Tax Attributes in Consolidated Groups, Including Losses, Loss Limitations & TCJA Changes

March 25, 2021
CHOOSING A PATH FORWARD in a Changed World

SPEAKER PANEL

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Agenda

• §163(j) for Consolidated Groups (15 minutes)
• §163(j) and Beat issues for Consolidated Taxpayers (10 Minutes)
• SRLY and Group Separation Issues with §163(j) (8 minutes)
• Clawback (13 minutes)
• §382 Applicable to GILTI (5 minutes)
• Sale of CFC Stock and §1.1502-13 (5 minutes)
• NOLs and §163(j) Ordering Rules (15 minutes w/ AMT)
• Departed Member AMT Issues for Carryback Claims
• PPP Loan Forgiveness and Consolidated Return Issues (3 Minutes)
§163(j) for Consolidated Taxpayers
§163(j) -- Background

• Limits the deductibility of business interest expense (BIE) to the sum of business interest income (BII), the prescribed percentage of adjusted taxable income (ATI), and floor plan financing interest expense.

• ATI is defined generally to be equal to taxable income w/o regard to NOLs, BIE, BII, and for years prior to 2022 including an add back for depreciation, amortization, and depletion (DAD) deductions.

<table>
<thead>
<tr>
<th>Year</th>
<th>% of ATI</th>
<th>Definition of ATI</th>
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<tbody>
<tr>
<td>2018</td>
<td>30%</td>
<td>EBITDA</td>
</tr>
<tr>
<td>2019</td>
<td>30% or 50%</td>
<td>EBITDA</td>
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<tr>
<td>2020</td>
<td>30% or 50% of 2019 ATI</td>
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<td></td>
<td>Or</td>
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<td></td>
<td>30% or 50% of 2020 ATI</td>
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<tr>
<td>2021</td>
<td>30%</td>
<td>EBITDA</td>
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<tr>
<td>Beginning in 2022</td>
<td>30%</td>
<td>EBIT</td>
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## §163(j) Guidance

<table>
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<tr>
<td><strong>2018 Proposed Regulations</strong></td>
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</tr>
<tr>
<td>Provided the regulations are applied in their entirety, with the exception of the COGs provision</td>
<td>2018, 2019, <strong>OR</strong> 2020</td>
</tr>
<tr>
<td><strong>2020 Final Regulations</strong></td>
<td>Calendar 2021</td>
</tr>
<tr>
<td>Provided the regulations are applied in their entirety.</td>
<td>2018, 2019, <strong>OR</strong> 2020</td>
</tr>
<tr>
<td><strong>2021 Final Regulations</strong></td>
<td>Calendar 2022 (Applies 60 days after January 19, 2021)</td>
</tr>
<tr>
<td>Provided the regulations are applied in their entirety.</td>
<td>2018, 2019, <strong>OR</strong> 2020</td>
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**Certain Relevant Differences**

- **2018 Proposed Regulations**: Broad definition of interest, depreciation included in COGs is not added back to ATI, modified single entity calculation of limitation for consolidated groups, strict “clawback” of ATI benefit on sale of group member stock, and lesser of gain or depreciation on asset sales.

- **2020 Final Regulations**: Narrowed definition of interest, depreciation included in COGs is added back to ATI, modified single entity calculation of limitation for consolidated groups, strict “clawback” of ATI benefit on sale of group member stock, and strict clawback on sale of depreciable assets.

- **2021 Final Regulations**: Adopt an expanded “lesser of” standard (to be described) for both the sale of stock and depreciable assets. Include tax-free transfers of stock (including certain section 381 transactions) as requiring the “clawback” adjustment. Provide that Section 382 applies to BIE carryforwards of CFCs.
Consolidated Section §163(j)

• Treas. Reg. §§ 1.163(j)-4(d) – Special Rules for Consolidated Groups
  • A consolidated group has a single Section 163(j) limitation, BII, and BIE (Treas. Reg. §§ 1.163(j)-4(d)(2))
  • The absorption of this single limitation, however, is determined under Treas. Reg. §§ 1.163(j)-5 (discussed below), largely on a separate company basis (i.e., NOT proportionately by each member of the group)
  • Begin with consolidated taxable income as determined under Treas. Reg. § 1.1502-11, but without regard to BIE carryforwards
  • Disregard intercompany obligations and intercompany items and corresponding items under Treas. Reg. §1.1502-13 to the extent that they offset in amount (exception for bond premium when external debt becomes intercompany debt)

• Special Rules for Groups owning Partnership Interests
  • Rules applicable to the disposition of partnership interests where the partner has disqualified BIE allocated from the partnership are inapplicable on the deconsolidation of the member owning the partnership interest
  • There are no investment adjustments under Treas. Reg. §1.1502-32 for an allocation of disallowed BIE from a partnership to a member or the increase in the basis of an interest in the partnership interest immediately prior to the disposition of the partnership interest
  • Investment adjustments under Treas. Reg. §1.1502-32 are made when excess BIE allocable to a partner/member is deducted by the member and absorbed on the group’s return
  • Special rules for groups that have multiple CFCs with different member shareholders

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Example 1 – Intercompany Obligations

**Facts**
- P borrowed $100 from Bank at a 10% interest rate and then loaned 100% of such borrowing to S at a 10% interest rate.
- P has $10 of BIE to the Bank, $10 of BII from S, and $30 of other deductible expenses.
- S has $10 of interest expense and $40 of income.

