

FINANCE MEMORANDUM

Attribution of Interest Deductions for Taxpayers with IRC §163(j) Limitations under the Business Corporation Tax, General Corporation Tax, Banking Corporation Tax, and Unincorporated Business Tax

This memorandum provides modifications to the required methodology for the attribution of interest deductions for taxpayers subject to the Business Corporation Tax (BCT), General Corporation Tax (GCT), Banking Corporation Tax (BTX) or the Unincorporated Business Tax (UBT) with:

- a carryforward of interest deductions limited by Internal Revenue Code (IRC) §163(j) that is deductible for federal purposes in the current year; or
- federal interest deductions limited by IRC §163(j) in the current tax year, or
- federal interest deductions in tax year 2019 or 2020 that would have been limited by IRC §163(j) as it existed prior to the amendments to IRC § 163(j)(10) made by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Public Law 116-136).

The CARES Act, which was enacted on March 27th, 2020, made a number of retroactive changes to IRC §163(j) for taxable years beginning in 2019 and 2020. The CARES Act added IRC § 163(j)(10), which increases the business interest expense limitation from 30% of Adjusted Taxable Income to 50% (plus interest income and floor plan financing income) for tax years beginning in 2019 and 2020, allows partners to deduct 50% of the 2019 excess business interest allocated to them from a partnership for tax years beginning in 2020 whether or not excess taxable income has been allocated to them by the partnership, and gives taxpayers an election to compute their 2020 interest expense limitation using their 2019 Adjusted Taxable Income. However, for tax years beginning in 2019 and 2020, New York City's BCT, GCT, BTX, and UBT are decoupled from all changes to IRC § 163(j) made by the CARES Act.¹ Required modifications to NYC interest expense computations for Tax Year 2019 are included in the instructions below.

Business Corporation Tax

The modifications described in this memorandum as applicable to BCT taxpayers must be read **in conjunction with** previously issued Finance Memorandum 16-2, *Direct and Indirect Attribution of Interest Deductions under the Business Corporation Tax (Corporate Tax of 2015)*, (2/25/16) (FM 16-2).

Taxpayers must attach a copy of federal Form 8990 to their New York City return, along with a statement detailing the computation of their NYC interest expense limitation. If a taxpayer is part of a federal affiliated group that files a consolidated return, but files a separate City return, the taxpayer should compute and attach a pro forma Form 8990 showing their IRC § 163(j) limitation computed on a separate basis. The designated agent of a New York City combined group that is different from the federal consolidated group must complete a pro-forma Form 8990 as if the group was a single taxpayer.

For all tax years in which a carryforward of interest deductions limited by IRC §163(j) is subsequently deductible for federal purposes, the carryforward amount deducted in subsequent taxable years must not be included in directly traced amounts. Instead the carryforward amounts must be indirectly attributed using the methodologies in FM 16-2, if indirect attribution is applicable (e.g., if the taxpayer did not make the 40% safe harbor election). Taxpayers (or combined groups) that are also impacted by the IRC §163(j) limitation with regard to interest expenses generated in the current tax year must attribute these expenses according to the instructions in the *Attribution Methodology* section below.

¹See L. 2020, Ch. 58, part WWW; and L. 2020, Ch. 121.

Special rules for tax years 2019 and 2020: Pursuant to Administrative Code §11-652(8)(b)(22), for taxable years beginning in 2019 and 2020, NYC Entire Net Income (ENI) must be computed without the exclusion, deduction or credit of the amount of any increase in the federal business interest expense deduction allowed pursuant to IRC §163(j)(10). As a result, taxpayers who have deducted an amount of business interest expense pursuant to IRC § 163(j)(10) (“supplemental federal interest”) on their federal returns **must add back such amounts when computing ENI** as follows:

1. Taxpayers must compute their IRC § 163(j) limitation by applying the provisions under IRC §163(j) as it existed prior to the CARES Act amendments to IRC§163(j)(10). When completing this step, taxpayers that are partners in a partnership may not apply the increase in the interest expense carryforward deduction allowed under IRC §163(j)(10)(A)(ii)(II); taxpayers who made an election pursuant to IRC §163(j)(10)(B) must recalculate their IRC §163(j) limitation using their 2020 Adjusted Taxable Income; and taxpayers must apply the 30% of Adjusted Taxable Income limitation under IRC §163(j)(1)(B).
2. Subtract the amount computed above from the amount of interest expense deducted at the federal level in the current year to arrive at the amount of supplemental federal interest deducted in the current year.
3. Add the amount of supplemental federal interest computed above back to ENI. See Step 6 below.
4. For taxable years beginning in 2020, a BCT taxpayer that includes on its BCT return a distributive share of income or loss from a partnership that files a UBT return must also add back its allocable portion of supplemental federal interest taken by the partnership in such taxable year.

