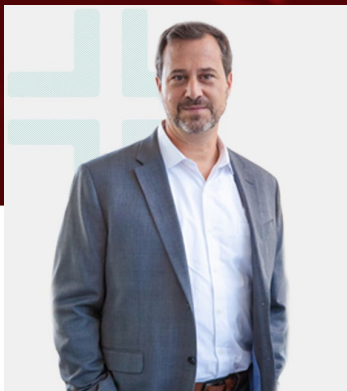


Top 7 Tax Issues Affecting Auto Dealers and Dealer Principals November 2023

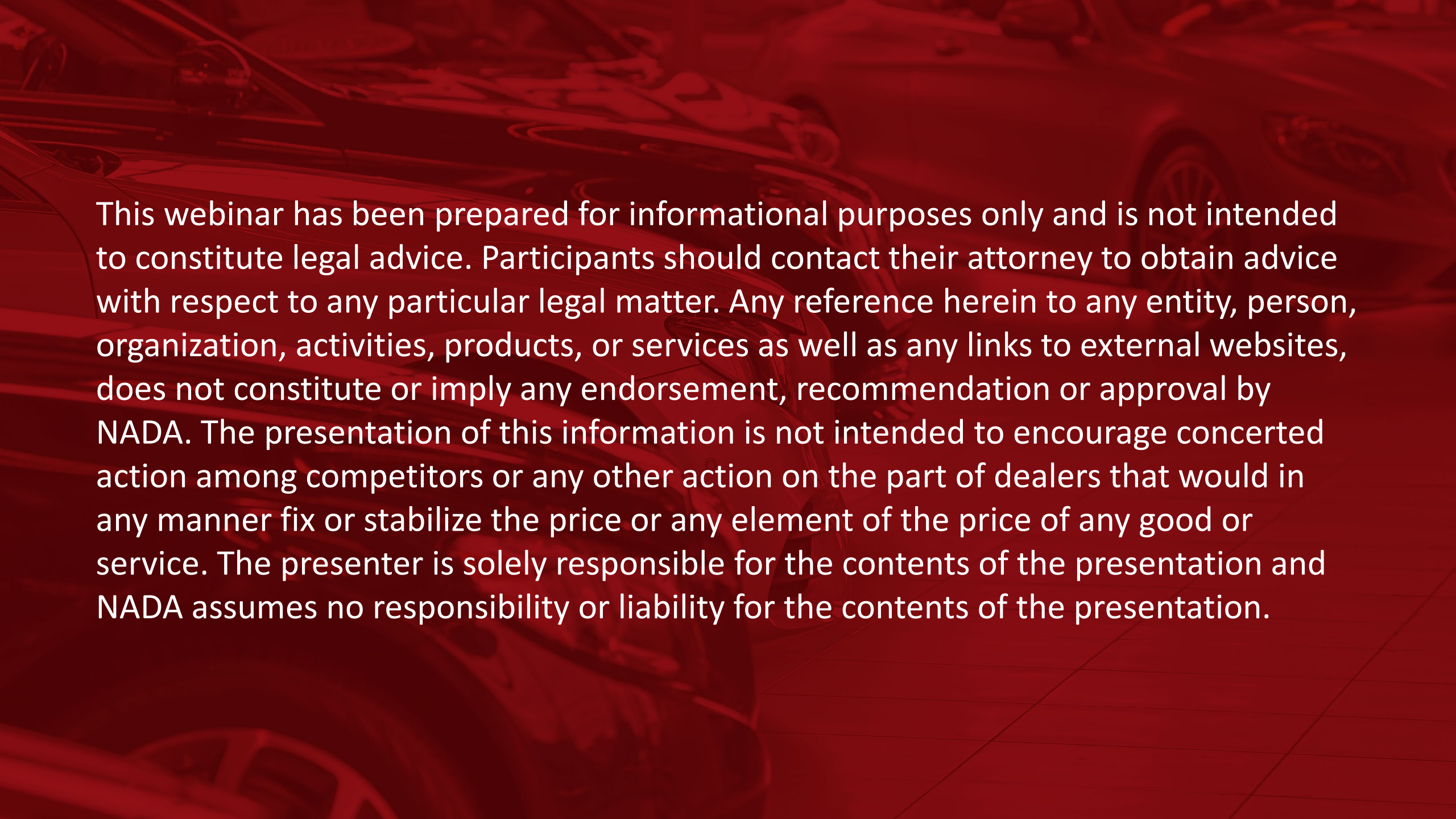


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Agenda

1. Interest deduction limitations under Section 163(j)
2. Section 179 Expense and Bonus Depreciation & Capitalization Policy – De Minimis Threshold
3. Qualified Business Income Deduction under Section 199A
4. Individual income tax rates
5. Estate tax exemptions
6. Pass-through Entity Tax Elections
7. Clean Vehicle (CV) Credits
8. Corporate Transparency Act
9. Captive Reinsurance (\$2.8M) and Insurance