**Analysis**
- Under the 2020 Final Regulations, P will disregard its intercompany obligation in determining its BIE, BII, and ATI for section 163(j).
- P has $10 of BIE and $30 of other business expenses, and S has $40 of income.
- Under the 2020 Final Regulations, the group's ATI is $10 ($40 - $30), and the interest limitation is $3 ($10 x 30%).
- Disallowed interest expense = $7 (interest expense of $10 exceeds the limit of $3 [$10 x 30%]).
- P carries over the $7 of disallowed BIE to the succeeding taxable year.
Steps for Calculating Consolidated §163 Limitation

• Modified Consolidated return approach (Treas. Reg. §§ 1.163(j)-5(b)(3))

  • Step 1: Determine the group’s section 163(j) limitation (i.e., % of ATI, BII, and floor plan financing, etc)

  • Step 2: Identify members’ separate company BIE, BII, and floor plan financing interest

  • Step 3: Allocate the consolidated section 163(j) limitation among the members of the group
    • Unlike the method for allocating a CNOL, where the CNOL for the year is generally deductible up to the amount of the consolidated limitation on such NOLs and all members’ NOLs for a year are absorbed on a pro rata basis, the consolidated section 163(j) limitation must be allocated to each member of the group in a multi-step process to determine the portion of each member’s BIE that is eligible for deduction in that year
    • IRS/Treasury rejected comments to simplify these rules and to conform the rules to the approach for NOLs
    • **Practice Tip:** Annual computation of each member’s Section 163(j) amounts is likely necessary rather than computing such amounts only when a member is leaving the consolidated group. This is particularly true if the consolidated group is subject to BEAT.
Steps for Calculating Consolidated §163 Limitation (cont’d)

• Modified Consolidated return approach (Treas. Reg. §§ 1.163(j)-5(b)(3))
  • Allocation of the consolidated 163(j) limitation among the members of the group
    • If the group’s section 163(j) limitation for the current year exceeds the group’s aggregate current-year BIE, none of the current year BIE would be subject to disallowance.
      • If the group has any section 163(j) limitation remaining after deducting current year BIE, then carryforwards are permitted to be deducted in the order of the year in which they arose. Carryforwards from the same year are deducted on a pro rata basis.
    • If the members’ aggregate current year BIE exceeds the group’s section 163(j) limitation for the current year:
      • Each member deducts its separate company current-year BIE up to the amount of its separate company BII (and floor plan financing), if any (netting by member)
      • The remaining consolidated section 163(j) limitation is allocated proportionately among members based on the remaining separate company BIE
### Example 2 – Location of Interest Income Affects Section 163(j) Limitation

ATI: $0

#### Consolidated Group (Year 1)
- 163(j) Limitation: $60
- Deduction of P’s Interest: $60
- Deduction of S1’s Interest: $0
- Deduction of S2’s Interest: $0

#### BII and BIE

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<th>P</th>
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<td>BII:</td>
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<td>BIE to Bank:</td>
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#### BIE to Bank

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<td>BIE to Bank:</td>
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#### BIE Carryforward

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</thead>
<tbody>
<tr>
<td>BIE Carryforward</td>
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<td>$40</td>
<td>$80</td>
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</table>

#### Compare

If S2 had $60 of BII instead of P, the P Group deducts $60 of S2’s current year BIE and none of P’s and S1’s.

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<tr>
<th></th>
<th>P</th>
<th>S1</th>
<th>S2</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIE Carryforward</td>
<td>$60</td>
<td>$40</td>
<td>$20</td>
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Facts:
- During the current year (Year 1), P had $60 of BII and incurred $60 of BIE; S1 incurred $40 of BIE; and S2 incurred $80 of BIE.
- The group’s §163(j) limitation for the year is $60 ($0 ATI + P’s BII of $60).
- After applying the rules in §1.163(j)-5(b)(3), the group deducts $60 of P’s current year BIE and none of S1’s and S2’s.

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[Diagram showing consolidated group structure with BII and BIE entries]
§163(j) and BEAT issues for Consolidated Taxpayers
BEAT Taxpayers – Treas. Reg. §§ 1.59A-3(c)(4) and 1.1502-59(c)(3)

• Treatment of BIE as a base erosion tax benefit

  • BIE paid or accrued to a foreign related party will give rise to base erosion tax benefit to the extent such BIE is allowed as a deduction by Section 163(j).
  • For this purpose, a taxpayer’s allowed BIE deduction is required to be allocated first to payments to related parties and only the excess is allocated to payments to unrelated parties
  • The allocation of the consolidated section 163(j) limitation to current year BIE and carryforwards is based on a pro-rata allocation between foreign related parties and domestic related parties (not including group members) and the excess is allocated to unrelated parties
  • Requires a year-by-year tracing of the BIE that is treated as “foreign related party” interest expense and disregards the nature of the actual separate company payments.
Example 3 – BEAT Coordination with §163(j): Allocating Current Year Deduction

