

Tax Management

Allocation and Apportionment of Interest Expenses

Corporations with operations in the U.S. and overseas are required by the Internal Revenue Service to apportion interest expense based on the value of assets that generate foreign versus domestic income. This apportionment, which must be done annually, can be challenging for companies that elect to allocate interest expense based on the fair market value of their assets. Gordon Brothers has the proven expertise to help companies establish the fair market value of their worldwide assets to the satisfaction of the Internal Revenue Service and fulfill the document and information requirements of Rev. Proc. 2003-37.

What are the reporting requirements?

Internal Revenue Code Section 864(e) rules for allocating interest requires taxpayers to apportion interest expense between U.S. and foreign source income in accordance with Temporary Treasury Regulations Section 1.861-9T, which requires corporate taxpayers to allocate interest expense to U.S. and foreign source income on the basis of the tax book value of its assets, or at the election of the taxpayer, the fair market value of its assets.

How is interest expense allocated?

Corporations that elect to apportion interest expense using the fair market value method must value their U.S. and foreign assets according to the methodology detailed in §1.861-9T(h). There are four steps:

1. Value the total assets. For publicly traded corporations, that amount is equal to the aggregate year-end trading value of the corporation's stock, increased by the corporation's year-end liabilities to unrelated persons and its pro rata share of year-end liabilities of all related persons owed to unrelated persons.
2. Value the tangible assets in accordance with generally accepted valuation techniques.
3. Value the intangible assets. Subtract the tangible asset value from the corporation's total value.
4. Apportion the intangible assets between domestic and foreign in proportion to the group's net income before interest expense and including the group's pro rata share of the net income before interest expense of each related person held by the taxpayer.

Maximize your domestic allocation

For many multinational corporations, the decision to elect the fair market value method can result in a more favorable interest expense allocation and tax savings, especially for corporations with older U.S. assets with a low tax basis compared to their foreign assets. At Gordon Brothers, we have a dedicated team of machinery & equipment appraisers who more accurately assess the value of these assets than traditional accounting firms. This approach also means that the work is done faster and at a lower cost.

If you currently use, or are considering switching to, the fair market value method, please contact Gordon Brothers for a complimentary discussion and overview.

