Potential tax law changes affecting retail dealers

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Kevin Gilbreath, CPA
Tax Partner

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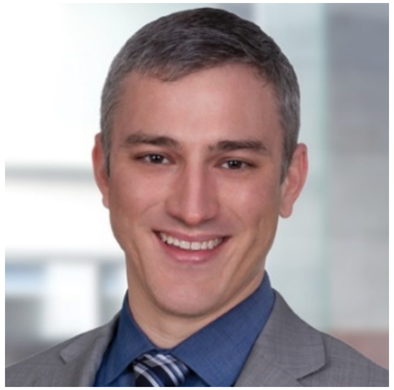
Your presenter



Kevin Gilbreath, CPA

PARTNER, CROWE LLP

Kevin.Gilbreath@crowe.com

Tax considerations given the election results

- Biden campaign tax proposals include:
  - Raise top rate to 39.6% for those with income over $400,000
  - Remove tax preference for capital gains and qualified dividends for those with income over $1Million
  - Support for limited repeal of the cap on state tax itemized deductions
  - Limit itemized deductions for taxpayers in brackets above 28%
  - Phase out 199A 20% deduction for income over $400K
  - Raise estate tax to 2009 levels (possibly 45% rate and an acceleration of reduced exemption)
  - Add social security tax on wages and SE earnings above $400,000
  - Eliminate Section 1031 like-kind exchanges for real estate
  - Make the electric motor vehicle tax credit permanent, repeal the per-manufacturer cap, and phase out the credit for taxpayers with income above $250,000

Raising top tax rate to 39.6%

- This rate change would be on those with taxable income over $400,000
- The current 2020 tax brackets set the highest rate at 37% for income over $622,051 (MFJ), 518,401 (Single/HOH).

Remove tax preference for LT capital gains & qualified dividends

- Under current law, the maximum effective federal income tax rate on net long-term capital gains and qualified dividends recognized by individual taxpayers is 20% plus the potential 3.8% net investment income tax for a 23.8% potential total rate.

- Under the Biden proposal, net long-term gains and qualified dividends reported by taxpayers with income above $1 million would be taxed at the same 39.6% maximum rate that is proposed for ordinary income and net short-term capital gains.

- With the 3.8% NIIT add-on, the maximum effective rate on net long-term gains would 43.4% (39.6% plus 3.8%).

- If this tax increase was passed it’s possible we would see many taxpayers attempt to sell and reap capital gains before the year of implementation.

Itemized deductions

- The Biden proposal would eliminate the $10,000 cap and provide taxpayers with higher state income tax bills a larger itemized deduction on annual tax return filings.
  - This may be an improved tax deduction for dealers that reside in states with higher income tax rates such as California.
  - The Pease phase out limitation on itemized deduction may be re-implemented under Biden which reduced the effect of deductions like state tax for those in higher income tax brackets.
- Biden has also proposed limiting the tax benefit of itemized deductions to 28% for taxpayers in brackets above 28% so that the effect of each dollar of deduction is not more than 28 cents of deductions even if you are in the 39.8% bracket.

Phase out 199A 20% deduction for those with over $400K income

- Under current law, pass through qualified business income may be eligible for 20% deduction. The net effective top Federal tax rate on qualified business income from a dealership operational activities in a partnership or s-corporation structure is 29.6%.

- The Biden proposal is to eliminate the 199A deduction for taxpayers with income over $400,000. This proposal combined with the Biden proposal to increase the top bracket would increase the Federal tax rate to 39.6% on dealership operational income. That's a 10% tax increase.

- If Biden was unable to get this proposal passed the 199A deduction is scheduled to expire on December 31, 2025.

- This change may or may not make C-Corp structure more attractive if qualified dividend tax rates were maintained at current levels.

Estate tax changes

- The current lifetime gift/estate tax exemption is $11,580,000 per person and the estate tax rate on the taxable portion of an estate is 40%.
- The Biden proposal is to reduce the exemption by approximately 50% and repeal the step up in basis at death.
- Under current law, the federal income tax basis of an inherited capital-gain asset is stepped up to fair market value on the decedent's date of death. If heirs sell inherited capital-gain assets, they only owe federal capital gains tax on the post-death appreciation, if any. The Biden plan would eliminate this tax-saving provision.

