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163(j): Excess Business Interest

The Tax Cuts and Jobs Act of 2017 introduced limitations on the deductibility of interest available to a taxable business entity. Because these limits may adversely affect the economic benefits of incorporating debt in renewable energy financings, they have become a necessary consideration for partnership flip transactions. Tracking the impact of interest limits poses unique challenges in partnerships because the limitation affects taxable income calculated at the partnership level, but the balance of disallowed taxable interest carries forward as a benefit directly to the partner. Similarly, taxable income incurred in the partnership and allocated to the partners may be used by each partner to reduce interest deductibility limits computed for its business operations outside the partnership.

On an annual basis, a partnership either incurs excess business interest (EBI) or excess taxable income (ETI). EBI occurs when taxable business interest in the partnership exceeds 30% of adjusted taxable income. Conversely, ETI occurs when 30% of adjusted taxable income exceeds total business interest. For this annual computation, adjusted taxable income is either defined as earnings before income taxes, depreciation and amortization (EBITDA), or simply as earnings before income taxes (EBIT). EBITDA applies to years 2018-2021 and EBIT applies to years from 2022 forward. Both calculations of adjusted taxable income exclude business interest in the definition of earnings.

When a partnership has EBI, the EBI amount is allocated to the partners and directly reduces the deductibility of total taxable interest allocated to the partner. Each partner may carry forward the amount of its EBI limitation to future years to be used as described below.

In years in which the partnership has ETI, it is also allocated to the partners. A partner with sufficient EBI carry-forward balance may take a deduction equal to its ETI allocation and reduce its EBI carry-forward balance by the same amount. Once the EBI carry-forward balance is zero, the partner may use its allocated ETI to increase the adjusted taxable income of its own business operations outside the partnership. Unlike EBI, ETI may not be carried forward and can only help to reduce the current year's EBI balance.

Partnership EBI and ETI are allocated to partners according to the ratio of each partner’s income to the total annual income of the partnership. When there are multiple sources of debt financing present in the partnership, the amount of EBI and ETI associated with each instrument of debt computed on a weighted basis, regardless of any special allocations of taxable interest to the partners.

ABC *keeps track of ETI and EBI allocations in standard partnerships, multi-tiered partnerships, and portfolios. The PSHIP/INTEREST report provides a way to see the impact of the new interest deductibility limits.*

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