



## Attribution of Interest Deductions for Article 9-A Taxpayers with Repatriated Income or IRC § 163(j) Limitations

This memorandum provides modifications to the required methodology for the attribution of interest deductions for Article 9-A taxpayers with:

- repatriated income under Internal Revenue Code (IRC) § 965;
- a carryforward of interest deductions limited by IRC § 163(j) that is deductible for federal tax purposes in the current year; or
- federal interest deductions limited by IRC § 163(j) in the current tax year.

This memorandum must be read **in conjunction with** previously issued [TSB-M-15\(8\)C, \(7\)I](#), *Direct and Indirect Attribution of Interest Deductions for Article 9-A Taxpayers (the 2015 TSB-M)*.

### Taxpayers with Repatriated Income

For tax years beginning on or after January 1, 2017, the IRC § 965(a) inclusion amount received from both unitary and non-unitary corporations not included in a combined return with the taxpayer is included in gross exempt controlled foreign corporation (CFC) income. The IRC § 965(a) inclusion amount, less any interest deductions directly or indirectly attributable to the income (or less 40% of the IRC § 965(a) inclusion amount if the safe harbor election is made), is included in exempt CFC income.<sup>1</sup>

- If the stock of a foreign corporation that generates the IRC § 965 inclusion amount is business capital, the stock is considered exempt CFC stock for purposes of the 2015 TSB-M and no modifications to the 2015 TSB-M attribution methodology are necessary.
- If the stock of the foreign corporation that generates the IRC § 965(a) inclusion amount is investment capital, then modifications to Step 3 of the 2015 TSB-M are needed.<sup>2</sup> The stock is **not** considered exempt CFC stock used in Step 3(C) of the 2015 TSB-M. Rather, the stock is included in the indirect attribution formula for investment capital computed in Step 3(D) of the 2015 TSB-M.

### Taxpayers with a Carryforward of Interest Deductions limited by IRC § 163(j)

For all tax years in which a carryforward of interest deductions limited by IRC § 163(j) is subsequently deductible for federal tax purposes, the carryforward amount deducted in subsequent taxable years must not be included in directly traced amounts. Instead these amounts must be indirectly attributed using the methodologies in the 2015 TSB-M, if indirect attribution is applicable. However, taxpayers (or combined groups) that are also impacted by the

<sup>1</sup> See Tax Law § 208(6-a).

<sup>2</sup> The IRC 965(a) inclusion amount is never considered gross investment income.

IRC § 163(j) limitation in the current tax year must instead follow the instructions in the section immediately below.

### **Taxpayers Impacted by IRC § 163(j) Limitation in the Current Tax Year**

A taxpayer or the designated agent of a combined group must modify the attribution methodology in the 2015 TSB-M when the federally deductible interest expense is limited by IRC § 163(j) in the current tax year **and** either:

- it has not made the 40% safe harbor election; **or**
- it has made the 40% safe harbor election and the taxpayer (or combined group) owns exempt cross-article stock.

The steps below explain the modifications necessary.

#### **Step 1: “As-if unlimited” total interest deductions subject to attribution**

Taxpayers (or combined groups) must complete *Step 1-Total amount of interest deductions subject to attribution* on page 5 of the 2015 TSB-M, starting with the amount of interest deductions prior to the IRC § 163(j) limitation (instead of the amount of the interest deductions included in your Form CT-3, Part 3, line 1 amount or Form CT-3A, Part 3, line 1a amount) to determine the amount of “as-if unlimited” total interest deductions subject to attribution.

#### **Step 2: “As-if unlimited” total interest deductions directly traceable**

Next, follow the procedures in *Step 2-Direct attribution* on page 6 of the 2015 TSB-M to determine how much of the “as-if unlimited” total interest deductions subject to attribution is directly traceable, whether in whole or part, to gross exempt cross-article dividends, gross exempt unitary corporation dividends, gross exempt CFC income, gross investment income or investment capital, and business income or business capital. If the amount computed in Step 1 above includes any carryforward of interest deductions limited by IRC § 163(j), such carryforward amount must **not** be included in directly traced amounts.

#### **Step 3: Determine total interest deductions subject to attribution after the IRC § 163(j) limitation**

Recalculate *Step 1-Total amount of interest deductions subject to attribution* on page 5 of the 2015 TSB-M, starting with the amount of interest deductions included in your Form CT-3, Part 3, line 1 amount, or your Form CT-3-A, Part 3, line 1a amount. The resulting amount is the total interest deductions subject to attribution **after** the IRC § 163(j) limitation.

**Step 4: Determine direct and indirect attribution amounts  
after the IRC § 163(j) limitation**

If the total interest deductions subject to attribution after the IRC § 163(j) limitation (computed in Step 3 above) are **less than** the amount of the “as-if unlimited” total interest deductions directly traceable (computed in Step 2 above), complete Step 4(A) below, and then continue with Step 5.

If total interest deductions subject to attribution after the IRC § 163(j) limitation are **greater than or equal to** the amount of the “as-if unlimited” total interest deductions directly traceable, complete Step 4(B) below, and then continue with Step 5.

**Step 4(A):** Determine the amount of interest deductions directly traced to a specific category of income or capital by multiplying the total interest deductions subject to attribution after the IRC § 163(j) limitation by the following fraction:

$$\frac{\text{“As-if unlimited” total interest deductions directly traceable to a specific category of income or capital}}{\text{“As-if unlimited” total interest deductions directly traceable to all categories of income and capital}}$$

If the 40% safe harbor election **is** made, the formula above is only needed to determine the amount directly traced to gross exempt cross-article dividends. There are no interest deductions indirectly attributable to such income. The 40% safe harbor election methodology is used for all other categories of income and capital. See Step 5 below for reporting instructions.

