



The Interaction of the Section 250 Deduction with Taxable Income Limited Deductions:

The Unresolved Ordering Problem and Its Evolution Through 2026

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■ INTRODUCTION



Since the Tax Cuts and Jobs Act (TCJA) introduced section 250 in 2017, domestic corporations claiming a deduction for foreign-derived intangible income (FDII) – now renamed "foreign-derived deduction eligible income" (FDDEI) under the One Big Beautiful Bill Act (OBBBA) – have faced a persistent and technically demanding question: how should the section 250 deduction interact with other Code provisions that also limit deductions based on a taxpayer's taxable income? The most prominent of these provisions are section 163(j), which limits the deduction for business interest expense, and section 172, which limits the deduction for net operating loss (NOL) carryforwards.

Difficulty arises because each of these provisions defines its limitation by reference to taxable income, which itself depends on

the amount of deductions allowed under the other provisions. This circularity – sometimes described as a "chicken-and-egg" problem – has remained only partially resolved through a patchwork of proposed regulations, final regulations, and preamble guidance. Despite repeated promises of a comprehensive guidance project, Treasury and the IRS have yet to issue definitive rules coordinating these provisions. Meanwhile, the OBBBA's sweeping changes to the FDII regime, effective for taxable years beginning after December 31, 2025, add a new layer of complexity and opportunity.

This article examines the current state of the law, distinguishes between the two distinct computational contexts in which these interactions arise, and evaluates the practical options available to taxpayers in 2026 and beyond.



B. Section 163(j): The Business Interest Expense Limitation

Section 163(j) generally limits a taxpayer's deductible business interest expense to 30% of its adjusted taxable income (ATI). ATI is the taxpayer's taxable income computed without regard to business interest expense, the section 172 NOL deduction, the section 199A deduction, and, for taxable years beginning after December 31, 2024, with the depreciation, amortization, and depletion add-back restored by the OBBBA. The OBBBA also modified ATI to exclude Subpart F and NCTI inclusions, section 78 gross-up amounts, and amounts included under section 956.

Disallowed business interest expense carries forward indefinitely under section 163(j)(2) and remains potentially usable in future years; a significant contrast to the section 250 deduction, which has no carryforward mechanism.

C. Section 172: The NOL Deduction

For taxable years beginning after December 31, 2020, the NOL deduction is limited to 80% of the taxpayer's taxable income, computed

without regard to the deductions allowed under sections 172, 199A, and 250. This last exclusion, the disregard of section 250, was added by the CARES Act in 2020 and effectively orders the NOL deduction before the section 250 deduction for post-2020 years. Like section 163(j) carryforwards, unused NOLs carry forward and remain available for future use.

D. The Circularity Problem

The computational difficulty becomes apparent when one considers that: (1) the section 250 deduction depends on taxable income, which depends on the section 163(j) and section 172 deductions; (2) the section 163(j) limitation on business interest depends on ATI, which under pre-OBBBA law was computed net of the full section 250 deduction (but post-OBBBA still includes the FDDEI portion – so the circularity is reduced but not eliminated); and (3) the section 172 NOL deduction depends on taxable income computed without regard to the section 250 deduction. Each provision's output is an input for the others, creating a circular computation that the Code itself does not resolve.

II. TWO DISTINCT COMPUTATIONAL CONTEXTS



A crucial distinction that practitioners sometimes overlook exists between two separate contexts in which sections 163(j) and 172 interact with the section 250 regime: (1) the computation of deduction eligible income (DEI) and FDDEI, which determines the amount of FDDEI eligible for the deduction; and (2) the section 250(a)(2) taxable income limitation, which caps the deduction based on the corporation's overall taxable income.

A. Computation of DEI and FDDEI: Treas. Reg. § 1.250(b)-1(d)(2)(ii)

DEI and FDDEI are the building blocks of the FDII (now FDDEI) calculation. DEI is the excess of a corporation's gross income (excluding certain items such as Subpart F and GILTI inclusions) over the deductions properly allocable to that gross income. FDDEI is the subset of DEI derived from qualifying foreign sales and services. Pre-OBBBA, the section 250 deduction was a function of the ratio of

FDDEI to DEI, so the allocation and apportionment of deductions to gross DEI and gross FDDEI directly affected the size of the deduction. From 2026 forward, however, the formula is fundamentally simplified and the FDDEI deduction is $33.34\% \times \text{FDDEI}$.

The 2020 Final FDII Regulations introduced Treas. Reg. § 1.250(b)-1(d)(2)(ii), which provides that for purposes of determining the deductions properly allocable to gross DEI and gross FDDEI, a corporation's deductions are determined "without regard to sections 163(j), 170(b)(2), 172, 246(b), and 250." The practical effect of this rule is clear for most of the listed provisions but involves a genuine interpretive question with respect to section 172.

