

May 31, 2018

CC:PA:LPD:PR (Notice 2018-28)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Submitted electronically via the following email address:
Notice.Comments@irsounsel.treas.gov (Notice 2018-28)

Re: Comments on Initial Guidance under Section 163(j) as Applicable to Taxable Years
Beginning After December 31, 2017

Dear Sir or Madam:

BKD, LLP respectfully submits the following response to Notice 2018-28. BKD is one of the largest CPA and advisory firms in the U.S., with 36 offices in 16 states, and we appreciate the opportunity to comment.

In Notice 2018-28, the Treasury Department and the IRS announced their intention to issue proposed regulations providing guidance to assist taxpayers in complying with §163(j) of the Internal Revenue Code (IRC), as amended on December 22, 2017, by “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” P.L. 115-97 (the Act). The Treasury Department and the IRS invited comments on the rules described in Sections 3 through 7 of the Notice as well as additional issues that should be addressed by proposed regulations to assist taxpayers in applying §163(j).

We are providing comments on the following areas contained within Notice 2018-28 or pertaining to the application of §163(j):

- Coordination of §163(j) with §250, foreign-derived intangible income and global intangible low-taxed income
- Computation of adjusted taxable income for accrual basis taxpayers
- Application of the definition of floor plan financing interest under §163(j)(9) to sellers of farm machinery or equipment
- Clarification regarding real property trades or businesses
- Application of the limitation to tiered structures

We also conclude with overall comments on the Notice including several additional areas not addressed within the Notice.

Coordination of §163(j) with §250

- Is adjusted taxable income under §163(j)(8) computed with or without regard to the global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII) deductions of §250(a)?
- Is taxable income under §250(a)(2)(A)(ii) determined with or without regard to the business interest limitation under §163(j)?
- Is “deduction eligible income” under §250(b)(3) determined with or without regard to §163(j)?

Similar to the §199A deduction, which is explicitly excluded from the calculation of adjusted taxable income under §163(j)(8)(A)(iv), the GILTI and FDII deductions under §250 represent non-cash, non-economic deductions. The concept of adjusted taxable income under §163(j) is closely tied to EBITDA, which is widely understood to have strong correspondence with actual cash generation from business operations. The GILTI and FDII deductions under §250 depart from this concept and, therefore, should not be included in the determination of adjusted taxable income under §163(j)(8).

Additionally, §250 does not give the Secretary authority to define the taxable income limit under §250(a)(2) in any way other than explicitly provided under §250(a)(2)(A)(ii). Therefore, it seems apparent §163(j) must be considered before computing the deductions under §250. Section 163(j)(8)(B), on the other hand, gives the Secretary authority to provide for other adjustments in computing adjusted taxable income not specifically provided in §163(j)(8)(A).

To prevent an iterative, circular relationship between §163(j)(8) and §250(a)(2) and to more closely align adjusted taxable income with a taxpayer’s cash flow, we suggest proposed regulations provide for the computation of adjusted taxable income under §163(j)(8) without regard to the GILTI and FDII deductions of §250.

Computation of Adjusted Taxable Income for Accrual Basis Taxpayers

- Will accrual basis taxpayers need to compute adjusted taxable income under amended §163(j)(8) on a modified cash basis, similar to the adjustments required under former §163(j)(6)(A) as provided in Prop. Reg. §1.163(j)-2(f)?

Prop. Reg. §1.163(j)-2(f)(2)(vii) [and (viii)] required adjustments for the increase in accounts payable balance (and the decrease in accounts receivable balance) between the end of the preceding year and the end of the current year as part of the calculation of an accrual basis

taxpayer's adjusted taxable income under former §163(j)(6)(A). Under current law, adjusted taxable income for purposes of determining the limitation under §163(j) includes add-backs for depreciation, amortization and depletion through December 31, 2021. To further align adjusted taxable income with a taxpayer's cash flow, the proposed regulations for amended §163(j) should include similar adjustments for changes in the year-end balances of accounts payable and accounts receivable.

Application of Floor Plan Financing Interest under §163(j)(9) to Sellers of Construction Equipment to Farmers

- Is floor plan interest associated with construction equipment sold to farmers included in the definition of “floor plan financing interest” under §163(j)(9)? If so, how should taxpayers that sell construction equipment to both farmers and non-farmers determine the qualifying portion of their interest expense?

