Congress Should Maintain the Full Deductibility of Business Interest

Issue

Eliminating or curtailing the deductibility of business interest could immediately increase the cost of debt financing that many small-business automobile dealerships need to create jobs and maintain economic activity on Main Street. The House Republican Tax Blueprint, which provides an outline for tax reform in the House, would allow businesses to fully and immediately expense all tangible and intangible investments, except land. To offset part of the revenue loss from full expensing in year one, the Blueprint would allow the deduction of interest expense only against interest income. No current deduction would be allowed for the excess interest expense. Net interest expense could be carried forward as a deduction against interest income in future years. Congress should maintain the full deductibility of business interest.

Background

The majority of auto dealerships are organized as closely held businesses and do not have access to public equity markets for raising capital. Dealerships are extremely capital intensive, relying heavily on debt to finance their vehicle inventory, as well as facilities improvements. A relatively small dealership could require inventory financing of $3 million and additional financing for investment in land, showrooms and service bays. Larger dealerships need even more capital to finance greater inventory and more costly land and facilities, especially in suburban and urban areas.

Since the inception of the tax code more than 100 years ago, Congress has treated interest the same as other operating costs, such as salaries, rent and utilities. Limiting interest deductibility would increase the cost of working capital for dealerships and simultaneously overstate taxable income. The higher cost of capital and the increased taxes would disrupt cash flow and decrease internal working capital, threatening investment, economic growth and jobs in the auto retailing industry, which employs more than 1.1 million people on Main Streets across America.

The proposal to limit deductibility to net interest expense would disproportionately harm small-business dealerships because the typical dealership does not generate significant interest income. As a result, the current deduction for interest expense, historically one of the largest dealership expenses, effectively would be eliminated for dealerships. Therefore, the linkage between drastic reductions in interest deductibility and full expensing would be problematic for many dealerships. A better pro-growth alternative (S. 1144), introduced by Sen. John Thune (R-S.D.), would accelerate cost recovery on property, equipment and inventory without changing the deductibility of interest.

Key Points

- Restricting interest deductibility would have an immediate, adverse effect on capital-intensive, small-business dealerships that rely heavily on debt to finance vehicle inventory and facilities improvements.
- Reducing the deductibility of business interest would immediately increase the cost of debt financing and reduce the internal working capital necessary to maintain investment, economic growth and job creation.
- For more than 100 years, the tax code has allowed the deduction of ordinary and necessary businesses expenses. Business interest should continue to be deductible, so that taxable income is not overstated.

Status

Tax reform legislation from the Trump administration and congressional leaders is expected to be released in September. **NADA urges Congress to ensure that any changes to interest deductibility do not negatively impact small businesses.**

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