

Chapman Client Alert

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Current Issues Relevant to Our Clients

Proposed House Tax Bill: Limits on the Deductibility of Interest

On November 2, 2017, Representative Kevin Brady (Chairman of the House Ways and Means Committee) released the proposed text of the long-awaited federal income tax reform bill entitled the “Tax Cuts and Jobs Act.” Much of the early media coverage has focused on the changes to the individual and corporate tax rates and certain popular deductions. However, the bill also includes a provision that creates a limit on the deductibility of interest. If enacted, the Act would modify Section 163(j) of the Internal Revenue Code as follows:

(j) LIMITATION ON BUSINESS INTEREST.—

(1) IN GENERAL.—In the case of any taxpayer for any taxable year, the amount allowed as a deduction under this chapter for business interest shall not exceed the sum of—

(A) the business interest income of such taxpayer for such taxable year, plus

(B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year.

For these purposes, the term ‘business interest’ means any interest paid or accrued on indebtedness properly allocable to a trade or business. The term does not include investment interest.

If enacted, this provision could have potentially wide-reaching impacts on securitization transactions where the underlying property is not debt. For example, the securitization of lease receivables, income from power purchase agreements, and service receivables could be directly affected. In such transactions, the deduction for the interest on the notes issued in the securitization would be limited to 30 percent of the income on the underlying property (before interest and depreciation deductions). The issuer (or the issuer’s parent) would need to receive cashflow in the transaction sufficient to pay the taxes on the excess of the income received over the deductions allowed.

Certain businesses have been excluded. For example (A) a real property trade or business or (B) the trade or business of the furnishing or sale of (i) electrical energy, water, or sewage disposal services, (ii) gas or steam through a local distribution system, or (iii) transportation of gas or steam by pipeline would not be subject to the proposed limitations (with the caveat that the rates charged by the business described in clause (B) must also have been established or approved by a governmental authority or regulatory commission).

The proposed provision applies to corporations and partnerships. For partnerships, the limitation is first applied at the partnership level in calculating the non-separately stated income of the partnership. Then the limitation applies again at the partner level with the partner including the partner’s share of the partnership’s excess interest expense in calculating the partner’s excess interest expense.

The excess interest expense can be carried forward five years, so, in some transactions, the limitation will only create a timing issue. In other transactions, the limitation could create a permanent difference.

We will continue to monitor the legislation and consider what steps might be advisable to plan for this significant potential change. Although the outlook of the bill is highly uncertain at this point, it is common for provisions of bills that are introduced to reappear in later versions or later bills.

As currently drafted, the bill would change the deductibility of interest for years beginning after 2017.

For More Information

If you would like further information concerning the matters discussed in this article, please contact any of the following attorneys or the Chapman attorney with whom you regularly work:

Paul D. Carman

Chicago
312.845.3443
carman@chapman.com

Melanie J. Gnazzo

San Francisco
415.278.9020
mgnazzo@chapman.com

Thomas F. Howard

Chicago
312.845.3812
howard@chapman.com

Christie R. Galinski

Chicago
312.845.3431
galinski@chapman.com

Chapman and Cutler LLP

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