We believe the definition of “floor plan financing interest” should include interest associated with construction equipment sold to farmers under §163(j)(9)(C)(iii). While the Senate amendment to the House bill modified the definition of a motor vehicle to exclude construction machinery or equipment, the fact that the final enacted law includes farm machinery or equipment in that definition should permit any construction equipment sold to farmers for use as farm machinery to be considered as a “motor vehicle.”

If construction equipment sold to farmers is included in the definition of a motor vehicle, the financing interest associated with that equipment should be eligible as floor plan financing interest, if the indebtedness meets the other criteria provided in §163(j)(9)(B). The proposed regulations should provide a safe-harbor threshold for determining whether a taxpayer's financing interest, as a whole, meets sufficient criteria to be considered floor plan financing interest. Taxpayers unable to meet this safe harbor threshold should have the option to allocate their financing interest between floor plan and non-floor plan interest.

If Treasury were to adopt this suggestion, it would need to address the taxpayer's eligibility for bonus depreciation under §168(k). Taxpayers with only a de minimis amount of construction equipment sales to farmers should not be precluded by §168(k)(9)(B) from taking advantage of bonus depreciation on otherwise qualified property.

Application of the §163(j) Limitation to Tiered Structures

- How will the §163(j) limitation be allocated among consolidated group members?
- How will disallowed interest deduction carryforwards be treated when a member leaves or joins the group?

- How should disallowed interest carryforwards from pre-Act §163(j) be treated if those amounts include interest from super-affiliated groups?
- How will the limitation be applied to a consolidated group when one or more of its members conduct a trade or business described in §163(j)(7), such as an electing real property trade or business or an electing farming business? Similarly, what if one of the members holds an interest in a partnership that conducts such a trade or business?

Several possibilities exist for allocating the §163(j) limitation, and associated carryforwards, among consolidated group members. However, we believe allocations based on each member's share of taxable income or direct debt-tracing would be inappropriate for this determination. We suggest an allocation method based on the members' proportionate share of the group's assets, similar to the asset method provided under Reg. §1.861-9T(g) related to the interest expense allocation for foreign tax purposes. This method would best reflect each member's relative reliance on the indebtedness that produced the business interest. Allocations based on debt-tracing would be administratively burdensome and may not accurately match each member's allocable business interest to the adjusted taxable income generated to support that interest. While we find this basis allocation decision to be important, we believe the more critical issue is to ensure that a consistent approach for all situations is reached.

For disallowed interest carryforwards from pre-Act §163(j), we suggest these amounts be determined and allocated to members of the affiliated group in the same manner as the disallowed carryforward amounts allocated to members of a consolidated group (as to be determined under the proposed regulations). Once identified, any disallowed interest attributable to a member of the super-affiliated group, beyond the consolidated group, should be segregated from the consolidated group's §163(j) carryforward and allocated solely to that member for purposes of determining its separate §163(j) limitation.

Additional Comments

- How will interest-like items be handled under §163(j)? The proposed regulations should clarify the treatment of items such as mortgage discount points and deferred financing fees.
- Further clarification is needed regarding real property trades or businesses, including:
 - How will the election under §163(j)(7)(B) apply to businesses such as nursing facilities, hotels or short-term rentals? Page 233 of the Conference Report states the legislative intent that "a real property operation or a real property management trade or business includes the operation or management of a lodging facility." The proposed regulations should include official guidance regarding the application of the election to those businesses that may be considered a "lodging facility."

- What, specifically, is the process by which electing real property trades or businesses or electing farming businesses will make the election under §163(j)(7)(B) and (C)? Section 163(j)(7) grants Treasury the authority to prescribe the method for making such an election.
- Will assets subject to the alternative depreciation system (ADS) conversions under §168(g)(8) be required to use the 40-year life previously attributed to 27.5-year property or will those assets be given the benefit of the reduced 30-year ADS life granted to assets placed in service after December 31, 2018?
- How will disallowed business interest amounts be handled if a taxpayer makes the election under §163(j)(7)(B) or (C) *after* January 1, 2018? Will the taxpayer be allowed to deduct these amounts immediately upon making the election?
- Will a taxpayer be able to split out its real property from its operating business for purposes of making the real property election under §163(j)(7)(B)? The proposed regulations should clearly indicate whether such distinctions will be honored or disregarded for election purposes.

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The issues discussed in this letter represent a non-exhaustive list of items and recommendations related to the limitation on deduction for interest under §163(j). If you have any questions on these comments or would like to discuss any of the points raised herein in more detail, please contact:

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Sincerely,



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