For sections 163(j), 170(b)(2), and 246(b), the regulation cites only the specific limitation subsection. The underlying deductions are authorized elsewhere – interest under section

163(a), charitable contributions under section 170(a), and the dividends-received deduction under sections 243–245A. Disregarding these limitation provisions means the full, uncapped amount of the current-year deduction is treated as allocable for DEI/FDDEI purposes.

For section 250, the exclusion from the allocation is compelled by a different consideration entirely: circularity. DEI and FDDEI are computed in order to determine the section 250 deduction. Including the section 250 deduction as an allocated expense in the computation of DEI and FDDEI would make the deduction an input to its own calculation – a logical impossibility. Section 250 must therefore be excluded from the DEI/FDDEI allocation regardless of how one interprets the phrase "without regard to."

Section 172 presents a genuinely different question. Unlike section 250, the NOL deduction does not depend on DEI or FDDEI; there is no circularity in allocating it to gross DEI and gross FDDEI. The interpretive difficulty arises instead from the scope of the regulatory text: the regulation cites section 172 in its entirety, not section 172(a)(2), which houses the 80% taxable income limitation. From this author's standpoint, two competing readings are available:

1: Complete exclusion. Because section 172 is itself the sole source of the NOL deduction, there is no separate Code provision authorizing an NOL deduction independent of section 172. The "without regard to" language referencing the entire section means the NOL deduction drops out of the DEI/FDDEI allocation altogether. This contrasts with sections 163(j), 170(b)(2), and 246(b), where the regulation cites only the limitation subsection and the underlying deduction survives under its own authorizing provision. For section 172, there is no residual deduction left standing once the section is disregarded; the

deduction and its authorizing provision are one and the same.

2: Remove the limitation only. Under this reading, "without regard to section 172" is understood – consistent with the evident pattern of the regulation as a whole – to mean that the taxable income-based limitation on the NOL deduction is disregarded, so that the full, unlimited NOL is allocated to gross DEI and gross FDDEI. Treasury cited section 172 in its entirety rather than section 172(a)(2) for practical reasons: unlike the other limitation provisions, the 80% cap's precise location within section 172 was in flux during the drafting period (i.e., the TCJA restructured it, and the CARES Act, enacted just months before the final regulations were published, suspended it entirely for 2018–2020). The preamble's parenthetical characterization of the listed provisions as those "which limit certain deductions and provide for the carryover of the amounts not currently allowed," describing section 172 in the same terms as sections 163(j), 170(b)(2), and 246(b), supports this parallel reading.

The preamble sheds light on Treasury's purpose but does not definitively resolve the question. It explains that the rule was adopted in response to comments requesting clarification about whether taxpayers must allocate carryover deductions incurred before the effective date of the 2019 Proposed Regulations. Treasury stated that it "considered a rule that would require expenses incurred in prior years, including in years before the effective date of the proposed regulations, to be allocated to gross DEI and gross FDDEI, but determined that the benefit of the theoretical precision of this approach would be outweighed by the burden on taxpayers and the IRS that would be associated with making retroactive determinations." Treasury further stated that "the approach taken in the final regulations is

consistent with the premise that the section 250 deduction is calculated based on annual income and expenses." The parenthetical characterization of the listed provisions supports this parallel-treatment reading, while the "annual income and expenses" rationale supports the complete exclusion reading. The NOL deduction under section 172 is, by definition, a mechanism for carrying losses from other taxable years into the current year; not a current-year operating expense.

The prevailing practitioner view favors complete exclusion, and this author believes this is the better reading as well. Shortly after publication of the final regulations, an article from Fenwick & West observed that under the rule, "neither DEI nor FDDEI will be reduced on account of deductions for NOL carryovers and carrybacks, excess interest expense carryovers under section 163(j), or charitable contribution carryovers." The Tax Adviser reached the same conclusion in its July 2023 analysis. This "complete exclusion" reading finds support in three reinforcing considerations.

First, the regulatory text says "without regard to" the entire section, and section 172 is the exclusive statutory authority for the NOL deduction; if Treasury had intended only to remove the 80% cap, it could have cited section 172(a)(2) specifically, as it did with the parallel limitation provisions. Second, the preamble's "annual income and expenses" rationale is most naturally read to exclude the NOL deduction – which inherently carries prior-year losses into the current year into a computation intended to reflect current-year economic activity. Third, the practical result is consistent with the stated purpose of the rule: excluding the NOL deduction from the DEI/FDDEI allocation eliminates the need for taxpayers and the IRS to trace carryover losses from potentially distant taxable years

through the allocation framework, directly addressing the administrative burden Treasury identified.

We acknowledge that the parallel-treatment reading (i.e., remove limitations only) is textually available and that the preamble's parenthetical language provides some support for it. A taxpayer choosing to allocate the full, unlimited NOL to gross DEI and gross FDDEI could point to the preamble's characterization of section 172 as a provision that "limit[s] certain deductions and provid[e]s for the carryover of the amounts not currently allowed," arguing that Treasury viewed section 172 as functionally parallel to the other listed limitation provisions. However, that reading must overcome the plain text of the regulation, which disregards section 172 in its entirety, and not merely section 172(a)(2).

