

2018 Tax Reform

Key Provisions Impacting Dealerships & Their Owners



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Business Tax

Pass-Through Entities

New 20% Deduction

- For tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026, taxpayers who have domestic “qualified business income” (QBI) from a partnership, S corporation, or sole proprietorship are entitled to deduction of the lesser of such QBI or 20% of taxable income.
 - Rental real estate and management companies may not be eligible.
 - QBI deduction on pass-through income from Specified Service Businesses is subject to substantial restrictions.
- The deduction is generally limited to the greater of either:
 - 50% of the W-2 wages paid with respect to the qualified trade or business, or
 - the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the **unadjusted basis**, immediately after acquisition, of all qualified property.
 - Qualified property is defined as any tangible property subject to depreciation, which is held by the business at the end of the year and is used at any point of the year in production of QBI.
 - The depreciable period cannot have ended prior to the last day of the year.
 - The depreciable period starts on the date the property is placed in service and ends on the LATER of;
 - 10 years, or
 - The last day of the last full year in the asset’s regular (not ADS) depreciation period
 - Ex. Any asset that was fully depreciated prior to 2018, unless it was placed in service after 2008, would not count towards basis.

Limitation on Pass-Through Losses

- Effective for tax years beginning after Dec. 31, 2017, the Act disallows an excess business loss of a taxpayer other than a C corporation.
- An excess business loss is treated as part of the taxpayer’s net operating loss carryover to the following year.
 - An excess business loss for the tax year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount (\$500,000 for married taxpayers filing jointly; \$250,000 for all other taxpayers (indexed for inflation)). The limitation applies at the partner or S corporation shareholder level.

Net Operating Losses

- The Act limits the deduction for net operating losses (NOLs) to 80% of taxable income (determined without regard to the deduction) for losses.
- Taxpayers are allowed to carry NOLs forward indefinitely. The two-year carryback and special NOL carryback provisions were repealed.

Depreciation

Bonus Depreciation

- The Act initially allows full expensing for property placed in service after Sept. 27, 2017, reducing the percentage that may be expensed for property placed in service after Jan. 1, 2023, as follows:

| Placed in Service | Bonus Depreciation |
|---|-----------------------|
| After September 27, 2017 and before January 1, 2023 | 100% |
| 2023 | 80% |
| 2024 | 60% |
| 2025 | 40% |
| 2026 | 20% |

- For each of the above taxpayers could elect 50% in lieu of 100% expensing for qualified property placed in service during the first tax year ending after Sept. 27, 2017.
- The Act amends the definition of qualified property to exclude any property used in a trade or business that had floor plan financing indebtedness (indebtedness used to finance the acquisition of motor vehicles by retail outlets and secured by those vehicles) that was deducted as business interest.
- The Act also removed the rule that made bonus depreciation available only for new property.

Luxury Automobile Depreciation Limits

- The Act increased the depreciation limits under Sec. 280F that apply to listed property.
- For passenger automobiles placed in service after 2017 and for which bonus depreciation is not claimed, maximum depreciation will be limited to:

| | | |
|------------------|----|--------|
| Year 1 | \$ | 10,000 |
| Year 2 | \$ | 16,000 |
| Year 3 | \$ | 9,600 |
| Year 4 and later | \$ | 5,760 |

Sec. 179 Expensing

- The Act increased the maximum amount a taxpayer may expense under Sec. 179 to \$1 million and increased the phaseout threshold to \$2.5 million.
 - These amounts will be indexed for inflation after 2018.
 - The \$25,000 cost limitation for SUVs is also indexed for inflation beginning in 2019.
- The Act also expanded the definition of qualified real property eligible for Sec. 179 expensing to include any of the following improvements to nonresidential real property: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Depreciation Deductions for Nonresidential Real Property

- The Act provides a 15-year recovery period for qualified improvement property.
 - Eliminates the separate definitions of “qualified leasehold improvement property,” “qualified restaurant property,” and “qualified retail improvement property.”
- Applies to property placed in service after Dec. 31, 2017.



Business Interest Deduction Limitation

- Under the Act, the deduction for business interest is limited to 30% of the taxpayer’s Adjusted Taxable Income (ATI) for the tax year
 - ATI approximates EBITDA until December 31, 2021.
 - Beginning in 2022, depreciation and amortization cannot be added back.
 - Any disallowed business interest deduction can be carried forward indefinitely
- Floor plan interest is excluded from the 30% limitation
- Floor plan financing interest is defined as interest paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the inventory so acquired.
 - Motor Vehicle definition:
 - Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road
 - A boat
 - Farm machinery or equipment
 - Construction equipment, power sport and recreational vehicles that are not self-propelled would be excluded from the definition of motor vehicle.
- Any taxpayer that meets the \$25 million gross-receipts test is exempt from the interest deduction limitation. (3-year gross receipts test)
 - Aggregation rules apply to this test.
- The limitation will also not apply to any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. – Must use ADS depreciation for this exception to apply.

