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Year-End Tax Planning for Dealerships in Light of Tax Reform

Final tax reform legislation is here, with changes in tax law unmatched since 1986. The *Tax Cuts and Jobs Act* offers significantly lower tax rates for both C corporations and individuals, as well as reduced rates on pass-through entity income from S corporations and partnerships, effective January 1, 2018. There are few remaining days in 2017, but you can still fit in a handful of year-end activities to avail yourself and your business of the new law's largesse.

The general strategy for tax planning is to defer income until 2018 and accelerate deductions for 2017. This is a good strategy every year, but now it's particularly important because of the historically low tax rates taking effect in 2018. Implementing tax saving strategies before year-end could result in permanent tax savings. Below are some strategies specifically designed for dealerships reduce your tax liabilities.

Note: Tax reform includes many changes that will impact dealership owners and their tax returns. We have not enumerated all the effects of these changes in this article, except to the extent they affect 2017 tax planning. We will have further guidance forthcoming on the longer-tem impact on dealerships and their owners.

****NEW DEVELOPMENT**** Bonus depreciation

The new tax bill includes a provision for 100 percent bonus depreciation for property placed in service after September 27, 2017. If you place in service any equipment, loaner vehicles, or certain qualified building improvement property before the end of the year, they may be eligible for a 100 percent deduction. The bill eliminates the requirement that assets be new, so used equipment is also be eligible. If you anticipate the need for equipment in the next year, this provides a strong incentive to purchase such equipment in 2017 when tax rates are higher.

****NEW DEVELOPMENT**** State and local tax deductions

The new tax law limits state and local tax deductions to $10,000 for married taxpayers starting in 2018. Because of this change, taxpayers should strongly consider making their quarterly state or local income tax estimates (along with any potential balances for state tax that you estimate to be due on April 15, 2018, for 2017 taxes), real estate tax payments, or personal property tax payments before yearend. If your total yearly state income and real estate tax exceeds $10,000 and you wait until 2018 to make these payments, you will not receive any tax benefit from the payment.

****NEW DEVELOPMENT**** Entity structure

Although not a year-end 2017 item, with the C corporation maximum tax rates changing to 21 percent, dealers will want to reassess the dealership's entity tax structure. Many small business owners have moved away from the C corporations to become S corporations. With the reduction in C corporation tax rates, you may want to reconsider your dealership entity structure. There is no "bright line" answer for the best structure for most dealerships; it will depend on various factors specific to each business. Since the new law also provides for a deduction for pass-through income, a decision to change your dealership's structure should only be done after consulting with your tax advisor.

New vehicle inventory planning and LIFO

If you are currently not on the last-in, first out (LIFO) inventory accounting method, consider adopting it for 2017. The main benefit of adopting LIFO is that it results in a higher cost of goods sold during times of inflation. If you are considering or if you are currently on LIFO, make sure to monitor your new-vehicle inventory in stock at year-end together with the type of vehicles you will have in stock.

Planning note: Don't forget that a year-end LIFO estimate must be included on any manufacturer or other financial statement that has 12 months of income reported on it and is provided to a third party.

Used vehicle write-downs to market and LIFO

If your dealership is not determining used vehicle inventory using LIFO, you may be able to reduce your used vehicle inventories from cost value to market value (if the market value is less). But to do so, you must have made the correct elections in prior-year tax returns. Such market value adjustments should be based on industry and market-value guides. If you have not made the appropriate elections to make used vehicle write-downs, contact your accountant for assistance.

Make sure you're properly accounting for trade discounts

Many new car dealers improperly account for trade discounts such as floor plan assistance or manufacturer rebates by recognizing income when the payments are received or, worse yet, when the vehicle is booked into inventory. The proper accounting for these discounts is to reduce the cost of the inventory, thereby deferring the related income until the vehicle is sold. If you've been improperly reporting these payments, filing a change of accounting method could save you a considerable amount on your 2017 tax return.

Expensing manufacturer's advertising assessments on vehicle invoices

Some manufacturers may assess an amount for advertising as a separate line item on a vehicle invoice. If this assessment is used to pay for advertising in your local or regional area and they are not reimbursed by the manufacturer, these costs should be deducted when the vehicle is purchased. If you have not been properly accounting for these costs, a change of accounting method could be filed to deduct these costs for 2017.

Receivable write-offs

Review customer accounts receivable to determine which past-due accounts are uncollectible. You can claim deductions for bad debt expense. Remember that uncollectible factory incentives, rebates, and other receivables can also be written off.

Section 179 expensing

For 2017, the Section 179 first-year expense deduction is capped at $510,000. This allows a dealership to purchase up to $510,000 of new or used equipment, furniture, or fixtures by year-end and expense the entire purchase price to the extent of taxable income. Once total expenditures for such assets exceed $2,030,000, the amount of available Section 179 expense begins to phase out.

Stock basis issues with S corporations and partnerships and officer note payable repayments

If you own an interest in an S corporation, you need to evaluate your dealership's stock and debt basis before year-end. Issues relating to stock and debt basis can prevent you from deducting losses in part or in full and/or recognizing gain on distributions or shareholder loan repayments on your personal tax return.