Attribution Methodology- Required Modifications

A taxpayer or the designated agent of a combined group must modify the attribution methodology in FM 16-2 when its federally deductible interest expense is limited by IRC §163(j) in the current tax year, or for tax years 2019 and 2020, when its federally deductible interest expense would have been limited by IRC §163(j) as it existed prior to the CARES Act (Public Law 116-136) amendments to IRC§163(j)(10), **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 insurance or utility corporation stock.

The steps below explain the necessary modifications.

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 FM 16-2, starting with the amount of interest deductions prior to the IRC §163(j) limitation (instead of the amount of the interest deductions included on Form NYC-2, Schedule B, line 1 or Form NYC-2A, Schedule B, line 1a) 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 FM 16-2 to determine how much of the “as-if unlimited” total interest deductions subject to attribution is directly traceable, whether in whole or in part, to gross exempt insurance or utility corporation 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 FM 16-2, starting with the amount of interest deductions included on Form NYC-2, Schedule B, line 1, or Form NYC-2A, Schedule B, line 1a. The resulting amount is the total interest deductions subject to attribution after the IRC § 163(j) limitation.

Special rule for tax years 2019 and 2020: When completing Step 1(A) of FM 16-2, as part of this Step 3, subtract from the amount of interest expense deductions included in the Form NYC-2, Schedule B, line 1 amount, or Form NYC-2A, Schedule B, line 1a amount, those federal interest expense deductions required to be added back to taxable income in computing ENI, including any additional federal interest expense deductions taken pursuant to IRC § 163(j)(10) as added by section 2306 of the CARES Act.

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:

“As-if unlimited” total interest deductions directly traceable
to **a specific** category of income or capital

“As-if unlimited” total interest deductions directly traceable
to all categories of income and cap

If the 40% safe harbor election **is** made, the formula above is only needed to determine the amount directly traced to gross exempt insurance or utility corporation 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 NYC-2, Schedule B, line 1 amount. The remaining \$70,000 of interest expense is disallowed and 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 FM 16-2.

*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:*

$\$20,000/\$100,000 \times \$50,000 = \$10,000$	<i>directly attributable to gross exempt unitary corporation dividends</i>
$\$30,000/\$100,000 \times \$50,000 = \$15,000$	<i>directly attributable to gross exempt CFC income</i>
$\$10,000/\$100,000 \times \$50,000 = \$ 5,000$	<i>directly attributable to gross investment income or investment capital</i>
$\$40,000/\$100,000 \times \$50,000 = \$20,000$	<i>directly attributable to business income or business capital</i>

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 insurance or utility corporation 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 FM 16-2*.

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 NYC-2, Schedule B, 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 FM 16-2.

*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 FM 16-2 using the \$10,000 amount in place of the amount that would have been calculated in Step 2(A) of FM 16-2.

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 insurance or utility corporation stock.

Step 5: Reporting Interest Deductions Attributable

Complete *Step 4 – Reporting Interest Deductions Attributable* on page 9 of FM 16-2 as directed, but use the amounts computed in this Finance Memorandum rather than the FM 16-2 amounts.

Step 6: Adding Interest Deductions Taken Under IRC § 163(j)(10) Back to ENI for Tax Years 2019 and 2020.

- For tax year 2019, include the amount of supplemental federal interest allowed pursuant to IRC § 163(j)(10) on Form NYC-2, Schedule B, line 14, or Form NYC-2A, Schedule B, line 14, Column A.
- For tax year 2020, include the amount of supplemental federal interest allowed pursuant to IRC § 163(j)(10) on Form NYC-2, Schedule B, line 13, or Form NYC-2A, Schedule B, line 13.