The OBBBA made a significant change relevant to this context: for taxable years beginning after December 31, 2025, interest expense and research or experimental (R&E) expenditures are specifically excluded from the deductions that are allocable to gross DEI and gross FDDEI. This statutory exclusion partially moots the pre-OBBBA controversy regarding the treatment of interest expense in the DEI/FDDEI allocation context, because interest expense is now statutorily excluded from the allocation regardless of whether section 163(j) applies or not. However, Treas. Reg. § 1.250(b)-1(d)(2)(ii) remains relevant for other categories of deductions subject to taxable-income-based limitations (such as the charitable contribution limitation under section 170(b)(2) and the dividends-received deduction limitation under section 246(b)), for the continued exclusion of the section 172 NOL deduction from the allocation under the prevailing reading described above, and for pre-2026 taxable years that may still be under examination.



B. Section 250(a)(2) – Taxable Income Limitation

The section 250(a)(2) taxable income limitation operates at a different level. It compares the corporation's combined FDDEI and NCTI to its overall taxable income (determined without regard to the section 250 deduction) and reduces the deduction if FDDEI plus NCTI exceeds the latter (taxable income). The question here is whether "taxable income" for

this purpose is determined before or after applying the section 163(j) business interest limitation and the section 172 NOL deduction.

This is a distinct (and different) question from the DEI/FDDEI allocation issue addressed by Treas. Reg. § 1.250(b)-1(d)(2)(ii). The taxable income limitation under section 250(a)(2) looks at the corporation's bottom-line taxable income – not merely at how deductions are allocated among income categories.

III. THE REGULATORY HISTORY

Proposed Rules, Final Rules, and the Unresolved Gap



A. The 2019 Proposed Regulations: A Five-Step Ordering Rule

The 2019 Proposed Regulations (84 Fed. Reg. 8189) attempted to resolve the circularity by establishing a five-step sequential ordering rule, set forth principally in an example (Example 2 of Prop. Reg. § 1.250(a)-1(f)(2)) as follows:

Step 1: Compute a tentative FDII and tentative section 250 deduction, without regard to sections 163(j), 172, or the section 250(a)(2) taxable income limitation.

Step 2: Compute the allowed business interest deduction under section 163(j), taking into account the tentative section 250 deduction but not the section 172 NOL deduction.

Step 3: Compute the section 172 NOL deduction, considering the section 163(j) limitation but without regard to the section 250 deduction.

Step 4: Recompute FDII (including DEI and FDDEI) by allocating deductions allowed after application of sections 163(j) and 172(a).

Step 5: Compute the final section 250 deduction, applying the section 250(a)(2) taxable income limitation based on taxable income that reflects the section 163(j) and section 172 deductions.

The proposed definition of the section 250(a)(2) amount in Prop. Reg. § 1.250(a)-1(c)(4) explicitly stated that a corporation's taxable income was determined "with regard to all items of income, deduction, or loss, except for

the deduction allowed under section 250," and specifically noted that taxable income was determined "taking into account the application of sections 163(j) and 172(a)."

B. The 2020 Final Regulations: Withdrawal and Reservation

The 2020 Final Regulations (T.D. 9901; 85 Fed. Reg. 43,042) took a dramatically different approach. Treasury and the IRS made several key changes to the proposed regulations as follows:

- Withdrew Example 2 and the five-step ordering rule;
- Reserved Treas. Reg. § 1.250(a)-1(c)(5)(ii) for future guidance on coordinating section 250(a)(2) with other taxable-income-based provisions;
- Define taxable income for section 250 purposes by reference to section 63(a), determined without regard to the section 250 deduction (Treas. Reg. § 1.250(a)-1(c)(5)(i));
- Adopted Treas. Reg. § 1.250(b)-1(d)(2)(ii), providing that sections 163(j), 172, and the other enumerated provisions are disregarded for purposes of allocating deductions to gross DEI and gross FDDEI; and
- Stated in the preamble that taxpayers may use "any reasonable method (which could include the ordering rule described in the proposed regulations or the use of simultaneous equations)" provided the method is applied consistently for all taxable years beginning on or after January 1, 2021.

C. The Internal Inconsistency

The 2020 Final Regulations contain a tension that has occupied practitioners since their

publication. Treas. Reg. § 1.250(b)-1(d)(2)(ii) governs the DEI/FDDEI allocation by requiring that deductions be determined "without regard to" the enumerated provisions. As discussed in Section II.A, this means that the full amount of current-year interest expense is allocated (disregarding only the section 163(j) cap) while the section 172 NOL deduction is excluded entirely (because the regulation cites section 172, not merely the 80% limitation in section 172(a)(2)). Both results conflict with Step 4 of the withdrawn ordering rule in the proposed regulations, which computed FDII by allocating the deductions allowed after application of sections 163(j) and 172(a) – that is, only the interest permitted under the section 163(j) cap and only the NOL deduction as limited by section 172(a)(2). Thus, the regulation and the withdrawn ordering rule diverge in opposite directions depending on the provision: for interest, the regulation allocates more than Step 4 would (full interest rather than capped interest), but for the NOL deduction, the regulation allocates less than Step 4 would (zero rather than the 80%-limited amount).

