## PUMP THE BRAKES! ANALYZE AND STRATEGIZE BY DETERMINING YOUR BREAKEVEN POINT

Have you calculated your breakeven point for your various dealership departments?

Your dealership can make informed decisions regarding sales and pricing strategies, cost management analysis and allocation of capital by calculating your dealership's breakeven point for each of the various departments. These departments include new and used vehicle sales, parts and service sales, body shop sales (if applicable) and finance and insurance sales (if evaluated separately from the new and used sales departments).

A breakeven calculation by department provides for an analysis of the amount of department revenue a dealership must generate to make a profit. It is a simple calculation that provides many insights into each department's financial operations.

The breakeven point is determined by taking the fixed costs (gross margin less variable costs) for each department. Fixed costs are expenses that do not change due to department sales volume. Fixed costs include salaries, insurance, depreciation, utilities, telephone, etc. Variable expenses are expenses that change based on the department sales volume. They include sales commissions, supplies, advertising, policy work, etc.

In addition to the calculation for the breakeven point in dollars, the calculation can be enhanced to determine the breakeven point for the number of vehicles needed to be sold per month. This is determined by taking the breakeven point calculated in dollars and dividing this by the average selling price of a vehicle.

These simple calculations can enhance the dealerships strategies and allow dealerships to analyze their expenses and gross profit margins at the same time. It also provides an opportunity to focus on departments that are generating profit margins that are less than the industry trends.

Do you need help calculating your departmental breakeven points?

Please contact us and a member of our Automotive Dealership services team will be happy to assist you.

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## ADDITIONAL ERC CONSIDERATIONS FOR AUTO DEALERSHIPS

The Employee Retention Credit (ERC) is one of the most powerful tax incentive programs available to businesses that we have ever seen (or will likely ever see again). The ERC has provided billions of dollars of much needed relief to thousands of businesses across the country that were impacted by the pandemic. While auto dealerships have experienced record profits in recent years, there is no doubt that the automotive industry was negatively impacted by the pandemic and has faced unprecedented challenges. One common misconception is that many auto dealerships don't qualify for the ERC because their revenues didn't decrease or because they didn't incur losses. This isn't necessarily true.

How does a business qualify? There are two ways to qualify for ERC. Most entities will qualify for ERC based on a significant decline in gross receipts when comparing quarterly gross receipts in 2020 and 2021 to the same quarterly gross receipts in 2019. A significant decline in gross receipts occurs when 2020 quarterly gross receipts are less than 50% of the gross receipts (more than a 50% decline) for the same quarter of 2019; or when 2021 quarterly gross receipts are less than 80% of the gross receipts (more than a 20% decline) for the same quarter of 2019. The second way to qualify, and the way most auto dealerships will likely qualify, is if a business experienced a full or partial suspension (shutdown) of operations due to a governmental order or mandate. In New York State, sales showrooms were closed by the Governor from March to June 2020, thereby creating a partial suspension of operations, and qualifying most auto dealerships for ERC for that period. There are various issues that could have caused an auto dealership to have experienced a partial shutdown that qualifies the business for ERC in an eligible period. Some of these issues are:

- Decreased vehicle inventory
- Increased lead times for parts and accessories
- Inability to conduct test drives
- Restrictions on showroom capacity
- Restrictions on repossessions

In order to qualify for ERC with any of these issues, they must be tied back to a government order or mandate. More and more auto dealerships are qualifying for ERC due to its supply chain disruptions, both with vehicle inventory and with service and parts delays. It's important to work with a reputable firm that has the expertise related to these issues, and has the ability to compile the necessary data to support an ERC claim.

If qualified for ERC in 2020, the credit is 50% of the first $10,000 of qualified wages paid to each employee during the eligible quarter, capped at $10,000 of qualified wages per employee for the entire year. If qualified for ERC in 2021, the credit is 70% of the first $10,000 of qualified wages paid to each employee during the eligible quarter, there is no annual qualifying wage cap in 2021. If fully qualified for all quarters under the program, a business could claim ERC of up to $26,000 per employee.