Facts:

- Assume the group is an applicable taxpayer for purposes of §59A.
- The group’s §163(j) limitation for the year is $60 ($0 ATI + P’s BII of $60).
- After applying the rules in Treas. Reg. § 1.163(j)-5(b)(3), the group deducts $60 of P’s current year BIE and none of S1’s and S2’s.
  - A member’s BIE is netted with its BII before applying the “single entity” calculation to the group.
  - See and compare to Treas. Reg. § 1.1502-22 (no netting of capital gain and loss in member before consolidated calculation)
Example 3 – BEAT Coordination with §163(j): Allocating Current Year Deduction

Analysis:
Application of the classification rule in Treas. Reg. § 1.1502-59A(c)(3) for current year deduction

- Under Treas. Reg. § 1.1502-59A(c)(3), the group’s $60 of aggregate current year BIE deduction is first classified as payments or accruals to related parties (pro-rata among domestic related parties and foreign related parties), and second as payments or accruals from unrelated parties. See §59A(c)(3).
- The group’s total related party interest expense in Year 1, $100 (sum of the group’s domestic related current year BIE, $60, and the group’s foreign related current year BIE, $40), exceeds the group’s aggregate current year BIE deduction of $60.
- Thus, the group’s aggregate current year BIE deduction will be classified, pro-rata, as from payments or accruals to domestic related parties ($60 X ($60/$100) = $36) and foreign related parties (($60 X $40/$100) = $24).
Example 3 – BEAT Coordination with §163(j): Allocating Current Year Deduction

Application of the allocation rule in Treas. Reg. § 1.1502-59A(c)(5) to BIE carryforwards

- In Year 1, the group has $60 of domestic related current year BIE, of which $36 is deducted in the year (by operation of the classification rule).
  - Therefore, the group has $24 of domestic related BIE carryforward.
- Similarly, the group has $40 of foreign related current year BIE in Year 1, of which $24 is deducted in the year.
  - Therefore, the group has $16 of foreign related BIE carryforward.
- The $24 domestic related BIE carryforward and $16 foreign related BIE carryforward will be allocated to P, S1, and S2 in proportion to the amount of each member’s disallowed BIE carryforward.
Example 3 – BEAT Coordination with §163(j): Allocating Current Year Deduction

Analysis (cont.):
Application of the allocation rule in Treas. Reg. § 1.1502-59A(c)(5) (cont.)

- P has $0 disallowed BIE carryforward ($60 - $60), and its percentage of disallowed BIE carryforward is 0%.
- The percentage of disallowed BIE carryforward allocable to S1 is 50% (S1’s Year 1 disallowed BIE carryforward, $40 ($40 - $0), divided by the group’s Year 1 disallowed BIE carryforward, $80 ($40 + $40)). S1’s carryforward is treated as related (domestic and foreign) and unrelated interest proportionate to the group’s remaining amounts.
- The percentage of disallowed BIE carryforward allocable to S2 is 50% (S2’s Year 1 disallowed BIE carryforward, $40 ($40 - $0), divided by the group’s Year 1 disallowed BIE carryforward, $80 ($40 + $40)). S1’s carryforward is treated as related (domestic and foreign) and unrelated interest proportionate to the group’s remaining amounts.
Example 3 - BEAT in Consolidation: Coordination with §163(j)

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<thead>
<tr>
<th></th>
<th>P</th>
<th>S1</th>
<th>S2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Year Interest Deduction</td>
<td>$60 ($36 domestic, $24 foreign)</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Domestic Related BIE Carryforward</td>
<td>$0</td>
<td>$12 (.5 x $24)</td>
<td>$12</td>
</tr>
<tr>
<td>Foreign Related BIE Carryforward</td>
<td>$0</td>
<td>$8 (.5 x $16)</td>
<td>$8</td>
</tr>
<tr>
<td>Unrelated BIE Carryforward</td>
<td>$0</td>
<td>$20 (.5 x 40)</td>
<td>$20</td>
</tr>
<tr>
<td>Total</td>
<td>$0</td>
<td>$40</td>
<td>$40</td>
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BEAT and §1.1502-13

- All members of a consolidated group are aggregated and treated as a single taxpayer for BEAT purposes.
- Items resulting from intercompany transactions described in Treas. Reg. Section §1.1502-13(b)(1)(i) are disregarded in making the required computations. Treas. Reg. Section §1.1502-59A(b)(1).
- What happens when the property or entity leaves the group? How does the matching rule apply?
§163(j) and Clawback Rules
DAD Deduction “Clawback”

• 2020 Final Regulations
  • Asset Sales – Strict Clawback (Treas. Reg. § 1.163(j)-1(b)(1)(ii)(C))
    • On the sale of an asset where DAD deductions that were added back to ATI (or possibly included in cost of goods sold (“COGs”)), such DAD deductions must be subtracted from tentative taxable income (“TTI”) to arrive at ATI
  • Disposition of Group Member Stock or Partnership Interest – Strict Clawback (§§ 1.163(j)-1(b)(1)(ii)(D) and (E))
    • Investment adjustments attributable to DAD deductions of the member that were added back to ATI (or possibly included in COGs) must be subtracted from TTI to determine ATI. Similar adjustments are required for a disposition of a partnership interest
    • Disposition is defined to include a deconsolidation of the member, including a deconsolidation resulting from a reverse acquisition or a group continuation transaction described in Treas. Reg. § 1.1502-75(d)(2). Section 381 transactions are excluded.

