Tax Law Changes & Other Considerations

On November 6, 2009, the President signed the "Worker, Homeownership, and Business Assistance Act of 2009 (H.R. 3548)." There are many other factors which can also affect your business' taxable income for 2009 and beyond. Some of the below changes and other items are beneficial and some are not.

Net Operating Loss (NOL) Carrybacks
Under the prior law, NOLs generally could be carried back two years and forward 20 years. The new law gives most businesses longer carryback options. Under the Act, most taxpayers (some exceptions apply, i.e., TARP recipients) may elect to increase the carryback period for an applicable NOL to three, four, or five years from two years. An applicable NOL means the taxpayer's NOL for any tax year ending after December. 31, 2007 and beginning before January 1, 2010.

The amount of the NOL that can be carried back to the 5th tax year before the loss year may not be more than 50% of the taxpayer's taxable income for that 5th preceding tax year determined without taking into account any NOL for the loss year or for any tax year after the loss year. The 50% limitation does not apply to an eligible small business with respect to an election made under pre-Act law. Once made, the extended carryback election is irrevocable.

Larger businesses with over $15 million of average gross receipts can electively apply this rule to only one current loss year, while smaller businesses may use this provision for two years.

Additional FUTA Surtax Extension
The Worker, Homeownership and Business Assistance Act of 2009 provides that the 6.2% FUTA tax rate continues to apply through June of 2011, and the 6.0% rate applies for the remainder of calendar year 2011 and for later years. That is, the temporary 0.2% surtax is extended for 1½ years through June 30, 2011.

Refundable Tax Credit
The present $8,000 refundable tax credit for first-time homebuyers has been extended, and a new $6,500 credit has been added for existing homeowners who acquire a different principal residence. Also, there are a number of new restrictive changes to the eligibility rules.

Partnership and S Corporation Late Filing Penalty
Presently, a partnership or S corporation that files a late return is assessed a penalty of $89 per owner per month. The penalty is capped after 12 months of delinquency. Accordingly, a partnership or S corporation return that is more than 12 months late produces a maximum penalty of $1,068 per owner.

Effective for partnership and S corporation tax returns for years beginning after 2009, the penalty increases to $195 per owner per month, again capped after 12 months. Accordingly, the penalty is increased to a maximum of $2,340 per owner for a return that is delinquent by 12 months or more.

Other tax law problems and considerations you may want to discuss with your tax advisor are:

LIFO Income or Expense
Inventory levels are significantly lower for the 2009 year-end due to the sales generated during the Car Allowance Rebate System (CARS or "cash for clunkers"). To avoid tax surprises, dealers should prepare projections on current inventory levels to assess whether they'll recognize LIFO income for 2009 or LIFO expense. If recognizing income, the additional cash requirements to pay the income tax due on the LIFO recapture could be significant.

Loaner Vehicles Subject to Depreciation Under New IRS Interpretation
Most dealerships have loaner vehicles available for customers to use while their vehicles are being serviced, and several luxury manufacturers require franchised dealerships to maintain loaner vehicles on site for this purpose. If the IRS applies section 280F of the IRC code to loaner vehicles, the depreciation deduction is significantly limited on vehicles with costs above the "luxury" vehicle cutoff. Recent tax depreciation incentives, such as the expanded expensing election under IRC Section 179 and bonus depreciation under IRC Section 168(k), would also be severely restricted and in some cases eliminated.

It generally defines a luxury vehicle as any car having a purchase price of $14,800 or any truck or SUV having a purchase price of $15,800. Based on this definition, a substantial number of loaner vehicles and dealerships could be affected.

Capital Gains Tax Rate
There is a good chance the capital gains rate will increase by five percent in 2011 and the individual top tax rate may increase by 4.6 percent. With this in mind, it may make sense to either accelerate installment sale proceeds if possible to tax years 2009 and 2010 or negotiate expected sales and receive the proceeds by the end of 2010 rather than deferring the gain to 2011 and beyond under the higher tax rates.

