

IRC 163(j) Conformity Comments – Virginia Department of Revenue

On November 1, 2019, the Department issued draft Guidelines Regarding the Business Interest Limitation, inviting practitioner comment by December 26, 2019.

We have reviewed the draft guidelines and renew our comments that there is no rationale for Virginia conformity to 163(j), that other southeastern states have decoupled from 163(j), and application of 163(j) at the state level is extremely complex. Because Virginia decouples from the federal expensing provisions, it is both logical and fair it should also decouple from the interest expense limitation.

Several states, including Tennessee, South Carolina, and Georgia, have already decoupled from the business interest expense deduction in IRC § 163(j), and by conforming to the limitation, Virginia becomes a less attractive state for business growth and development (even considering the 20% state deduction).

If, however, Virginia insists on conformity to 163(j), the Department should modify its draft guidance to make several things clear:

- If a taxpayer does not have a 163(j) limitation at the federal level on a federal consolidated group basis, then it does not have a 163(j) limitation at the state level regardless of whether the taxpayer is a single entity or a group that does not mirror the federal consolidated group. The 163(j) limitation is designed to combat excessive interest deductions among related companies, and if there is no federal limitation, then presumably that is not happening and there is no reason to limit the deduction at the state level. Conforming to 163(j) introduces more complexity to the tax code as taxpayers are forced to recompute taxable income. Similar guidance to what we suggest was issued by New Jersey, Pennsylvania, and Tennessee.

For example, Pennsylvania has adopted the following language: “As a threshold issue, the Department will not expect any Pennsylvania corporate taxpayer which files its federal return on a consolidated basis to limit its separate company interest expense deduction for Pennsylvania purposes in a given tax period unless the federal consolidated group of which it is a part reports an interest expense limitation under Code Section 163(j) on the group’s consolidated federal form 1120 filed with the federal tax authorities for that same tax period.” Pa. Dep’t of Revenue, Corp. Tax Bulletin 2019-03 (Apr. 29, 2019).

- The Department should not require the Virginia taxpayer to recompute the 163(j) limitation at the state level, but instead should require allocation of the federal limitation among the members of the federal consolidated group using any reasonable allocation method. The Virginia taxpayer’s state 163(j) limitation should be the allocated 163(j) amount of the Virginia taxpayer or the combined group members.