These credits won't be available forever, as the statute of limitations to amend 2020 forms ends April 15, 2024, and the statute of limitations to amend 2021 forms ends April 15, 2025. The time to act is now. Does your auto dealership qualify for ERC? Let's start a discussion. If you have any questions, or need further information, please contact your trusted TBC advisor.

By: Mike Cesternino, CPA, Partner

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## INFLATION REDUCTION ACT OF 2022: IMPACT ON ELECTRIC VEHICLES AND RELATED EQUIPMENT

If you have considered installing electric vehicle charging stations at your home or business or have thought of purchasing an electric vehicle, you may be able to take advantage of tax credits that were recently updated in the Inflation Reduction Act of 2022.

The Inflation Reduction Act (IRA) of 2022 included several provisions related to electric vehicles (EVs) and related equipment. Tax credits and incentives for EVs and charging stations have existed for some time, but the IRA has updated or extended many of these provisions for vehicles and equipment purchased after December 31, 2022.

Previously, tax credits were available for certain electric vehicles and were phased out once the vehicle manufacturer sold 200,000 of the vehicles for use in the United States. The IRA eliminated the phase out. This allows qualifying consumers the opportunity to take up to the full $7,500 credit, even on the most popular EVs. In addition, the IRA includes a new tax credit for the purchase of a used EV for qualifying taxpayers. The used vehicle credit is up to $4,000 for qualifying vehicles. The credits are subject to income limitations and also require that the final assembly of the vehicle occurs in North America.

The IRA extended and modifies the credit for qualifying EV refueling property. The credit was extended through December 31, 2032. The amount of the credit was increased to the lesser of 30% of the property's cost or $100,000 per qualifying item. The definition of qualified property was also modified. Beginning in 2023, qualifying property includes charging stations for 2 and 3 wheeled vehicles and, most notably, places certain geographic restrictions on the installed equipment. EV refueling property that is used by a business must meet certain other requirements to be eligible for the credit.

Individuals can take advantage of the tax credits for EV charging stations as well. The installation of a home EV charging station is eligible for a tax credit of 30% of the cost of the property up to $1,000.

Further guidance is expected to be released by December 31, 2022. For more information on how these changes could impact you or your business, or if you will qualify for specific credits, please contact us and a member of our auto dealership services team will be happy to help.

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## LIFO IMPACTS ON AUTO DEALERS

These last 2 years have certainly been a rollercoaster ride for most automobile dealers. From the fear and uncertainties caused by shutdowns at the start of the pandemic, to labor shortages, to parts inventory delays and shortages, to government assistance programs, to record high used vehicle prices, to new vehicle inventory supply issues caused by the microchip shortage, all the way to record profits and cash flow surpluses. It has certainly been… to say the least.

Most dealerships are still dealing with new and used vehicle supply issues, and record low vehicle inventory levels. Those dealers using the Last-In, First-out (LIFO) method to account for their inventory valuation, a method generally used to defer taxes, may be in for an unexpected tax liability caused by the significant reduction of their vehicle inventory levels. The sharp decrease of inventory could force LIFO reserves that were previously deferred, to be recaptured, therefore increasing taxable income and increasing the dealership's tax liability. For some dealerships this unexpected tax liability could be substantial. Consider a dealership with a $1 million LIFO reserve, normally carrying 100 vehicles in inventory, is currently only carrying 10 vehicles in inventory due to supply shortages. This dealership will likely have to recapture a large majority of their LIFO reserve, which could result in upwards of $300,000 – $400,000, or more, of additional tax liability.

What options do dealers using the LIFO method have to help combat this potential tax burden? One option is to do nothing, record the LIFO recapture as taxable income, pay the tax, and move on. This may be the best option if your inventory decrease doesn't cause a significant LIFO recapture amount.

A second option could be to change to another acceptable LIFO calculation method allowed under existing LIFO provisions. There are four methods allowable for automobile dealerships; the General Dollar-Value LIFO Method, the Simplified Dollar-Value LIFO Method, the Inventory Price Index Computation Method, and the Alternative LIFO Method (most commonly used method by dealerships). A dealership could also choose a LIFO method that also allows used vehicles and parts to be included in the inventory valuation. A change in the LIFO calculation method being used, and including additional inventory types in the LIFO calculation, could help offset the tax liability caused by the LIFO recapture. This option would require a Form 3115 be filed, and the new method must be kept for at least 5 years.

