferred deduction under Regulation section 1.1502-36(f)(2) and the approach of Proposed Regulation section 1.163(j)-4(d)(4)(ii), we recommend that Regulation section 1.1502-36 be amended to address (i) the treatment of EBIE that has been allocated to a member as a deferred deduction that is taken into account in the determination of the net inside attribute amount for purposes of applying Regulation section 1.1502-36(c) and (d); and (ii) the possibility that EBIE may be reattributed to the common parent of the consolidated group pursuant to an election under Regulation section 1.1502-36(d)(6) where the common parent also is a partner in the partnership from which the EBIE was allocated to the member whose stock is transferred. With respect to the latter recommendation, we offer the following points of consideration:

- Section 163(j)(4)(B)(ii)(I) does not provide that the receipt of excess taxable income can occur only with respect to the particular partnership interest with respect to which an allocation of EBIE previously was made. Rather, the statute looks only to the allocation of excess taxable income by the partnership to the partner to which an allocation of EBIE previously was made.

- Regulation section 1.1502-36(d)(6)(i) provides that the common parent of the consolidated group, i.e., P, may reduce the potential for loss duplication, and thereby reduce or avoid attribute reduction, by electing to reattribute all or any portion (including any portion in excess of a specified amount) of S’s Category A, Category B, and Category C attributes to the extent that they

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84 Reg. § 1.1502-36(a)(5) provides that, “unless otherwise stated, for purposes of this section . . . P is the common parent of a consolidated group of which S, M, and M1 are members.”
otherwise would be subject to reduction under Regulation section 1.1502-36(d).\textsuperscript{85}

- As directed by Regulation section 1.1502-36(d)(6)(iv)(A), P succeeds to any reattributed attributes as if such attributes were succeeded to in a transaction to which section 381(a) applies.\textsuperscript{86} Thus, under this paradigm, P steps into the shoes of S with respect to any reattributed attributes.\textsuperscript{87}

- Nothing in Regulation section 1.1502-36 limits the attributes eligible for reattribution to the attributes enumerated in section 381; rather, any attribute that falls under Category A, Category B, or Category C in Regulation section 1.1502-36(d)(4)(i) is reattributable.\textsuperscript{88}

G. Treatment of Intercompany Obligations

1. Background

The Proposed Regulations generally would disregard the effect of intercompany obligations in calculating the section 163(j) limitation for members of a consolidated group, consistent with the legislative history.\textsuperscript{89} However, the Proposed Regulations go further than required by the legislative history by providing that interest income and expense from intercompany obligations are not treated as BIE or BII, and are not otherwise taken into account in determining the group’s ATI.\textsuperscript{90}

The Proposed Regulations further discuss intercompany obligations in the context of when a member ceases to be member of the consolidated group and allocation of disallowed BIE to the departing member.\textsuperscript{91} Treasury and the Service note three particular concerns that were considered in reaching the Proposed Regulations treatment to disregard intercompany obligations for such purposes: the administrative burden to taxpayers; a concern that the fungibility of money could lead to taxpayer manipulation of

\textsuperscript{85} Reg. § 1.1502-36(d)(4)(i) describes the attributes in Category A (capital loss carryovers), Category B (net operating loss carryovers), and Category C (deferred deductions).

\textsuperscript{86} Cf. Notice of Proposed Rulemaking, Unified Rule for Loss on Subsidiary Stock, 72 Fed. Reg. 2,964, 2,981 (Jan. 23, 2007) (“The election can be made with respect to loss carryforwards and deferred deductions of S or any of S’s lower-tier subsidiaries, but only to the extent . . . such attributes would otherwise have been reduced under the attribute reduction rule. . . . When this election is made, P is treated as succeeding to the attributes as though it had acquired them in a section 381(a) transaction.”).

\textsuperscript{87} See, e.g., Rev. Rul. 75-223, 1975-1 C.B. 109; see also National Savings Life Ins. Co. v. Commissioner, 84 T.C. 509, 519, 524 (1985) (concluding that “the policy behind section 381 is to allow the successor corporation to replace for tax purposes the acquired corporation, and to elevate the substance of the economic transaction over the particular form chosen by the parties” and, further, that the “essential purpose of section 381” is “enabling the acquiring corporation to step into the ‘tax shoes’ of the acquired corporation”).