General Corporation Tax

Note: The attribution methodology in this Finance Memorandum does not override, and should be applied **in conjunction with**, DOF Policy Bulletin 2-84.

Starting Point Modifications

For taxable years beginning on or after January 1, 2015, only S corporations are subject to the General Corporation Tax (GCT).² For GCT purposes an S corporation's entire net income (ENI) is equal to its federal entire taxable income calculated as if it had not made the election under Subchapter S of Chapter One of the IRC (the "S election"), with certain statutory modifications.³ At the federal level, the IRC §163(j) limitation applies differently to C corporations than it does to S corporations. Specifically, a C corporation must treat all of its interest income and expense as properly allocable to a trade or business⁴ This includes any investment interest income or expense, within the meaning of IRC §163(d), including investment interest expense that a partnership allocates to a C corporation partner.⁵ Additionally, all other items of income, gain, deduction, or loss of a C corporation are treated as properly allocable to a trade or business and factor into the computation of Adjusted Taxable Income (ATI), except to the extent such items are allocable to an excepted trade or business within the meaning of IRC §163(j)(7).⁶ On the other hand, S corporations are not required to treat all of their income and loss as allocable to a trade or business and may, for example, have investment interest income and expense within the meaning of IRC §163(d) that is not subject to the interest expense limitation under IRC §163(j).

GCT taxpayers to whom the IRC §163(j) limitation applies for federal purposes should attach a copy of Form 8990 filed with the IRS to their GCT return.

An S corporation that is a GCT taxpayer must recalculate its IRC §163(j) interest deduction limitation and ATI as if it were a C corporation and treat all of its interest income and expense as properly allocable to a trade or business and subject to the IRC §163(j) limitation, except to the extent such items are allocable to an excepted trade or business. Taxpayers should use Form NYC-ATT-S-CORP (ATT-S-CORP) to make the required recalculation in the manner provided below.

1. Taxpayers should determine the amount of interest expense deducted on the federal Form 1120S in arriving at the amount reported on line 1 of the ATT-S-CORP and add such amount back on line 4b of Part I of the ATT-S-CORP.
2. Taxpayers must compute the IRC §163(j) limitation as if they did not make the S election. To determine this limitation, taxpayers must treat all interest income/expense as business interest income/expense to which the IRC §163(j) limitation applies, regardless of actual treatment on the federal return.⁷ Taxpayers should fill out and attach a pro forma copy of federal Form 8990, taking into account any other items of income or deductions that would be available to a C corporation, but not an S corporation, for purposes of computing the IRC §163(j) limitation at the federal level.
3. Taxpayers should enter the amount of interest expense that would have been deductible in the current year if it were a C corporation (line 30 of the pro forma Form 8990) on line 17 of the ATT-S-CORP.⁸ This is the total amount of interest expense that will be subject to direct and indirect attribution to business capital, investment capital, and subsidiary capital in the manner provided below. Note that where the amount reported on line 17 of the ATT-S-CORP includes any carryforward of interest deductions limited by IRC § 163(j) in a prior taxable year, such carryforward amount must not be included in directly traced amounts and must be attributed indirectly.

Any amount of interest expense in excess of the §163(j) limitation calculated on a taxpayer's pro forma Form 8990, will be carried to the succeeding GCT taxable years in the manner prescribed by IRC §163(j) as it relates to C corporations. This amount should be entered on line 31 of the pro forma Form 8990.

Special rule for tax years 2019 and 2020: Pursuant to Administrative Code §11-602(8)(b)(21), for taxable years beginning in 2019 and 2020, NYC Entire Net Income must be computed without the exclusion, deduction or credit of the amount of any increase in the federal interest deduction allowed pursuant to IRC § 163(j)(10). As a result, taxpayers who have deducted an amount of federal interest pursuant to IRC § 163(j)(10) ("supplemental federal interest") on their federal return for tax years 2019 and 2020 must **add back such amounts when computing ENI** as follows:

²Ad. Code §11-602.1(1).

³Ad. Code §11-602(8)(ii).

⁴See Prop. Treas. Regs. §1.163(j)-4(b)(1).

⁵See Prop. Treas. Regs. §1.163(j)-4(b)(3).

⁶Prop. Treas. Regs. §1.163(j)-4(b)(2).

⁷Except to the extent such items are allocable to an excepted trade or business.

