To Borrow or Not to Borrow, That is the New Question

Interest Expense Has New Limitations under the TJCA

Victoria S. Carlin vcarlin@dopkins.com March 2018

"30% of Adjusted Taxable Income" – That is the new, very important, limitation that Congress has placed on the deductibility of "net business interest expense". A few concepts in this new law are very important.

First, it's important to mention that Congress added several exemptions to who or what this new limitation applies to. **Small Businesses are exempt from this new restriction**. It's worth repeating….Small Business are EXEMPT. What's a Small Business you ask? Congress changed their Small Business definition to a business, or a group of related businesses, with a prior 3 year gross receipts average under $25 Million.

Farming and real estate businesses (including certain development and rental real estate businesses) can elect out of the limitation, a consequence of making such an election will result in other additional complicated restrictions.

There is a special carve out for one type of interest. Specifically excluded from these rules is "floor plan financing" interest. But again, anyone who takes advantage of this exception will have additional restrictions and limitations.

Also, the limitation is on "business interest". This means that investment interest expense doesn't fall under these new rules. However, it's important to note that the other interest rules, such as those on investment interest expense, are still alive and kicking.

While the idea of the limitation seems simple, the execution is not. Adjusted Taxable Income can mean TAX EBIDTA or TAX EBIT depending on if it's before or after 2021. The new Section 199A Pass-through deduction, any allowable net operating losses, and any non-business items are also removed to get to Adjusted Taxable Income. In addition, business interest income must offset the business interest expense first to determine the "net business interest expense" subject to the limitation.

The limitation is applied at the business entity level, so you cannot combine the income from a loss business and an income business to increase the limitation. The deduction, on the other hand is applied at the taxpayer level. This means that Partnerships and S Corporation may have further restrictions on the ability to utilize this expense.

On the positive side, any disallowed interest expense is not lost, just carried forward, and forward, and forward, until utilized under the limitation.

So why is this whole thing so important? Business that are highly leveraged, in a loss situation, that have large flexible expenses (such as bonuses or profit sharing contributions), or are using accelerated depreciation methods to drive down their income will need to review their financials carefully to determine if this new provision will place them in a taxable income situation by disallowing some or all of the business interest as a deduction. Translation, they may owe taxes when they never have in the recent past.

If you would like assistance with determining how the new rules will impact you, contact our tax professionals now for assistance. Waiting until the year end to determine if you will be able to deduct all of your interest will undoubtedly be way too late.

For more information, please contact:

Victoria Carlin, CPA
Tax Manager
vcarlin@dopkins.com ▪ (716) 634-8800

Victoria has over 25 years of experience in providing tax consulting, compliance and tax audit representation to closely held businesses and the owners of closely held businesses. She delivers a full range of tax services in covering federal and multi-state laws and regulations for partnerships, S and C corporations, and individuals.