Cost Segregation
Any building acquisition, construction project, or renovation greater than $500,000 can usually defer tax liability and provide a cash flow benefit through some form of cost segregation study. These studies segregate the various costs of the structures and land improvements into different depreciation method and useful life categories which can accelerate your tax deduction for depreciation in excess of your book depreciation methods used for your financial statements.

Conversion of Traditional IRA's to ROTH IRA's

The Internal Revenue Code provides a significant tax planning opportunity for many people beginning in 2010 concerning conversions of traditional IRA's to ROTH IRA's. The $100,000 income limit is eliminated starting January 1, 2010 and you will be able to defer the income tax from a 2010 conversion to 2011 and 2012.

Unicap (IRC Sec. 263A)
The IRS is currently reviewing how dealerships should capitalize certain costs attributable to carrying inventory under IRC Sec. 263A. A field directive also instructs field examiners to essentially stand down on raising 263A on new audits beginning September 15, 2009 and concluding December 31, 2010 to allow time for auto dealers to comply with the IRS's positions outlined in TAM 200736026. The position the IRS takes on this issue can significantly impact the deductibility of various expenses on the tax return and increase taxable income.

Please consult your tax advisor to discuss any of the above items you believe may affect your business.

Are You Surprised?

By now you have probably ended your company's calendar year end for federal income tax purposes. I don't mean you have filed your tax return yet, but you have some idea of where you are at, either income or loss, for the 2009 year end.

Review your year-to-date income statement as compared to the prior year. Review whether your vehicle gross profit percentages remained consistent or were lower than the prior year of industry guidelines. If not, you should review your individual vehicle sales and associated cost of sales accounts to find out which product has generated the lower than normal gross profit percentage which reduced your overall gross profit. If you are not tracking your various types of vehicle sales and cost of sales separately, it could be hard to find the problem. One way to find the problem is to print a report of all your individual sales transactions and review which sales are lower than normal. If your report doesn't give you the gross profit percentages, see if you can export the report to a spreadsheet where you can calculate the gross profit percentage yourself.

Once you have found the problem sales, find out how many times this happened and pull the car deals to review why the gross profit was low. It could be a number of things, such as higher than normal reconditioning expense, misclassification of expenses, old age units you sold for a reduced sales price, etc. After classifying the problem deals for the different reasons, you will know what you have to correct. It could be as simple as increased inventory turnover to reduce overage units or monitoring your reconditioning process closer.

If you have a service, body shop and or a parts department, you can complete the same process as above to also find the problem repair orders or parts tickets. If you have a software system that allows you to schedule your accounts in a side-by-side format, you can set up a new schedule as a balance forward type format scheduled by repair order number and or parts ticket number. For example, you would have the customer labor sales and cost of sales accounts and the customer parts sales and cost of sales accounts on the same schedule. Each control number in the schedule would be the gross profit of the entire customer repair labor and parts ticket. Most systems allow you to export or copy the schedule to a spreadsheet where you can add columns to calculate the gross profit percentages for labor sales, parts sales and the total ticket. You can then sort the data by lowest to highest gross profit percentage first by the labor sales, then by the parts sales and then by the total ticket sales. This will put all the problem tickets together and make it easier to review. You can then pull the tickets for review to find why they are low. You can also use this method for your vehicle sales, cost of sales and reconditioning expense accounts on the same schedule.

If your software system reports or data exports don't allow you to either schedule the accounts or copy the data to a spreadsheet, contact your software vendor to see if a custom report can be setup to easily give you this information. Again, if you are not tracking your individual sales accounts with matching cost of sales accounts, find out if it is possible on your software system. Call your vendor to find out if you are processing the information in your system incorrectly or if it is even possible to match up the sales and cost of sales by changing the setups in the system and retraining your personnel to record future transactions correctly.

Next you will want to review your expenses as a percentage of gross profit and or sales, whichever is more appropriate for your company. First review your chart of accounts to find out if your expenses are separated correctly into variable and fixed expenses. Variable expenses include sales personnel and management, employee benefits, advertising, delivery expense, etc. which is only incurred only if your sales increase or decrease based on your sales volume. Fixed expenses include rent, utilities, general liability insurance, administrative salaries, repairs, etc. which are not normally affected by the amount of sales you record. There may also be some semi-fixed expenses which do change somewhat based on sales volume, but also have a fixed characteristic.