⁸See Prop. Treas. Regs. §1.163(j)-4(d)(2).

1. Taxpayers should determine the amount of interest expense deducted on federal Form 1120S in arriving at the amount reported on line 1 of Form NYC-ATT-S-CORP and add such amount back on line 4b of Part I of Form ATT-S-CORP.
2. Taxpayers should compute the amount of interest expense that would have been deductible in the current year if it were a C Corporation by applying the provisions of IRC §163(j) as it existed prior to CARES Act amendments to IRC §163(j)(10). When completing this step, taxpayers that are partners in a partnership may not apply the increase in the interest expense carryforward deduction allowed under IRC §163(j)(10)(A)(ii)(II); taxpayers who made an election pursuant to IRC §163(j)(10)(B) must recalculate their IRC §163(j) limitation using their 2020 Adjusted Taxable Income; and taxpayers must apply the 30% of Adjusted Taxable Income limitation under IRC §163(j)(1)(B).
3. Include the amount computed in Step 2 above on line 17 of Form NYC-ATT-S-CORP.
4. Note that for taxable years beginning in 2020, a GCT taxpayer that includes on its GCT return a distributive share of income or loss from a partnership that files a UBT return must add back to ENI its allocable portion of supplemental federal interest taken by the distributing partnership by subtracting this amount from the amount to be included on line 17 of Form NYC-ATT-S-CORP.

Taxpayers must attach a statement to their GCT returns showing their computation of the addback amount.

Combined Groups

Federal consolidated groups have a single 163(j) limitation.⁹ Similarly, for GCT purposes, NYC combined groups should calculate their IRC §163(j) limitation on the combined group level and fill out a single pro forma Form 8990, calculating the income and expenses of each member as if it had not made the S election and disregarding any intercompany transactions. Once the group's IRC §163(j) limitation is determined, it must be allocated among the members of the group in the manner provided in Treasury Regulations regarding federal consolidated groups.¹⁰ Each member's share of the group's deductible interest expense should be entered on line 17 of such member's ATT-S-CORP. This is the amount subject to attribution among business capital, investment capital, and subsidiary capital reflected on the form NYC-3A/B, or form NYC-3A in the case of a combined group with only two members. The attribution shall be done in accordance with the methodology provided below.

Special rule for combined groups in tax years 2019 and 2020: Compute the amount of the interest expense that the combined group would have been allowed to deduct if its members were C corporations by applying the provisions of IRC §163(j) as it existed prior to CARES Act amendments to IRC §163(j)(10), then allocate the resulting amount of deductible interest expense among the members of the combined group. Each member's share of the group's deductible interest expense should be entered on line 17 of the member's Form NYC-ATT-S-CORP.

Attribution Methodology- Required Modifications

Step 1: Calculate directly traceable "as-if unlimited" interest expense

Taxpayers should calculate the "as-if unlimited" amount of interest expense directly attributable to each class of capital without regard to the IRC §163(j) limitation.

Note: Any amount of interest expense carried forward from prior years pursuant to IRC §163(j) cannot be directly attributed to any class of capital and must be indirectly attributed.

Step 2: Determine direct and indirect attribution amounts after the IRC §163(j) limitation

If total interest deductions subject to attribution after the IRC § 163(j) limitation (line 17 of the ATT-S-CORP) are **less than** the amount of the "as-if unlimited" total interest deduction directly traceable (computed in Step 1 above), complete Step 2(A) below, and then continue with Step 3.

If total interest deductions subject to attribution after the IRC § 163(j) limitation (line 17 of the ATT-S-CORP) are **greater than or equal to** the amount of the "as-if unlimited" total interest deductions directly traceable (computed in Step 1 above), complete Step 2(B) below, and then continue to Step 3.

Special rule for tax years 2019 and 2020: When computing the amount of interest deductions subject to attribution after the IRC §163(j) limitation (line 17 of the ATT-S-CORP) exclude any federal interest expense deductions required to be added back to taxable income in computing ENI, including the amount of any supplemental federal interest deducted on federal returns.

⁹For rules on allocating IRC §163(j) limitation among members of a consolidated group, see Prop. Treas. Regs. §1.163(j)-5(b)(3)(ii).

¹⁰Ad. Code §11-639(a)(2).