However, the preamble explicitly blesses continued use of the 2019 ordering rule as a "reasonable method" for purposes of determining the section 250(a)(2) taxable income limitation, but it is important to recognize the scope of that blessing. The preamble's "any reasonable method" language is directed specifically at the coordination of sections 250(a)(2), 163(j), and 172 in computing the taxable income cap on the section 250 deduction – it does not purport to override the operative text of Treas. Reg. § 1.250(b)-1(d)(2)(ii), which governs the separate question of how deductions are allocated to gross DEI and gross FDDEI (as discussed above).

Step 4 of the 2019 ordering rule, if followed in its entirety, would compute FDII by allocating

only the business interest actually allowed after application of section 163(j) and by including the NOL deduction as limited under section 172(a)(2), directly contradicting § 1.250(b)-1(d)(2)(ii)'s instruction to determine deductions for allocation purposes without regard to section 163(j) and section 172 in their respective manners described in Section II.A. This tension is not resolved by the preamble's reasonable-method permission, because that permission is scoped to the taxable income limitation and has nothing to do with the DEI/FDDEI allocation. Rather, the conflict between Step 4 and § 1.250(b)-1(d)(2)(ii) is best understood as further evidence of the internal inconsistency within the 2020 Final Regulations; an inconsistency that, as discussed above, supports the conclusion that Treasury did not intend § 1.250(b)-1(d)(2)(ii) to serve as a broad rule governing the interaction of sections 250 and 163(j) for all purposes.

Accordingly, for pre-2026 taxable years, the DEI/FDDEI allocation and the section 250(a)(2) taxable income limitation operate as independent computations. When allocating deductions to gross DEI and gross FDDEI, a taxpayer applies Treas. Reg. § 1.250(b)-1(d)(2)(ii), which requires that deductions be determined without regard to sections 163(j), 170(b)(2), 172, 246(b), and 250. As explained in Section II.A, the practical effect differs by provision: for sections 163(j), 170(b)(2), and 246(b), where the regulation cites only the limitation subsection, the full uncapped amount of the underlying deduction is allocated; for sections 172 and 250, where the regulation cites the entire section, the better view (in this author's opinion) is the deduction is excluded from the allocation altogether.

For pre-2026 taxable years, the result is that current-year interest expense is allocated at its full amount (before the section 163(j) cap),

while the section 172 NOL deduction is not allocated to gross DEI or gross FDDEI at all (under our primary read). For taxable years beginning after December 31, 2025, the OBBBA's statutory exclusion of interest expense from the DEI/FDDEI allocation moots the interest allocation question going forward, though the NOL exclusion under the regulation remains operative. Separately, when computing the section 250(a)(2) taxable income limitation, the taxpayer applies whatever reasonable method it has selected – whether the 2019 ordering rule, simultaneous equations, or another approach – using the same method consistently for all relevant Code sections and for all taxable years beginning on or after January 1, 2021.

Taxpayers who disagree with the regulation's treatment would be directly contradicting an operative final regulation and should be prepared to defend that position in controversy, though the strength of the available arguments varies by provision. A taxpayer who allocates only the section 163(j)-capped interest rather than the full current-year amount faces a difficult challenge: the regulation's text unambiguously says "without regard to section 163(j)," and there is little room for an alternative reading of that instruction. By contrast, a taxpayer who includes the section 172 NOL deduction in the allocation, whether at the full or 80%-limited amount, can point to the preamble's parenthetical characterization of section 172 as a provision that "limit[s] certain deductions and provide[s] for the carryover of the amounts not currently allowed," which describes section 172 in the same terms as the other listed limitation provisions. That argument, while available, must still overcome the regulatory text's citation to section 172 in its entirety and the weight of practitioner commentary favoring complete exclusion, as discussed in Section II.A.

IV. THE SECTION 250(A)(2) TAXABLE INCOME LIMITATION

Applicable Deductions, Viable Methods, and Current Positions



As established in Section II, the section 250(a)(2) taxable income limitation is a distinct computation from the allocation of deductions to gross DEI and gross FDDEI. The allocation question is governed by the operative text of Treas. Reg. § 1.250(b)-1(d)(2)(ii), which instructs taxpayers to disregard certain enumerated provisions when allocating expenses. The taxable income limitation, by contrast, asks a different question: what is the corporation's overall taxable income – determined without regard to the section 250 deduction – against which the combined FDDEI and NCTI are measured? The answer depends on which other deductions are reflected in that taxable income figure, and in what order they are computed.