Social Security Tax

- The current law allows social security tax of 6.2% employee portion and 6.2% employer portion (12.4% for self-employed) on up to the social security taxable wage base ($137,700 for 2020 / $142,800 for 2021).
- The Biden proposal is to tax that amount plus impose the social security tax on wages or self-employed income above $400,000 with no limits.
- Wages or self-employed income between the wage base and $400K would exempt from the tax and every dollar of wages or SE income above $400K would be subject to the social security tax.
- A dealer receiving a partnership K-1 from the dealership showing $1Million of self-employment income would owe an additional $74,400 of self-employment tax under this proposal.
- If this passed we may see a shift by active owners away from the partnership structure of ownership to S-Corps or C-Corps as a strategy to limit the social security tax.

1031 Like-Kind Exchanges

- Current law allows deferral of capital gains taxes on like-kind exchanges of appreciated real property that qualify under the many 1031 exchange rules.
- Many dealers have used the 1031 exchange rules to defer tax on appreciated real estate when selling dealership real estate where proceeds are to be reinvested in another real estate asset.
- The Biden proposal is to eliminate the 1031 exchange.
- If the proposal is passed we may see an uptick in real estate buy/sell activities before the new law takes effect.

Electric Motor Vehicles

- Current law provides for up to $7,500 credit against taxes owed on the purchase of a new qualified plug-in vehicle.
- The credit begins to phase out when at least 200,000 qualifying vehicles manufactured by each company have been sold in the U.S. (Tesla and GM are beginning to phase out in 2020)
- The Biden proposal makes the credit permanent and eliminates the manufacturer phase out, however it begins to phase out for taxpayers with over $250,000 income.

When would these changes take effect?

- It’s unknown if or how soon any of these proposals could be passed into law and when they would be effective.
- The party that controls the senate has an effect on these questions and that will not be known until the Georgia runoff election on January 5th.
- If the Republican party wins one of the two runoff elections the Senate would remain controlled by Republicans and many of these proposals that increase taxes would find difficulty getting a majority vote.
- If the Democratic party won both runoff elections that would give them 50 seats in the senate and the tie-breaking vote of the Vice President.
- Some Democratic Senators who will be up for re-election may be reluctant to support tax proposals the believe lean too far left.

LIFO Recapture

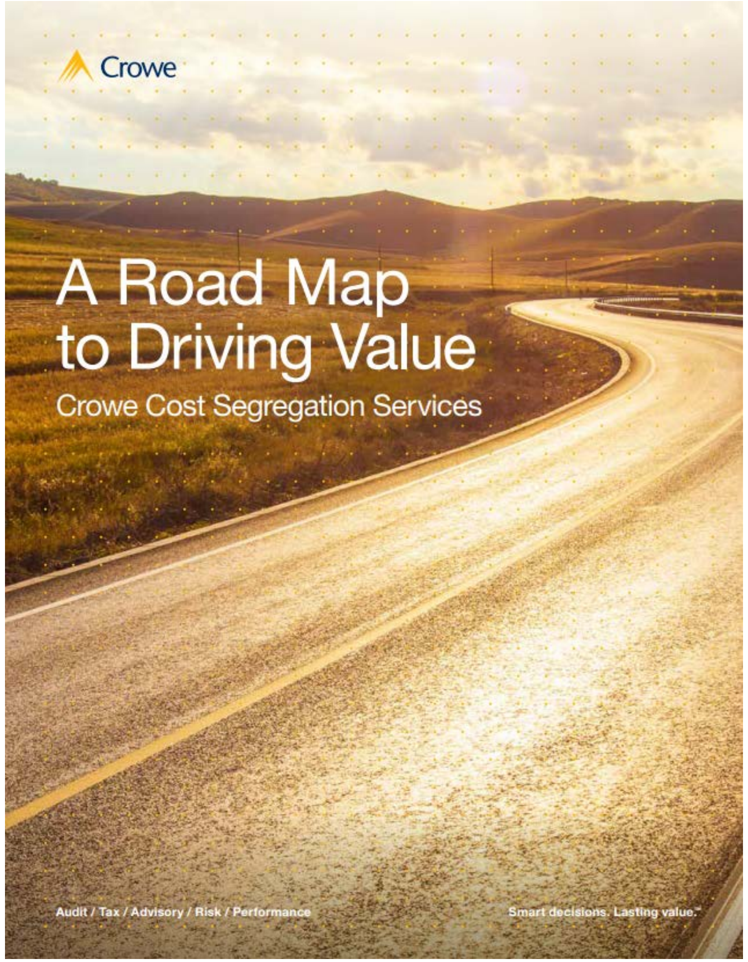
- Given possible decreases in inventory at December 31, 2020, do not forget about LIFO recapture!
- Could be a sizable income pick-up (coupled with expected income pick up from PPP forgiveness)
- Do not forget, LIFO is a tax deferral strategy, not a permanent tax deduction

Cost Segregation Studies

1) Did you acquire, renovate or construct an auto dealership during 2020?