Step 2(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:

“As-if unlimited” total interest deductions directly traceable
to a **specific** category of income or capital

“As-if unlimited” total interest deductions directly traceable
to all categories of income and capital

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.

Step 2(B):

- (I) Determine interest deductions subject to direct attribution - Use the “as-if unlimited” total interest deductions directly traceable amounts for total interest deductions subject to direct attribution.
- (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 apply the existing indirect attribution rules.

Step 3: Reporting Interest Deductions Attributable

Enter the amount of deductible interest expenses directly attributable to subsidiary capital on Form NYC-3L or NYC-3A, Schedule B, line 3.

Enter the amount of deductible interest expenses indirectly attributable to subsidiary capital on Form NYC-3L or NYC-3A, Schedule B, line 4.

Enter the total amount of deductible interest expenses directly and indirectly attributable to investment capital on Form NYC-3L or NYC-3A, Schedule B, line 20(f).

Example:

X is a corporation that makes the S election for federal purposes each year. In 2018, X has \$100x of Adjusted Taxable Income (ATI), 50x of Net Investment Income (within the meaning of IRC §163(d)) and the following federal interest items:

- \$ 20x of Business Interest Income
- \$ 80x of Business Interest Expense
- \$ 50x of Investment Interest Income within the meaning of IRC §163(d)
- \$ 60x of Investment Interest Expense within the meaning of IRC §163(d)

Due to the IRC § 163(j) limitation, X may deduct on its federal return an amount of Business Interest Expense equal to the sum of 30% of ATI (30% x 100x) and its Business Interest Income (\$20x), for a total deduction of \$50x. The remaining \$30x will be carried forward and may be deducted in subsequent years. IRC §163(d) allows the deduction of Investment Interest Expense up to the amount of Net Investment Income, thus X may deduct \$50x, and the remaining \$10x of Investment Interest Expense will be carried forward and may be deducted in subsequent year(s).

As a General Corporation Tax (GCT) taxpayer, X must recompute its taxable income as if it had not made the S election. Assume that X’s ATI will remain \$100x for GCT purposes. X’s Investment Interest Income/Expense must be treated as if allocable to a trade or business for the purposes of determining the §163(j) limitation, resulting in the following GCT interest items:

- \$ 70x (\$20x+\$50x) of Business Interest Income
- \$ 140x (\$80x+\$60x) of Business Interest Expense

Due to the IRC § 163(j) limitation, X may deduct on its GCT return an amount of Business Interest Expense equal to the sum of 30% of ATI (30% x 100x) and its Business Interest Income (\$70x), for a total deduction of \$100x. The remaining \$40x will be carried forward and may be deducted in subsequent year(s).

Assume that pursuant to GCT rules, X’s “as-if unlimited” attribution of Interest Expense is as follows:

\$ 33x	<i>directly attributable to Business Income or Business Capital</i>
\$ 55x	<i>directly attributable to Investment Income or Investment Capital</i>
\$ 22x	<i>directly attributable to Subsidiary Income or Subsidiary Capital</i>
\$ 30x	<i>indirectly attributable</i>

Since the \$100x of total interest deductions subject to attribution after the IRC § 163(j) limitation is **less than** the \$110x 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:

$\$33x/\$110x \times \$100x = \$30x$	<i>directly attributable to Business Income or Business Capital</i>
$\$55x/\$110x \times \$100x = \$50x$	<i>directly attributable to Investment Income or Investment Capital</i>
$\$22x/\$110x \times \$100x = \$20x$	<i>directly attributable to Subsidiary Income or Subsidiary Capital</i>

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

The \$10x of directly attributable interest expense and \$30x of indirectly attributable interest expense that are limited by IRC § 163(j) in 2018 and carried forward to subsequent year(s) must be indirectly attributed in the subsequent tax year(s).

Banking Corporation Tax

For taxable years beginning on or after January 1, 2015, only S corporations are subject to the Banking Corporation Tax (BTX).¹¹ For BTX purposes, an S corporation’s ENI is equal to its federal entire taxable income calculated as if it had not made the S election, subject to certain statutorily prescribed modifications.¹² BTX taxpayers use Form NYC-ATT-S-CORP (ATT-S-CORP) as the starting point for City tax computations and should follow the same methodology as GCT taxpayers to re-determine their IRC §163(j) limitation. BTX taxpayers must complete and attach a pro forma Form 8990. All BTX taxpayers to whom the IRC §163(j) limitation applies for federal purposes should also attach a copy of Form 8990 filed with the IRS to their BTX return.