A. The Statutory Starting Point: Section 63(a) and Section 250(a)(2)(A)(ii)

Section 250(a)(2)(A)(ii) refers to "the taxable income of the domestic corporation (determined without regard to section 250)." Section 250 does not independently define "taxable income." In the absence of a provision-specific definition, the general definition in section 63(a) governs: taxable income means gross income minus deductions allowed by Chapter 1, other than the standard deduction. This definition applies throughout Subtitle A of the Code: sections 1 through 1564, which encompass sections 163, 170, 172, 246, and 250. The 2020 Final Regulations confirm this (in Treas. Reg. § 1.250(a)-1(c)(5)(i)), by defining taxable income for section 250 purposes as the amount determined under section 63(a), without regard to the section 250 deduction.

The only stated exclusion from the taxable income computation is the section 250

deduction itself. Congress knew how to exclude specific items, and it explicitly did so for section 250 in the text of section 250(a)(2)(A)(ii), and also for additional items in other provisions (for example, the CARES Act amendments to section 172(a)(2)(B)(ii)(I), which compute the NOL limitation without regard to deductions under sections 172, 199A, and 250). The absence of any further exclusions in section 250(a)(2) is significant: it indicates that all other deductions allowed under Chapter 1, as limited by their respective statutory provisions, are to be considered.

B. Treatment of Specific Deductions in the Taxable Income Limitation

1. Section 163(j): Business Interest Expense

The strongest statutory argument supports the conclusion that the section 163(j) limitation must be applied before determining taxable income for section 250(a)(2) purposes. Under section 63(a), only deductions "allowed" reduce gross income. Section 163(j) limits the amount of business interest that is "allowed as a deduction" to 30% of adjusted taxable income. Business interest expense more than that limit is not "allowed" in the current year; it is carried forward under section 163(j)(2). Therefore, the taxable income figure under section 250(a)(2) should reflect only the business interest expense allowed after the section 163(j) cap, not the full amount incurred.

The 2019 Proposed Regulations adopted this approach. Prop. Reg. § 1.250(a)-1(c)(4) defined the section 250(a)(2) amount by reference to taxable income determined "with regard to all items of income, deduction, or loss, except for the deduction allowed under section 250," and specifically stated that taxable income is determined "taking into account the application of sections 163(j) and 172(a)."

The 2020 Final Regulations did not repudiate this approach. While Treasury removed the specific language referencing sections 163(j) and 172(a) from Treas. Reg. § 1.250(a)-1(c)(4), the preamble makes clear that this revision was not because Treasury concluded that 163(j) should be disregarded, but because Treasury determined that the interaction required further study. In the interim, the preamble provides that taxpayers may use "any reasonable method (which could include the ordering rule described in the proposed regulations or the use of simultaneous equations)" applied consistently for all taxable years beginning on or after January 1, 2021. Because the 2019 ordering rule applies the section 163(j) limitation before computing the section 250(a)(2) taxable income cap, a taxpayer following that rule would take section 163(j) into account. Treasury has blessed that approach as reasonable.

The OBBBA made several changes to section 163(j) that affect the practical significance of this issue. For taxable years beginning after December 31, 2024, the depreciation, amortization, and depletion add-back is restored in computing ATI, which increases the section 163(j) ceiling. However, ATI is now also computed without regard to Subpart F and GILTI inclusions, section 78 gross-up amounts, and amounts included under section 956, and because these are income items, their exclusion reduces ATI. The net effect on a given taxpayer's section 163(j) limitation will depend on the relative magnitude of these competing adjustments. Corporations with large GILTI/NCTI inclusions relative to their depreciation and amortization could find themselves more constrained by section 163(j) under the OBBBA than under prior law, while asset-heavy domestic manufacturers may see their section 163(j) ceiling increase.

For any corporation where the section 163(j)

limitation continues to bind, the method chosen to coordinate sections 250(a)(2) and 163(j) creates a zero-sum allocation problem. A larger section 250 deduction reduces taxable income, which in turn reduces ATI (under pre-OBBBA law for the full section 250 deduction, and under the OBBBA for the FDDEI component under section 250(a)(1)(A), which remains in the ATI computation), which lowers the section 163(j) ceiling, which then pushes more business interest expense into future-year carryforwards.

Conversely, a larger section 163(j) allowance in the current year reduces taxable income, which can trigger or deepen the section 250(a)(2) taxable income limitation, permanently eliminating section 250 deduction that would otherwise be available (and which does not carry forward). The method chosen determines where that tradeoff lands. The ordering rule tends to favor the section 250 deduction: Step 1 computes an inflated tentative section 250 deduction (before any 163(j) or NOL adjustment), and Step 2 uses that inflated figure to suppress ATI, which suppresses the 163(j) allowance. The net result is a larger current-year section 250 deduction and more disallowed interest carried forward.

