

## Tax Notes

# IRS Provides Business Interest Expense Election Guidance

By Benjamin Beskovic, CPA, Partner, and Christopher Johnson, JD, LL.M., MBA, CPA

The Coronavirus Aid, Relief, and Economic Security (CARES) Act introduced several changes to the limitations on business interest expense deductions under Internal Revenue Code (IRC) §163(j). The IRS provided such guidance in [Rev. Proc. 2020-22](#) regarding certain elections now available under these new provisions.

All discussions of the CARES Act in this newsletter are with regard to U.S. federal income tax consequences; any non-income tax consequences, or any state, local or foreign income tax consequences are not discussed in this forum.

### New IRC 163(j) CARES Act Elections

Beginning in 2018, §163(j) generally limits the deductibility of business interest expense to 30% of adjusted taxable income (ATI). The recently passed CARES Act increases the deductible amount from 30% to 50% of ATI for the 2019 and 2020 tax years. The new limit for partnerships only applies to tax year 2020, although with respect to a partner's share of a partnership's 2019 "excess business interest expense" [EBIE, the interest expense of the partnership in excess of the 163(j) limitation], 50% may be treated as deductible interest expense in 2020 that is not subject to §163(j).

The CARES Act permits a taxpayer to elect out of the new 50% ATI limit (and remain subject to the 30% limit) and to separately elect to use its 2019 ATI for purposes of calculating its 2020 163(j) limitation. Partners may also elect out of deducting 50% of partnership EBIE in 2020. Rev. Proc. 2020-22 provides guidelines on how to make such elections.

Each election may be made by filing:

- an original income tax return or Form 1065, **or**
- an amended income tax return or Form 1065X, **or**
- an administrative adjustment request (AAR).

The election is implemented through the use of the elected option in the filing by: (1) using the 30% ATI limit rather than the 50% limit, (b) using 2019 ATI for 2020 163(j) calculations, and/or (c) not applying the special 50% EBIE rule.

The 30% ATI election must be made **separately** for the 2019 and 2020 tax years. The other elections are only available with respect to the 2020 tax year. No statement is required with any election. Each election may be revoked by filing an amended income tax return, amended Form 1065 or AAR which does not use the elected option.

## Electing Real Property and Farming Businesses

Business interest expense subject to §163(j) does not include interest expense of an “electing real property trade or business” or an “electing farm business.” Business interest expense of such electing businesses is deductible without limitation under §163(j). However, electing businesses are required to use the alternative depreciation system (ADS) for certain property. ADS property is subject to longer depreciation recovery periods and is not eligible for bonus depreciation. The decision of an eligible real property or farming business to make such an election [§163(j)(7) Election] involves a consideration of the expected levels of interest and depreciation expense. The §163(j)(7) Election is made with the taxpayer’s timely filed tax return and is irrevocable.

The CARES Act changes to §163(j) may cause eligible real property and farming businesses to reexamine whether or not to make a §163(j)(7) Election. Rev. Proc. 2020-22 outlines procedures under which an eligible real property or farming business may make a late §163(j)(7) Election or may revoke a previously made §163(j)(7) Election.

One of the main reasons why an electing real property or farming trade or business might wish to withdraw its election out of the business interest expense limitation involves the ability to take a bonus depreciation on qualified improvement property (QIP) as a result of changes made by the CARES Act. Under the CARES Act, QIP is now eligible for the additional first-year depreciation deduction (“bonus depreciation”) under §168(k). This provision is retroactively effective for assets placed in service after 2017.

A late election or revocation of a prior election may be done by filing an amended income tax return, an amended partnership Form 1065, or an AAR, as applicable, for the 2018, 2019 or 2020 tax year. Generally, the amended filing or AAR must be filed by October 15, 2021 and no later than the end of the applicable statute of limitations for the relevant tax year. For most partnerships – to the extent they are subject to the audit rules pursuant to the Bipartisan Budget Act of 2015 – amended partnership Forms 1065 for tax years 2018 and 2019, as outlined in Rev. Proc. 2020-23, must be filed by September 30, 2020.

A taxpayer filing a late §163(j)(7) Election shall be treated for all purposes as if it had filed a timely election with its originally filed return for the effective tax year of the late election, while a taxpayer that revokes its §163(j)(7) Election in accordance with Rev. Proc. 2020-22 is treated as if it had never made the withdrawn election.

A required filing for a late §163(j)(7) Election or revocation of a prior §163(j)(7) must reflect all applicable adjustments to taxable income (changes to interest expense and depreciation expense) and tax liability attributable to the late election. Such adjustments must also be made, if required, on amended returns or AARs for any affected later taxable year.

## Contact Us

The tax professionals at PKF O’Connor Davies are here to help during these trying times. We know the tax law and can help you make an informed decision about the optimal utilization of these new opportunities. If you have any questions or need assistance, please contact your client partner in charge or any of the following:

Benjamin Beskovic, CPA  
Partner  
[bbeskovic@pkfod.com](mailto:bbeskovic@pkfod.com) | 646.449.6379

Christopher Johnson, JD, LL.M., MBA, CPA  
Senior Manager  
[cjohnson@pkfod.com](mailto:cjohnson@pkfod.com) | 646.449.6305

## **About PKF O'Connor Davies**

PKF O'Connor Davies, LLP is a full-service certified public accounting and advisory firm with a long history of serving clients both domestically and internationally. With roots tracing to 1891, twelve offices in New York, New Jersey, Connecticut, Maryland and Rhode Island, and more than 800 professionals, the Firm provides a complete range of accounting, auditing, tax and management advisory services. PKF O'Connor Davies is ranked 27th on *Accounting Today's* 2020 "Top 100 Firms" list and is recognized as one of the "Top 10 Fastest-Growing Firms." PKF O'Connor Davies is also recognized as a "Leader in Audit and Accounting" and is ranked among the "Top Firms in the Mid-Atlantic," by *Accounting Today*. In 2020, PKF O'Connor Davies was named one of the 50 best accounting employers to work for in North America, by *Vault*.

PKF O'Connor Davies is the lead North American representative in PKF International, a global network of legally independent accounting and advisory firms located in over 400 locations, in 150 countries around the world.

Our Firm provides the information in this e-newsletter for general guidance only, and it does not constitute the provision of legal advice, tax advice, accounting services, or professional consulting of any kind.