bulletin

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YEAR END TAX BULLETIN

As 2017 draws to a close, tax reform remains the major topic of discussion in Washington, but we are closer to the largest tax reform this country has seen in 30 years. At the time of the writing of this bulletin, tax reform was not yet close to being finalized. Because of this, it is extremely important for dealers to take a close look at their compliance and how certain elements of their income tax returns are handled. Careful understanding of the activities reported on your return and your level of participation are critical factors to consider.

To help taxpayers plan for these changes, the Baker Tilly national tax practice has published its 2017 year-end tax planning letter, discussing the status of tax reform, estate planning, ACA reporting updates, and the latest changes in state and federal tax.

Further, Baker Tilly's dealership services team of tax professionals compiled a list of dealer-specific tax considerations below. Please keep in mind that your goal should be to maximize your long-term wealth and profitability; decisions on tax policy are secondary considerations to this goal.

DEALERSHIP-SPECIFIC INFORMATION

Plate Tax: Rate Change for 2017 & 2018

2018 Rate is $157

The motor vehicle dealers' measure of use tax increased to $154 for 2017 and is increasing again to $157 effective January 1, 2018. Wisconsin-licensed motor vehicle dealers are permitted to report use tax on a certain dollar amount

per plate per month for the use of motor vehicles assigned to certain employees and dealership owners.

Note: the use tax per plate is not the amounts listed above; rather, the applicable amount above multiplied by the use tax rate applicable at your dealership (5 percent, 5.1 percent, 5.5 percent, etc.).

See Baker Tilly Guide for More Information

Demo Tax

During 2001, the Internal Revenue Service issued Revenue Procedure 2001-56 to provide safe harbor rules for computation of wage income for the use of a demonstrator vehicle. These rules are optional.

Baker Tilly has made its document, Guide to IRS Demonstrator Rules available to WATDA members. The Guide gives information for determining if an employee qualifies as a full-time salesperson, determining the value of the vehicle, record-keeping requirements, and discusses methods. The guide is attached to this Bulletin (in email format) and available upon request for dealers receiving Bulletins via US Mail. To request a copy please phone or email Julie Farmer at WATDA, jfarmer@watda.org, (608)251-5577.

The information in this guide is presented in summary form. Please contact WATDA if you have any additional questions.

Bonus depreciation phase-out

Depreciation

Bonus depreciation has been extended for property acquired and placed in service during 2015 through 2019 (with an additional year for certain property with a longer production period). The bonus depreciation percentage is 50 percent for property placed in service during 2015, 2016 and 2017, but then phases down to 40 percent in 2018 and 30 percent in 2019. The tax reform act could change bonus depreciation.

Section 179 limits

Section 179 was permanently extended and phase-out amounts will be increased annually for inflation. The expensing limitation for 2017 was $510,000 with phase-out beginning at $2.03 million on qualifying property placed in service during the year. The tax reform act could change the Section 179 limits.

New Partnership Audit Regime

Partnership Reporting Changes

The Bipartisan Budget Act of 2015 ("BBA") lays out a new set of streamlined audit procedures that significantly changes how the Internal Revenue Service ("IRS") will audit partnerships and LLCs taxed as partnerships ("partnerships") for tax years ending after December 31, 2017.

The most noteworthy change is that audit adjustments will be applied at the partnership level in the year of adjustment (as opposed to the year under review) unless an opt-out election is made. An opt-out election can only be made by a qualifying "small partnership" which includes only those partnerships with 100 or fewer qualifying partners (e.g. individuals, corporations, and estates of deceased partners). The opt-out election must be made annually on a timely filed return, and each partner must receive notice that the election was made.

If the partnership is not a qualifying "small partnership" or an opt-out election is not made, a push-out election can be made within 45 days of the final adjustment notice that transfers the audit adjustments to the reviewed-year partners. If this election is made, the partnership must supply each impacted partner with a statement of adjustment within 60 days of the final notice.

The implications of the BBA are considerable and will likely require partnerships to update their operating agreements to address how they intend to handle the new procedures. If your dealership or any related entity (including a real estate holding company) operates under the partnership form, please review the related section in the 2017 Baker Tilly year-end tax planning letter and reach out to your tax advisor.

Wisconsin Personal Property Taxes

Change on WI PPT

On September 21, 2017, Wisconsin enacted Act 59 ("the Act"). Among the many changes included in the Act are two key changes to the taxation of personal property. The most significant change is the exemption from taxation of personal property classified as machinery, tools, and patterns. Another key change is the elimination of the provision allowing assessing officials to remove the tax exemption for computers and computerized equipment from

business that file their personal property tax returns after the due date.

These changes are in effect for the upcoming 2018 personal property tax returns, and there is no better time than now to review your property schedules to make sure any assets that qualify as machinery, tools, and patterns are classified appropriately. During this review, it is also a good idea to make sure assets the dealership no longer owns are removed to avoid paying unnecessary tax.

Mileage Rates

2018 Federal Rate is $0.545

For dealers and employees who use their personal vehicles for business purposes, the optional standard mileage rate was 53.5 cents per mile for 2017. Beginning January 1, 2018, the rate has been changed to 54.5 cents per mile. The optional rate for use of an automobile as a charitable contribution remained consistent at 14 cents per mile for 2018; the rate for medical and moving was 17 cents per mile for 2017 and has changed to 18 cents per mile for 2018.

