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Room 5203

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Internal Revenue Code Section 168(k) PROPOSED REGULATIONS

Crowe LLP submits the following comments in response to the proposed regulations under Internal Revenue Code section 168(k) regarding Bonus Depreciation released by the Department of the Treasury and the Internal Revenue Service in the Federal Register on August 8, 2018. These comments are being submitted on behalf of the National Automobile Dealers Association (NADA), which represents over 16,000 franchised dealers located in all 50 states who sell new and used cars and trucks, extend vehicle financing and leases to consumers, which are generally assigned to third-party finance sources, and engage in service, repair, and parts sales. The members of NADA collectively employ over 1.1 million people nationwide. Most of the members are small businesses as defined by the Small Business Administration.

We also request a public hearing and the opportunity to present this information in summary form.

Floor Plan and Bonus Depreciation

Crowe and NADA fully support the provisions of IRC 163(j)(1)(C) that allow for the full deduction of interest related to floor plan financing indebtedness even though such a deduction may affect the deduction of 100% Bonus Depreciation under IRC 168(k)(9)(B). Crowe and NADA believe that the wording of IRC 168(k)(9)(B) can only be read to provide for a disallowance of Bonus Depreciation in the case of floor plan interest if, and only if, the dealer actually deducts floor plan interest under the provisions of IRC 163(j)(1)(C) and that such deduction is in excess of what would be deductible absent the existence of subparagraph (C). Therefore, Crowe and NADA believe that the proposed regulations should be amended to affirmatively state that for a taxable year when a taxpayer does not deduct floor plan interest in excess of what would be deductible under IRC 163(j)(1)(A) and (B) (here in after referred to as the 30% limitation), the taxpayer is allowed Bonus Depreciation deductions under IRC 168(k) and the provisions of IRC 168(k)(9)(B) do not apply. We urge the Department of the Treasury and the IRS to make this modification for the reasons described below.

Background and Legislative process of IRC 163(j)(1)(C) and IRC 168(k)(9)(B)

Automobile manufacturers sell new vehicles to franchised auto dealers, not directly to end users. Automobile dealers generally finance the inventory purchase of new vehicles held in inventory by the dealer, and each vehicle is identified by a unique Vehicle Identification Number (VIN). According to the terms of the floor plan financing agreement, when a vehicle is sold by a dealer to a customer, the financed amount with respect to that VIN-specific vehicle is required to be paid off. Periodically, the finance company may visit the dealer's place of business to physically inspect the VINs of all vehicles on location to ensure that the dealer is in compliance with the floor plan financing agreement.

A key benefit of the floor plan financing arrangement is that the manufacturer or distributor of the vehicle is able to access the floor plan account so that when the vehicle is ready to be shipped to the dealer, payment is made to the manufacturer for the invoice amount of the vehicle. This allows for a steady flow of vehicles through the manufacturing process and delivery to the designated dealer. This efficiency of motor vehicle commerce supports millions of direct well-paying jobs with manufacturers, suppliers and dealers, as well as jobs in other supporting roles.

Dealers may also have a floor plan financing arrangement for the inventory purchase of used vehicles. These arrangements facilitate new vehicle sales by providing a supporting market for the flow of used vehicles from dealer trade-in to secondary used vehicle markets.

Historically, floor plan interest has been one of the largest expense items for franchised dealers. Removing or diminishing that deduction would trigger a significant financial hardship because of the additional tax liability that the dealer would incur. The hardship would be especially burdensome during times of economic downturn.

When dealers learned that Congress was considering tax legislation that could limit deductions for business interest to 30% of taxable income, they were very concerned about the loss of some or all of a very significant tax deduction for floor plan interest. In years of economic downturn, this situation would be intensified and could cause dealers to limit the number of vehicles that they would be willing to purchase for inventory from the manufacturer. The steady flow of vehicles through manufacturing would be disrupted, likely causing factory and supply chain slow-downs or closures. Workers throughout the supply chain could be laid off, which would add a serious blow to the economy during a downturn. In addition to limiting the deduction for interest, Congress was also considering a provision to limit the carryforward of unused interest deductions to seven or fewer years. The combination of these two provisions could cause dealers to permanently lose the deduction for floor plan interest and make it even more difficult for dealers to recover from an economic downturn. Finally, dealers were concerned that the problems would be intensified due to the probable increase in market interest rates that may accompany an economic downturn.

Based on these economic concerns, Congress decided to retain the 100% deduction for floor plan interest rather than subject the floor plan interest to the new 30% limitation. Additionally, Congress denied the 100% Bonus Depreciation deduction for dealers relying on this provision.

As enacted, the law allows a deduction for business interest that is subject to a 30% limitation plus an additional deduction for floor plan financing interest.

IRC 163(j)(1)

In general — The amount allowed as a deduction under this chapter for any taxable year for business interest shall not exceed the sum of —

- (A) the business interest income of such taxpayer for such taxable year,
- (B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year, plus
- (C) the floor plan financing interest of such taxpayer for such taxable year.

