



## Initial Guidance for Corporation Business Tax Filers and the IRC § 163(j) Limitation

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**Tax: Corporation Business Tax**

As part of the Tax Cuts and Jobs Act, I.R.C. § 163 was amended effective for tax years beginning on and after January 1, 2018. Specifically, a number of changes were made to the I.R.C. §163(j) limitation.

The Internal Revenue Service (IRS) published an initial notice on the I.R.C. § 163(j) limitation ([IRS Notice 2018-28](#)). They subsequently published proposed [regulations](#) consistent with their initial notice, which generally treats taxpayers filing a federal consolidated return as one taxpayer for the purposes of applying the I.R.C. § 163(j) limitation (i.e., the limitation applies at the federal consolidated tax return filing level and that group has a single I.R.C. § 163(j) limitation). For federal purposes, members of an affiliated group that do not file a consolidated return would not be aggregated for purposes of applying the I.R.C. § 163(j) limitation.

For purposes of the New Jersey Corporation Business Tax Act, the starting point for taxable income is entire net income before net operating losses and special deductions with several modifications for additions and deductions. (See [N.J.S.A. 54:10A-4](#); [N.J.A.C. 18:7-3.12](#).) Thus, a taxpayer's entire net income as reported on a federal consolidated return must match the taxpayer's entire net income on line 28 on Schedule A of the CBT-100 or BFC-1, before the respective New Jersey modifications, even though the taxpayer's New Jersey return was filed on a separate entity basis. This principle was successfully litigated by the Division in *MCI Communication Services, Inc. v. Director Division of Taxation*, Docket No. 013905-2010, (Tax Court of New Jersey 2015); affirmed 2018 N.J. Super. Unpub. LEXIS 1401; cert. denied 195 A.3d 528 (October 18, 2018).

P.L. 2018, c. 48, enacted a method for applying the I.R.C. § 163(j) limitation. Specifically [N.J.S.A. 54:10A-4\(k\)\(2\)\(K\)](#) states that:

(K) For privilege periods beginning after December 31, 2017, the interest deduction limitation in subsection (j) of section 163 of the Internal Revenue Code (26 U.S.C. s.163), shall apply on a pro-rata basis to interest paid to both related and unrelated parties, regardless of whether the related parties are subject to the add-back provision of either subparagraph (I) of paragraph (2) of this subsection or in section 5 of P.L.2002, c.40 (C.54:10A-4.4).

[N.J.S.A. 54:10A-4\(k\)\(2\)\(K\)](#) made no modification to the overall calculation of the I.R.C. § 163(j) limitation or the income that is reported on line 28 for federal purposes. Further, [N.J.S.A. 54:10A-4\(k\)\(2\)\(K\)](#) did not indicate that the taxpayer should apply the I.R.C. § 163(j) limitation without regard as to whether the taxpayer was included on a federal consolidated return.

Therefore, the amount the taxpayer reported for federal purposes is the amount that must be reported for New Jersey purposes. This means that taxpayers will use the interest expense and interest income allocation methods adopted in the federal regulations as the pro-rata calculation for New Jersey purposes ([N.J.S.A. 54:10A-4\(k\)\(2\)\(K\)](#)) and any related party addbacks must be applied after the I.R.C. § 163(j) limitation.

**Note:** The application of N.J.S.A. 54:10A-4(k)(2)(K) comes first before the application of N.J.S.A. 54:10A-4(k)(2)(I) and N.J.S.A. 54:10A-4.4.

### **New Jersey Separate Returns and the I.R.C. § 163(j) Limitation**

Taxpayers that file separate New Jersey Corporation Business Tax returns but file a single federal consolidated return together are treated as one taxpayer for the purposes of applying the I.R.C. § 163(j) limitation. Each taxpayer makes the adjustments required by N.J.S.A. 54:10A-4(k)(2)(I) and N.J.S.A. 54:10A-4.4, as applicable.

### **New Jersey Combined Returns and the I.R.C. § 163(j) Limitation**

Taxpayers must use the same accounting method for New Jersey purposes that they use for federal purposes. However, taxpayers included as members on a New Jersey combined return may: 1) be from multiple federal consolidated returns; 2) be from partially the same federal consolidated return; 3) be from the same federal consolidated return; or 4) file separate federal returns.

The Division of Taxation has determined it is fair and equitable to apply the single federal consolidated return rule to New Jersey combined returns. For the purposes of applying I.R.C. § 163(j) and N.J.S.A. 54:10A-4(k)(2)(K), the members included in a New Jersey combined return will be treated in the same manner as though they filed a single federal consolidated return. This is true regardless of whether the members of the New Jersey combined return are on one federal consolidated return. Therefore, the single federal consolidated return rules, as proposed by the U.S. Department of Treasury for the I.R.C. § 163(j) limitation, will apply.

The members of the combined group will be treated as one taxpayer for purposes of applying the new I.R.C. § 163(j) limitation. This is true even if some of the combined group members included in the New Jersey combined group were not included on the same federal consolidated return. If there are taxpayers that are in the same federal consolidated return that are not included on the same New Jersey combined return, the taxpayers will still be treated as one taxpayer for purposes of applying the new I.R.C. § 163(j) limitation. For example, a group of taxpayers that are included in the same federal consolidated return, but are not unitary, and have not made an affiliated group combined return election would still be treated as one taxpayer for the purposes of the I.R.C. § 163(j) limitation.

This also applies to the New Jersey world-wide group combined returns and New Jersey affiliated group combined returns, despite the intent of Congress to bar the super-aggregation of affiliates that were not included on the same federal consolidated return for the purposes of I.R.C. § 163(j). A combined return for New Jersey Corporation Business Tax purposes is treated as one return and taxpayers should make adjustments applying the I.R.C. § 163(j) limitation as though they had been included on a single federal consolidated return. The Division is in the process of creating a schedule on which taxpayers will report this information.

The single federal return rule will also apply to taxpayers that are not included in the same New Jersey combined return, but are included in the same federal consolidated return as one or all of the members of the New Jersey combined return. A rider detailing why the taxpayer was not included in the New Jersey combined return and a copy of the federal consolidated return must accompany the tax return.

Each member of the combined group included on the same New Jersey combined return will make the adjustments required by N.J.S.A. 54:10A-4(k)(2)(I) and N.J.S.A. 54:10A-4.4, as applicable.

**Note:** N.J.S.A. 54:10A-4(k)(2)(I) and N.J.S.A. 54:10A-4.4 do not apply to transactions between members of the combined group reported on the same New Jersey combined return because each provide an exception for New Jersey combined return members.

There will be additional guidance in the future.

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