Reviewing your basis before year-end is especially important if you're expecting to have a loss year, taken distributions or received payments on debt owed to you by your corporation during the year. Buy-Here Pay-Here dealership with related finance companies in particular are notorious for having basis issues. A basis calculation for your S corporation and or partnership should be done as part of your year-end tax projection as strategies to increase basis need to be executed prior to year-end.

S corporation owner's health insurance deduction

It is important that the corporation pay the health insurance premiums of an S corporation shareholder or reimburse the shareholder for premiums paid personally, in accordance with a corporate plan. Those premium payments must be added to the owner's Form W-2 as taxable wages. This allows the individual owner to claim a deduction for the health insurance costs. The income added on Forms W-2 is not subject to FICA or Medicare.

It should also be noted for dealers covered by Medicare your company could be reimbursing you for premiums paid during the year. A reimbursement arrangement will allow for an ordinary deduction of these premiums on your personal return. Alternatively, not setting up a reimbursement arrangement will almost guarantee you won't receive a tax benefit for these premiums due to the high threshold of itemizing medical deductions.

As with any health insurance Medicare premiums reimbursed by your dealership should be added to your W-2 wages. Partners of partnerships may also benefit from a reimbursement arrangement of Medicare premiums.

Cost segregation of buildings or improvements

Any building acquisition, construction project, or renovation which costs more than $500,000 can usually defer tax liabilities and provide a cash flow benefit through some form of a cost segregation study. These studies separate the various costs of the structures and land improvements into different depreciation methods and shorten the depreciable life categories, which accelerate your tax deduction for depreciation. The tax depreciation may be greater than the book depreciation methods used for your financial statements.

With many of the manufacturer programs requiring facility image upgrades, cost segregation or repair studies might be the silver lining that allows you to claim current tax benefits for the significant amounts expended on such facility upgrades.

Many manufacturers offer some type of assistance payments to encourage dealership improvements. The IRS issued guidance that generally requires such payments to be treated as taxable income, as opposed to offsetting building costs. Cost segregation of the building or improvement may be the best alternative to offset the income reporting for these assistance payments.

Capitalize or expense dealership repairs?

Generally, most dealerships' fixed assets are capitalized and depreciated over a number of years. The regulations in place now may allow dealerships to expense items that you would have depreciated in past years. Effectively implementing these capitalization policies will allow the dealership to expense items that cost less than $2,500, and may allow for expensing items up to $5,000. This can benefit a dealership and should be looked at closely.

Parts inventory adjustments

Make sure to reconcile your parts inventory balances on your books with your parts inventory counter pad. This is normally done if a physical-parts inventory is taken, but it doesn't require a physical inventory. Reconciling the two inventory balances often results in decreased taxable income. Consider writing off obsolete inventories before year-end.

Meals and entertainment expenses

Many dealerships lump all meal and entertainment expenses into one account. As a result, most of these expenses will only have half of these expenses deducted on the company's tax return. Such expenses should be reviewed by dealership personnel to determine meals and entertainment that

may be 100 percent deductible such as office parties, meal provided to employees at the dealership, and food purchases for customers.

Review January expenses and other chargebacks

Taxpayers are usually encouraged to review their expenses paid in January of 2017 to determine if they are properly deductible in 2017. With the significant tax rates many dealers will face this year, you will want to review all January and February invoices to find those that can be deducted in 2017.

Harvesting capital gains or losses

If you have unrealized gains or losses in your stock portfolio, there is a potential to use them for 2017. If your income is low for 2017, it might make sense to recognize gains, pay the tax at a lower rate, and then repurchase similar holdings. If your income is already quite high for 2017, consider recognizing losses to reduce your tax liability and then repurchase similar holdings. Because of the wash sale rules, you have to be careful. However, there are ways to harvest losses without triggering the wash sale rules. Likewise, if you already have carryover capital losses from previous years, you could harvest gains in order to offset those losses, as you can only deduct a net loss of $3,000 per year.

Charitable donations of appreciated stock

Another way to minimize tax on capital gains is to directly donate appreciated stock. There are multiple benefits, such as deducting the higher, appreciated value of the stock as opposed to its original cost basis. Plus, there is no income recognition on the donation of the appreciated stock.

Maximize contributions to your 401(k) and other retirement plans

Many dealerships have instituted retirement plans so employees can make contributions to reduce the employees' wages. Most of these plans have limits on the amounts that officers and owners of the dealership may contribute (and sometimes require that such contributions are returned at year end). However, owners frequently do not contribute the maximum amount. After the year ends, the opportunity to contribute more is missed. Contact your retirement plan administrator to determine if you can contribute additional funds to these accounts

Demo income

When preparing your Forms W-2, don't forget to include demo income benefits for sales persons and other managers that must be included in taxable income.

How we can help

Our dealership industry tax practitioners can help you both comply and optimize tax savings for your business and yourself. We can work with you to develop a strategic tax plan and make sense of complex regulations and rules.

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