If the 40% safe harbor election is **not** made, use the amount of interest deductions directly traced to each specific category of income or capital as determined using the formula above. There are no interest deductions subject to indirect attribution. See Step 5 below for reporting instructions.

**Example:**

*A taxpayer has \$120,000 in interest expense for 2018 prior to applying the IRC § 163(j) limitation, of which \$100,000 is directly traced as follows:*

\$ 20,000	<i>directly attributable to gross exempt unitary corporation dividends</i>
\$ 30,000	<i>directly attributable to gross exempt CFC income</i>
\$ 10,000	<i>directly attributable to gross investment income or investment capital</i>
\$ 40,000	<i>directly attributable to business income or business capital</i>

*Due to the IRC § 163(j) limitation, \$50,000 of interest expense is deducted on the taxpayer’s 2018 federal Form 1120 and is included in the taxpayer’s 2018 Form CT-3, Part 3, line 1 amount. The remaining \$70,000 of interest expense is carried forward to subsequent years. The taxpayer did not make the 40% safe harbor election and has no subtractions or additions needed for Steps 1(A) and 1(B) of the 2015 TSB-M.*

Since the \$50,000 of total interest deductions subject to attribution after the IRC § 163(j) limitation is **less than** the \$100,000 of “as-if unlimited” total interest deductions directly traceable, the amount of interest deductions directly attributed to each specific category of income or capital is determined as follows:

$\$20,000/\$100,000 \times \$50,000 = \$10,000$  directly attributable to gross exempt unitary corporation dividends

$\$30,000/\$100,000 \times \$50,000 = \$15,000$  directly attributable to gross exempt CFC income

$\$10,000/\$100,000 \times \$50,000 = \$ 5,000$  directly attributable to gross investment income or investment capital

$\$40,000/\$100,000 \times \$50,000 = \$20,000$  directly attributable to business income or business capital

There are no interest deductions subject to indirect attribution for 2018.

The \$70,000 of interest expense that is limited by IRC § 163(j) in 2018 and carried forward to subsequent years must be indirectly attributed in the subsequent tax year(s) in which the interest expense becomes deductible for federal tax purposes unless the 40% safe harbor election is made and the taxpayer does not own exempt cross-article stock.

**Step 4(B):**

- (i) Determine interest deductions directly attributed - Use the “as-if unlimited” total interest deductions directly traceable amounts for total interest deductions directly attributed.
- (ii) Determine interest deductions subject to indirect attribution - Subtract the “as-if unlimited” total interest deductions directly traceable amount from the total interest deductions subject to attribution after the IRC § 163(j) limitation. The result is the amount of total interest deductions subject to indirect attribution.
- (iii) Determine interest deductions indirectly attributable to specific categories of income or capital using the amount determined in (ii) above and the methodology in *Step 3 – Indirect Attribution* of the 2015 TSB-M.

**Example:**

A taxpayer has \$120,000 in interest expense for 2018, prior to applying the IRC § 163(j) limitation, of which \$40,000 is directly traced as follows:

\$ 8,000	<i>directly attributable to gross exempt unitary corporation dividends</i>
\$ 17,000	<i>directly attributable to gross exempt CFC income</i>
\$ 5,000	<i>directly attributable to gross investment income or investment capital</i>
\$ 10,000	<i>directly attributable to business income or business capital</i>

*Due to the IRC § 163(j) limitation, \$50,000 of interest expense is deducted on the taxpayer's 2018 federal Form 1120 and is included in the taxpayer's 2018 Form CT-3, Part 3, line 1 amount. The remaining \$70,000 of interest expense is carried forward to subsequent years. The taxpayer did not make the 40% safe harbor election and has no subtractions or additions needed for Steps 1(A) and 1(B) of the 2015 TSB-M.*

*Since the \$50,000 of total interest deductions subject to attribution after the IRC § 163(j) limitation is **more than** the \$40,000 of "as-if-unlimited" total interest deductions directly traceable, the amount of interest deductions directly attributed to each specific category of income or capital is as determined as follows:*

\$ 8,000	<i>directly attributable to gross exempt unitary corporation dividends</i>
\$ 17,000	<i>directly attributable to gross exempt CFC income</i>
\$ 5,000	<i>directly attributable to gross investment income or investment capital</i>
\$ 10,000	<i>directly attributable to business income or business capital</i>

*To determine the amount of interest deductions subject to indirect attribution, the taxpayer must reduce the \$50,000 of total interest deductions subject to attribution after the IRC § 163(j) limitation by the \$40,000 of interest deductions directly traced above. The resulting \$10,000 of interest deductions must be indirectly attributed by completing Step 3 of the 2015 TSB-M using the \$10,000 amount in place of the amount that would have been calculated in Step 2(A) of the 2015 TSB-M.*

*The \$70,000 of interest expense that is limited by IRC § 163(j) in 2018 and carried forward to subsequent years must be indirectly attributed in the subsequent tax year(s) in which the interest expense becomes deductible for federal tax purposes unless the 40% safe harbor election is made and the taxpayer does not own exempt cross-article stock.*

### **Step 5: Reporting Interest Deductions Attributable**

Complete *Step 4-Reporting Interest Deductions Attributable* contained in the 2015 TSB-M on page 10, as directed, but use the amounts computed in this TSB-M rather than the 2015 TSB-M amounts.

**Note:** A TSB-M is an informational statement of existing department policies or of changes to the law, regulations, or department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in department policies could affect the validity of the information presented in a TSB-M.