# Comprehensive Tax Reform

*Congress Must Ensure Tax Reform Provides Relief for Small Businesses*

## Issue

The tax reform framework released by the Administration and Republican Congressional leadership seeks to lower tax rates and foster businesses investment and job creation. Small business auto dealers, who typically operate pass-through entities, rely disproportionately on bank financing, advertising, and the LIFO (last-in-first-out) accounting method, which could be eliminated or limited as part of tax reform. Unless the new business rate for pass-through entities provides practical relief, auto dealerships could face an even higher tax burden, especially in the short term. *Congress should examine the cumulative impact of eliminating or limiting interest and advertising deductibility and LIFO, so that tax reform provides meaningful tax relief for small businesses (such as auto dealerships) that drive major investment and jobs in local communities.*

## Background

Small-business auto dealerships employ more than 1.1 million individuals and generate significant state and local tax revenue. Most dealerships are organized as pass-through entities that results in a blended tax rate, split between wage income and business profits. Because of the unique nature of auto retailing, eliminating interest and advertising deductibility and LIFO could trigger higher taxes for pass-through owners, which could threaten new investments and jobs. Tax reform should encourage, not threaten, growth for small businesses across the country.

Eliminating or limiting interest deductibility could disrupt motor vehicle commerce, since small-business dealers rely heavily on bank financing to fund expensive vehicle inventory (through floor planning). Floor plan financing enables dealers to buy vehicles from auto manufacturers. Unlike large corporations, dealers do not have access to equity financing. Floor plan loans are collateralized by the vehicles. Once the dealer sells the vehicle, the lender is repaid with interest. If the dealers' floor plan costs increase, dealers would likely purchase fewer vehicles from the manufacturers, because full expensing would not offset eliminating interest deductibility.

Limiting advertising deductibility would strip working capital from small-business dealerships, which operate on historically-thin margins and tight cash flow**.** Dealers use advertising extensively to market vehicles and create a competitive marketplace for consumers. Advertising deductibility is essential to properly calculate a dealer's net income tax liability and has been 100 percent deductible in the year the expense is incurred as a normal business expense. Current deductibility is appropriate given that dealer advertising is generally focused on marketing short-term vehicle sales (holiday or other limited-time promotions), and not for building a brand image. Eliminating or limiting advertising deductibility would disrupt vehicle sales at the retail and wholesale levels.

Congress should maintain the LIFO inventory accounting method. Eliminating LIFO would have a significant effect on dealerships because most dealerships are family-owned, multi-generational businesses that have built up LIFO reserves over decades. Dealerships use LIFO to match the cost of goods sold to the cost of replacing inventory, so its preservation is important to manage price increases. The recapture of taxes on LIFO reserves for pass-through entities would trigger current tax liability at personal rates, which would have to be paid out of current income. That result would severely reduce cash flow and likely threaten payroll for many small businesses.

The definition of "reasonable compensation" is critical to implementing equitable tax treatment to pass-throughs under the new 25 percent rate. Congress should create a reasonable compensation test that accommodates various business models, instead of imposing a single "70/30" formula. A rigid approach, coupled with the elimination of longstanding deductions, would inhibit cash flow and curtail dealership inventory and growth, resulting in lost dealership jobs.

Auto dealers support reforming our outdated tax code, but Congress must ensure that overall changes to the tax code promote economic growth and positively impact small-business dealerships which help create jobs on Main Street.

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