C Corporations

- Reduces the corporate tax rate to a flat 21% for tax years beginning after Dec. 31, 2017.
- Repeals the maximum corporate tax rate on net capital gain as obsolete.
- Does not require a special rate for personal service corporations.
- No expiration.
- Reduces the 80% dividends received deduction to 65% and the 70% dividends received deduction to 50%. Also reduces the corresponding taxable income limitations.
- Eliminates AMT.

Other Business Provisions

Electric plug-in vehicles – \$7,500 credit retained.

Inventory methods – Lower of cost or market and LIFO retained.

Solar credits – Investment tax credit remains subject to step down under prior law where the 30% credit is reduced gradually to 10% beginning in 2022.

UNICAP – Taxpayers that meet the cash-method \$25 million gross-receipts test are exempted from the uniform capitalization rules of Sec. 263A. (The exemptions from the UNICAP rules that are not based on gross receipts are retained in the law.)

Like-kind exchanges – Under the Act, like-kind exchanges under Sec. 1031 will be limited to exchanges of real property that is not primarily held for sale.

Entertainment expenses – The Act disallows a deduction for (1) an activity generally considered to be entertainment, amusement, or recreation; (2) membership dues for any club organized for business, pleasure, recreation, or other social purposes; or (3) a facility or portion thereof used in connection with any of the above items.

Meals – Under the Act, taxpayers are still generally able to deduct 50% of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after Dec. 31, 2017, and until Dec. 31, 2025, the Act expands this 50% limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes and for the convenience of the employer. Such amounts incurred and paid after Dec. 31, 2025, will not be deductible.

Employer credit for paid family or medical leave – The Act allows eligible employers to claim a credit equal to 12.5% of the amount of wages paid to a qualifying employee during any period in which the employee is on family and medical leave if the rate of payment under the program is 50% of the wages normally paid to the employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. The maximum amount of family and medical leave that may be taken into account for any employee in any tax year is 12 weeks. However, the credit is only available in 2018 and 2019.

Denial of deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment or sexual abuse – The Act disallows a deduction for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement. Effective for amounts paid or incurred after the date of enactment.

Individual Income Tax

New individual income tax rates:

| Rates | Single | Married Filing Joint (MFJ) | Married Filing Separate |
|-------|-----------------------|----------------------------|-------------------------|
| 10% | \$0 - \$9,525 | \$0 - \$19,050 | \$0 - \$9,525 |
| 12% | \$9,525 - \$38,700 | \$19,050 - \$77,400 | \$9,525 - \$38,700 |
| 22% | \$38,700 - \$82,500 | \$77,400 - \$165,000 | \$38,700 - \$82,500 |
| 24% | \$82,500 - \$157,500 | \$165,000 - \$315,000 | \$82,500 - \$157,500 |
| 32% | \$157,500 - \$200,000 | \$315,000 - \$400,000 | \$157,500 - \$200,000 |
| 35% | \$200,000 - \$500,000 | \$400,000 - \$600,000 | \$200,000 - \$300,000 |
| 37% | Over \$500,000 | Over \$600,000 | Over \$300,000 |

* No change to net investment income tax or high earners tax

Child tax credit increase

- Credit increases from \$1,000 to \$2,000
- Income phaseout increases from \$110,000 to \$400,000 (MFJ)
- First \$1,400 is refundable

Standard deduction and personal exemption changes

- Personal exemptions eliminated
- Increases the standard deduction to \$12,000 for single filers, \$18,000 for heads of household, and \$24,000 for joint filers in 2018 (compared to \$6,500, \$9,550 - and \$13,000 respectively, under current law)

State and local tax limit – Real estate, personal property and state income tax deductions capped at \$10,000

Home mortgage interest limits

- Mortgage interest deduction is limited to \$750,000 on post Dec. 15, 2017 acquisition indebtedness
- The \$1m limitation remains for older debt
- Deduction for home equity interest is eliminated

Medical expense deduction – AGI limit reduced to 7.5%

Charitable contributions

- AGI limit increased from 50% to 60%
- Repeals current 80% deduction for athletic seating rights
- Repeals the exception to the contemporaneous written acknowledgement requirement for contributions of \$250 or more when the donee organization files the required return

Miscellaneous itemized deductions – Eliminated

Pease limitation – Eliminated

Alimony

- Effective for divorce decrees entered into after 2018
- Above the line deduction eliminated
- Payee no longer includes alimony in income

Gift and estate tax

- Estate and gift tax exemption doubled – \$10 million (adjusted for inflation from the same 2010 base year) per individual – approx. \$11.2 million for 2018
- Gift tax annual exclusion increases to \$15,000
- Valuation discounts for minority interests in a closely held business allowed
- Basis step-up at death continues

The majority of the tax reform changes expire on Dec. 31, 2025.

For more information on how BlumShapiro can help your organization, contact one of our professionals below.

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