Simultaneous equations, by contrast, appear to maximize total current-year deductions across all three provisions, generally producing lower bottom-line taxable income. But they may do so by allocating more deduction to interest at the expense of the section 250 deduction. Because unused section 250 deductions are permanently lost, while disallowed business interest carries forward indefinitely under section 163(j)(2), most taxpayers should prefer a method that preserves the section 250 deduction even at the cost of deferring interest deductions to future years.

That said, the analysis is taxpayer-specific. The ordering rule's structural advantage depends on the assumption that deferred interest deductions will eventually be used. A corporation that expects its section 163(j) limitation to continue binding indefinitely, for example, because it is highly leveraged with no realistic prospect of deleveraging or increasing earnings, cannot assume that interest carried forward will ever produce a tax benefit. For such a taxpayer, the ordering rule's sacrifice of current-year interest deductions to preserve section 250 may buy nothing, and the taxpayer should instead model all available methods to determine which produces the greatest total current-year tax benefit rather than reflexively favoring the method that preserves the section 250 deduction.

2. Section 172: Net Operating Loss Deduction

The interaction between the section 172 NOL deduction and the section 250(a)(2) taxable income limitation has been substantially clarified by statute, at least for taxable years beginning after December 31, 2020.

The CARES Act amended section 172(a)(2)(B)(ii)(I) to provide that, for post-2020 taxable years, the 80% taxable income limitation on the NOL deduction is computed without regard to the deductions under sections 172, 199A, and 250. This statutory ordering effectively means that the NOL deduction is computed before the section 250 deduction – the NOL limitation looks at taxable income without section 250, which is the same taxable income figure that section 250(a)(2) uses. As a result, for post-2020 taxable years, the NOL deduction (as limited to 80% of taxable income determined without regard to sections 172, 199A, and 250) should reduce taxable income for section 250(a)(2) purposes. This is consistent with the plain

language of section 63(a): the NOL deduction is a deduction "allowed" under Chapter 1, and it reduces taxable income.

It is important to distinguish this treatment of the NOL deduction in the section 250(a)(2) taxable income limitation context from its treatment in the DEI/FDDEI allocation context discussed in Section II.A. For the section 250(a)(2) taxable income cap, the NOL deduction (as limited under section 172(a)(2)) reduces bottom-line taxable income because it is a deduction "allowed" under section 63(a). For the DEI/FDDEI expense allocation, by contrast, Treas. Reg. § 1.250(b)-1(d)(2)(ii) requires that the NOL deduction be disregarded entirely (in the author's view) – it is not allocated to gross DEI or gross FDDEI. These two rules operate independently and are not in conflict: the NOL deduction affects overall taxable income for purposes of the section 250(a)(2) cap, but it does not enter the calculation of DEI and FDDEI themselves.

The 2019 ordering rule reached the same result. Step 3 computed the NOL deduction considering the section 163(j) limitation but without regard to the section 250 deduction, consistent with the CARES Act's subsequent statutory amendment. Step 5 then applied the section 250(a)(2) taxable income limitation to a taxable income figure that reflected the NOL deduction computed in Step 3.

For pre-2021 taxable years, the interaction was more complex because the CARES Act temporarily suspended the 80% taxable income limitation on NOLs for 2018 through 2020. During that period, NOLs could fully offset taxable income, and the section 172 deduction was computed without reference to the section 250 deduction (because section 172(d)(9) has always excluded section 250 from the NOL computation). The preamble to the 2020 Final Regulations acknowledged that any future guidance would need to

account for the CARES Act amendments, and the consistency requirement for the chosen reasonable method applies only to taxable years beginning on or after January 1, 2021, leaving pre-2021 years available for taxpayers to select whichever method is most beneficial.

3. Other Taxable-Income-Limited Deductions

The preamble to the 2020 Final Regulations identified several other Code provisions that limit deductions based on taxable income and that Treasury intended to address in a separate guidance project: sections 170(b)(2) (charitable contribution limitation for corporations), 246(b) (dividends received deduction limitation), 613A(d) (percentage depletion limitation), and 1503(d) (dual consolidated losses). For purposes of the section 250(a)(2) taxable income limitation, the same statutory logic applies: if these deductions are "allowed" under Chapter 1 after application of their respective limitations, they should reduce taxable income under section 63(a) and thus reduce the taxable income used for section 250(a)(2).

In practice, the charitable contribution limitation under section 170(b)(2) and the dividends received deduction limitation under section 246(b) are most likely to be relevant. Both are computed by reference to taxable income with certain adjustments, creating the same type of circularity that exists with sections 163(j) and 172. The preamble's "any reasonable method" permission was stated broadly enough to encompass these provisions – it refers to the interaction of "sections 163(j), 172, 250(a)(2), and other Code sections that refer to taxable income." Accordingly, a taxpayer's chosen method should account for all applicable taxable income limited deductions, not just sections 163(j) and 172.