Another option is to elect out of the LIFO method by filing Form 3115 with the entity's income tax return. This option requires that the entire LIFO reserve be recaptured, however the recaptured income would be spread over 4 years, allowing the tax liability to be paid over a 4 year period, potentially at lower tax rates. This could be a welcome option when faced with having to pay that tax liability all in one year. If the dealership choses this option and elects out of the LIFO method, it cannot re-elect to use the LIFO method again for at least 5 years. There is also uncertainty with how future tax law or tax rate changes could effect this decision. If Congress were to drastically increase tax rates, or limit the QBI deduction for pass-through entities, it could negatively affect the outcome of this option to elect out of the LIFO method by increasing the tax liability on the deferred portion of the LIFO recapture.

Could there be tax relief on the way? There has been recent activity that suggests that there could be the possibility of some tax relief coming from Congress or the U.S. Treasury Department. Organizations such as National Automobile Dealers Association (NADA) have been lobbying for the U.S. Treasury Department, U.S. Senators, and U.S. Congressmen to take action to provide relief for those impacted by unexpected tax liabilities caused by LIFO recapture. However, there is nothing certain at the time of writing this article.

It's important to keep an eye on what's happening in Washington, and to consult with a knowledgeable tax and accounting professional when determining which method or options are best for your dealership. If you have any questions, or need further information, please contact your trusted TBC advisor.

By: Mike Cesternino, CPA, Partner

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## SUCCESSION PLANNING

Operating a business is a tremendous investment of time and effort. Years of hard work have been put into building your company into what it is today. This, coupled with the fact that many companies have seen record profits recently, the importance of having a business plan that extends into the future cannot be overstated. Strategic succession planning ensures your company will continue to thrive with the next generation of leadership. Who is best suited to lead the company in the future? Are your children passionate, but also capable? Is there an individual currently employed that is ready for this responsibility? How involved will you have to be? How involved do you want to be? These questions, among others, are questions that business owners need to answer as they approach this next chapter of their lives.

Planning for the future takes time, and several variables require careful consideration. Business development, management and workplace culture may be important factors while developing a succession plan. In many cases, current employees are ready to tackle these factors along with other challenges that lay ahead. However, it is important to consider the value in searching for external individuals with perspectives outside of the Company.

The legal and regulatory environment is a significant factor when developing a succession plan, and is ever-changing. President Biden's proposed American Families Plan calls for changes to what is known as basis "step up" for assets received by estate beneficiaries. Under current tax law, beneficiaries inherit estate assets with a basis value that is "stepped up" to the market value at the decedent's date of death, therefore minimizing the gain a beneficiary would recognize when the inherited assets are sold. Under President Biden's proposed plan, the beneficiaries would inherit estate assets with the same basis value as the decedent, opening the door to potential increases in capital gains tax. The proposal does state "The reform will be designed with protections so that family-owned businesses and farms will not have to pay taxes when given to heirs who continue to run the business," however, it is still largely unclear how these protections would work in practice.

The House Ways and Means Committee is currently considering a reconciliation bill that could further influence future decisions. The bill includes a provision that accelerates the expiration of estate and gift tax rate levels and would cut the lifetime estate, gift and generation skipping tax exemptions from the current $11.7 million level to approximately $5-6 million per taxpayer beginning in January 2022. These provisions, though not yet law, are an example of other factors to consider when developing a succession plan.

Often times it is easier to reflect on our past selves, experiences, and mistakes. It is much harder to look ahead to our future selves and circumstances. Your succession planning should be started sooner rather than later, with careful and honest consideration of your situation, and should be reviewed and updated on a regular basis. We are available to have these conversations with you. Please contact your trusted TBC advisor for more information or to start the process.

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## WHAT AUTO DEALERS NEED TO KNOW ABOUT THE NEW TAX REFORM

As the new tax reform took shape in late 2017 and then was approved just a few days before Christmas, our auto dealership services team were examining what elements could have the most impact on contractors and small business owners. Now, what is commonly being called the Tax Cut and Jobs Act (TCJA) of 2017 has caused a lot of discussion on whether companies will come out as winners or losers in 2018. While it has enhanced some tax breaks for auto dealers, it has also reduced or eliminated others.