• 2021 Final Regulations
  • Adopt an optional “lesser-of” rule for both asset sales and dispositions of stock or partnership interests that reduce ATI by the lesser of the gain on the disposition or the prior DAD deductions added to ATI
  • Add an additional optional limitation on the clawback of prior DAD deductions that were added to ATI to the extent that the taxpayer can prove that the DAD deduction add back did not result in an increase in the amount of actual BIE deductions (e.g., the taxpayer would have been eligible to deduct its BIE without regard to the DAD add back).
DAD Deduction “Clawback” – Lesser of Calculation

• 2021 Final Regulations – Optional “Lesser of” Rules

• Asset sale or disposition
  • Disposition is defined to include certain tax-free transactions (e.g., Section 351 or Section 721 transactions, but not Section 381 transactions) and require the addback of prior DAD deductions to ATI in the year of the transfer
  • The required adjustment to ATI is the lesser of (i) the amount of gain on the sale or other disposition of property; or (ii) the amount of DAD deduction addback to ATI with respect to the property
    • In the case of tax-free transactions, this may present valuation questions with respect to the transferred property (e.g., a transfer of the business to a partnership)
  • Taxpayer can limit this clawback to the extent that it is shown that the DAD deduction addback did not result in the allowance of additional deductions of BIE

• Clarified that DAD deductions that are added to COGs are deemed to have been included in ATI regardless of when such additions are recovered
DAD Deduction “Clawback” – Lesser of Calculation (cont’d)

• 2021 Final Regulations – Optional “Lesser of” Rules
  • Member stock sale or disposition
    • Disposition is defined to include a deconsolidation of the member stock (other than whole group transactions, including group continuation transactions such as a reverse acquisition or -75(d)(2) transaction) and certain tax-free transactions (e.g., Section 351 and Section 721 transactions, but not Section 381 transactions)
    • Absent the “lesser of” alternative described below, the required adjustment to ATI is the investment adjustments under Treas. Reg. § 1.1502-32 attributable to any DAD deduction addback to ATI
  • Neither the operative rules nor the examples take into account the application of §1.1502-11(b)
  • If eligible, the consolidated group is permitted to use the “alternative method” to limit this clawback to the lesser of (i) the amount of gain on the sale or other disposition of the STOCK; or (ii) investment adjustments under Treas. Reg. § 1.1502-32 attributable to any DAD deduction addback to ATI.
    • This alternative method is available only for the sale of the stock of a member that had DAD deductions for an item of property
    • This method is not available on the sale of the stock of a “higher tier” member that itself owns the stock of the member with the DAD deductions
    • There is a cap on the clawback with respect to member stock to extent that it is shown that the DAD deduction addback did not result in the allowance of additional deductions of BIE
  • Anti-Duplication Provision – the amount of the clawback for the group cannot exceed the amount of the DAD deductions (e.g., if the asset is sold and the clawback occurs for the asset sale, there is no further clawback with respect to the stock).
Assume S1 acquired the DAD Property in 2019 for $100 and fully depreciated it in that year. The inclusion of the $100 DAD deductions in 2019 permitted $30 of additional BIE to be deducted in 2019. In 2022, P sells its S1 stock to an unrelated buyer for $60, recognizing a $50 gain. Because S1 had DAD deductions on eligible property, the “lesser of” rule can apply to limit the clawback to the lesser of $100 DAD deductions or the $50 gain on the stock of the S1 stock. However, the “cap” on the clawback will apply to limit it to $30.

- But consider application of Treas. Reg. §1.1502-11(b)
Example 5 – Disposing of Subsidiary Chain

Assume instead that S1 owns the stock of S2 and S2 acquired the DAD Property in 2019 for $100 and fully depreciated it in that year. The inclusion of the $100 DAD deductions in 2019 permitted $30 of additional BIE to be deducted in 2019. In 2022, P sells its S1 stock to an unrelated buyer for $60, recognizing a $50 gain.

- This sale results in the “deconsolidation” of S2, which requires adjustments with respect to the stock of S2 and the “lesser of” rule applies to this stock.
- Because S1 did not have DAD deductions on eligible property, the “lesser of” rule does not apply to limit the clawback with respect to the stock of S1.
- It would appear that there must be an adjustment to ATI in 2022 with respect to the stock of S2, but the application of the “lesser of” rule requires a valuation of such stock.
- The anti-duplication rule may apply with respect to the ATI adjustment for the sale of the stock of S1.
- Regardless, the “cap” of $30 should apply.
SRLY and Group Separation Issues with §163(j)
SRLY Limitations – Application to Disallowed BIE

- The Final Regulations set forth rules similar to, yet separate and distinct from, those found in Treas. Reg. § 1.1502-21(c) (relating to NOLs) for disallowed BIE carryforwards from SRLYs.

