

## IRS Modifies its Position on UNICAP

By: Daniel P. Thompson, CPA

UNICAP is a federal tax provision that requires a taxpayer to defer certain current expenses by adding them to their year-end inventory values. For most dealerships, UNICAP has been an afterthought. It was nothing more than a quick computation performed by the CPA firm at year-end that had an immaterial impact on taxable income. That all changed in 2005 when IRS agents modified their interpretation of this provision as it applies to dealers and began proposing UNICAP audit adjustments equal to as much as 5 to 10 percent of year end inventory. In 2007, the IRS formally adopted this new position and in the fall of 2009 provided their field agents with specific guidance on how to quantify these significant adjustments. In addition, the IRS notified dealer taxpayers that they had until the end of 2010 to change their method of accounting to comply with this new interpretation. The financial impact to dealerships was potentially catastrophic.

What a difference a year can make. In 2010, NADA was successful in facilitating a discussion with IRS, dealership and CPA firm representatives (including Boyer & Ritter). The objective was to provide industry specific input aimed at enlightening the Service on dealer business and cost accounting methods and their impact on the clear reflection of income. We are pleased to report that our voices have been heard and the IRS has adjusted its position on UNICAP with the November 9, 2010 release of a safe harbor UNICAP method (Rev Proc 2010-44).

Rev Proc 2010-44 is a significant victory for dealers. As a practical matter, the Revenue Procedure puts to rest the concern of a significant tax liability as a result of UNICAP. The new safe harbor method clarifies and restates the IRS' position on UNICAP for dealerships and provides two different safe harbor methods that dealerships can use to satisfy UNICAP compliance. The first is the retail sales facility safe harbor method which expands and clarifies the definition of a retail sales facility allowing most dealers to avoid capitalizing handling and storage costs related to their dealership facility. The second is the reseller without production activities safe harbor method which clarifies the treatment of handling costs on dealership-owned and customer-owned vehicles and requires that only the cost of parts added to the vehicles must be capitalized for work performed at the dealership.

A dealership has the option to implement either or both of these safe harbor methods by filing a timely form 3115, Application for Change in Accounting Method with the IRS. We strongly encourage all eligible dealers to elect these safe harbor methods with your 2010 tax filings. Failure to do so could subject the dealer to significant UNICAP adjustments. If you need assistance in analyzing your particular situation, please feel free to contact us at 717-761-7210.

*Daniel P. Thompson, CPA, is the partner in charge of the Dealership Services Group at Boyer & Ritter, CPAs and Consultants. For more information contact Dan at (800) 843-1120, or via email at [dthompson@cpabr.com](mailto:dthompson@cpabr.com).*

---

Camp Hill, PA • Carlisle, PA • Chambersburg, PA • State College, PA

An Independently Owned Member, McGladrey Alliance

The McGladrey Alliance is a premier affiliation of independent accounting and consulting firms. The McGladrey Alliance member firms maintain their name, autonomy and independence and are responsible for their own client fee arrangements, delivery of services and maintenance of client relationships.