\textsuperscript{88} See Reg. § 1.1502-36(d)(6)(i)(B).

\textsuperscript{89} See Preamble, 83 Fed. Reg. at 67,499.

\textsuperscript{90} Prop. Reg. § 1.163(j)-4(d)(2)(v).

the location of BIE; and, the potential non-economic allocation of disallowed BIE carryovers. While we acknowledge all three concerns as valid, the following observations raise the same issues with regard to the latter two governmental concerns if the Proposed Regulations were finalized without modification.

2. Comments and Recommendations

We are concerned that by ignoring intercompany obligations (and thus intercompany interest income and expense), the Regulations would create uneconomic and distortive allocations of disallowed BIE within groups unable to fully deduct their current year BIE. Many groups arrange their external financing through a single point such as the common parent or a particular finance subsidiary, for non-tax reasons (i.e., to reduce the cost of borrowing, efficiency in management, economies of scale, etc.), accompanied by guarantees of the external debt by other members of the group. The group’s borrower then on-lends the proceeds within the group to its business units, based on the needs of the businesses.

Consider an example where P functions as the group’s sole external borrower, and it on-lends proceeds to S1 for S1 to use in its business operations. The Proposed Regulations would allocate any current year BIE that cannot be deducted to P. The effect would be to channel the disallowed BIE away from S1, the member that is the economic user of the borrowed funds, that substantively bears the cost of borrowing, and that holds the assets and generates the income that supports the external debt. If S1 subsequently were to depart the group, the assets and income functionally related to the debt will be severed from the disallowed BIE carryforwards that resulted from the true incidence of the borrowing costs. By allocating the disallowed BIE to the member that is the nominal borrower, the Proposed Regulations distort the location of the disallowed BIE, and in so doing provide for an allocation that is divorced from the underlying economics. Taxpayers would be able to structure their external borrowings in a manner that would allow for noneconomic, locational manipulation, thereby affecting the resulting application of the investment adjustment and SRLY rules. We have similar concerns regarding how a group’s choice of which member is to be the nominal recipient of BII can affect the manner and location in which BIE is absorbed within the group. We also note that considerable uncertainty can result in situations where external lenders require legal documentation creating a co-borrower arrangement. We view the approach taken in the Proposed Regulations to be sufficiently problematic as to warrant re-examination.

There are differing approaches to address concerns about the effect of ignoring intercompany obligations. One approach would be to fully factor intercompany interest income and expense into the calculations, allocate disallowed current year interest expense to members without regard to whether the interest results from intercompany obligations or external borrowings, and to de-link disallowed intercompany interest expense from intercompany interest income for purposes of the timing aspects of the matching rule. Some of the contributors to this report were concerned that a de-linking could introduce additional complexity that may not be warranted under the circumstances, especially in light of the considerable complexity introduced by other aspects of the Proposed Regulations, and others believed that de-linking would provide for a less uneconomic approach with relatively little additional complexity.
Another approach would be to allow taxpayers the option to apply any reasonable approach (perhaps apart from tracing) consistent with the economics, which can be tailored to a taxpayer’s particular circumstances and which can be paired with a narrowly-crafted anti-avoidance rule. While we were unable to coalesce around a particular alternative approach, we are in agreement that the issue is sufficiently important as to require further study.

H. **Allocation Rules and Disallowed Disqualified Interest**

1. **Background**

   The Preamble\(^{92}\) requests comments regarding how the allocation rules in Proposed Regulation section 1.163(j)-10 should apply to disallowed disqualified interest (i.e., disallowed interest carryovers from years in which old section 163(j) applied).

2. **Comments and Recommendations**

   We recommend that Treasury and the Service explicitly provide that taxpayers may use any reasonable method to allocate the amount of disallowed disqualified interest between excepted and non-excepted trades or businesses. As there was no previous requirement to make a similar allocation previously and a taxpayer’s disallowed disqualified interest may have been incurred years or even decades ago, the information available to taxpayers to make any allocation is likely to vary significantly. Further, as a practical matter, we would expect the number of taxpayers required to allocate disallowed disqualified interest will be limited. Therefore, we believe allowing taxpayers to use any reasonable method in applying the allocation rules to disallowed disqualified interest provides affected taxpayers with the flexibility to use the information they have available while still limiting taxpayers to a reasonable method.

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