- Disallowed BIE carryforwards of a member arising in a SRLY that are included in the consolidated group’s BIE deduction may not exceed the group’s §163(j) limit, determined by reference only to the member’s cumulative items of income, gain, deduction and loss.
  - The Proposed Regulations contained *no cumulative register* -- the limitation would have been determined on a year by year basis.

- Deduction of SRLY BIE carryforward is only available if the group has any remaining §163(j) limitation for the current year after the deduction of:
  - Current year BIE,
  - Disallowed BIE carryforwards from earlier years, and
  - Only to the extent that the cumulative section 163(j) SRLY limitation exceeds the amount of the SRLY member’s current year BIE deducted by the group.

- SRLY limited disallowed BIE carryforwards are deducted on a pro rata basis with non-SRLY limited disallowed BIE carryforwards from years ending on the same date.

- The Final Regulations also apply the principles of Treas. Reg. § 1.1502-21(g) (i.e., making SRLY inapplicable under the so-called “overlap rule”) to disallowed BIE carryforwards when the application of the SRLY limitation would overlap with the application of §382.
Example 6 – SRLY Limitations

Facts

- In Year 1, S joins the P consolidated group with a $100 §163(j) carryforward arising from before joining the group (i.e., a SRLY carryforward). (§382 does not apply.)
- In Year 2, S has $100 of taxable income and P has $100 of taxable loss on a separate entity basis.
- In Year 3, S has $0 of income or loss and P has $300 of taxable income.

Analysis

- Under the Final Regulations, S would be able to use all of its §163(j) carryforward in Year 3 because, although it did not have any taxable income in Year 3, on a cumulative basis it has contributed $100 to the group’s consolidated taxable income since joining.
Example 7 – SRLY Limitations

Facts

- In Year 1, S joins the P consolidated group with a $100 §163(j) carryforward from before joining the group. P also has a §163(j) carryforward of $100 from the same year as S’s BIE carryover. (§382 does not apply.)
- In Year 2, the P Group has a $100 §163(j) interest limitation (determined without regard to S’s ATI). S has $50 of §163(j) limitation on a standalone basis (i.e., $50 of ATI).
- In Year 3, S has no taxable income/loss and P has $100 of taxable income.

Analysis

- S may only utilize its carryforward that is permitted to be absorbed on a pro rata basis with the P Group’s overall carryforward.
- Accordingly, S uses $33 of its 163(j) carryforward [$100 x ($50 SRLY Limit/$150 total available carryforward)], and P uses $66 of its carryforward [$100 x ($100/$150)].
§163(j) and Separation from the Consolidated Group

- While the §163(j) limitation on the deductibility of BIE is calculated as if the entire consolidated group were a single entity, the amount of BIE generated by each member of the group is calculated on a separate entity basis.

- When an entity leaves a consolidated group during a taxable year, BIE allocable to such entity is available to the consolidated group to reduce the group’s income in that consolidated return year in the amount of:
  - The departing entity’s current year BIE, accrued up to the day that the entity leaves consolidation; plus
  - Disallowed BIE carryforwards allocable to that entity from prior tax years when the entity filed a consolidated return.

- If a Group’s BIE exceeds the amount deductible under §163(j) in a year, such that some BIE will be disallowed for that year, the group must calculate the amount of deducted BIE and disallowed BIE allocable to each group member.
  - The Group deducted BIE allocable to a particular entity, S, is equal to ([Group’s §163(j) limitation in the test year] x ([S’s BIE in current year] / [Group’s BIE in current year]).
  - The Group disallowed BIE allocable to a particular entity, S, is equal to [S’s BIE in current year] – [S’s deducted BIE in current year].
Example 8 – Allocating BIE within a Consolidated Group

Facts

- A is a wholly-owned subsidiary of P and a member of P’s consolidated group (“P Group”), which includes other wholly-owned subsidiaries of P. The BIE of each of P and A is set forth in Table 1. P Group’s §163(j) limitations are as set forth in Table 1. (Assume no business interest income or floor plan financing interest expense.)

- Analysis

  - In Year 1, P and A’s aggregate BIE exceeds the P Group’s 163(j), so the deducted BIE ($100) must be allocated among P and A. P’s allocable share is $75 ($100 $163(j) limit x [$150 P’s Y1 BIE / $200 P Group Y1 BIE]), and A’s allocable share is $25 ($100 Y1 §163(j) limit x [$50 A’s Y1 BIE / $200 P Group Y1 BIE]). As a result, in Year 1 P has $75 of disallowed BIE carryforward, and A has $25 of disallowed BIE carryforward.