IRC Sec. 163(j) Interest Limitation

- IRC Section 163(j) limits business interest
 - Deductible business interest expense in a taxable year cannot exceed the sum of:
 - The taxpayer's business interest income for the taxable year; PLUS
 - 30% of the taxpayer's adjusted taxable income (ATI); PLUS
 - Floor plan financing interest expense.
 - ATI = EBIT-based formula for 2023. No addback for depreciation and amortization.
 - Who is NOT subject to the 163(j) limitation?
 - For 2023, taxpayers with less than \$29 million of gross receipts (3-year average) will be exempt from the business interest limitation.
 - Real estate trade/business making the election to depreciate real property using ADS.

Bonus Depreciation & 163(j) Interest Limitation

- There is an exception for dealerships in the calculation as it relates to the floor plan financing. The exception allows the dealership to subject only non-floor plan interest to the limitation calculation.
- However, to use this exception and exempt floor plan interest from the 163(j) interest limitation, a dealership cannot utilize bonus depreciation.
- If the floor plan exception provides no benefit, the taxpayer can make the limitation calculation without including the floor plan exception and take bonus depreciation.
- Floor plan interest expense is NOT the amount net of any factory credits, it is the amount of interest paid prior to interest credits.
- 163(j) interest limitations should be evaluated throughout the year and particularly at year-end to understand if there is a potential limitation that would limit the ability to access bonus depreciation.

Bonus Depreciation & 163(j) Interest Limitation

- Sec. 163(j) – Planning Considerations
 - Examine and test for controlled groups.
 - Parent-Subsidiary or Brother-Sister
 - Real estate entities with a 163(j) interest expense limitation:
 - Consider electing real property trade or business. The entity is excepted from the interest expense limitation.
 - BUT the following assets must be depreciated using the alternative depreciation system (ADS) and are NOT eligible for bonus depreciation:
 - Nonresidential real property;
 - Residential rental property; and
 - Qualified improvement property.
 - The election is NOT an accounting method change, but the election is generally irrevocable.

Bonus Depreciation

- Bonus depreciation for 2023 tax year: 80%
 - 2023 is the first year of the bonus depreciation phase out.
 - Generally, applies to depreciable business assets with a recovery period of 20 years or less and other certain property.
 - Don't forget about qualified improvement property. 15-year straight-line property eligible for bonus depreciation.
 - Bonus depreciation is mandatory for qualified property. A taxpayer may elect out.
- Phase out of Bonus Depreciation: Unless the law changes, bonus depreciation will decrease by 20% each year for property placed in service after Dec. 31, 2022, and before January 1, 2027.
 - 2023: 80%
 - 2024: 60%
 - 2025: 40%
 - 2026: 20%
 - 2027: 0%

Section 179

- Maximum Sec. 179 deduction is \$1,160,000 for tax years beginning in 2023.
- The maximum section 179 deduction is reduced by the amount of qualified section 179 property placed in service during the year that exceeds a specified amount, \$2,890,000.
- Sec. 179 deduction is limited to the amount of business taxable income.
- Sec. 179 phase-out purchase limit. The section 179 expense amount is zero when total eligible purchases are \$4,050,000 or more for 2023.
- Consider the Sec. 179 Deduction Rules for Controlled Groups – this could apply to our largest groups.
 - Members of a controlled group are treated as a single taxpayer for purposes of the maximum annual dollar limit on the Sec. 179 deduction, the investment limit, and the taxable income limit.
- Planning considerations: Section 179 is not available to trusts and estates.

