

Tap tax brakes on vehicle trade-in

It used to be that you could trade in one business vehicle for another without any dire tax consequences. But now the new Tax Cuts and Jobs Act (TCJA) has turned the tax rules upside down.

Alert: Expect to pay current tax on a business car trade-in. The new rules generally apply to transactions after 2017.

This change of fortune is due to the TCJA's repeal of the tax deferral for exchanges of most business property.

Here's the whole story: Under prior law, if you traded in a vehicle used for business driving for another business vehicle, the transaction qualified as a "like-kind exchange" under Section 1031 of the tax code. In other words, you didn't have to pay any tax if you completed the deal within two tax law deadlines:

1. The new vehicle was identified within 45 days of the trade-in.
2. You received the new vehicle within 180 days or your tax return due date (plus extensions), if that was earlier.

If you didn't receive a business car in exchange, you would have either a taxable gain or loss.

With a trade-in, the adjusted basis of the new vehicle for depreciation equaled the adjusted basis of your old vehicle plus any additional amount you had to pay for the new vehicle, minus the excess depreciation you could have claimed if the vehicle was used 100% for business.

Example 1: Marty, a self-employed business owner, bought a pick-up truck years ago for \$50,000 that he used 100% for business. After years of depreciation deductions, he had fully deducted the cost. Thus, his tax basis in the truck in 2017 was zero.

If Marty wanted to, he could have sold the car to a third party for \$25,000. But instead he decided to trade it in for a new truck costing \$55,000 and pay the dealer \$30,000 in cash. So Marty didn't have to realize any taxable gain in 2017 and ended up with a basis of \$30,000 for his new truck.

But now the new law eliminates the Section 1031 tax deferral break for exchanges of property other than real estate, beginning in 2018. So you can no longer treat the trade-in of a business vehicle as a nontaxable Section 1031 exchange.

As a result, if you trade in your jalopy for a new model, you'll owe tax on any gain you've realized.

Example 2: Let's assume the same basic facts for Marty. Say he trades in his old pick-up for a new one in 2018 costing \$55,000. Just like before, he gives the dealer \$30,000 to even out the deal.

Under the new rules, Marty's basis in the new truck is \$55,000, which he can write off under the TCJA's super-favorable depreciation rules. For instance, under the current luxury auto depreciation limits, the maximum first-year deduction for a passenger vehicle placed in service in 2018 is \$18,000 if first-year bonus depreciation is claimed (versus only \$11,160 if the old-law rules still applied). (See ["4 ways to boost depreciation"](#) from our April

2018 issue.)

That's the good news. Now the bad news: Due to the repeal of like-kind exchanges for business vehicles, Marty shows a \$25,000 gain that he has to report on his 2018 tax return. The gain is taxable at the ordinary income rates, not the capital gains rates, to the extent that Marty claimed depreciation deductions for the truck in prior years.

Silver tax lining: At least Marty doesn't have to pay self-employment tax on the gain from the trade-in.

These rules are complex and could affect negotiations for a vehicle's price.

Tip: Consult with a tax pro before signing off on a deal.

What's your basis on a sale?

To figure out any gain you will realize when you sell a business vehicle, you must first calculate your basis. Generally, your tax basis is the vehicle's initial cost, plus improvements, less the annual depreciation deductions you have claimed.

Key point: You're treated as having claimed depreciation each year even if you're using the standard mileage rate to write off vehicle costs. The standard mileage rate for 2018 is 54.5 cents per business mile (plus related tolls and parking fees). The depreciation component of this rate is deemed to be 25 cents per business mile.

Therefore, if you drive your business car 10,000 miles in 2018 and use the standard mileage rate, the resulting \$2,500 depreciation deduction (25 cents x 10,000 miles) must be subtracted from your car's basis.