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How can you benefit from PATH Act provisions?

With fall approaching, now's a good time to start thinking about steps you can take during the rest of the year to save on your 2016 tax bill. And there's good news for dealerships: Two key tax breaks that were scheduled to expire have been extended.

By planning now, you may be able to save big tax dollars on purchases of fixed assets and equipment that you make for your dealership before the end of the year. The same goes for remodeling or constructing new dealership facilities.

THE PATH TO OPPORTUNITIES

The Protecting Americans from Tax Hikes (PATH) Act permanently extended and retroactively reinstated the increased Section 179 expensing limit of $500,000 for qualifying fixed asset purchases. In addition, the act temporarily extended first-year bonus depreciation through the end of 2019.

> *To take advantage of these tax strategies in 2016, you must buy or finance qualifying fixed assets and place them in service by December 31.*

Most dealerships tend to buy their fair share of fixed assets and equipment, such as computers and software — for example, a Dealer Management System (DMS) — showroom furniture and fixtures, and telecommunications systems. The service department is especially equipment-intensive: Wheel balancers, hydraulic lifts, alignment racks and inspection machines are a few types of new equipment commonly purchased for this area of the dealership.

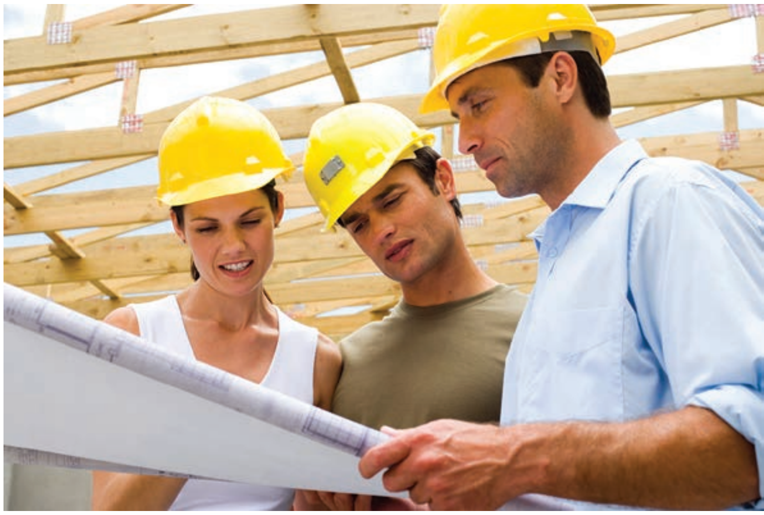
With the permanent extension of the increased Sec. 179 expensing limit, you can now plan your annual capital expenditure budget with more certainty. Say you're thinking of spending up to $500,000 this year on qualifying fixed assets such as those listed above. If so, you might want to make purchases and place the assets in service before the end of the year.

The PATH Act also permanently extended the higher annual phaseout threshold of $2 million in qualifying fixed asset purchases that can be expensed. Previously, the annual phaseout threshold was just $200,000. In fact, the $2 million limit is indexed for inflation, and for 2016 the phaseout starts at $2.01 million. Expensing for fixed asset purchases is still phased out on a dollar-for-dollar basis for purchases that exceed the threshold amount, which means that for this year the $500,000 will be reduced between $2.01 million and $2.51 million.

Accordingly, no Sec. 179 deduction is available if the total investment in qualifying property is $2.51 million or more. And the $500,000 limit is also indexed for inflation, although the eligible amount for 2016 hasn't increased.

BONUS DEPRECIATION: EXTENDED FOR NOW

The temporary extension of first-year bonus depreciation, meanwhile, allows your dealership to



immediately expense 50% of the cost of new property that you buy and place in service this year and next year. In 2018, you can expense 40% of the cost of new equipment, and in 2019 you can expense 30% of the new equipment's cost. Bonus depreciation ends in 2020, unless Congress extends it again.

Bonus depreciation applies to new (but not used) Modified Accelerated Cost Recovery System (MACRS) property with a recovery period not exceeding 20 years, computer software, water utility property and qualified improvement property. Original use of MACRS property must begin with your dealership.

To take advantage of Sec. 179 expensing or bonus depreciation in 2016, you must buy or finance qualifying fixed assets and place them in service by December 31. This makes the next few months critical in terms of planning your equipment acquisition strategies to maximize your benefits from these two tax breaks.