Repair and Maintenance

The regulations relating to repair and maintenance costs went into effect for the 2014 tax year. Deductible repairs include costs incurred to keep the business in normal operating condition and facilities looking fresh. Auto dealers are more likely to be able to deduct repair and maintenance expenses as they often undergo reimaging or remodel projects. Examples of deductible repairs include the following:

- Interior and exterior painting
- Replacing and repairing damaged windows
- Cosmetic updates to flooring and ceiling tiles
- Replacing and repairing portions of heating and air conditioning systems
- Replacing and repairing portions of plumbing and restroom fixtures
- Repaving and sealing parking lots

Deductible costs do not include costs to replace major components or substantial structural parts of a unit of property or amounts that result in a betterment, restoration, or change in use of a unit of property. Dealership owners should review their 2017 capitalized expenditures related to

building and land improvement property to take advantage of the repair and maintenance regulations and to ensure the correct methods of accounting are being followed.

De Minimis Safe Harbor

For tax years beginning on or after January 1, 2016, dealerships can increase their de minimis safe harbor threshold for their capitalization policy up to $2,500 without applicable financial statements or $5,000 with applicable financial statements. This allows dealerships to expense the cost to acquire or produce tangible property to the extent such amounts are deducted by you for financial accounting purposes instead of being depreciated over prescribed years.

Note that your capitalization policy can contain a larger amount than those listed above, but no audit protection is provided for those expensed items whose costs exceed these thresholds.

Treatment of Upgrade Image Support Payments

Based on the memorandum issued by the IRS Office of Chief Counsel on May 9, 2014, payments received from automobile manufacturers to dealerships for the purpose of upgrading their facilities are to be included in the dealerships' gross income. It was noted that these payments were being handled inconsistently by dealerships in the past. Some dealerships would classify these payments as a non-shareholder contribution, others would omit the payments from income and instead reduce the basis in constructed assets, and some would adjust the purchase price of vehicles by the amount of the payments. This memorandum represents the IRS's interpretation of how existing tax law should be applied regarding these payments. Please seek advice from your tax advisor regarding the handling of these payments, in light of this memorandum.

Inventory on LIFO

Make sure that a reasonable estimate of your LIFO adjustment for the year is on all versions of your December financial statement. A dealership will meet the conformity requirements and will not be in violation if it makes an actual or estimated adjustment to its LIFO reserve through cost of sales or other income. The adjustment may be on the twelfth-month factory statement or thirteenth-month statement, if the latter is issued before the January statement.

The IRS allows auto dealerships to use a single, combined LIFO pool for all new vehicles, eliminating the requirement of using a separate pool for cars and light duty trucks. Speak

with your tax advisor on whether changing to a single LIFO pool would be to your advantage. A request to change to the single-pool method is an automatic change and may be filed at the same time as your tax return.

Inventory not on LIFO

Used vehicles: Adjust your used vehicles to current average wholesale market value by the end of the year. Evaluate the tax-deferred benefits of electing used car LIFO.

Parts: Compare your actual parts inventory to the accounting parts inventory and make any adjustments where appropriate. Donate or scrap obsolete parts by year-end if they cannot be returned for credit.

Net Investment Income

The Affordable Care Act added a 3.8 percent income tax on net investment income beginning in 2013. The 3.8 percent tax applies when a taxpayer's income is greater than $200,000 for single taxpayers and $250,000 for joint taxpayers. Net investment income includes interest, dividends, capital gains/losses, passive rental income, and income/losses passing through from investments in which you do not actively participate. Certain investment income can be excluded from the 3.8 percent tax and are common issues among dealerships. Self-charged interest exists when a pass-through entity reports interest expenses related to a partner or shareholder loan. The related interest income reported on the individual taxpayer's return can be excluded from net investment income for the pro rata amount of interest expense reported by the pass-through entity to the respective individual. Self-charged rent presents a similar situation in being excluded from net investment income. Make sure these items are being properly excluded, if applicable, from net investment income when calculating your 3.8 percent tax.

Grouping Related Activities

You may be able to group related pass-through activities together on your individual income tax return for purposes of the passive activity limitations and to reduce your net investment income tax. As a result of the net investment income tax regulations, individuals should review their groupings and consider changes, if allowed. For example, many dealerships have a separate legal entity which holds its real estate. However, you should be aware that the grouping of activities is subject to complex rules, and a taxpayer’s ability to regroup is limited. Further, even if you

have never grouped activities in prior years, you are still subject to the regrouping rules.

Grouping real estate with the operations of the dealership may reduce certain taxes on your individual tax return. Losses from activities in which you regularly participate (nonpassive activities) typically are deductible. Losses from activities in which you do not regularly participate (passive activities) typically are only deductible when you have income from other passive activities. For example, rental real estate is a passive activity, and losses from rental real estate generally are not deductible due to passive activity limitations. However, by grouping the real estate entity with the active dealership, the combined activity would be considered nonpassive and all losses would be allowed (assuming that you "materially participate" in the dealership). Please note that the grouping rental real estate with trade or business activities is subject to substantial restrictions. All activities should be evaluated to determine if regrouping is advantageous and permissible.

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http://bakertilly.com/insights/2017-year-end-tax-letter