If your software allows you to print an income statement with expenses as percentages of sales or gross profits, you can more easily review this year versus the prior year. Some expense percentages can look out of line if your sales are either abnormally low or high in relation to the dollar amount of expense incurred. The expense dollar amount may be correct and be as low as you can achieve and still remain in business. This could be a semi-fixed or fixed expense as it doesn't totally depend on your sales volume after a certain point. If possible try to put each month of the current and prior year side-by-side so you can easily see the variances month by month. The problems will stand out and be more easily found this way than just looking at one or two months of one year to the prior year.

When reviewing all of the above, keep in mind the changes in the economy form one year to another. Try to document why sales, gross profit percentages and expenses ended up the way they did. Don't guess, but do your homework and really find out why things ended the way they did. Once you discover the problems, start preparing the scenario for the current year so you end the current year with what you set your goals at. Communicate these goals to all your managers and employees so everyone is aware of what you want to accomplish. If you don't communicate in detail with the people responsible, don't expect different results from what happened last year.

Improving results while not changing the company's business methods won't happen unless you are very lucky. In the current economic climate, don't count on lucky. Instead count on accurate and communicated results to all along with your goals. Monitor it monthly compared to the prior year and your individual account goals to make sure you get there and enable you to be able to quickly make changes if you are not achieving your goals.

Good luck this year. I hope everyone meets their goals this year and this economy improves from what we have experienced in the last one to two years.

TAX TIP

Ten Tax Topics for Taxpayers with Tots and Teens

Got Kids? They may have an impact on your tax situation. Listed below are the top 10 things you should consider if you have children.

1. **Dependents** In most cases, a child can be claimed as a dependent in the year they were born.
2. **Child Tax Credit** You may be able to take this credit on your tax return for each of your children under age 17. If you do not benefit from the full amount of the Child Tax Credit, you may be eligible for the Additional Child Tax Credit. The Additional Child Tax Credit is a refundable credit and may give you a refund even if you do not owe any tax.
3. **Child and Dependent Care Credit** You may be able to claim the credit if you pay someone to care for your child under age 13 so that you can work or look for work. Maximum credit is $3,000 for taxpayer with one qualifying individual and $6,000 for taxpayer with two or more qualifying individuals.
4. **Earned Income Tax Credit** The EITC is a benefit for certain people who work and have earned income from wages, self-employment or farming. EITC reduces the amount of tax you owe and may also give you a refund.
5. **Adoption Credit** You may be able to take a tax credit for qualifying expenses paid to adopt an eligible child. Eligible child must be under age 18 or physically or mentally disabled.
6. **Children with Earned** Income If your child has income earned from working they may be required to file a tax return. Unearned income over $950 and earned income over $5,700.
7. **Children** with **Investment Income** Under certain circumstances a child's investment income may be taxed at the parent's tax rate. Children subject to Kiddie Tax rules for 2009. Child is under 18 or age 18 (or full time student age 19-23). Child has more than $1,900 of investment income.
8. **Coverdell Education Savings Account** This savings account is used to pay qualified educational expenses at an eligible educational institution. Contributions are not deductible. Earnings in the account are tax def-deferred, and subsequent distributions are tax-free if used for qualified educational expenses.
9. **Higher Education Credits** Education tax credits can help offset the costs of education. The American Opportunity and the Lifetime Learning Credit are education credits that reduce your federal income tax dollar-for-dollar, unlike a deduction, which reduces your taxable income.
10. **Student Loan Interest** You may be able to deduct interest you pay on a qualified student loan. The deduction is claimed as an adjustment to income so you do not need to itemize your deductions. For 2009, the deduction is phased out when modified AGI is between $60,000 and $75,000 ($120,000 and $150,000 if married filing joint).

You should consult with your ATA representative to determine whether you qualify for any of these deductions or credits.