MAXIMIZING YOUR TAX SAVINGS

If you're remodeling your dealership or constructing or buying new facilities, one way to maximize your tax savings is to have a cost segregation study performed. This study will separate individual components in a facility into different categories for depreciation purposes, enabling you to depreciate them faster.

A commercial building isn't eligible for bonus depreciation because its useful life is greater than 20 years. But by breaking out building components — for instance, the plumbing and electrical, carpeting, parking lot paving, and awnings and canopies — you can take bonus depreciation on them.

For example, a New York Honda dealership recently built a brand new facility at a total cost of $5 million. Conducting a cost segregation study enabled them to reclassify $1.5 million of the costs as tangible personal property and depreciate them over five, seven or 15 years instead of 39 years. As a result, the dealership was able to take 50% bonus depreciation of $750,000, which resulted in a tax savings of approximately $300,000.

Another dealership in Nevada recently decided to install a new DMS and replace some aging equipment in its service department. The total cost of these assets was $400,000, which the dealership was able to take Sec. 179 expensing on and write off immediately. The result: a tax savings of approximately $140,000.

MORE DETAILS

The potential tax savings with Sec. 179 expensing and bonus depreciation are significant. Be sure to consult with your tax advisor for more details on how you can take full advantage of the opportunities.

The watchful eyes of the IRS

Tread carefully when setting owner compensation

You'd like to reward yourself and your partners with attractive compensation when business is good. But be careful: The IRS is watching to make sure compensation levels are "reasonable," and it pays particular attention to your business structure.

CONSIDER THE BASICS

Compensation is affected by the amount of cash in your dealership's bank account. But just because your financial statements report a profit doesn't necessarily mean you'll have cash available to pay owners a salary or make annual distributions. Net income and cash on hand aren't synonymous.

Other business objectives — for example, buying new equipment, repaying debt and sprucing up your showroom — will demand dollars as well. So, it's a balancing act between owners' compensation and dividends on the one hand, and capital expenditures, expansion plans and financing goals on the other.

C CORPORATIONS

If you operate as a C corporation, your dealership's income is taxed twice. First, business income is taxed at the corporate level. Then it's taxed again at the personal level as you draw dividends — an obvious disadvantage to those owning C corporations.

C corporation owners might be tempted to classify all the money they take out as salaries or bonuses to avoid being double-taxed on dividends. But the IRS is wise to this strategy. It's on the lookout for excessive compensation to owners and will reclassify above-market compensation as dividends — potentially resulting in additional income tax as well as interest and penalties.

The IRS also monitors a C corporation's accumulated earnings. Generally, similar to retained earnings on your balance sheet, accumulated earnings measure the buildup of undistributed earnings. If these earnings get too high and can't be justified as needed for such things as a planned expansion, the IRS will assess a tax on them.

S CORPORATIONS, LLCs AND PARTNERSHIPS

Perhaps your dealership is structured as an S corporation, limited liability company or partnership. These are all examples of "flow-through" entities that aren't subject to federal income tax at the entity level. Instead, income flows through to the owners' personal tax returns, where it's taxed at the individual level.

> *IRS agents are watchful of S corporation dealer-owners who* under*pay themselves to avoid payroll taxes on owners' compensation.*

Dividends (typically called "distributions" for flow-through entities) are tax-free to the extent that an owner has tax basis in the business. Simply put, basis is a function of capital contributions, net income and owners' distributions.

So, the IRS often has the opposite concern (from C corporations) if you're treated as an S corporation for tax purposes. Specifically, agents are watchful of dealer-owners who *under*pay themselves to avoid payroll taxes on owners' compensation. If the IRS thinks you're downplaying compensation in favor of payroll-tax-free distributions, it'll reclassify some of your distributions as salaries. In turn, while your income taxes won't change, you'll owe more in payroll taxes than planned — plus, potentially, interest and penalties.

LEVELS OF SCRUTINY

Above- or below-market compensation raises a red flag with the IRS — and that's definitely undesirable. Not only will the agency evaluate your compensation expense — possibly imposing extra taxes, penalties and interest — but a zealous IRS agent might turn up other challenges in your records, such as nonsalary compensation or benefits.

What's more, an investigation might cause a domino effect, drawing attention in the states where you do business. Many state and local governments face budget shortages and are hot on the trail of the owners' compensation issue and will follow federal audits to assess additional taxes when possible.