For all businesses, the deduction of business interest for a taxable year is limited to the sum of business interest income for the year plus 30% of the adjusted taxable income for the year. For certain other businesses, there is an additional unlimited deduction under subparagraph (C) for floor plan financing interest. However, the 100% Bonus Depreciation that is otherwise allowable for most other businesses is denied for businesses that deduct floor plan financing interest that exceeds the 30% threshold (IRC 168(k)(9)(B) and IRC 163(j)(1)).

While relying on IRC 163(j)(1)(C) is essential for many dealers, some dealers would rather use the same regime as other taxpayers that do not have floor plan interest. That is, these dealers would like to deduct their business interest expense, including floor plan interest, under the 30% limitation applicable to other taxpayers and still be permitted to deduct 100% Bonus Depreciation. Such an option appears to be consistent with the intent of the law. If dealers did not take a deduction under the floor plan interest provision (IRC 163(j)(1)(C)), they would be entitled to Bonus Depreciation similar to other taxpayers. There is no indication in the statute or legislative history that the provisions were ever meant to work against dealers or to be a penalty provision.

These examples illustrate the need for clarification.

Situation 1: Dealer is well-financed and has floor plan interest of \$10,000, other business interest of \$90,000 with a deduction limit of \$300,000 under the 30% limitation. Property that qualifies for 100% Bonus Depreciation was placed in service during the year with a cost of \$500,000. Some commenters believe that the dealer must deduct the \$10,000 floor plan interest under IRC 163(j)(1)(C) even though when combined with the other business interest of \$90,000, the combined total is less than the 30% limitation and would be completely deductible without using the special floor plan rule. Such an interpretation would result in the dealer not being allowed to deduct the 100% Bonus Depreciation of \$500,000 for the qualifying property and only being allowed to deduct the normal depreciation on the \$500,000 amounting to \$100,000 (assuming property is all MACRS 5-year property under the half-year convention).

Situation 2: Same facts as in Situation 1 but the dealership operations also include a transportation activity with a rental fleet of high-end vehicles that is not subject to the limitations under IRC 280F. This fleet usually has 20 vehicles that cost \$60,000 each, totaling \$1,200,000. In 2017, the dealer replaced the vehicles in the fleet in the beginning of the year and deducted 50% Bonus Depreciation of \$600,000. In keeping with the dealer's policies that the vehicles are to be replaced every eighteen months, the dealer replaced all 20 vehicles late in 2018. Because 100% Bonus Depreciation is not allowed, the dealer is required to pay significant additional tax in 2018 because the \$400,000 recapture income on the sale of the 2017 vehicles (assuming a \$400,000 gain on disposal) is offset only by the normal depreciation of the 2018 vehicles of \$60,000 (assuming 2018 vehicles are placed into service in the 4th quarter under the mid-quarter convention). The dealer has a \$340,000 income pick up.

These examples demonstrate that, while the Interest/Bonus Depreciation provisions are well intended, there would be adverse unintended consequences if they are not correctly interpreted. The dealers that wish to deduct Bonus Depreciation and deduct their business interest only under the 30% limitation rules should not be denied the Bonus Deduction and be prevented from realizing the benefits that non-dealer taxpayers enjoy. Dealers who want the option of not relying on the special floor plan interest deduction provision and are denied the Bonus Depreciation deduction will not realize the tax cuts that were so highly publicized. Tax Reform would be costly for them since, prior to the TCJA, dealers were able to deduct both floor plan interest and 50% Bonus Depreciation.

IRC 163(j) should be read as providing dealers with a choice of including their floor plan interest as a part of the other business interest expense that is subject to the 30% limitation. There is no statutory language that excludes floor plan interest from "business interest."

Dealers who would like to deduct all of their floor plan interest would deduct their business interest, except floor plan interest, subject to the 30% limitation, and also deduct additional floor plan interest in full without limitation under IRC 163(j)(1)(C). These dealers would not be entitled to 100% Bonus Depreciation.

In some cases, the total business interest for a dealership, including floor plan interest, could be less than the 30% limitation and, therefore, fully deductible without using IRC 163(j)(1)(C). Dealers in this situation are in the same position as non-dealer taxpayers and should be able to take both this interest deduction and the Bonus Depreciation deduction.

In a case where total business interest is treated as including floor plan interest, and the 30% limitation does apply, and the dealer does not want to deduct all of their floorplan interest, the portion of the interest in excess of the 30% limitation would not be deductible in the current year and, as with non-dealer taxpayers, would be carried over to the subsequent year as business interest other than floor plan interest.

Because these dealers would not, for the current year, take any deduction under IRC 163(j)(1)(C), they, like other non-dealer taxpayers, should be able to take the business interest deduction, including floor plan interest, with the carryover like other taxpayers and they should also be entitled to 100% Bonus Depreciation the same as taxpayers that do not have floor plan interest.