Let's start with the good news first. Here are some of the positive outcomes we think may be coming auto dealers' way with the new law.

**Favorable Depreciation Rules – Bonus depreciation, Section 179 and Vehicles**

The IRS has effectively lowered the cost of acquiring capital assets by making substantial changes to the income tax rules for bonus depreciation, Section 179 expensing, and depreciation on passenger automobiles, small vans, and trucks. The two big changes with bonus depreciation are the deduction is raised to 100 percent of the purchase price from 50 percent and bonus depreciation is available on new and used purchases where in the past it was limited to new equipment. Code Section 179 expensing limits were raised from $500,000 to $1,000,000 in 2018, and the new law allows for $2,500,000 in total qualified purchases before the deduction is phased out while prior to the new law the phase out threshold was $2,000,000. The new law triples the annual dollar caps on depreciation of passenger automobiles, small vans, and trucks.

**New Deduction on Pass-through income**

Many auto dealers have set-up S-Corporations or partnerships (LLCs) which "pass-thru" income to its shareholders / partners. The new law provides a 20 percent deduction for "qualified business income," defined as income from a trade or business conducted within the U.S. by a partnership, S-Corporation, or sole proprietorship. Investment items, reasonable compensation paid by an S-Corporation, and guaranteed payments by a partnership (LLC) are excluded. There are some limitations on taxpayers with taxable income over $157,500 for single and $315,000 for joint filer. Limitations will be calculated based on W-2 wages paid by the businesses and basis of acquired depreciable tangible property used in the business. The deduction is phased out for certain service related trades or businesses for tax payers over the income levels, such as health, law, consulting, financial or brokerage services, and unfairly, accountants. The reason being that with these types of businesses the principle asset is the reputation or skill of one or more employees or its owners.

**C-Corporation Tax Rates and Corporate AMT**

The new law will change the rates of C-Corporations from graduated tax rates to a flat tax rate. The new law has a flat tax rate of 21 percent when prior law had graduated tax rates of 15 percent on income up to $50,000, 25 percent on income between $50,000 and $75,000 and 34 percent on income between $75,000 and $10,000,000. The law also eliminates corporate AMT which could help contractors (C-Corporations) who were on cash basis but had to record a long-term contract adjustment for AMT purposes.

**Personal Income Tax Rates**

Personally, business owners and their employees will receive a break on the rates they are taxed at. Rates have been dropped between 0 percent and 4 percent based on each bracket. The tax rates were adjusted as follows: 10 percent stayed the same, 15 percent was dropped to 12 percent, 25 percent was dropped to 22 percent, 28 percent to 24 percent, 33 percent to 32 percent, 35 percent stayed the same, and 39.6 percent was dropped to 37 percent. Along with the rates, the brackets in the upper limits improved slightly (continued on other side).

Here are the changes within the new tax code that may negatively impact auto dealers:

**Like Kind-Exchanges on Non-Real Estate Properties**

The Section 1031 exchange rules that allowed tax-deferred exchanges of appreciated like-kind property is only allowed for real estate after December 31, 2017 There will be no more like-kind exchanges for personal property assets like vehicles and equipment. To offset this issue, the depreciation rules have improved on expensing so if you have to pick up a gain on the trade-in, you should be able to depreciate (write off the purchase). We work with several auto dealers that switched from C-Corporations to a S-Corporation with built-in gains. These particular auto dealers will need to monitor these transactions so they don't trigger the built-in gains tax during

the recognition period.

**Reduced or Eliminated Travel and Entertainment Deductions**

The new law now limits some of the travel and entertainment deductions which were allowed in the past. After December 31, 2017, entertainment deductions are disallowed and there are reduced deductions for meals. Meals provided out of town could still count, but meals on the employers' premise could be excluded.