2) Qualified Improvement Property

3) Floor Plan Financing & Bonus Depreciation



Qualified Improvement Property

- Technical correction with CARES Act to correct prior drafting error to make Qualified Improvement Property (QIP) 15 year depreciable property and eligible for bonus depreciation
- Available for property placed in service starting January 1, 2018
- Qualified Improvement Property (QIP) generally includes interior improvements to a commercial building after the building is placed in service
  - Interior Improvements generally consist of things such as drywall partitions, ceilings, ceramic flooring, interior doors and windows, interior lighting, plumbing, fire sprinklers, interior portions of HVAC (not rooftop unit)
  - Does not qualify if building footprint was expanded

Business Interest Expense Limitation

- Under TCJA, interest expense deductions capped at 30% of adjusted taxable income (ATI)
  - Carve out for floorplan interest expense
  - CARES Act increases the limitation to 50% of ATI for 2019 and 2020
  - Available for corporations and individuals starting in 2019
  - For 2020 an election can be made to use 2019 ATI in the computation for 2020 allowable interest expense limitation
  - Partnerships get the 50% limitation for 2020 (not 2019)
  - 50% of a partner’s 2019 share of disallowed excess business interest expense passed through by a partnership will be treated as business interest that is not subject to any section 163(j) limitation paid or accrued by the partner in 2020

Structure of Override Money from Warranty Companies

- If the dealership is structured as a flow through entity (partnership or s-corporation), there is a tax advantage of flowing override money through the dealership vs. directly to the owner.
- Anything going direct to owner has a potential 37% Fed tax rate for those in the highest bracket plus potential self employment taxes.
- Flowing the funds through the dealership could take advantage of the 20% flow through deduction under 199A providing a net effective Fed tax rate of 29.6% for those in the highest bracket. The dealership entity makes sense as the contracts are related to that business that qualifies for 199A. Using other non-dealer entities is unlikely to qualify for 199A treatment.

IRS Issues Revenue Ruling on PPP Expenses

A taxpayer that received a covered loan guaranteed under the PPP and paid or incurred certain otherwise deductible expenses listed in section 1106(b) of the CARES Act (“PPP eligible expenses”) may not deduct those expenses in the taxable year in which the PPP eligible expenses were paid or incurred if, at the end of such taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan, even if the taxpayer has not submitted an application for forgiveness of the covered loan by the end of such taxable year.

IRS Issues Revenue Procedure On PPP Expenses

Safe harbor for deduction of PPP eligible expenses applies if in a subsequent taxable year, the taxpayer's request for forgiveness of the covered loan is denied, in whole or in part, or the taxpayer irrevocably decides never to request forgiveness of the covered loan, as described in section 3 of the revenue procedure. A taxpayer described in section 3.01 or 3.02 of the revenue procedure may be able to deduct some or all of the PPP eligible expenses on (1) the taxpayer's timely filed, including extensions, original income tax return or information return, as applicable, for the 2020 taxable year; (2) an amended return or an administrative adjustment request (AAR) under section 6227 of the Internal Revenue Code (Code) for the 2020 taxable year, as applicable; or (3) the taxpayer's timely filed, including extensions, original income tax return or information return, as applicable, for the subsequent taxable year. Requires specific statement attached to relevant return.

Net Operating Loss Carrybacks (NOLs)

- NOL carrybacks which were previously eliminated in the 2017 tax reform have been restored
- Available for corporations and individuals
- 5 year carryback on losses incurred in 2018, 2019, and 2020
- 2 year carryback on losses incurred fiscal years beginning 2017 and ending in 2018
- 80% limitation temporarily removed on NOLs from 2018 through 2020

Charitable Contributions

- Expanded charitable contribution deductions
- Nonitemizers can take a deduction for up to $300 of cash contributions in 2020
- In 2020 the 50% limitation on cash contributions by an individual will not apply
  - Does not apply to contributions to private foundations or donor advised funds
- Corporate charitable contributions limitation of taxable income for 2020 increased from 10% to 25%

Individual Income Tax

- Section 461(l) – an individual's business losses will no longer be capped at $500,000 until the 2021 tax year.
  - (taxpayers can amend 2018 and 2019 returns that included a cap on business losses)

Thank you

Kevin Gilbreath
Partner, Federal Tax Retail Dealerships
+1 615 515 3912
kevin.gilbreath@crowe.com

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