C. Comparison of Available Methods

The preamble to the 2020 Final Regulations identifies two specific methods, the 2019 ordering rule and simultaneous equations as valid, and permits any other "reasonable method." Each approach has distinct characteristics.

1. The 2019 Ordering Rule

The ordering rule applies a sequential, iterative computation. It computes a tentative section 250 deduction first, uses that tentative figure to determine the section 163(j) limitation, then computes the section 172 NOL deduction, then recomputes FDII on those two numbers, and finally computes the actual section 250 deduction subject to the taxable income limitation.

Because the tentative section 250 deduction at Step 1 is computed without regard to the

section 163(j) limitation or the NOL deduction, it will typically be larger than the final section 250 deduction. This tentative figure feeds into the section 163(j) computation at Step 2, reducing ATI and thereby reducing the amount of business interest allowed. In some cases, this effect can reduce the section 163(j) allowance below what simultaneous equations would produce, resulting in a larger section 250 deduction but a smaller interest deduction.

The ordering rule has the advantage of administrative simplicity; each step is computed in sequence using fixed inputs from prior steps, without the need for algebraic solutions. Treasury proposed it for precisely this reason, having rejected simultaneous equations as creating "undue administrative and compliance burdens." However, the sequential nature of the computation means it is path-dependent: the result varies depending on which deduction is computed first. The 2019 ordering rule's sequence: section 250 (tentative), then 163(j), then 172, then section 250 (final), generally favors preserving the section 250 deduction, because the tentative deduction reduces the section 163(j) allowance before the section 163(j) limitation can reduce taxable income for section 250(a)(2) purposes.

As noted in Section III.C, a taxpayer applying the 2019 ordering rule for the section 250(a)(2) taxable income limitation must also determine how to handle the DEI/FDDEI allocation at Step 4. Step 4 as originally proposed would allocate only the deductions allowed after application of sections 163(j) and 172(a), which conflicts with the operative text of Treas. Reg. § 1.250(b)-1(d)(2)(ii). A taxpayer using the 2019 ordering rule for the taxable income limitation may therefore need to modify Step 4 to conform with the final regulation – allocating full current-year interest (without the section 163(j) cap) and excluding the section 172 NOL

deduction entirely – while applying the remaining steps of the ordering rule to the section 250(a)(2) computation.

2. Simultaneous Equations

Simultaneous equations solve the system of statutory constraints optimally, maximizing total deductions across all three provisions at once. As a result, they will generally produce the lowest bottom-line taxable income. The Libin Zhang comment letter submitted during the 2019 rulemaking illustrated this with a worked example in which simultaneous equations produced taxable income of \$82 compared to \$86 under the ordering rule. However, lower bottom-line taxable income does not necessarily mean a better outcome for the taxpayer. What matters is the allocation of deductions among the three provisions. The ordering rule, by computing an inflated tentative section 250 deduction at Step 1 and using it to suppress ATI at Step 2, tends to reduce the section 163(j) allowance in favor of a larger section 250 deduction. That trade-off can be advantageous precisely because the forgone interest deduction carries forward under section 163(j)(2) while the section 250 deduction does not. A taxpayer whose section 163(j) limitation will relax in future years, whether due to the OBBBA's ATI changes, reduced leverage, or increased earnings, may prefer the ordering rule's allocation even at the cost of modestly higher current-year taxable income.

The principal disadvantage of simultaneous equations is practical implementation. Major tax compliance software platforms are designed around sequential form-based computations and do not, to our knowledge, include built-in functionality to solve the system of equations required by this approach. A taxpayer electing simultaneous equations would need to solve them outside the compliance software, typically in a

spreadsheet model, and manually override the software's computed figures. This practical burden is consistent with Treasury's original concern in the 2019 Proposed Regulations that simultaneous equations would create "undue administrative and compliance burdens," and likely explains why there is no indication of widespread adoption of this method.

3. Other Reasonable Methods

The preamble's reference to "any reasonable method" leaves open the possibility that a taxpayer may design its own approach. Such a method must account for all the variables required under the statute, including the allocations required when computing FDDEI. It must also be internally consistent and produce results that are defensible under the statutory framework. A method that simply ignores the section 163(j) limitation or the section 172 NOL deduction entirely, thereby inflating taxable income for section 250(a)(2) purposes and maximizing the section 250 deduction, would be difficult to defend as "reasonable" given the plain language of section 63(a). However, a method that applies the statutory limitations in a different sequence from the 2019 ordering rule, or that uses a modified iterative approach, could qualify as reasonable if it produces results consistent with statutory text.

D. The Consistency Requirement and Method Selection

The consistency requirement (in the corrected preamble to the 2020 final regulations) applies only to taxable years beginning on or after January 1, 2021. For pre-2021 taxable years, taxpayers are free to file or amend returns using whichever method produces the most favorable result, without regard to the method chosen for 2021 and later. This freedom exists because the CARES

Act's temporary suspension of the section 172(a)(2) limitation and expansion of the section 163(j) ATI percentage (to 50% for 2019 and 2020) created a materially different computational landscape for those years, and the preamble acknowledged that any future guidance would take these statutory changes into account.