MULTIPLE FACTORS

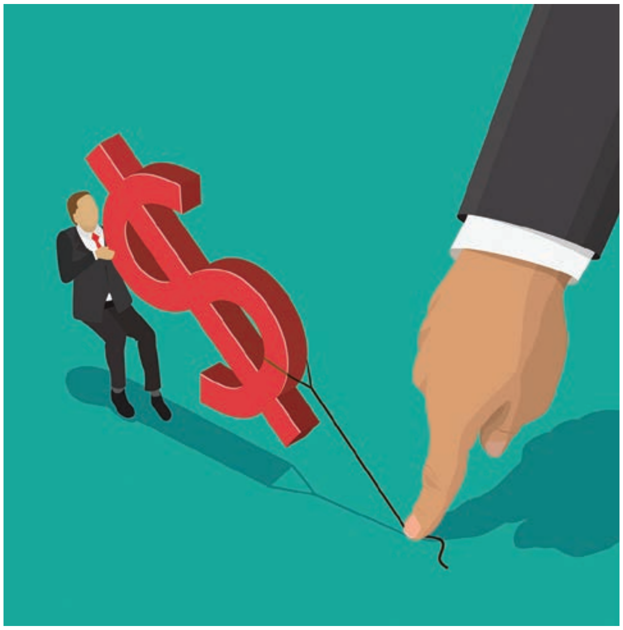
Setting owner compensation requires careful consideration. If your compensation levels are contested, tax courts will look at a number of factors in addition to "market rate" to determine whether the compensation is reasonable, including:

- Training and experience,
- Duties and responsibilities, and
- Time and effort devoted to the dealership.

The timing and manner of paying bonuses to key people, compensation agreements and the use of a formula to determine compensation are among the other factors that may be considered.

BE PROACTIVE

No one wants to have his or her business practices challenged. So, before it happens to you, work with your CPA to determine whether your dealership's compensation levels are vulnerable to an IRS inquiry.



Work it!

Make sure your website is doing its job

In recent years, the Internet has become an integral part of most dealerships' marketing efforts. So, to stay competitive, you've got to ensure that your website is working hard as a powerful sales and lead-generation tool.

BEST PRACTICES

Here are some best practices that successful dealerships follow when designing and redesigning a website:

Enable buyers to narrow down vehicles before they visit your showroom. Car buyers now spend an average of 14 hours shopping online, up from just five hours a decade ago, according to a study by the National Automobile Dealers Association and global consultants McKinsey & Company. So, the more you can do to help customers zero in on the right vehicle using your website, the faster and smoother their shopping experience might be once they arrive at your store.

Focus, in particular, on your online product presentation. Make it easy for customers to browse your entire vehicle inventory online using whatever criteria they choose: used vs. new, price, make, model, mileage and so on. Include plenty of high-quality vehicle photos and even videos to enable customers to take a “virtual test drive” of the car or truck they’re interested in.

Encourage vehicle trade-ins. To boost profitability, try to get your customers thinking trade-in before they set foot on your dealership’s property.

For example, create a “Trade-in” page on your website that includes an explanation of the benefits of trading in at the dealership vs. selling a vehicle to a private party. Also explain how your trade-in process works. And work with your website designer to create an online trade evaluation tool that customers can use to get an idea of their trade-in’s approximate value.

Include plenty of quality content. Content is “king” in the online marketing world, so include plenty of resources on your site designed to help educate and inform customers, rather than just sell to them. Adding fresh new content to your site also can help improve your search engine optimization results.

Articles, e-books and videos on buying and maintaining vehicles are some of the most helpful types of content found on dealership websites today. Some dealers prefer to outsource content creation to an agency that specializes in this instead of trying to create and manage it themselves.

CUSTOMERS START REVVING UP FOR ONLINE BUYING

The desire among customers to adopt a fully digital car-buying experience is relatively small but growing, according to Foresight Research’s recent Dealer Action Report, *Making Digital Work for You*.

Fourteen percent of respondents said they prefer a full online showroom where they can complete the car-buying process without visiting a dealership, up from 10% a year ago. Conversely, 60% said they prefer physically visiting the dealership, down from 68% a year ago.

Not surprisingly, a higher percentage of younger car buyers ages 18–34 (20%) and a lower percentage of buyers age 55 and over (11%) prefer a full online showroom.

