2020 Year-End Checklist for Dealers

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December 9, 2020

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The following pages include specific suggestions to help you reduce 2020 income taxes, as well as various administrative matters to address as part of the year-end close. Please take a few minutes to review the following checklist and consult a member of Boyer & Ritter's Dealership Services Group with any questions you may have.

The Tax Cuts and Jobs Act ("TCJA") enacted in December of 2017 was the most comprehensive and complex change in the tax law in the last 30 years. The TJCA reduced the C corporation tax rate to a flat 21%. To attempt to equalize the tax treatment for owners of S corporations and partnerships, the TCJA created the new section 199A deduction of up to 20% of qualified business income, resulting in an effective tax rate of 29.6% on qualified business income for dealers in the highest tax bracket.

The TCJA also limits the amount of business interest that can be deducted. Beginning in 2018, the deduction allowed for interest expense is limited to the sum of (1) the taxpayer's business income for the year, (2) 30% of the taxpayer's adjusted gross income for the year, and (3) the amount of floor plan financing interest for the year. Floor plan interest remains fully deductible, but interest expense on debt other than floor plan financing debt may be limited due to (1) and (2). The CARES Act enacted in March of 2020, increased the 30% limit to 50% for 2019 and 2020 tax years. The CARES Act also allows the use of the 2019 adjusted taxable income in 2020.

Other changes made by the TCJA and CARES Act impacting dealers are discussed throughout the sections of the checklist.

Capital Expenditures / Depreciation / Repairs

The IRS has issued what are commonly referred to as the Tangible Property Regulations ("TPR") as final regulations. They provide rules regarding the treatment of expenditures for acquiring, maintaining, or improving tangible property, and for dispositions of tangible property.

The regulations allow certain taxpayers to establish a safe harbor capitalization policy of up to $2,500. That is, qualifying items that cost less than $2,500 could be expensed for tax reporting purposes if they were also expensed on the Company's books.

Applying TPR to any business is fact specific and can be very cumbersome. It includes many other factors not presented here. Talk to your CPA about applying the TPR to your dealership, as you consider the following:

1. Review your fixed asset purchases and expense all items where appropriate.
2. Section 179 expensing election - for 2020, a taxpayer can elect to expense up $1,040,000 of eligible property placed in service in 2020. Eligible property would generally include all new and used purchases of equipment, furniture, computers, some software, etc. To the extent a taxpayer invests more than $2,590,000 in eligible property, the expensing election limit would

be reduced dollar for dollar. There is also an income limitation; the deduction can be used to reduce income but not increase a loss.

3. Bonus depreciation – One hundred percent of the cost of eligible new and used property placed in service could be deducted as "bonus depreciation". This bonus is for all assets placed in service after September 27, 2017 and before January 1, 2023. Generally, eligible property includes all equipment, furniture, computers, etc. and excludes real estate, except for certain qualifying improvements. Note that used property is now eligible for bonus depreciation. Dealers cannot elect out of application of the Section 163(j) business interest limitations, but may take bonus depreciation if they do not utilize the floor plan carve out to deduct its business interest expense.
4. Qualified Improvement Property. The CARES Act made a technical correction to correct the life of qualified improvement property to 15 from 39 years. The CARES Act retroactively assigns a 15-year recovery period to QIP placed in service after December 31, 2017. QIP qualifies for 100 percent bonus depreciation if all bonus requirements are met. QIP is broadly defined as an internal improvement to nonresidential real property but does not include improvements related to elevators and escalators, the internal structural framework, or an enlargement of the building. The improvement must be placed in service after the date the improved building is first placed in service. The improvement must be made by the taxpayer. Therefore, the 15-year recovery period and bonus depreciation does not apply to a taxpayer that purchases a building that includes qualified improvement property depreciated by the seller over 15 years.
5. If you have any building repair or maintenance items such as painting, etc. that needs to be completed in the next few months, have these performed by the end of 2020.
6. Consider performing a cost segregation study for recent construction projects or building acquisitions. This could provide significant tax benefits, which result from accelerating depreciation deductions.
7. Consider performing a partial asset disposition study if you have recently remodeled or refreshed your store to write-off the costs of prior capitalized costs removed as part of the project.

Inventory

1. Make sure that a reasonable estimate of your LIFO adjustment for the year is on all versions of your December financial statement. There are no exceptions.
2. If you are not on LIFO for used vehicles, adjust all your used vehicles to current wholesale market value as of the end of the year. Caution: take care to follow all the conditions to qualify for the tax deduction. In a recent tax case, a dealer was denied his used car write-down deduction. The dealer's write-down records were incomplete as they lacked make, model, and year of several automobiles and did not include mileage, condition or options of any automobiles. In addition, the dealership claimed a deduction for a reserve amount rather than the computed write-down amount.

3. For each of your manufacturers summarize any trade discount programs offered (advertising, interest, etc.) and document how the payment is recorded on your books. Determine if more tax efficient treatment exists.
4. Compare your actual parts inventory versus the accounting parts inventory and record any adjustments as needed. Have your parts manager determine which parts would be considered worthless or obsolete. Subject to your review, dispose of these parts by year-end. Have the parts manager give you a copy of the parts inventory summary that shows the dollar amount of parts in inventory at the end of the year along with the aging of the inventory.

Other Assets

1. Review all past due accounts receivable and write off those receivables that are uncollectible.
2. Review your bank reconciliations and void out any checks that are not expected to clear. Consider the Pennsylvania unclaimed funds reporting requirements when voiding old outstanding checks.
3. Carefully review prepaid assets and expense all items in this account that pertain to 2020.