For taxable years beginning on or after January 1, 2021, a taxpayer must apply its chosen method consistently. The OBBBA's 2026 amendments, which fundamentally alter the FDDEI computation, the section 163(j) ATI definition, and the section 250 deduction percentage, may reasonably justify selecting a new method, but taxpayers should document the rationale for any change and be prepared to explain why the prior method is no longer appropriate under the revised statutory framework.

E. Preparing for Controversy

Regardless of which method a taxpayer selects, the absence of definitive guidance means that the IRS could challenge the taxpayer's approach. Several practical considerations bear on controversy preparedness.

First, taxpayers with material deductions should model all available methods and retain documentation showing the analysis that led to their selection. If the IRS proposes an adjustment based on a different method, the taxpayer's ability to demonstrate that its chosen method is reasonable, consistently applied, and grounded in the statutory text will be critical.

Second, for the section 250(a)(2) taxable income limitation, a taxpayer following the 2019 ordering rule or simultaneous equations, both of which take section 163(j) into account, is on solid footing. The corrected preamble for the 2020 Final Regulations identifies these

as examples of reasonable methods, and Treas. Reg. § 1.250(a)-1(c)(5)(i) defines taxable income by reference to section 63(a), which requires that only deductions "allowed," i.e., after the application of section 163(j), be subtracted from gross income. The reserved paragraph at Treas. Reg. § 1.250(a)-1(c)(5)(ii) confirms that Treasury has not yet issued a contrary rule for the taxable income limitation.

Until further guidance is issued, taxpayers applying a consistently chosen reasonable method that takes section 163(j) into account should not face significant challenge on this point. The greater area of controversy risk lies in the DEI/FDDEI allocation context, where taxpayers who deviate from Treas. Reg. § 1.250(b)-1(d)(2)(ii) – whether by allocating only the interest allowed after the section 163(j) cap rather than the full amount, or by including the section 172 NOL deduction in the allocation rather than excluding it – would be directly contradicting an operative final regulation. While such positions may be supportable under statutory arguments and the post-Loper Bright framework, they carry inherent litigation risk.

Third, taxpayers should be alert to the possibility that Treasury and the IRS may yet issue the promised separate guidance project addressing the ordering question. That said, the 2025-2026 Priority Guidance Plan does not appear to include this project, and Treasury's current focus on OBBBA implementation, deregulation, and other priorities suggest that definitive guidance may not be imminent. Nonetheless, any future guidance could retroactively affect method selection if it prescribes a mandatory approach. Taxpayers should monitor regulatory developments and consider whether protective claims or amended returns may be appropriate if guidance is issued that validates a more favorable method than the one originally elected.

V. CONCLUSION



The interaction of the section 250 deduction with sections 163(j), 172, and other taxable-income-limited deductions presents two distinct computational questions that practitioners must address separately.

The allocation of deductions to gross DEI and gross FDDEI is governed by Treas. Reg. § 1.250(b)-1(d)(2)(ii), which requires that deductions be determined without regard to sections 163(j), 170(b)(2), 172, 246(b), and 250. Because the regulation cites only the limitation subsection for some of these provisions (sections 163(j), 170(b)(2), and 246(b)), but the entire section for others (sections 172 and 250), the practical effect varies: for interest, charitable contributions, and dividends-received deductions, the underlying deduction is allocated at its full, uncapped amount; for the section 172 NOL deduction, as discussed above in detail, the most likely interpretation is that it is excluded

in full, along with the section 250 deduction. For taxable years beginning after December 31, 2025, the OBBBA's statutory exclusion of interest expense and R&E expenditures from the DEI allocation largely moots the pre-OBBBA controversy as it relates to interest in this context.

The section 250(a)(2) taxable income limitation is a separate computation that remains unresolved nearly eight years after Treasury reserved on the ordering question. The plain language of sections 63(a) and 250(a)(2)(A)(ii) supports the conclusion that taxable income should be determined after applying all deduction limitations, including sections 163(j) and 172(a)(2). The corrected preamble to the 2020 Final Regulations permits taxpayers to use any reasonable method – citing the 2019 ordering rule and simultaneous equations as examples (or another approach) – applied consistently for post-2020 taxable years. Each method has advantages and disadvantages that depend on the taxpayer's specific profile of FDDEI, business interest expense, NOL carryforwards, and other taxable-income-limited deductions.

Because unused section 250 deductions are permanently lost while section 163(j) and section 172 carryforwards survive, taxpayers should generally favor methods that maximize the section 250 deduction. Rigorous modeling, careful method selection, thorough documentation, and readiness for controversy remain essential for any domestic corporation claiming the benefit of section 250.



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