  - In Year 2, again, aggregate BIE exceeds the P Group’s 163(j) limitation, and the deducted BIE ($120) must be allocated among A and P. P’s allocable share is $48 ($120 Y2 163(j) limit x [$60 P’s Y2 BIE / $150 P Group Y2 BIE]), and A’s allocable share is $72 ($120 Y2 163(j) limit x [$90 A’s Y2 BIE / $150 P Group Y2 BIE]). As a result, in Year 2, P has $12 of disallowed BIE carryforward and A has $18 of disallowed BIE carryforward.

  - In total, after Year 2, P has $87 of disallowed BIE carryforwards, and A has $43 of disallowed BIE carryforwards.

### Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>P’s BIE</th>
<th>A’s BIE</th>
<th>P Group’s section 163(j) limitation</th>
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<tr>
<td>1</td>
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<td>3</td>
<td>$25</td>
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### Table 2

<table>
<thead>
<tr>
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<th>Year 1 disallowed BIE carryforwards</th>
<th>Year 2 disallowed BIE carryforwards</th>
<th>Total disallowed BIE carryforwards</th>
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</thead>
<tbody>
<tr>
<td>P</td>
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<td>$87</td>
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<tr>
<td>A</td>
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<td>$18</td>
<td>$43</td>
</tr>
<tr>
<td>Total</td>
<td>$100</td>
<td>$30</td>
<td>$130</td>
</tr>
</tbody>
</table>
Example 8 – Allocating BIE within a Consolidated Group (cont’d)

### Analysis

- In Year 3, the P Group can use all $75 of their Year 3 BIE ($75 = $25 P’s Y3 BIE + $50 A's Y3 BIE) since it is less than the Group’s §163(j) limitation ($185).

- P Group may recognize on a pro rata basis disallowed BIE carryforwards from prior years, starting from Year 1, up to $110 ($185 P Group’s Y3 §163(j) limit – $75 P Group Y3 BIE).

- Since there is only $100 of disallowed BIE carryforward from Year 1, all $100 are deducted from P Group’s Year 3 income. P Group may still deduct $10 of BIE in Year 3.

- There are $30 of disallowed BIE carryforwards for Year 2, of which $10 may be deducted in Year 3 on a pro rata basis. P’s allocable share is $4 ($10 remaining Y3 §163(j) limit x [$12 P’s Y2 disallowed BIE carryforward / $30 P Group’s Y2 BIE carryforward]) and A's allocable share is $6 ($10 remaining Y3 163(j) limit x [$18 A’s Y2 disallowed BIE carryforward / $30 P Group’s Y2 disallowed BIE carryforward]). As a result, P retains $8 of disallowed Year 2 carryforward and A retains $12 of disallowed Year 2 carryforward that can reduce income in a future year.

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<thead>
<tr>
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</tr>
<tr>
<td>Total</td>
<td>$100</td>
<td>$30</td>
<td>$130</td>
</tr>
</tbody>
</table>

Table 1: Yearly BIE Information

Table 2: Disallowed BIE Carryforwards
Spin-off and Attribute Allocation

• Distributing, S and Controlled are members of a consolidated group.

• At the time of the spin-off:
  • Distributing has a $100 NOL carryforward and a $300 disallowed BIE carryforward,
  • S has a $100 NOL carryforward and a $200 disallowed BIE carryforward, and
  • Controlled has a $200 NOL carryforward and a $500 disallowed BIE carryforward.

• Are the allocations of consolidated NOL carryforward and consolidated disallowed BIE carryforward to Controlled computed using the same methodology?

• Consider impact of DAD clawback
§382 Applicable to GILTI
§382 -- Background

• Limits a “loss corporation”
• That undergoes an “ownership change”
  • An ownership change occurs if immediately after an owner shift or an equity structure shift - The percentage by value of stock of the loss corporation owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage ownership of such shareholders
• During a 3-year “testing period”
• From utilizing “pre-change losses” or other tax attributes
• Against “post-change” income
Application of §382 to GILTI

• §951A provides that a U.S. shareholder of any Controlled Foreign Corporation (CFC) is required to include its pro rata share of GILTI in its annual reportable Gross Income.

• Comments from IRS personnel suggest that §382 would apply to GILTI.
  • One effect is that the use of built-in losses and other tax attributes might be limited when computing GILTI.
  • What about other aspects of §382
    • Reporting rules?
    • Built-in Gain?
Application of §382 to GILTI (cont’d)

- The language of §382 suggests that the application of §382 to GILTI should be limited.
  - A CFC is not a U.S. taxpayer unless it has income that is effectively connected with the conduct of a U.S. trade or business.
    - Although the CFC computes its income under U.S. tax principles, that is true of all foreign corporations. That does not mean that §382 applies to them.
    - Does the CFC meet the definition of a “loss corporation”?
  - The Code implicitly acknowledges that §382 only applies to ECI. §382(e)(3) states that the value of a foreign corporation which is a loss corporation only takes into account those items which are effectively connected with the conduct of a U.S. trade or business.
Application of §382 to GILTI (cont’d)

• Technical Problems with Applying §382 to GILTI
  • To determine whether §382 applies it is not clear whether that is based on the CFC itself or consolidated with U.S. shareholder.
  • What if the CFC has a NUBIL in its assets and the domestic corporation does not? Do you still have to test whether there is an ownership change?
Sale of CFC Stock and §1.1502-13
Sale of CFC Stock – The Intersection of §245A and §1.1502-13

- Treas. Reg. Section §1.1502-13(a)(1) requires that the consolidated group rules clearly reflect taxable income and prevent intercompany transactions from changing the group’s consolidated taxable income or tax liability.