Section 179

- What property is eligible for Sec. 179 expensing?
- Most types of real property (Sec. 1250 property), such as land improvements, **do not qualify** for the section 179 deduction.
- Taxpayers may elect to treat “qualified real property” as qualifying section 179 property.
 - Qualified real property consists primarily of qualified improvement property “QIP.”
 - Examples of qualified real property that is eligible for section 179:
 - QIP generally includes interior, non-structural improvements to nonresidential buildings placed in service after the buildings were originally placed in service.
 - No enlargements of the building, elevators and escalators, internal structural framework, residential property.
 - Certain improvements to nonresidential real property: roofs, HVAC property, fire protection and alarm systems, and security systems are eligible. (Not eligible for bonus depreciation).
 - Qualified “off-the-shelf” software.

Capitalization Policy – De Minimis Safe Harbor

- The IRS Tangible Property Regulations permit taxpayers to make an annual *de minimis* safe harbor election to deduct capital expenditures.
- We include the *de minimis* safe harbor election in every dealership return, but are dealers using it correctly?
- Dealerships have an opportunity to expense most property that would otherwise have to be capitalized:
 - \$2,500 per item or invoice for dealerships without applicable financial statement (AFS), typically an audit.
 - \$5,000 per item or invoice for dealerships with an AFS.
- **Book accounting and tax accounting policy must match. Cannot capitalize for book and expense for tax.**
- Dealerships without an applicable financial statement must have a capitalization policy/procedure in place.
- Dealerships WITH an AFS (audit) are required to have a written policy in effect at the beginning of the tax year the election is made.
- Dealers may set a policy of a lesser amount that fits their business needs and still rely on the safe harbor up to the amount of their policy.

QBI Deduction

- For certain high-income taxpayers, the QBI deduction for the business is equal to the lesser of
 - (1) 20% of the business's QBI, or
 - (2) the greater of:
 - (a) 50% of the W-2 wages for the business, or
 - (b) 25% of the W-2 wages plus 2.5% of the business unadjusted basis in all qualified property (UBIA).
- Dealerships are usually limited by the 50% of wages, dealership real estate by 2.5% of business UBIA.
- To avoid QBI limitations, consider making an "aggregation election." You can elect to aggregate separate entities and treat that as one business unit in order to maximize the QBI deduction.
- Consider Aggregation Criteria – a trade or business must meet the aggregation criteria in order to be aggregated together.
 - Same person or group of persons owns 50% or more of each trade or business
 - No specified service trade or business (SSTB); and
 - Satisfy at least two of the following factors:
 - Provide products, property, or services that are the same or offered together;
 - Share facilities or share significant centralized business elements, such as personnel, accounting, legal, HR, IT.
 - Operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.
- **Once you elect to aggregate, you must aggregate the same entities going forward.** You can add new entities to the aggregation group.

QBI Deduction Sunset

- QBI deduction is no longer available starting January 1, 2026.
- In addition, the individual income tax rates revert to pre-2018 amounts in 2026. Maximum individual tax rate of 39.6%
- The elimination of the QBI deduction and increase in tax rates is significant!
- For example, \$10M in taxable income = \$1,000,000 more in federal income tax in 2026.
- A bill has been introduced in both the U.S. Senate and House of Representatives to make the 20% QBI deduction permanent.

Individual Income Tax Rates

YEAR	2025	2026	CHANGE
Maximum Federal Tax Rate	37%	39.6%	2.6%
QBI Deduction	20%	n/a – sunsets	20%
Effective Federal Tax Rate	29.6%	39.6%	10%
Taxable Income	\$10,000,000	\$10,000,000	
Federal Tax Liability	\$2,960,000	\$3,960,000	\$1,000,000

- Recent proposals to expand the scope of the 3.8% Medicare Net Investment Income Tax to include flow through income. This would bring the effective federal rate in 2026 to 43.4%
- C Corporations continue to enjoy a flat 21% federal tax rate

