BUSINESS INTEREST EXPENSE FOR MOTOR VEHICLE DEALERS
Updated Sept 2019 Due to REG-106808-19

On September 13, 2019, the IRS issued new proposed regulations (REG-106808-19) that provide guidance on the eligibility of motor vehicle dealers with business interest expense to claim bonus depreciation on their otherwise qualifying property.

The 2017 Tax Cuts and Jobs Act (TCJA) amended §163(j) to limit the deductibility of business interest. The limitation is equal to business interest income plus 30% of the **adjusted taxable** income (ATI) of the taxpayer. See §163(j)(1)(A) & (B). However, taxpayers are also allowed to fully deduct any floor plan financing interest. See §163(j)(1)(C).

Floor plan financing interest is interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness is indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory so acquired. A motor vehicle is any self-propelled vehicle designed for transporting persons or property on a public road, a boat, or farm machinery or equipment. See §163(j)(9).

Unfortunately, there is a trade-off to deducting floor plan financing interest in excess of the general limitation. Under §168(k)(9)(B), qualified property for bonus depreciation shall not include **any property** used in a trade or business that **has had** floor plan financing indebtedness, if the floor plan financing interest related to such indebtedness **was taken into account under §163(j)(1)(C)**. See also Treas. Reg. §1.168(k)-2(b)(2)(ii)(G).

Therefore, it was argued that once a taxpayer deducts business interest as floor plan financing interest under §163(j)(1)(C), any property placed in service during the same and **all subsequent** taxable years by the motor vehicle dealer would be ineligible for bonus depreciation.

Prop. Reg. §1.168(k)-2(b)(2)(ii)(G) provides that if the trade or business has taken floor plan financing interest into account pursuant to §1.168(k)-2(b)(2)(ii)(G) for a taxable year, §1.168(k)-2(b)(2)(ii)(G) applies to any property placed in service by that trade or business in that taxable year. Therefore, the **determination** of eligibility of property for bonus depreciation that is used in a trade or business that has, or has had, floor plan financing indebtedness, **is made annually.** The prior deduction of floor plan financing interest under §163(j)(1)(C) will not permanently disqualify a motor vehicle dealer from claiming bonus depreciation.

Additionally, some commentators argued that the deduction of floor plan financing interest would always be taken into account under §163(j)(1)(C). That interpretation, in conjunction with the argument that all subsequent taxable years were tainted by a taxpayer's first deduction under §163(j)(1)(C), led to the conclusion that any motor vehicle dealer with any floor plan financing interest was permanently barred from claiming bonus depreciation.

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Scarpello Consulting had argued that position was unsupported by the law and available official guidance. To conclude that floor plan financing interest is always taken into account under §163(j)(1)(C), whether or not total business interest expense exceeds the general limitation, would render the phrase "if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section" in §168(k)(9)(B) superfluous because §168(k)(9)(B) would have the same meaning with or without the phrase. Under canons of judicial interpretation/statutory construction, courts will typically avoid interpreting a provision in a way that would render other parts of the provision, or other provisions of the same law, superfluous or unnecessary.

Prop. Reg. §1.168(k)-2(b)(2)(ii)(G) now provides that for purposes of §168(k)(9)(B), "floor plan financing interest is not taken into account for the taxable year by a trade or business that has had floor plan financing indebtedness if the sum of the amounts calculated under section 163(j)(1)(A) and (B) for the trade or business for the taxable year equals or exceeds the business interest, as defined in section 163(j)(5), of the trade or business for the taxable year (which includes floor plan financing interest)."

In short, if the sum of the business interest income and 30% of the ATI of the taxpayer for the taxable year equals or exceeds the total business interest expense of the taxpayer for the taxable year (including carryforwards of disallowed business interest under §163(j)(2)), then no business interest expense is taken into account under §163(j)(1)(C), §168(k)(9)(B) does not apply, and the taxpayer remains eligible to claim bonus depreciation on otherwise qualifying property.

It was also argued that under §168(k)(9)(B)'s reference to "any property used in a trade or business that has had floor plan financing indebtedness," any property, including property leased to a motor vehicle dealer with floor plan financing indebtedness, would be disqualified from taking bonus depreciation.

Prop. Reg. §1.168(k)-2(b)(2)(ii)(G) now provides that it "does not apply to property that is leased to a trade or business that has had floor plan financing indebtedness by a lessor's trade or business that has not had floor plan financing indebtedness during the taxable year or that has had floor plan financing indebtedness but did not take into account floor plan financing interest for the taxable year pursuant to this paragraph (b)(2)(ii)(G)."

Therefore, under the common dealership structure where an LLC taxed as a partnership owns real and personal property leased to a S-Corp. operating entity, so long as the LLC/partnership is treated as a separate taxable trade or business, and is not itself a motor vehicle dealer with floor plan financing interest taken into account under §163(j)(1)(C) for the taxable year, the LLC/partnerships' property is not disqualified from claiming bonus depreciation under §168(k)(9)(B).

Note: It remains to be determined if otherwise passive rental activities grouped with an active trade or business activity under Treas. Reg. §1.469-4(d)(1) for purposes of the passive activities loss limitations under §469 will still be considered separate trades or businesses for purposes of §163(j) & §168(k)(9)(B).

§1.469-4(a) provides that it sets forth rules for grouping a taxpayer's trade or business activities and rental activities for purposes of applying the passive activity loss and credit limitation rules of §469. No mention is made to any other code provision, so a literal/textual analysis would indicate that grouped activities for §469 purposes will remain separate activities for purposes of other code sections.

However, Treasury/IRS has not always adopted a literal/textual understanding of §163(j) (see above for the discussion concerning the annual determination of the eligibility for the bonus depreciation), so a future regulation, procedure, or notice could provide that such a grouping election would result in the grouped activities being treated as one trade or business for purposes of §163(j) and/or §168(k)(9)(B).

Finally, it should be noted that while the JCT had interpreted §163(j)(1)(C) as optional, (i.e., a taxpayer could choose not to deduct business interest expense in excess of business interest income and 30% of ATI; see JCS-1-18, pg. 127), in the preamble to the proposed regulations it states that "[t]he Treasury Department and the IRS do not believe that section 163(j) is optional." See pg. 6, 3rd sentence under Section C. Therefore, business interest expense incurred in excess of the §163(j)(1)(A) & (B) amounts will disqualify the motor vehicle dealer trade or business from claiming bonus depreciation for any assets they place in service during the same tax year.

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