- Could the Service apply the intercompany transaction rules to recharacterize a dividend a U.S. parent corporation receives from a controlled foreign corporation as something other than a dividend eligible for the §245A DRD (e.g., as GILTI)?
Example 9 - Sale of CFC Stock

- A U.S. parent (P), S, and B are members of a consolidated group. P owns all the stock of CFC2, which has a tested loss of $10 in year 4. S owns all the stock in CFC1, which it has owned since the beginning of year 1.

- At the beginning of year 4, S has a $600 adjusted basis in CFC1 stock, and CFC1 has a fair market value of $620. On June 30, CFC1 distributes a $120 dividend to S.

- CFC1 had $20 of earnings and profits at the start of year 4 unrelated to GILTI and earned $100 of current E&P and tested income during the year.

- S sells CFC1 stock to B for $600 in an intercompany transaction, and in a later year B sells the stock to an unrelated party for the same amount.

- Whether the entities are treated as separate entities produces very different results.
  - Treating S and B as divisions of a single corporation means the entity would have $90 of GILTI income — tested income offset by the tested loss. For S’s $120 extraction from CFC1, $90 is previously taxed E&P associated with GILTI, with the remaining $30 qualifying for the DRD. There is no capital gain or loss on the sale.
  - Treating S and B as separate entities results in S’s $120 of dividend income being subject to the section 245 extraordinary reduction rules, yielding $80 ineligible for the DRD. The remaining $40 dividend income that would be DRD eligible includes $20 of E&P unrelated to GILTI, $10 that would be taxed to B, and $10 that was offset by the tested loss and that didn’t produce a GILTI inclusion.
• Analysis Continued.
  • Under separate-entity treatment and §951(a)(2)(B) rules, B’s $100 tested income is offset by a $10 tested loss and reduced to a $10 GILTI inclusion that would increase B’s basis. When B sells CFC1 stock, it would have a $10 capital loss.
  • Redetermination under §1.1502-13?
    • Under §1.1502-13(c), the $120 dividend income is redetermined to consist of $80 of GILTI income and $30 of dividend eligible for a 100 percent DRD. The $120 would have to be identified as an intercompany item for §1.1502-13 to be used to solve the problem.
    • Because there’s an actual dividend instead of a §1248 deemed dividend, does that mean the $120 should not be treated as the intercompany item because it arose before the intercompany transaction?
    • Perhaps the $120 isn’t the intercompany item, but that the DRD-eligible and ineligible items could be viewed as separate items?
NOLs and §163(j) Ordering Rules
§382 and §163(j)

- §382(d)(3) treats a disallowed business interest expense carryforward as a “pre-change loss” subject to §382.

- Final Regulations clarify the term “§382 disallowed business interest expense carryforward” of a loss corporation consists of –
  - The loss corporation’s disallowed business interest expense carryforwards, including disallowed disqualified interest, as of the ownership change, and

- If a closing-of-the-books election is made under Reg. §1.382-6(b), current-year BII and expense is allocated to the pre- and post- ownership change periods as if the corporation’s books were closed on the date of the ownership change. (departure from the proposed regulations)

- Final Regulations clarify that §382 disallowed business interest carryforwards are not treated as recognized built-in losses under §382(h)(6).
Attribute Ordering

• Under an ordering rule, current-year business interest expense is deducted in the current taxable year before any disallowed business interest expense carryforwards are deducted for that year.

• After current-year business interest expense has been exhausted, disallowed business expense carryforwards are deducted in the order of the taxable years in which they arose, beginning with the earliest taxable year, subject to certain limitations.

• Treas. Reg. §1.383-1(d) provides ordering rules for the utilization of pre-change losses and credits and the absorption of the §382 and §383 limitations.

• The Final Regulations amend this provision to reflect that §382 has been extended to apply to disallowed business interest expense carryforwards.

• Under the revised ordering rules, the §382 limitation will generally be absorbed in the following order:
  • Pre-change capital losses and recognized built-in losses
  • Disallowed business interest expense carryforwards
  • NOLs and other pre-change losses
  • Pre-change credits
Example 10 - Attribute Ordering

- On January 1, Year 2, taxpayer has an ownership change and is in a NUBIL. As a result of the ownership change, Taxpayer has a $500 NOL carryover subject to a §382 limitation of $300.
- In Year 2, taxpayer has no income and $400 of disallowed business interest expense carryforward.
- In Year 3, taxpayer has $1,500 of taxable income (before interest deduction) and ATI. Taxpayer has $400 of current-year business interest expense subject to a current year §163(j) limitation of $450. Taxpayer has $100 of recognized built-in loss.
- Taxpayer can utilize the following expenses and attributes in Year 2 against its $1,500 of taxable income:
  - $400 of its current-year business interest expense.
  - $100 RBIL
  - $50 of Year 1 interest carryforward
  - $450 of Year 1 NOL carryover (Exceeds the cumulative annual limitation of $600 ($300 X 2) after taking into account the RBIL and interest carryforward)
Departed Member AMT Issues for Carryback Claims
The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was enacted on March 27, 2020.