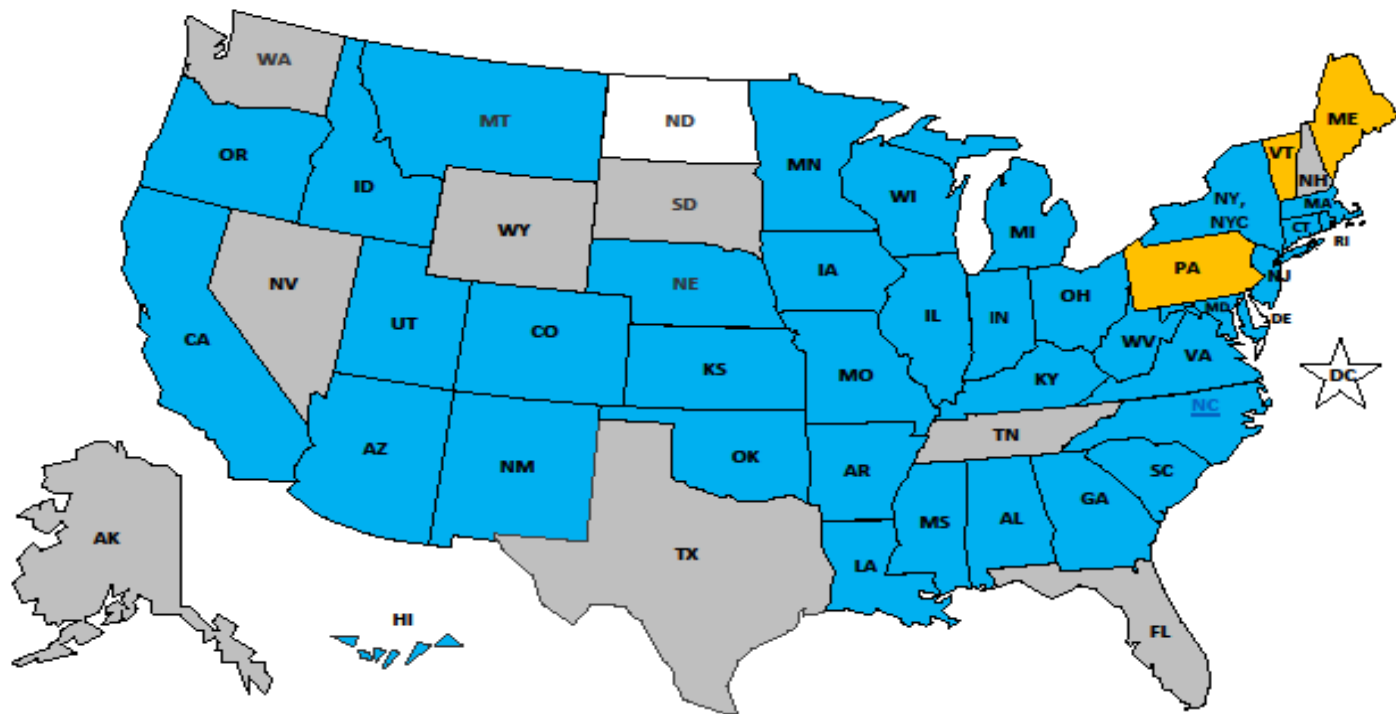
Estate and Gift Tax Exemptions

- **Gift tax annual exclusion.** For gifts made in 2024, the gift tax annual exclusion will be \$18,000 (\$17,000 in 2023).
- **Unified estate and gift tax exclusion amount.** For gifts made and estates of decedents dying in 2024, the exclusion amount will be \$13,610,000 (\$12,920,000 for gifts made and estates of decedents dying in 2023).
 - After 2025, this higher estate exemption is scheduled to revert to pre-2018 levels (adjusted for inflation), which is estimated to be approximately \$7M
 - Estate planning opportunities

PTE Tax Elections

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of August 10, 2023



● 36 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

[AL](#), [AR¹](#), [AZ¹](#), [CA](#), [CO³](#), [CT⁴](#), [HI²](#), [GA¹](#), [IA¹](#), [ID](#), [IL](#), [IN¹](#), [KS¹](#), [KY¹](#) (& [KY](#)), [LA](#), [MA](#), [MI](#), [MD](#), [MN](#), [MO¹](#), [MS¹](#), [MT²](#), [NC¹](#), [NE³](#), [NJ](#), [NM¹](#), [NY](#), [OH¹](#), [OK](#), [OR¹](#), [RI](#), [SC](#), [UT⁴](#), [VA](#), [WI](#), [WV¹](#), and [NYC¹](#)

¹ Effective in 2022

² Effective in 2023 or later

³ Retroactive to 2018

⁴ Mandatory 2018-2023, elective starting 2024

● 3 states with proposed PTE tax bills:
ME - [LD 1891](#) introduced (session ended)
PA - [SB 659](#) and [HB 1584](#) introduced
VT - [SB45](#) passed Senate, in House (session ended)

● 9 states with no owner-level personal income tax on PTE income:
AK, FL, NH, NV, SD, TN, TX, WA, WY

