

Instructions for Form 8926

(December 2008)



Department of the Treasury
Internal Revenue Service

Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Corporations use Form 8926 to figure the amount of any corporate interest expense deduction disallowed by section 163(j). A corporation's interest expense deduction may be disallowed if it paid or accrued disqualified interest during the tax year. However, if at least one of the following statements is true, disqualified interest paid or accrued in the current tax year will not be disallowed by section 163(j).

- The corporation's debt to equity ratio at the end of the tax year does not exceed 1.5 to 1.
- The corporation does not have any excess interest expense for the tax year.

Corporations also use Form 8926 to figure the amount of any interest expense deduction disallowed by section 163(j) for a previous tax year that is allowed for the current tax year. If the corporation's debt to equity ratio does not exceed 1.5 to 1, disqualified interest previously disallowed by section 163(j) may be allowed to the extent it exceeds the corporation's excess interest expense for the tax year.

Who Must File

A corporation (other than an S corporation) must file Form 8926 if it paid or accrued disqualified interest during the current tax year or had a carryforward of disqualified interest from a previous tax year.

Disqualified Interest

Disqualified interest is:

- Interest paid or accrued (directly or indirectly) to a related person not subject to U.S. income tax on the interest,
- Interest paid or accrued on indebtedness held by an unrelated

person if there is a disqualified guarantee of the indebtedness and the interest is not subject to a U.S. gross basis income tax (a tax figured on the gross amount of an item of income without reduction for any allowed deduction), and

- Interest paid or accrued (directly or indirectly) to a taxable real estate investment trust (as defined in section 856(l)) by a subsidiary of the trust.

Also, any disqualified interest disallowed as a deduction by section 163(j) in a tax year is carried forward and treated as disqualified interest paid or accrued in the next tax year.

Related Person

A related person is a person who is related to the corporation under sections 267(b) or 707(b)(1). For this purpose, the attribution rules of section 267(c) apply. In determining whether persons are related, the substance of ownership, rather than its form, controls.

You determine relatedness as of the date on which an item of interest expense accrues. Consequently, changes in the relationship between the payor corporation and the payee after the accrual date are irrelevant.

Partnerships. A partnership is not a related person if less than 10% of the profits and capital interest in the partnership are held by partners not subject to U.S. income tax on the interest. However, the partners may be related persons.

If a treaty between the United States and a foreign country reduces the rate of income tax imposed on a partner's share of any interest paid or accrued to a partnership, that partner's interests in the partnership are treated as held in part by a person subject to and in part by a person not subject to U.S. income tax on the interest.

In this situation, figure the interest treated as held by a partner not subject to U.S. income tax by multiplying the interest by:

- The rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, divided by
- The rate of tax imposed without regard to the treaty.

Pass-Through Entities

In the case of any interest paid or accrued to a partnership, the determination of whether any tax is subject to U.S. income tax is made at the partner level. A similar rule applies in the case of other pass-through entities and in the case of tiered partnerships and other entities.

Treaties

If a treaty between the United States and a foreign country reduces the rate of income tax imposed on the interest paid or accrued to a person, the interest is treated as paid or accrued in part to a person subject to and in part to a person not subject to U.S. income tax on the interest.

In this situation, figure the interest treated as paid or accrued to a person not subject to U.S. income tax on the interest by multiplying the interest by:

- The rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, divided by
- The rate of tax imposed without regard to the treaty.

Disqualified Guarantee

A guarantee includes any arrangement under which a person (directly or indirectly through an entity or otherwise) assures, on a conditional or unconditional basis, the payment of another person's obligation under any indebtedness.

A disqualified guarantee is generally a guarantee by a related person that is a tax-exempt organization or a foreign person, unless the corporation owns a controlling interest in the tax-exempt organization or foreign person. However, an additional exception may be provided by regulations. For details, see section 163(j)(6)(D)(ii)(I).

For this purpose, a controlling interest is direct or indirect ownership of at least 80% of the total voting power and value of all classes of stock of a corporation, or 80% of the profit and capital interests in any other entity. For this purpose, the rules of paragraphs (1) and (5) of section 267(c) apply to both corporations and entities other than corporations.

Affiliated Groups

All members of an affiliated group (described in section 1504(a)) are treated as one corporation.

Ratio of Debt to Equity

A corporation's ratio of debt to equity is the ratio the total indebtedness of the corporation bears to the sum of its money and the adjusted basis of all other assets reduced (but not below zero) by the total indebtedness. For this purpose, use the adjusted basis that would be used to determine gain. Also, for indebtedness with original issue discount (OID), use its issue price plus the portion of the OID previously accrued as determined under the rules of section 1272 (determined without regard to section 1272(a)(7) or (b)(4)).

Indebtedness. Debt is determined in accordance with generally applicable tax principles. Thus, in general, a contingent liability for financial accounting purposes that has not accrued for tax purposes will not be treated as a liability for purposes of section 163(j).

Net Interest Expense

A corporation's net interest expense is the excess (if any) of:

- The interest paid or accrued by the corporation during the tax year, over
- The interest includible in the gross income of the corporation for the tax year.

Excess Interest Expense

A corporation's excess interest expense is the excess (if any) of:

- The corporation's net interest expense, over
- The sum of 50% of the adjusted taxable income of the corporation plus any excess limitation carryforward.

A corporation's excess limitation is the excess (if any) of:

- 50% of the adjusted taxable income of the corporation, over
- The corporation's net interest expense.

