HEADLIGHTS

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QUICK GUIDE TO EXPENSE MANAGEMENT

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NADA economists have recently stated what everyone in the automotive industry already knows: Dealerships are relying more and more on manufacturers' incentive money for profit. There is, however, another way to help increase the bottom line. In 2008–2009, sales volume plummeted, and dealers took a hard look at their expenses. In today's ultracompetitive environment, it is crucial for auto dealers to once again manage their expenses. But what exactly does that mean?

Obviously, employment costs are the largest expense of a car dealership. Making sure the workforce is the right size, has the right individuals and awards the right compensation is key to managing employment costs. Compensation includes benefits. If you were to poll your employees, I imagine many of them could not name all the benefits you provide. One example could be the company's contribution to the 401(k) plan. When looking at their retirement statements, many employees do not recognize a contribution made on their behalf, let alone appreciate the contribution. Most employees recognize a cash bonus and appreciate it. So maybe a cash bonus instead of a profit-sharing contribution is a more effective way of creating goodwill with employees. The key is to determine what is important to your workforce and adjust your practices accordingly.

Vendor relationships are arguably just as important as employee relationships. Take a look at your vendor list. Do you know what product or service each one provides and why it is your supplier? If you haven't established an approved vendor list, you may be surprised by what you find. You may discover that you are purchasing from mul-

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tiple vendors in an expense category or that you are paying an outside party for work that could and should be done internally. For instance, you may have a body shop that has the capacity, but because of poor communication between the used car department and fixed operations, you are paying an outside vendor for dent removal on your used units.

When evaluating your vendor relationships, assess whether you are "overbuying." For instance, think of your cell phone. Like most people, you may not utilize many of the features you paid for. You may be doing the same with some of your vendors. The options sounded good at the time you purchased them, but now you realize they just aren't practical. Trim the list to the options you actually use. If you determine that you have been purchasing the same product from multiple vendors, you may be able to negotiate a better price with one by promising them more of your business.

Expense management takes time and effort, and is an ongoing process. Contact an AutoCPAGroup member to help you establish a plan to get the ball rolling. ✍

INVENTORY MANAGEMENT

Aaron J. Winiarz, CPA

It has been a long time since automobile dealerships have experienced the rising interest rates that we have seen over the past year. With two more rate hikes predicted by the end of 2018, it becomes even more important to control your vehicle inventories. If, on average, you carry an inventory of $10,000,000, an increase of 1% in interest rates would cost you $100,000 per year. That can quickly eat away at your profits.

One way to control new vehicle inventory is to keep a 60-day supply of core vehicles and a 30-day supply of noncore vehicles. Each manufacturer has its own definition of core vehicles, and tracking and ordering these vehicles are key to keeping your sales volume at your desired levels. The turn rate of your new vehicles will also depend on the ordering time frame for your individual manufacturer. Maintaining your noncore vehicles at a 30-day level will help keep your interest expense low. Often, noncore vehicles are more readily available from stock the manufacturer builds on speculation or from other dealers.

Used vehicles should also be kept at a strict 60-day inventory level. For your best-selling models and model years, used vehicle sales need to be tracked so that you maintain the proper units in stock to keep them turning. As you are aware, the best grosses are made during the first 30 days after the unit is either purchased or traded in. One of the keys to rapid used vehicle sales is to quickly post pictures of the vehicles on your website to attract the most attention.

The best way to obtain trades, as we all know, is at the door. Purchased vehicles can cost you money if they remain unsold. Certified vehicles, especially if they come from your loaner fleet, can cause particular concern because their depreciated cost can be similar to the cost of a new vehicle when the incentive monies that attach to the new vehicles are included. You need to be sure to price the loaners at an appropriate amount to make them more saleable. Tracking the grosses for each type of vehicle is critical to your profitability in the used vehicle department.

Not all used vehicles are the same. Consider assigning each vehicle, particularly if it is not one of the core sellers, a certain number of days before you reduce the price, so that it does not age you into a loss. If you would like to discuss inventory management further, please feel free to contact your local AutoCPAGroup member. ✍

TIME TO CONSIDER C CORPORATION STATUS?

Jim Tanner, CPA

With the December 2017 passage of the Tax Cuts and Jobs Act (TCJA), there has been renewed interest in C-corp status for closely held businesses. The TCJA has slashed the corporate rate from 35% to 21% while only lowering the top individual tax rate from 39.6% to 37%. Many business owners might consider terminating their S-corp or LLC pass-through status. However, you need to consider the following basic issues before changing your business tax status:

1. Pass-through deduction: The TCJA provides a new 20% deduction on qualified business income (QBI), which reduces many business owners' taxable income from S-corps, LLCs and other pass-through entities. The 20% QBI deduction is limited by two wage-based tests, of which the most beneficial for the majority of dealerships is the limitation of 50% of W-2 wages paid. Often, the 20% QBI deduction will lower an owner's maximum tax rate of 37% to just 29.6%.

2. C-corp double tax: If your dealership retains most of its earnings and you have no plans to sell the business in the foreseeable future, you may have a tax rate advantage as a C-corp. However, most dealers prefer to distribute much of their earnings for personal purposes or business ventures. Distributions from a C-corp inevitably trigger a second level of taxation to the shareholders at a federal rate of 20% or 23.8%. As an S-corp or other pass-through entity, no second tax is imposed upon owners' distributions or business sales.

3. Graduated rates for pass-through income: Most discussions of C-corps vs. S-corps ignore the benefit of graduated tax rates for income from S-corps and other pass-through entities. The federal tax rates start taxing individuals at 10% and gradually rise to 37% for married couples' taxable income above $600,000. After subtracting the 20% QBI deduction, many owners of pass-through entities will pay only $91,379 on the first $500,000 of QBI for their 2018 federal tax, an average rate of 18.3% (with no second tax on distributions from their business). This is particularly important to the many dealers and minority owners who often will not exceed an annual taxable income of $1,000,000 on their individual tax returns.

4. Pass-through entity losses offset other taxable income: Even well-run dealerships may experience some years of net operating losses (NOLs), especially in their early years. The owners of pass-through entities can utilize most actively managed business losses to offset their W-2 wages and other individual taxable income. This tax benefit is not available to C-corps, which are only allowed to carry forward tax losses to offset future corporate taxable income.

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5. State tax considerations: Most states assess both a corporate and an individual income tax, with rates that vary by state. In the majority of these states, there is an advantage to being a C-corp, which can still deduct all state and local taxes. The owners of pass-through entities can deduct only $10,000 per year of state and local taxes on their federal tax returns.

If you are considering changing your business's federal tax status, contact your AutoCPAGroup member to discuss this complicated tax law change. ✍

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