○ 3 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:
DC, DE, and ND

PTE Tax Elections

- Based on the previous map, 36 states and 1 locality (NYC) have enacted PTE tax
 - New states effective for 2023: Hawaii, Montana
 - States with proposed PTE tax bills: Maine, Pennsylvania, Vermont
 - Connecticut PTE tax is mandatory until 2024, then becomes elective.
- PTE tax elections are here to stay. Dealers should be taking advantage the PTE tax deduction. State PTE taxes reduce federal taxable income at the dealership and owners receive a state tax credit for amounts paid.
- There are situations where making the PTE tax election may not benefit.
 - In larger multi-state PTEs, only a few members may benefit at the expense of others. For example, nonresident owners may not be able to receive a state tax credit in their resident state for taxes paid by the PTE, resulting in higher state tax liability for certain owners.
 - In some cases, the PTE tax rate may be higher than the individual rate
 - It is important to plan and model the PTE tax benefits for your particular state before committing to the election.

Clean Vehicle (CV) Credits

- Consumer Credit - Section 30D New CV Credit:
 - New CV credit provides a maximum of \$7,500 per new CV, consisting of:
 - \$3,750 if certain critical mineral requirements are met and
 - \$3,750 if certain battery components requirements are met.
 - A new CV is a CV placed in service on or after January 1, 2023, that is acquired by a taxpayer for original use
 - A vehicle is not a new CV if:
 - (1) another person (including a dealer) has ever purchased, registered, or titled the CV and
 - (2) placed the CV in service for any purpose (including as a dealer demonstrator vehicle)
 - Where a vehicle is acquired for lease to another person, the lessor is the original user
 - A list of eligible CVs that qualify for the new CV credit can be found here:
<https://fueleconomy.gov/feg/tax2023.shtml>

Clean Vehicle (CV) Credits

- Consumer Credit - Section 30D New CV Credit:
 - The CV credit may only be claimed to the extent of reported tax due of the taxpayer and **CANNOT** be refunded
 - **CANNOT** be carried forward to the extent it is claimed for personal use on Form 1040
 - However, the new CV credit can be carried forward to the extent it is claimed for business use on Form 3800, General Business Credit
 - MAGI Threshold Amounts: \$300k for MFJ/SS, \$225k for HoH, \$150k for any other taxpayer.
 - **No credit is allowed for any taxable year if MAGI exceeds the threshold amount.**
 - Vehicle Price Limitations: MSRP for the new CV may not exceed the following amounts
 - Vans, SUVs, Pickup Trucks = \$80k
 - Other = \$55k
 - **If the MSRP exceeds the limitation for that specific vehicle type, that vehicle is NOT eligible for the new CV credit.**

Clean Vehicle (CV) Credits

- Consumer Credit - Section 25E Previously-owned CV Credit:
 - Beginning January 1, 2023, if you buy a qualified used vehicle (EV) or fuel cell vehicle (FCV) from a licensed dealer for \$25,000 or less, you may be eligible for a used CV tax credit.
 - **Used CV credit is equal to the lesser of:**
 - **(1) \$4,000, or**
 - **(2) the amount equal to 30% of the sale price with respect to such vehicle.**
 - **The credit is nonrefundable, cannot apply any excess credit to future tax years.**
 - Who Qualifies – To qualify, you must:
 - Be an Individual who bought the vehicle for use and not resale
 - Not be the original owner
 - Not be claimed as a dependent on another person's tax return
 - Not have claimed another used CV credit in the last 3 years before the purchase date
 - Taxpayer's income level cannot exceed certain thresholds

Clean Vehicle (CV) Credits

- Consumer Credit - Section 25E Previously-owned CV Credit:
 - MAGI Threshold Amounts: \$150k MFJ or SS, \$112,500 HoH, \$75k all other filers.
 - **No credit is allowed for any taxable year if MAGI exceeds the threshold amount.**
 - Qualified Vehicles and Sales
 - **To qualify, a vehicle must meet ALL of these requirements:**
 - \$25,000 or less sale price, does not include taxes, title and registration fees
 - Model year at least 2 years earlier than the calendar year when you buy it.
 - Have a GVWR of less than 14,000 pounds
 - Eligible FCV or plug-in EV with a battery capacity of at least 7 kilowatt hours
 - Be for use primarily in the U.S.
- A list of eligible CVs that qualify for the new CV credit can be found here:
<https://www.fueleconomy.gov/feg/taxused.shtml>