We urge Treasury to change the Proposed Regulations to include a provision that, since there is not a specific statute providing that business interest expense does not include floor plan interest, dealers can choose to either (i) deduct interest, including floor plan interest within the 30% limitation and also deduct 100% Bonus Depreciation or (ii) deduct their full floor plan interest under IRC 163(j)(1)(C) with no deduction for 100% Bonus Depreciation.

Related but Separate Real Estate Leasing Companies

For good business reasons, dealers frequently hold real estate used in dealership operations in separate companies and lease the property to the dealership. These leasing companies may have owners in common with the related dealership, but the ownership may not be identical. The leasing companies typically file their own federal income tax returns that are separate from the tax returns filed by the dealership.

Some of the property that is leased to the dealerships may otherwise qualify for Bonus Depreciation. In some cases, the related dealership may have deducted floor plan interest under IRC 163(j)(1)(C) and would be denied Bonus Depreciation. In other cases, the related dealership lessee may have deducted floor plan interest under the 30% limitation.

In most cases, the leasing company will be considered to be a separate company from the dealership but may be aggregated with the dealership trade or business under the proposed regulations for IRC 199A.

Under IRC 168(k)(9)(B),

(t)he term "qualified property" shall not include any property used in a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section.

Thus, a dealership operation that is a trade or business and deducts floor plan interest under subparagraph (C) cannot deduct Bonus Depreciation for property used in the dealership's trade or business.

The related real estate rental company is not in a trade or business that has floor plan financing indebtedness or interest deducted under IRC 163(j)(1)(C). Rather, the real estate company has property that is used in its leasing activity and some of this property can be qualified property for purposes of Bonus Depreciation.

We urge that the Proposed Regulations be changed to clarify that related real estate rental companies under these circumstances qualify for Bonus Depreciation.

Like Kind Exchange

The Tax Cuts and Jobs Act (TCJA) eliminates the benefit of like kind exchange (LKE) for all property except real property. Under prior law, LKE allowed taxpayers, like those who purchased fleets of vehicles for leasing, especially heavy-duty trucks, to trade-in their existing vehicles in exchange for new vehicles and defer the gain on the trade-ins. Since these businesses were trading up for new vehicles, LKE made it possible for them to improve their over-the-road fleet of vehicles and provide economic stimulus for the truck dealers, manufacturers and suppliers. Under the TCJA, there will be a tax penalty for such upgrades, and it is likely that economic activity for new trucks will be reduced.

For most taxpayers, the elimination of gain deferrals from LKE treatment is offset by the allowance of Bonus Depreciation. Under the TCJA, rather than defer the gain on the sale of depreciable property, the gain is taxable and is added to the basis of replacement property. This additional basis then is deductible as Bonus Depreciation for qualified property. The net effect is that the taxpayer does not pay any additional tax. However, taxpayers that deduct floor plan indebtedness interest under IRC 163(j)(1)(C) are denied the Bonus Depreciation deduction.

Dealerships that have a fleet vehicle leasing activity and also deduct floor plan interest under IRC 163(j)(1)(C) are denied the Bonus Depreciation related to their leasing activities and will face a significant tax increase, especially in tax years 2018 – 2020 as they trade-in their vehicles and update their leasing fleets. As a result of this negative economic consequence, fleet turnover will be delayed.

We urge that the Proposed Regulations be changed to include a provision that allows dealerships that purchase replacement property for use in their fleet of rental or leased vehicles to deduct Bonus Depreciation in transactions similar to LKEs when at least 10 vehicles are traded in during a taxable year. This would facilitate the purchase of new vehicles, which is consistent with the underlying intent of the TCJA.

Qualified Improvement Property (QIP) and Bonus Depreciation

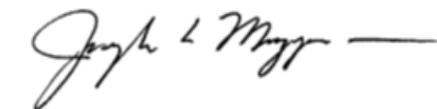
Before the TCJA, improvements to real property classified as qualified leasehold improvements, qualified retail improvements, and qualified restaurant property had a 15-year recovery period and were eligible for bonus depreciation. The conference committee report for the Tax Cuts and Jobs Act (TCJA) indicate that Congress intended to combine these three types of property into a new category of real estate improvements called “qualified improvement property” (QIP) that would be eligible for a 15-year life and bonus depreciation and would also include certain improvements to the interior portion of a building that is nonresidential real property.

Due to an apparent drafting error, the TCJA does not include any provision to extend the eligibility of QIP for a 15-year recovery period beyond December 31, 2017 and the proposed regulations also do not address this error.

NADA and Crowe urge that Treasury provide guidance that QIP is eligible for a 15-year recovery period and, therefore, eligible for bonus depreciation.

Thank you for the opportunity to comment on this matter.

Sincerely,



Joseph A. Magyar