BTX taxpayers do not attribute expenses between business and subsidiary capital, thus once the amount of IRC §163(j) limitation is determined, taxpayers should enter the amount of deductible interest on line 17 of the ATT-S-CORP. This amount will flow into Form NYC-1 or NYC-1A, Schedule B, line 1 and no further action is required.

Special rules for tax years 2019 and 2020: Pursuant to Administrative Code § 11-641(b)(17), for taxable years beginning in 2019 and 2020, NYC Entire Net Income (ENI) must be computed without the exclusion, deduction or credit of the amount of the increase in the federal interest deduction allowed pursuant to IRC § 163(j)(10) (“supplemental federal interest”). As a result, taxpayers who have deducted an amount of supplemental federal interest on their federal return must **add back such amounts when computing ENI** as follows:

1. Taxpayers should determine the amount of interest expense deducted on federal Form 1120S in arriving at the amount reported on line 1 of Form NYC-ATT-S-CORP and add such amount back on line 4b of Part I of Form ATT-S-CORP.
2. Taxpayers should compute the amount of interest expense that would have been deductible in the current year if it were a C Corporation by applying the provisions of IRC §163(j) as it existed prior to CARES Act amendments to IRC §163(j)(10). When completing this step, taxpayers that are partners in a partnership may not apply the increase in the interest expense carryforward deduction allowed under IRC §163(j)(10)(A)(ii)(II); taxpayers who made an election pursuant to IRC §163(j)(10)(B) must recalculate their IRC §163(j) limitation using their 2020 Adjusted Taxable Income; and taxpayers must apply the 30% of Adjusted Taxable Income limitation under IRC §163(j)(1)(B).
3. Include the amount computed in Step 2 above on line 17 of Form NYC-ATT-S-CORP.
4. Note that for taxable years beginning in 2020, a BTX taxpayer that includes on its BTX return a distributive share of income from a partnership that files a UBT return must add back to ENI its allocable portion of supplemental federal interest taken by the distributing partnership by subtracting this amount from the amount to be included on line 17 of Form NYC-ATT-S-CORP.

Taxpayers must attach a statement to their BTX returns showing their computation of the addback amount.

¹¹Ad. Code §11-641(a)(4).

¹²Ad. Code §11-503(a).

Unincorporated Business Tax

The Unincorporated Business Tax (UBT) is imposed on the unincorporated business taxable income of every unincorporated business wholly or partially carried on within the City.¹³ Unincorporated business taxable income is the excess of unincorporated business gross income over unincorporated business deductions, allocated to the City, minus certain deductions not subject to allocation and statutory exemptions.¹⁴ Unincorporated business gross income is federal gross income, subject to specified statutory modifications.¹⁵ Unincorporated business deductions are deductions allowed for federal purposes, subject to statutory modifications.¹⁶ Generally, interest expenses deducted for federal purposes flow into unincorporated business income without any adjustments, unless otherwise specified by statute. As such, no re-computation of the IRC §163(j) limitation is necessary for UBT purposes; UBT taxpayers may deduct the same amount of interest expense as allowed for federal purposes (subject to statutorily specified modifications), including any carryforwards of interest expense previously limited by IRC §163(j) limitation and deducted in the current year (but see **“Note on Partnerships,”** and **“Special rules for tax year 2019 and 2020”** below). The limitation under IRC §163(j) may affect the attribution of interest expenses between business and investment capital, as described in the section below.

UBT taxpayers to whom the IRC §163(j) limitation applies for federal purposes should attach a copy of Form 8990 filed with the IRS to their UBT return.

Note on Partnerships. For taxpayers that are treated as partnerships for federal purposes, the IRC §163(j) limitation is determined at the partnership level, and current year interest expenses are deducted at the partnership level.¹⁷ However, any interest expenses that cannot be utilized in the current year under IRC §163(j) are treated as excess business interest, allocated to the partners, and carried forward only at the partner level.¹⁸ Such excess business interest can be deducted by the partner in succeeding taxable years, to the extent of the partnership’s excess taxable income allocated to such partner.¹⁹ Because the unincorporated business taxable income of a partnership is based on its entity-level federal gross income, a partnership may only deduct business interest expenses up to the current year’s IRC §163(j) limitation²⁰ and no amount of interest expense allocated to a partner as excess business interest will be deductible on the partnership’s UBT return for any succeeding taxable year.