Clean Vehicle (CV) Credits

- Transfer of Clean Vehicle Credit:
 - Starting January 1, 2024, taxpayers who qualify will be able to transfer their new and previously-owned CV credits to dealerships who qualify as “eligible entities.”
 - Dealers that become eligible entities will receive advance payments of previously-owned CVs credits or new CV credits
- Qualifications of a Dealer
 - An eligible entity is the dealer that sold the CV to the taxpayer and that satisfies the following 4 requirements:
 - **1. Dealers MUST register with the IRS Energy Credits Online Portal to claim or transfer a credit.**
 - Registration portal is open NOW (launched November 1), now is the time to register.
 - Great Article by Withum - <https://www.withum.com/resources/irs-to-launch-online-registration-portal-for-ev-dealers/>
 - 2. The dealer must disclose to the taxpayer purchasing the CV:
 - MSRP
 - The value of the credit allowed
 - Any other incentive available for the purchase of such vehicle
 - The amount provided by the dealer to the taxpayer as a condition of the vehicle transfer election

Clean Vehicle (CV) Credits

- Transfer of Clean Vehicle Credit:
- Qualifications of a Dealer: Continued
 - 3. The dealer, not later than at the time of the sale, must have paid the taxpayer (whether in cash or in the form of a partial payment or down payment for the purchase of such vehicle) an amount equal to the credit otherwise allowable to such taxpayer; and
 - 4. The dealer with respect to any incentive otherwise available for the purchase of a vehicle for which a section 30D credit is allowed, including any incentive in the form of a rebate or discount provided by the dealer or manufacturer, must have ensured that the availability or use of such incentive does not limit the ability of a taxpayer to make a vehicle transfer election, and such election does not limit the value or use of such incentive
- **If the IRS has determined that a dealer has failed to comply with the requirements, the IRS may revoke a dealer's registration.**
- The payment is not includible in the gross income of the taxpayer and is not deductible with respect to the dealer

Clean Vehicle (CV) Credits

- Dealer Report – Revenue Procedure 2023-33
 - A dealer must provide the following information on a report to the taxpayer and to the IRS
 - Name and taxpayer identification number of the dealer
 - Name and taxpayer identification number of the taxpayer
 - VIN of the new CV
 - Battery capacity of the new CV
 - Verification that the taxpayer is the original user of the new CV
 - Date of the sale and sale price of the CV
 - Maximum credit allowable for the new CV being sold
 - For sales after Dec. 31, 2023, the amount of any transfer credit applied to the purchase
- For vehicle sales occurring in calendar year 2024 and later, sellers must file reports within 3 days of the time of sale, through IRS Energy Credits Online

Clean Vehicle (CV) Credits

- Benefits of Transferring a CV Tax Credit to a Dealer
 - A dealer can provide a purchasing taxpayer with a financial benefit in cash or in the form of a partial payment or down payment for the purchase of the vehicle
 - The taxpayer benefits by receiving an immediate financial benefit at the time of sale, rather than having to wait to file a tax return and claim the CV credit
 - The amount of the credit transferred can exceed the taxpayer's regular tax liability, essentially making it refundable.
 - The IRS will promptly issue advance payments via direct deposit typically occur within 48 – 72 hours of a successfully submitted time of sale report and advance payment request
 - Dealers will receive real time online confirmation as to whether an advance request was accepted or rejected

Clean Vehicle (CV) Credits

- Recapture of the new or used clean vehicle credit in the event the sale of the CV is cancelled:
 - In the case of a cancelled sale, the taxpayer may not claim a CV credit with respect to the vehicle.
 - The vehicle will still be eligible for a CV credit upon a subsequent qualifying sale to another taxpayer because the CV was not placed in service as part of the prior cancelled sale
 - Additionally, the seller report, if already submitted, must be rescinded by the seller pursuant to the procedures published in Revenue Procedure 2023-33
 - Because the taxpayer is not eligible for the CV credit, no vehicle transfer election is available under the CV credit transfer rules.