Liabilities

1. Accrue all expenses for wages, bonuses and vacation that will be paid within 2-1/2 months of year-end to employees.
2. Make sure you pay any interest, salaries, commissions, rents, or bonuses due to stockholders in December, in order to take the deduction this year (for S corps, all shareholders; for C corps, 50% or greater shareholders; or anyone related to either.) Also, be sure a Form 1099 is issued for interest and rents paid to any individual in excess of $600.
3. Check that the payroll tax and sales tax payable accounts equal the actual amount of all taxes to be paid for the 2020 fourth quarter and year-end tax returns.
4. Accrue any unpaid 2020 profit sharing plan contributions, where applicable. These can be deducted in 2020 as long as they are paid before the extended due date of the company's income tax return.
5. If you have any nonqualified deferred compensation arrangements, review them carefully with your CPA or attorney to assess how the American Jobs Creation Act of 2004 or the Tax Cuts and Jobs Act ("TCJA") of 2017 may affect them. Certain terms can make deferred income taxable now or within 5 years, as well as incur an additional 20% penalty.

General

1. Keep your accounting records open at the end of December:
   a. Record December finance chargebacks at 12/31/2020.
   b. To maximize LIFO deductions, record all new vehicles that were built and in transit in 2020

as vehicle purchases in 2020 by keeping the new vehicle purchase journal open the first few days of 2020.

c. Keep your accounts payable journal open to record all 2020 expenses in 2020 including advertising, interest, utilities, telephone, gasoline, data processing, insurance, etc.

d. Account for all missing documents.

e. If any vehicle deal is not a 100% completed deal in 2020, then treat it as a 2021 vehicle sale.

f. Make sure all miscellaneous inventories are adjusted to actual including labor inventory, sublet, gas-oil-grease, body shop materials, etc.

g. Where possible, reconcile all balance sheet accounts before closing year-end.

2. Review the IRS cash reporting requirements and check that all of your customers that had an IRS Form 8300 filed for them in 2020 have been notified.

3. You will need to know the amount spent on meals in 2020 for the dealership federal tax return. This does not include travel and it should not include functions that can benefit all employees such as the employee holiday party. Further, after 2017's TCJA entertainment, amusement and recreation will no longer be a part of the traditional M&E Deduction. Food and beverages that are provided during entertainment events will not be considered entertainment if purchased separately from the event. Consider establishing a separate sub-account for meals & entertainment to avoid additional work to identify these costs at the end of the year.

4. Make sure you have made all required personal and corporation income tax deposits for 2020 and see that your personal income tax withholding is adequate. For individuals, the real estate and state income taxes deduction is capped at $10,000. Therefore, any amount paid beyond this in 2020 will not receive a tax benefit.

5. If you plan to make any charitable contributions (both cash and non-cash) in the next few months, consider making them before the end of 2020 to get the deduction now. In certain circumstances, charitable contributions made by corporations can be accrued at year-end if paid within 2-1/2 months. Please also consider how the TCJA and CARES Act will affect your tax return. The CARES Act allows charitable contributions up to 100% of adjusted gross income. (To qualify for the 100% limitation, the contribution must be a cash contribution and cannot be made to a private foundation or donor advised fund.) However, at an individual level with the increased standard deduction, itemizing your deductions might no longer be applicable. Consult with your CPA on ways to manage this such as timing charitable contributions or donating other assets such as appreciated stock.

6. For S corporations, partnerships, and LLC's that will incur a loss in 2020, make sure you have sufficient stock or debt basis in order to deduct the loss. If you will not have sufficient basis, consider making a loan to the entity to create basis. Remember that all loans must bear adequate interest and be in the form a formal written loan document.

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Payroll - General

1. Employees' W-2s should include any personal expenses paid by the company during the year on their behalf, including personal use of company automobiles. (See next item.) For S Corporation shareholders, amount of group health insurance and disability insurance should be added to their W-2s. We have attached a Fringe Benefit Matrix to assist you preparing employee's W-2's.
2. All users of demonstrator vehicles should have signed a comprehensive demonstrator agreement. Additionally, review the procedures issued by IRS regarding the clarification of taxation of demo use:
    a. The "Partial Exclusion Method" allows salespersons to drive a demo with no record keeping requirements and provides for a small amount to be included in their income and taxed.
    b. The "Simplified Out / In Method" provides that the dealership, not the salesperson, maintains records of the demonstrator's use. Salespersons qualify for full exclusion under this method.
3. A dealership which is an S Corporation, Partnership, or LLC should be reminded that owners of these entities cannot participate in Section 125 Plans (Cafeteria Plans).
4. An IRS Form 1099-NEC (new form) should be issued to all non-employees (not corporations) that received over $600 in 2020. Review these non-employees to see if they should really be considered employees for payroll tax purposes.
5. 2020 W-2s and 1099s are due to the IRS by January 31.

Payroll – Affordable Care Act

Employees are to receive information returns for health insurance coverage as of March 2, 2021. This information reporting system is similar to the W-2 reporting system. Each applicable employee is to receive a 1095-B or 1095-C.

Finance and Insurance

Furnish a list to your CPA of all reinsurance companies you and your dealerships participate in.

Individual

1. If you or the dealership own stocks that have unrealized losses, consider selling them to offset any capital gains recognized earlier in the year.
2. If you make gifts to children or other relatives each year for estate tax purposes, make the gifts no later than December 31, 2020. Review gift tax return filing requirements.