Any excess limitation in a tax year is treated as an excess limitation carryforward to the first following tax year and, if unused in that tax year, similarly carried forward to the second and third following tax years. However, the carryforward that can be used in each of the following tax years cannot exceed the excess interest expense for that tax year (figured without the use of any excess limitation carryforward).

Corporate Partners

If a corporation owns (directly or indirectly) an interest in a partnership, the following rules apply.

- The corporation's distributive share of interest income paid or accrued to the partnership is treated as interest income paid or accrued to the corporation.
- The corporation's distributive share of interest paid or accrued by the partnership is treated as interest paid or accrued by the corporation.
- The corporation's share of the liabilities of the partnership is treated as liabilities of the corporation.

Passive Activity and At-Risk Rules

Section 163(j) is applied before the passive activity and at-risk rules.

Other Interest Limitations

Other sections limiting the deductibility of interest, such as sections 267(a)(3) and 163(e)(3), apply before section 163(j).

Specific Instructions

Affiliated Group Checkbox

A single form must be filed for all members of an affiliated group as defined in section 163(j)(6)(C), including those that are not members of the same consolidated group.

Line 1d

Enter the total amount of the corporation's indebtedness as of the last day of the tax year. Enter all indebtedness owed to related parties and all indebtedness owed to third parties. For more information, see *Ratio of Debt to Equity*, earlier.

Line 1f. Debt to Equity Ratio

Divide line 1d by line 1e.

Divide the total amount of the corporation's indebtedness as of the last day of the tax year by the sum of money and adjusted basis of all the corporation's other assets reduced by the total indebtedness.

Enter the results as a decimal (rounded to five decimal places).

Example 1. Corporation A is a calendar year corporation. At the end of 2008, Corporation A's money totaled \$300,500. The adjusted basis of the corporation's other assets totaled \$574,500. Corporation A's total indebtedness at the end of 2008 is \$525,000. The debt to equity ratio for Corporation A is 1.50000.

Example 1:

Money	\$300,500
Plus: Adjusted basis of all other assets	574,500
Total	<u>\$875,000</u>
Minus: Total indebtedness	525,000
Corporation A's equity	<u>\$350,000</u>

Calculation of Corporation A's debt to equity ratio:

Corporation A's total indebtedness	\$525,000
Divided by: Corporation A's equity	<u>350,000</u>
Corporation A's debt to equity ratio (Form 9926, line 1f)	<u><u>1.50000</u></u>

Note. Since the debt to equity ratio does not exceed 1.5 to 1, disqualified interest paid or accrued in the current tax year will not be disallowed by section 163(j).

Example 2. Corporation B is a calendar year corporation. At the end of 2008, Corporation B's money totaled \$400,000. The adjusted basis of the corporation's other assets totaled \$599,950. Corporation B's total indebtedness at the end of 2008 is \$600,020. The debt to equity ratio for Corporation B is 1.50031.

Example 2:

Money	\$400,000
Plus: Adjusted basis of all other assets	599,950
Total	<u>\$999,950</u>
Minus: Total indebtedness	600,020
Corporation B's equity	<u>\$399,930</u>

Calculation of Corporation B's debt to equity ratio:

Corporation B's total indebtedness	\$600,020
Divided by: Corporation B's equity	<u>399,930</u>
Corporation B's debt to equity ratio (Form 8926, line 1f)	<u>1.50031</u>

Note. Since the debt to equity ratio exceeds 1.5 to 1, disqualified interest paid or accrued in the current tax year will be disallowed by section 163(j) to the extent it does not exceed the corporation's excess interest expense for the tax year.

Line 1i

Enter all assets that are directly owned by the corporation, including assets held through a partnership or trust.

Note. Partnerships and simple trusts are treated as aggregates.

Line 3f

Enter any additional adjustments the corporation has made to its taxable income (loss) in arriving at its adjusted taxable income under section 163(j)(6).

Attach to your return a separate sheet showing:

- A list of each adjustment item and the amount for each adjustment item, and
- The total of all adjustments at the bottom.

Enter the total of all adjustments on line 3f.

Line 4b

Enter the amount of any unused excess limitation carried forward (if any) from the corporation's first preceding tax year and, to the extent not previously taken into account in a prior tax year, the second and third preceding tax years.

Line 7. Amount of Interest Deduction Disallowed Under Section 163(j) and Carried Forward to the Next Tax Year

Subtract the amount entered on line 7 from the interest the corporation would have otherwise deducted on its tax return. A corporation filing Form 1120 will reduce the amount reported on page 1, line 18. A corporation filing Form 1120-F will reduce the amount reported on Schedule I (Form 1120-F), line 24b. A corporation filing another tax return will reduce the amount reported on the appropriate interest deduction line.

The corporation may be allowed by section 163(j) to deduct the disallowed amount in a subsequent year. If not, it can be carried forward indefinitely.

Also, any amount reported on line 5e is allowed as an additional interest expense deduction in the current tax year to the extent it exceeds the amount on line 7. Include the excess as an interest expense deduction on the corporation's tax return on the lines referenced above.

Line 8c. Excess Limitation Carryforward to the Next Tax Year

If the corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the first succeeding tax year and to the second and third succeeding tax years to the extent not previously taken into account in a prior tax year.

Add lines 8a and 8b. This is your excess limitation carryforward to your next tax year. Generally, this will be the amount you will enter on line 4b of Form 8926 in the following tax year.

Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	10 hrs., 16 min.
Learning about the law or the form	2 hrs., 17 min.
Preparing and sending the form to the IRS	2 hrs., 33 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.