Clean Vehicle (CV) Credits

- Commercial Credit – Section 45W Qualified Commercial CVs
 - Businesses that buy a commercial clean vehicle may qualify for a clean vehicle tax credit of up to \$40,000 under IRC 45W. The credit equals the lesser of:
 - 15% of your basis in the vehicle (30% if the vehicle is not powered by gas or diesel)
 - The incremental cost of the vehicle
 - Maximum credit is \$7,500 for qualified vehicles with GVWR under 14,000 pounds and \$40,000 for all other vehicles.
 - Applies to loaners, shuttles, delivery vehicles.
 - See Vehicles That Qualify: <https://www.irs.gov/credits-deductions/commercial-clean-vehicle-credit>
 - IRS is finalizing a form to claim the credit.
 - The depreciable basis of the vehicle is reduced by the amount of the commercial clean vehicle credit received.
 - Nonrefundable credit but allowed to carry forward as a general business credit.

Alternative Fuel Vehicle Refueling Property Credit

- The credit is available to businesses and individuals that place qualified refueling property into service during the tax year.
- Refueling property must be used to store or dispense clean-burning fuel.
- Starting in 2023, qualifying property will be limited to property placed in service within low-income communities or non-urban census tracts.
- January 1, 2023, the credit for qualified refueling property equals 6% with a maximum credit of \$100,000 for each single item of property – per station, not per project.
 - Businesses meeting the prevailing wage and apprenticeship requirements may be eligible for a 30% credit with the same \$100,000 limit.
 - Residential credit equals lesser of \$1,000 or 30% of the cost of qualifying property.
- The property credit base is reduced by Section 179 expense and rebates.
- Property may qualify for 80% bonus depreciation.

Corporate Transparency Act

- Enacted as part of the Anti-Money Laundering Act of 2020 in the National Defense Authorization Act for Fiscal Year 2021. CTA is not part of the tax code, but instead part of the Bank Secrecy Act
- Requirement - Each **reporting company** shall submit to FinCEN a report that identifies each **beneficial owner** of the applicable reporting company.
- Compliance date - For entities in existence January 1, 2023, **filing is due January 1, 2024**. For newly formed entities, 30 days from date of formation. There are penalties for noncompliance.
- A **Reporting Company** is - A corporation, limited liability company, or other similar entity that is created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe(domestic reporting company) or a foreign entity that registers to do business by filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe(foreign reporting company). There are 23 exemptions.
- A **Beneficial Owner** is - an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise
 - Exercises substantial control over the entity (C Suite executives) OR
 - Owns or controls at least 25% of the ownership interest of the entity

Captive Insurance and Reinsurance

- How does captive reinsurance work:

	Traditional Extended Warranty	Captive Reinsurance
Sale price of warranty	\$1,800	\$1,800
“Cost” of warranty	\$1,000	\$1,000
Profit to dealership	\$800	\$800
“Cost” paid to reinsurance company		\$1,000
Admin fee (\$200) + Average claims (\$350)		(\$550)
Profit in reinsurance company		\$450

- Profit in reinsurance company is not taxable to reinsurance company. It eventually becomes taxable to the owner when money is paid out as a qualified dividend (taxed at long-term capital gains rates).
- 100 per month for 7 years = \$3,780,000 (excluding investment earnings inside the captive reinsurance company)
- Enterprise Captive?
 - IRS Scrutiny
 - Risks must be legitimate – alternative to traditional Cyber insurance?

Planning Considerations

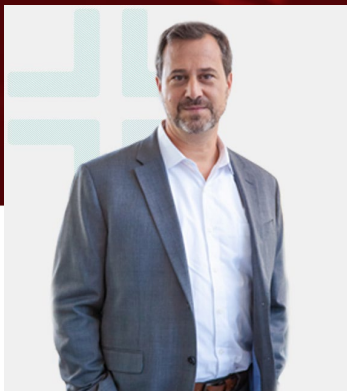
- What is the environment for dealers in 2023?
 - 2023 profitability not as strong as 2022 - Lower gross on new car sales
 - Higher inventory levels/ higher floor plan balances/ higher interest rates = higher interest expense
 - Many dealers will need to utilize the “floor plan interest exception” and will not be able to take advantage of bonus depreciation.
 - Consider putting facility upgrade costs on dealer owned realty company –
 - Cost segregations are still a valuable, great tax saving idea.
 - Dealership real estate could be considered a self-rental, consider making the election to group activities to avoid self-rental trap.
 - Capitalization Policy – revisiting a dealer’s capitalization policy. Do they have one? Are they following it?
 - Could we avoid capitalizing property and bonus depreciation limitations due to 163(j) by expensing?



Questions?

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November 2023



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NADA

