2017 Tax Cuts and Jobs Act

Analysis from Councilor, Buchanan & Mitchell, PC

The Tax Cuts and Jobs Act (TCJA), the most far-reaching overhaul of the tax code since 1986, was enacted on December 22, 2017. There are certain provisions that affect vehicle dealers specifically. Most of its provisions are effective as of January 1, 2018. Exceptions are noted below.

Business Interest Deduction – Generally, deduction of business interest will be limited to the sum of 30% of the taxpayer's “adjusted taxable income” and the taxpayer's interest income. Any excess interest expense is carried forward. However, for motor vehicle dealers, there is an unlimited deduction allowed for "floor plan interest." Other interest expense of dealers is subject to the same limitation that applies to other taxpayers.

A caveat, however - taxpayers availing themselves of the unlimited deduction for floor plan interest are precluded from claiming bonus depreciation (see below). The dealer is left with a choice - either to claim bonus depreciation or to claim the unlimited deduction for floor plan interest. If floor plan and other interest paid is less than 30% of adjusted taxable income, then no choice need be made, and the dealer may deduct both bonus depreciation and all interest costs.

Another exception to the interest limitation is provided for real estate businesses - including those leasing property to dealers - who may elect out of the limitation. As with vehicle dealers, however, the election comes at the cost of eligibility for claiming bonus depreciation. In addition, real estate businesses electing out of the interest limitation must use a slightly longer depreciable life for real estate - 40 years instead of the normal 39.

Bonus Depreciation – The TCJA provides for 100% bonus depreciation of qualifying assets acquired after September 27, 2017. Bonus depreciation, previously limited to the cost of property the first use of which commenced with the taxpayer (i.e., "new" property), may now be claimed for the cost of "used" property as well. Dealers will be eligible to claim bonus depreciation on property placed in service from September 27, 2017 through December 31, 2017 without any restriction imposed by deducting floor plan interest.

Property Qualifying for Bonus Depreciation

- For property acquired prior to September 28, 2017, new tangible property that has a recovery period under the MACRS rules of 20 years or less;
- For property acquired after September 27, 2017, new and used tangible property that has a recovery period under the MACRS rules of 20 years or less;
- Water utility property (which, under MACRS, has a recovery period of 25 years);
- Computer software that is depreciated over 36 months, using the straight-line method.

Qualified Improvement Property

Certain "qualified" real estate improvements have for some time been eligible for a shorter depreciation period - 15 years - and for bonus depreciation. The new legislation expands the definition of "qualified" improvements, and the legislative history indicates that Congressional intent was for such property to be treated as 15-year property, and thus eligible for bonus depreciation. The necessary language is omitted from the statute, however, and it will be necessary for Congress to enact a technical correction for qualified improvement property to continue to have preferential treatment.

Section 179 Expense – The expense limit is increased to $1,000,000 and the asset acquisition limit is increased to $2,500,000 beginning in 2018.

Like Kind Exchanges – Deferral of gain, previously available for exchanges of both real and personal property used in a trade or business or held for investment, is now available only for exchanges of real property.

Corporate Tax Rate – The rate is a flat 21% for C corporations with a taxable year beginning after December 31, 2017. There is no longer a lower 15% rate on corporations with little taxable income, nor a higher flat 34% rate on "personal service" corporations.

20% qualified business income deduction – In an effort to mitigate the disparity on taxation of business income of C corporations and of individuals, an individual deduction is allowed for "qualified business income." The deduction applies to income received by an individual from partnerships, S corporations, sole proprietorships, or rental property.

The deduction is 20% of the qualifying income, with limitations depending on taxable income and type of business. "Personal service" businesses (physicians, attorneys, consultants, etc.) are eligible for the deduction only if taxable income falls below a statutory threshold. The applicable taxable income thresholds for 2018 are $315,000 for married filing joint status and $157,500 for other filing statuses.

If a taxpayer’s taxable income is less than the threshold, the deduction is 20% of the qualifying income.

If taxable income exceeds the threshold, the deduction is the lesser of (1) 20% of qualifying income, (2) 50% of wages paid by the entity, or (3) 25% of wages paid by the entity plus 2.5% of unadjusted basis of depreciable assets owned by the entity. There is a phase-in the above amounts for taxpayers with income between $315,000 and $415,000 (joint) or $157,500 and $207,500 (other filers).

We would expect that dealers, having both substantial wage costs and substantial investment in depreciable assets, will likely be eligible for the full 20% deduction.

If the individual is in the highest tax bracket (37%) and gets the full 20% deduction, the effective tax rate on the pass-through income is 29.6%. It may be advisable for taxpayers to review their business structures in order to minimize tax.

Net Operating Loss (NOL) – For both corporations and individuals, NOLs incurred in 2018 and later years may not be carried back, but must be carried forward. The carryforward period is unlimited. However, post-2017 NOLs may be used to offset only 80% of the taxable income of a carryforward year. The remaining 20% is carried forward.

Individual Changes

Generally, the changes to the provisions governing the taxation of individuals will expire at the end of 2025. Key items:

- Individual tax rates are reduced; the top rate dropped from 39.6% to 37%.
- Personal exemptions are eliminated.
- Standard deduction increased to $24,000, for joint filers, to $18,000 for heads of household, to $12,000 for other filers.
- Itemized deduction for state income taxes, real estate and other taxes capped at $10,000 total
- "2%" itemized deductions eliminated
- Mortgage interest deduction limited to interest on $750,000 of new debt
- No deduction for home equity interest
- Adjustments made to AMT, so that few will be subject to it
- Moving expense deduction eliminated, except for military personnel
- For post-2018 agreements, no deduction for alimony payers, no income for recipients

Estate and Gift Taxes – The exemption amount for transfers at death and during lifetime was doubled. For 2018, the amount an individual can gift or transfer at death tax free will be approximately $11.2 million. The TCJA retains the basis step-up rules for property received from a decedent, and the "portability" rules to allow a surviving spouse to utilize the unused exemption of a deceased spouse. In 2025, barring action by Congress, the exemption amounts will revert to the 2017 level (approximately $5.6 million) adjusted for inflation during the intervening years.

We are available to help address your particular situation.