Given these trends — and because young buyers are especially interested in purchasing cars online — it might be smart to begin taking steps toward creating a fully digital car-buying experience for the customers who want it.

Integrate all of your digital marketing activities on your website. Many dealerships use a wide range of digital marketing tools such as e-newsletters, social media marketing and online videos. Your website should centralize and organize all of these different marketing initiatives.

For example, make sure there are prominent links on your home page to your social media platforms, such as your dealership’s Facebook, Twitter and Google+ pages and your YouTube channel. Also include a signup box for your e-newsletter and consider adding a live chat option so customers can communicate virtually with a customer service rep.

YOUR VIRTUAL DEALERSHIP

Many car buyers will visit your virtual dealership — that is, your website — long before visiting your physical dealership. Therefore, you should put as much time and effort into designing and building your website as you do your store. Invest in quality, and the rest will follow.

Why buy-sell agreements are critical for dealerships

Part of your responsibility as a dealer-owner is to plan for worst-case scenarios. One such situation that many owners fail to anticipate is their sudden death or disability, or the death or disability of a partner. One of the best ways to prepare for such an event is to create a buy-sell agreement.

PLANNING AHEAD

A “buy-sell,” as it’s commonly known, is a legal document that details the conditions and terms under which the other owners may buy out one owner’s interest. Triggering events for the buyout may include an owner’s death or disability.

Having a buy-sell in place helps ensure that ownership interests are transferred to other partners in an orderly manner when a triggering event takes place. Without such an agreement, there could be conflicts and even litigation between partners and heirs over how, and to whom, interests are transferred.

Triggering events for a buyout may include the death or disability of one of the owners.

The buy-sell also will detail how ownership interests are to be valued. For example, it may set a predetermined price for the interests or include a valuation formula to be used upon the triggering event.

FUNDING THE AGREEMENT

Buy-sell agreements are often funded with cash-value life insurance or disability buyout insurance. With a cross-purchase agreement, each owner buys a policy on the other owners and uses the proceeds to buy the interest of a deceased or disabled owner. This arrangement usually works best when there are no more than two or three owners.

With an entity purchase agreement, the dealership buys policies on each owner and uses the proceeds to buy the interest of a deceased or disabled owner. The interest is then divided among the other owners. This arrangement usually works best when there are more than three owners due to the complexity and cost of owners having to buy multiple policies on each other with a cross-purchase agreement.

EXPERT ADVICE

Buy-sell agreements are complex legal documents. So, be sure to consult an attorney for more guidance on creating one.

Your success is our business

At Tyler, Simms & St. Sauveur we recognize that the challenges of owning and operating an automobile dealership are unique and ever changing. That's not only because your enterprise is essentially several different businesses rolled into one, each with its own special features. It's also because your business has evolved to where you need a CPA as well versed in estate and succession planning, tax strategies, and benefits administration as in dealership accounting, valuation, systems reviews and related areas.

Consequently, you need more than simply a CPA to prepare your taxes. You need an adviser who has invested time and effort into learning your industry and is trained in the dealership environment. At Tyler, Simms & St. Sauveur, we understand the challenges you face. Our professional staff includes former dealership CFOs and Controllers, so we know the demands placed on your people and how to lessen their burden. Most important, we realize that you now need more services than ever before, and we excel at delivering them.

To help you achieve your dealership's full potential — and make your job easier — we will meet with you quarterly to analyze your numbers and point out how you compare to your peers and where you may have opportunities to improve. We will not tell you how to run your dealership. But, drawing on our extensive experience, we will show what others have done to enhance their success and suggest ways you can do the same.

In addition to traditional audit, review, compilation and tax services, we can help you with:

- Operational audits
- Employee benefits consulting
- Estate and succession planning
- Management evaluations
- Business valuation
- Due diligence purchase systems reviews
- LIFO calculations and compliance
- Internal controls review
- Budgeting and forecasting
- Business consulting, and much more

Our expertise has enabled us to be instrumental in designing and presenting a series of accounting courses for the New Hampshire Automobile Dealers Association, and we have been featured speakers at NADA 20 groups. Also, we are members of Auto Team America, a national group of accounting firms specializing in dealership accounting that we meet with several times a year to discuss current and emerging industry issues.

Call us today at 603-653-0044 or visit www.tss-cpa.com to learn how Tyler, Simms & St. Sauveur is uniquely positioned to help you increase your success.

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