Carryforwards. UBT taxpayers that are treated as partnerships for Federal Income Tax purposes (hereinafter “UBT Taxpayer”) and that are partners in a partnership (“lower-tier partnership”) may deduct the carryforward of business interest expense allocated to it by the lower-tier partnership in the manner provided below.

1. The amount of the excess business interest expense carryforward deducted by the UBT Taxpayer for federal purposes in the current year must be added back on NYC-204, Schedule B, line 15.
2. If the lower-tier partnership was fully exempt from UBT in the current year, the excess business interest expense carryforward from such partnership that was deducted by the UBT Taxpayer for federal purposes in the current year will not be permitted for UBT purposes.
3. If the lower-tier partnership was partially exempt from UBT in the current year, the amount of excess business interest expense carryforward deductible for UBT purposes is the amount of the carryforward deducted for federal purposes multiplied by a ratio of non-exempt income from the lower-tier partnership to total income from the lower-tier partnership.
 - a. **Special rule for tax year 2020:** If the lower tier partnership was partially exempt from UBT in 2020, the amount of excess business interest expense carryforward deductible for UBT purposes is the amount of the carryforward that would have been allowed under IRC §163(j) as it existed prior to the CARES Act amendments to IRC §163(j)(10), multiplied by the ratio of non-exempt income from the lower tier partnership to total income from the lower tier partnership.

¹³Ad. Code §11-505.

¹⁴See Ad. Code §11-506.

¹⁵See Ad. Code §11-507

¹⁶IRC §163(j)(4)(A).

¹⁷IRC §163(j)(4)(B)(i).

¹⁸IRC §163(j)(4)(B)(ii).

¹⁹A partnership is fully exempt from UBT if it is solely engaged in holding, leasing, or managing real property within the meaning of Ad. Code §11-502(d), or if it is solely engaged in trading for its own account, pursuant to Ad. Code §11-502(c)(2).

²⁰A partnership is partially exempt from the UBT if it meets the requirements of Ad. Code §11-502(c)(4)(A).

4. The amount of business interest expense carryforward that is deductible for UBT purposes must be indirectly attributed between business and investment capital in the same proportion as the UBT Taxpayer's pro rata share of business and investment income from the lower-tier partnership in the current year.
5. The interest expense carryforward attributable to each category of capital must be allocated within and without the City using the Business Allocation Percentage or the Investment Allocation Percentage used by the lower-tier partnership in the current year, whichever is applicable. The amount of allocated excess business interest carryforward that is attributed to business capital should be included on Form NYC-204, Schedule A, line 3b and the amount attributed to investment capital is included on NYC-204, Schedule A, line 7b.

Special rules for tax years 2019 and 2020: Pursuant to Administrative Code § 11-506(b)(17), for taxable years beginning in 2019 and 2020, UBT taxpayers must add back to federal gross income the amount of any increase in the federal interest expense deduction allowed pursuant to IRC § 163(j)(10) ("supplemental federal interest"). As a result, taxpayers who have deducted an amount of supplemental federal interest on their federal return must add back such amounts when computing their Unincorporated Business Taxable income base as follows:

1. Taxpayers must compute their 163(j) limitation by applying the provisions under IRC §163(j) as it existed prior to the CARES Act (Public Law 116-136) amendments to IRC§163(j)(10). When completing this step, taxpayers that are partners in a partnership may not apply the increase in the interest expense carryforward deduction allowed under IRC §163(j)(10)(A)(ii)(II); taxpayers who made an election pursuant to IRC §163(j)(10)(B) must recalculate their IRC §163(j) limitation using their 2020 Adjusted Taxable Income; and taxpayers must apply the 30% of Adjusted Taxable Income limitation under IRC §163(j)(1)(B).
2. Subtract the amount computed above from the amount of interest expense deducted at the federal level in the current year to arrive at the amount of supplemental federal interest deducted in the current year.
3. Include the amount of supplemental federal interest computed above on Form NYC-202 or NYC-202EIN, Schedule B, line 11, or Form NYC-204, Schedule B, line 15.
4. Taxpayers must attach a statement detailing the computation of their NYC interest expense limitation and the amount of supplemental federal interest added back to their New York City return.