- NOLs arising in certain tax years may be carried back to 5 prior tax years (but not for REITs), including to years prior to 2018:
  - The entire NOL is carried back to the earliest year
  - Any excess NOL is used in the next earliest year

- Temporarily removes the 80% limitation for NOL usability
- February 2, 2021 letter to Speaker Pelosi and Leader Schumer urging retroactive appeal of the carryback provision
Minimum Tax Credit Background

• Prior to TCJA, corporate taxpayers were subject to AMT to the extent the AMT liability was greater than the corporate tax liability with the AMT liability creating a minimum tax credit (MTC) that could be carried forward into subsequent years.

• Transition rules allowed taxpayers to utilize remaining minimum tax credit carryovers before 2022.

• TCJA had allowed taxpayers in TYs beginning in 2018, 2019, and 2020 to claim a refundable credit equal to 50 percent of the excess of the MTC over the amount otherwise allowable for the year against regular tax liability.

• In TY beginning in 2020, the refundable credit amount was to be 100 percent (i.e., remainder fully refundable).

• CARES allowed corporations to claim 100% of MTCs as fully refundable for 2019.

• Election available to have the 100% refundable credit for 2018.
AMT Carryback Issues and FAQs

• Prior to TCJA, a corporate taxpayer carrying back an NOL would offset 90% of its AMT with an AMT NOL with the residual becoming an MTC carryforward

• May 28, 2020 IRS issued FAQs
  • Q1. A C corporation with an NOL arising in a taxable year beginning after December 31, 2017 (post-2017 year) is carrying back all or a portion of that NOL to a taxable year beginning before January 1, 2018 (pre-2018 year). Although the AMT does not apply to C corporations in post-2017 years, it does apply to such taxpayers in pre-2018 years. For purposes of determining the C corporation’s alternative minimum taxable income in the pre-2018 year, what should be the amount of alternative tax net operating loss (ATNOL) arising in the post-2017 year?
  • A1. For Forms 1120X, Amended U.S. Corporation Income Tax Return, or 1139, Corporation Application for Tentative Refund, filed on or after June 1, 2020, treat the ATNOL amount arising in a post-2017 year as zero. The processing of the C corporation’s refund may be delayed if it uses a different method to determine the amount of its ATNOL.

• Reliance on FAQs?
AMT Filing Issues

• Form 1139, Expedited Refund Claim must be filed by December 30, 2020
  • 2018 and 2019 claims – no issue
• 2020 Calendar year taxpayers will miss the deadline as the year end is one day later
  • Need to file amended Federal and State returns
  • Slows the process
  • See FAQ 4 on 1120X requirement
MTC Allocation to Departed Members

- How are MTCs allocated between departed members on carrybacks?
- Prop. Treas. Reg. §1.1502-55(h)(6)
- The allocation is based on the departing member’s contributions to the group's consolidated AMT during the consolidated return years when the member was part of the group and comparing it to the consolidated MTC
- Could lead to significant refund distortions
PPP Loan Forgiveness and Consolidated Return Issues
PPP Loans Tax Treatment Clarification

• Sections 276 and 278 of the Consolidated Appropriations Act, 2021 (ACT) clarify the federal income tax treatment of loan forgiveness under the Paycheck Protection Program (PPP) from the CARES Act.

• no amount is included in the gross income of the eligible recipient due to the debt forgiveness

• no deduction is denied, no tax attribute is reduced, and no basis increase is denied because of the exclusion from gross income

• in the case of an eligible recipient that is a partnership or S corporation—
  • any amount excluded from income is treated as tax exempt income, and in general, any increase in the adjusted basis of a partner’s interest in a partnership with respect to any amount excluded from income is equal to the partner’s distributive share of deductions resulting from costs giving rise to the forgiveness
Stock Basis Adjustments

• Excluded COD treated as tax-exempt income (giving rise to positive basis adjustment in stock of the debtor) only to the extent the COD is applied to reduce tax attributes of any member. Treas. Reg. § 1.1502-32(b)(3)(ii)(C)(1).

• Can the PPP loan forgiveness give rise to a stock basis adjustment for a member of a consolidated group?

• What is the E&P treatment of the PPP loan forgiveness?
ERC Credit

• Under CARES, employers who received PPP loans were not eligible to claim the employee retention credits (ERC)
• The Act retroactively confirmed that taxpayers who received PPP loans may elect to treat payroll costs paid during the loan-covered period as qualified wages to the extent the wages are not paid for with forgiven PPP loan proceeds
• M&A relief for departed members
• But consider impact on consolidated acquirer if target received PPP loan