INTEREST DEDUCTIBILITY ISSUES BRIEF

Association for the Improvement of American Infrastructure

P3 Tax Deductibility Issues related to HR 1 Tax Cuts and Jobs Act

The "Tax Cuts and Jobs Act of 2017" contains a limitation on deductibility of interest in the amended Code Section 163(j). This has potential impacts on the investment in and development of infrastructure.

Any taxpayer electing out of the business interest limitation of Code Section 163(j) is required to use the alternative depreciation system for certain of the assets of the trade or business. The provision would require a real property trade or business that elects out of the limitation on the interest deduction under Code Section 163(j) to use the alternative depreciation system to depreciate any of its (i) non-residential real property, (ii) residential rental property, and (iii) qualified improvement property.

The United States Department of the Treasury is currently looking for recommendations from industry, as they have begun drafting guidance to address some key concerns related to Section 163J as amended (LINK to Section 163J). There are essentially 3 levers which Treasury can exercise to appropriately address infrastructure for potential exemptions that might allow for appropriate interest deductibility for P3s:

- Definitions of real property trade or business;
- Methods for applying eligibility; and
- Proper allocability for exemption.

AIAI has been working closely through the P3 coalition and its member associations as well as other interested organizations to provide input from members and industry stakeholders involved in the development and delivery of public works to provide regulatory and legislative approaches to address this issue. These include eligibility for tax deductibility for certain, specified asset classes. These suggested recommendations will take the form of a letter to the Secretary of the Treasury.

Glenn Johnson, tax attorney with EY, has been directing and leading the effort on behalf of AIAI, along with several AIAI members which include Cohn Reznick and Squire Patton Boggs.

DEFINITIONS OF A REAL PROPERTY TRADE OR BUSINESS

We suggest that the term "real property" as used in the context of a real property trade or business in Code Section 163(j)(7) have the meaning in Code Section 897 and the Treasury Regulations promulgated under the "FIRPTA Rules"; applied without regard to whether the real property is located within the United States, which would include any "interest in real property,"

This would allow a trade or business involving the construction, operation or maintenance of infrastructure assets to be grouped, along with related financing activities, with the trade or business activities of infrastructure requiring the use of such real property where these infrastructure-related activities and the real property trade or business activities have common control, common ownership, common geographic location and are otherwise integrated financially and operationally.

METHODS FOR APPLYING ELIGIBILITY

We suggest that, pursuant to Code Section 163(j)(7), an electing real property trade or business may include trade or business activities other than a real property trade or business activities are appropriately grouped with a real property trade or business according to rules similar to those set forth in Treasury Regulations Section 1.469-4.

This would allow participants in a P3 to determine whether activities related to a specific infrastructure project to be grouped as a single trade or business. We anticipate that the typical P3 would be eligible for such a grouping and be treated as a single trade or business.

PROPER ALLOCABILITY FOR EXEMPTION

We suggest that the term "properly allocable" include the concept of direct tracing of the use of debt proceeds (i.e., the debt was incurred to finance the real property trade or business) and apply to allocate the interest on the debt to identified expenditures into the future.

This would allow the use of the income generated from the operation, management, maintenance, leasing or similar activities (e.g., an integrated infrastructure activity) and not from any assets owned by the taxpayer may not provide a workable allocation method in certain P3 transactions potentially constituting a real property trade or business.