HEADLIGHTS

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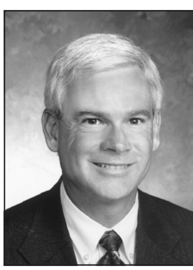
IRS ISSUES FINAL TANGIBLE PROPERTY REGULATIONS

On September 13, 2013, the IRS issued the final Tangible Property Regulations (TPRs). In general, these regulations are effective for tax years beginning on or after January 1, 2014.

The final TPRs will affect all taxpayers that have expenditures classified as any or all of the following:

- ✔ materials and supplies
- ✔ repairs and maintenance
- ✔ assets acquisitions
- ✔ improvements of tangible property



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The objective of the TPR is to provide more explicit guidance that helps taxpayers distinguish which expenditures need to be capitalized and which can be deducted as ordinary business expenses. These final TPRs retain the same basic structure as the temporary TPRs (see *Headlights*, Special NADA Issue, January 2013), with beneficial modifications, additional new safe harbors and annual elections provided.

The following points highlight the more significant changes included in the final TPRs:

1 **Change in accounting methods.** A taxpayer may elect to apply the final TPRs to tax years beginning as early as January 1, 2012, but must comply with these regulations for tax years beginning January 1, 2014. It is our expectation that taxpayers will be required to file at least one federal form 3115 (Application for a Change in Accounting Method); in all likelihood, multiple 3115s may be required in the year of the method changes.

2 **De minimis tax rule.** A revised de minimis rule has been established to provide a safe harbor provision that allows taxpayers to expense

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the purchase of tangible property—if consistent with its book capitalization policy—up to $5,000 per item or invoice if the taxpayer has an applicable financial statement (AFS), but only up to $500 per item or invoice if the taxpayer does not have an AFS. The de minimis rule is a safe harbor, not an absolute limit.

3 **Dispositions of modified accelerated cost recovery system property.** The intent of these proposed TPRs is to provide taxpayers with flexibility in accounting for a partial disposition of an asset. Final regulations on this issue are to be issued in late 2013.

4 **Asset acquisitions and/or improvement of tangible property.** The final TPRs do not provide bright line tests, particularly as related to the refreshing of retail stores. They have provided additional examples to illustrate distinctions between betterments and maintenance activities, particularly when a taxpayer undertakes multiple building refreshments.

5 **Routine maintenance (RM) safe harbor.** The final TPRs expand the RM safe harbor to include buildings. The new revised safe harbor provides that an RM expected to be performed on an asset more than once during the class life is considered to be a repair. For buildings and their structural components and building systems, an RM that is expected to be done more than once during a 10-year period beginning when the building or building systems is placed into service by the taxpayer is now considered a repair.

6 **Safe harbor for small taxpayers.** The final TPRs add an additional safe harbor for small taxpayers, defined as a business with average gross receipts of $10 million or less. These taxpayers need not apply the improvement rules to property with an unadjusted basis of $1 million or less.

Contact your AutoCPAGroup member to more fully discuss these new tax rules and the need to file form 3115s with your business income tax return. ✍

ALLOCATION OF EXPENSES IN DEALER FINANCIAL STATEMENTS

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Many dealers have regular “state of the dealership” meetings involving owners, key managers and, often, trusted professionals (their CPA, attorney or banker). The focal point for these meetings, usually held monthly, is the manufacturer’s dealership-prepared financial statement. These statements, which are required to be submitted to the manufacturer on a monthly basis, can be used for multiple internal operational purposes.

Financial statements are frequently used as a basis to implement and execute pay plans. Many pay plans, such as managers’ pay, may be keyed to a particular departmental line on the financial statement. It is important to both the dealer and the manager that expenses be allocated in the right amount to the right department. A dealer wants to pay his department managers based on performance, while a manager does not want to be underpaid due to an arbitrary or incorrect allocation. Managers’ pay plans are calculated based on their department’s profitability. A commonly used pay-plan metric is a percentage of a given department’s adjusted selling gross that, with some variation among manufacturers, is gross profit less variable-type expenses and often some “semi-fixed” expenses, such as salespersons’ salaries. Well-constructed and consistently applied expense allocations can help mitigate conflict among the dealer, department managers and the accounting office.

Dealers need to assess departmental profitability. The financial statement presents five standard departments: new, used, parts, service and body shop. Along with dealers and financial advisers, the accounting department needs to pay particular attention to expense allocation. Some expenses, such as floor-plan interest, can be easily identified on the floor-plan statement and allocated between new and used departments. Other expenses, such as advertising and promotion, need to be analyzed more carefully due to departmental overlap and the resulting subjectivity of the allocations. Invoices from the manufacturer and outside vendor advertising need to be reviewed to assess what is being paid for and which department benefits from the expense.

Dealership meetings can be a tool to focus the dealer and key managers on increasing profitability. An accurately departmentalized financial statement helps focus meeting participants on performance and facilitates a sober look at a dealership's operations by department. A dealership is many businesses, and the dealer and those advising the dealer need to know its various strengths and weaknesses. Accurate departmental financial statement accounting can provide that.

Contact your AutoCPAGroup member to discuss implementing an effective system to properly allocate expenses among departments. ✍

DEFENSE FOR DEALERS

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Offense scores points, but defense wins games. No matter how great a scoring threat your team may be, if you let the other team score more points, you still lose. Dealerships work the same way. No matter how many cars you sell or how much gross income you produce, you still could suffer a serious setback or loss.

Year-end is a good time to review with your team of professional advisers any holes in your defense that need to be addressed. Here is a list of considerations to evaluate that may one day help save your team.

✔ Check the limits on your employee dishonesty and theft policies. Often, standard limits in policies are insufficient to cover most claims, including the cost of investigation of the loss. Generally it costs very little in additional premiums to increase your policy limits. Most embezzlement is committed by a trusted employee, often over a long period of time. It is not uncommon for the loss to total hundreds of thousands of dollars. Once caught, the employee usually has few assets from which to repay the loss.

✔ While meeting with your insurance experts, get a layman's explanation of the different types of coverage you have and their meaning. What exclusions are in the various policies, and for what types of losses do you not have coverage? Get a clear explanation how you will be reimbursed for both the dealership physical assets (e.g., buildings; inventories; and furniture, fixtures and equipment) and the intangible assets (e.g., customer data, service histories, etc.) after an occurrence such as fire, flood, hail, hurricane, tornado, earthquake, etc. (each may have separate policy addenda). Often, the limits are too low and need to be increased. Consider raising deductibles to keep premium costs down.

✔ Consider how and where you would operate if the dealership had to close its current location for an extended period of time. Is an alternative temporary location available? How long would it take to get an office, computers, telephones, faxes, signage, Department of Motor Vehicles permits and manufacturer approval if you moved to a temporary location?

✔ Is your data available remotely if your server is destroyed? Where are backups stored? How current and accessible are they? How long would it take to get a temporary dealership management system, finance and insurance systems, printers, etc.? How would you write repair orders? Parts tickets?

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DEFENSE FOR DEALERS

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✔ Do you have insurance to reimburse income you would lose if a setback or loss took place (i.e., business interruption insurance)?

✔ Do you have an umbrella policy for the dealership that would kick in if policy limits on the underlying coverage are reached? Umbrella policies are usually inexpensive, so buy enough coverage to protect you from the worst loss you can imagine.

Periodically evaluating your defensive strategy can reap great rewards and give your offense time to recover until it can get back in the game. Contact your AutoCPAGroup member to discuss these issues. ✍

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