**Eliminated Unreimbursed Employee Business Expenses – Itemized Deduction**

An item that might affect auto dealers' employees more than the owners is the deduction for unreimbursed business expenses. The new law has eliminated this itemized deductions for unreimbursed business expenses over two percent of their adjusted gross income. Items like unreimbursed mileage, tools, and travel expenses are items commonly deducted by auto dealership employees.

**Limits on Interest Deductions**

Subject to some restrictions and exceptions, prior law stated that interest paid or accrued by a business generally is fully deductible. Under the new law, corporate and non-corporate businesses generally cannot deduct interest expenses in excess of 30 percent of "adjustable taxable income" starting in 2018. For S-corps, partnerships, and LLCs the limit is applied at the entity level rather than the owner level. Between 2018 and 2021, "adjustable taxable income" is calculated by adding back depreciation and amortization. Luckily for auto dealerships, the interest expense limitations in the TCJA **do not** apply to floor plan financing interest.

This article is general in nature. The reader should contact their tax advisor for additional information or for clarification on how this will affect their personal situation. For more information or a question specific to your entity, please contact us at 518-456-6663 and a member of our auto dealership services team can help you navigate the new tax law.

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## DIESEL ISSUE CHALLENGES VW DEALERS TO RETAIN KEY SALESPEOPLE

With the news of failed emissions tests and alleged knowledge of the shortcomings by the manufacturer, Volkswagen dealers have faced many challenges in the past year. For instance, an article in Automotive News discussed that through July 2016, VWs U.S. light-vehicle sales were down 14 percent compared to the first 7 months of 2015, while the industry as a whole posted gains of 1.1 percent.  As a result of the declining sales, it has been difficult for many VW dealers to retain their sales staff.

The dent in overall sales from the halt of diesel vehicle sales has hurt some VW salespeople's pay and has created pressures to look to other manufacturers for employment.  The pressure on the sales staff to leave has also been amplified in many cases by poaching from rival dealers.  According to an article featured in Automotive News, salespeople from two dealers in NADA 20 Group received calls asking, "Do you want to continue to work for a manufacturer who's been less than honest?"

Volkswagen dealers have been forced to get creative in order to battle the potential turnover in staff.  The managing partner of Camelback Volkswagen created a full-time customer relations manager to keep disgruntled customers affected by the scandal out of the showroom and ensure that the sales staff remain focused on selling.  He also started an annual employee survey and acts on staff feedback. Automotive News has more information on this topic.

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## ARE NEW DEALER INCENTIVE PROGRAMS TRYING TO SQUEEZE OUT THE SMALLER DEALER?

Cadillac has created a new dealer incentive program entitled “Project Pinnacle” expected to roll out early 2017. The objective of Project Pinnacle is to create tiers of “effective pricing.” The initiative aims to assign dealers to one of five tiers based on volume and high adherence to brand standards. Critics of the project note that the plan is essentially trying to squeeze out smaller stores. GM has had a past history of pulling franchise agreements from dealerships; think back to post recession 2009 when GM declared bankruptcy. While dealers are no stranger to incentive programs created by the manufactures, could “Project Pinnacle” be in violation of state franchise agreements meant to protect dealers from unfair treatment by the factory?

More information on this topic was found in Automotive News.

## IS THIS THE END OF SMALL DIESELS IN THE US?

Auto manufacturers are regularly shifting focus and trying to stay on the cutting edge in an effort to maximize revenues in the multi-billion dollar auto industry. As consumer demands change, auto manufacturers must adapt.

Recently, Volkswagen experienced turmoil as a result of failed emissions tests and alleged knowledge of the shortcomings by the manufacturer. The company faced backlash from government agencies and consumers alike. The manufacturer has come to a series of agreements which will end up costing them approximately $15 billion to settle claims from the scandal, including $10 billion to buy back the vehicles from the owners of affected diesel cars, $2.7 billion to the EPA, and $2 billion for the Clean Energy Technology mandates.

In an effort to re-gain consumer confidence and boost sales, VW has decided to scale back its diesel engine push that it had been actively promoting. The manufacturer has made a decision to change strategy and pursue other opportunities. Automotive News profiles the change and what lies ahead for the manufacturer.

TBC has a dedicated team of CPAs specializing in the automotive industry that meet monthly to discuss industry issues and changes that will affect our clients.