For taxable years beginning in 2020, a taxpayer that includes a distributive share of business or investment income or gains from a UBT partnership on its UBT returns must add back its allocable portion of supplemental federal interest taken by the partnership pursuant to IRC §163(j)(10) as follows:

1. Deduct the taxpayer's distributive share of business or investment income or gains from the distributing UBT partnership on Schedule B, line 23 of Form NYC-204.
2. Add, to the amount deducted above, the taxpayer's allocable portion of supplemental federal interest deducted by the distributing partnership.
 - i. The amount of the taxpayer's allocable portion of supplemental federal interest must be indirectly attributed between business and investment capital in the same proportion as the UBT taxpayer's pro rata share of business and investment income from the lower-tier partnership in the current year.
3. When computing the amount to be added back on Schedule A, line 3b of Form NYC-204 use the amount determined in paragraph 2 above instead of the amount deducted on Schedule B, line 23 of Form NYC-204.
4. When computing the amount to be added back on Schedule A, line 7b of Form NYC-204 use the amount computed in paragraph 2 above instead of the amount deducted on Schedule B, line 23 of Form NYC-204.
5. Taxpayers must attach a statement to their UBT returns showing their computation of the amount of supplemental federal interest that is added back to their distributive income from the UBT partnership.

For taxable years beginning in 2020, a taxpayer that includes a distributive share of business or investment loss from a UBT partnership on its UBT returns must add back its allocable portion of supplemental federal interest taken by the partnership pursuant to IRC §163(j)(10) as follows:

1. Add back the taxpayer's distributive share of business or investment loss from the distributing partnership on Schedule B, line 15 of Form NYC-204.
2. Subtract, from the amount added back above, the taxpayer's allocable portion of supplemental federal interest deducted by the distributing partnership.

- a. The amount of the taxpayer's allocable portion of supplemental federal interest must be indirectly attributed between business and investment capital in the same proportion as the UBT taxpayer's pro rata share of business and investment income from the lower-tier partnership in the current year.
3. When computing the amount to be subtracted on Schedule A, line 3b of Form NYC-204 use the amount computed in paragraph 2 above instead of the amount added back on Schedule B, line 15 of Form NYC-204.
4. When computing the amount to be subtracted on Schedule A, line 7b of Form NYC-204 use the amount determined in paragraph 2 above instead of the amount added back on Schedule B, line 15 of Form NYC-204.
5. Taxpayers must attach a statement to their UBT returns showing their computation of the amount of supplemental federal interest that is added back to their distributive loss from the UBT partnership.

Modifications required to attribution methodology

Step 1: Calculate directly traceable “as-if unlimited” interest expense

Taxpayers should calculate the “as-if unlimited” amount of interest expense directly attributable to each class of capital prior to the IRC §163(j) limitation.

Step 2: Determine direct and indirect attribution amounts after the IRC §163(j) limitation

If total interest deductions subject to attribution after the IRC §163(j) limitation are **less than** the amount of the “as-if unlimited” total interest deduction directly traceable (computed in Step 1 above), complete Step 2(A) below, and then continue with Step 3.

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 (computed in Step 1 above), complete Step 2(B) below, and then continue to Step 3

Special rule for tax years 2019 and 2020: When computing the amount of interest deductions subject to attribution after the IRC §163(j) limitation exclude any federal interest expense deductions required to be added back to federal gross income under Administrative Code §11-506(b)(17).

Step 2(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:

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

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.

Step 2(B):

- (I) Determine interest deductions subject to direct attribution - Use the “as-if unlimited” total interest deductions directly traceable amounts for total interest deductions subject to direct attribution.
- (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 existing indirect attribution rules.

Step 3: Reporting Interest Deductions Attributable

Enter the amount of deductible expenses directly and indirectly attributable to investment capital on Form NYC-204, Schedule B, line 29(f), NYC-202, Schedule B, line 25(f), or NYC-202EIN, Schedule B, line 25(f), whichever is applicable.