



# TH<sub>3</sub>RD THURSDAYS



Dealership  
Solutions

**SPECIAL EDITION**

HBK Dealership Solutions presents:

**What's a Dealer To Do:  
Blending the Benefits and Avoiding the Pitfalls  
of 2020 Tax Changes  
Recent Trump Tax Act,  
Old Tax Rules and  
Current Biden Proposals**

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Rex is a Principal of HBK CPAs & Consultants and directs the firm's [Dealership Solutions](#). He has worked extensively in the dealership industry since 1984 as a department manager, a general manager and an owner, as well as providing tax, accounting and operational consulting services exclusively to dealers as an independent CPA. This experience includes working closely with hundreds of dealers from coast-to-coast since 1987 on creative tax planning and financial statements issues. He provides clients with a wide range of transaction work services and consults for them in specialty areas such as operations, government regulatory compliance, valuations and M&A feasibility studies. Rex is active in many professional associations. He is the current Chairman of the BDO Dealership Industry Group, contributes articles and commentary to dealership industry publications, is frequently called upon to speak to industry associations and conferences, provides expert testimony, and is regularly quoted by industry and the general media.



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Amy is a Principal and the Chair of the Tax Advisory Group at HBK CPAs & Consultants. The Tax Advisory Group is a group of highly specialized professionals who provide tax training to our team members, oversee compliance with tax policies in order to mitigate risk to the firm, and provide tax planning and consulting services for our clients.

Amy specializes in estate, gift, trust, individual, and nonprofit taxation. She is skilled at researching complicated tax issues, consulting on complex estate plans, and providing guidance for our clients to ensure they are in compliance with their tax filing responsibilities.

Amy enjoys sharing her knowledge and passion for tax planning with clients and other professionals. She is a frequent speaker at bar association and estate planning council events and has authored many articles discussing tax planning techniques and compliance issues.





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Ben is a Principal in the Tax Advisory Group (TAG) of HBK and works in the Youngstown, OH office. He has been with the firm since 2009 and has focused extensively on entity tax issues, entity planning, and flow-through taxation. Additionally, he has experience with many of our real estate and manufacturing clients. As a member of TAG, Ben frequently teaches tax-related training courses both internally for the firm and externally for clients and the public. Ben provides research and expert counsel on complex tax issues for our clients. He also regularly appeared on the mid-day news broadcast of Youngstown, Ohio's NBC affiliate station in a segment called "Smart Money," which highlights personal financial planning tips.

**SPECIAL EDITION**

Join HBK Dealership Solutions  
Next week for our Third Thursday  
**Coronavirus Crisis Webinar Series**

**December 10<sup>th</sup> 11:00 – 12:00 EDT**

*Link to register will be provided after this webinar.*

Nothing is certain but change...

Things are changing on a frequent basis please contact us or check our website.

<https://hbkcpa.com/covid>

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# Dealership Hot Topics



# Tax Issues and Opportunities Relating to the Dealership



## C Corporation Tax Rates

- The Act provides a flat 21% corporate tax rate beginning after December 31, 2017
- Eliminates the current graduated rates of 15% on the first \$50,000, 25% on next \$25,000, and 35% for taxable income from \$75,001 to \$10,000,000

“A tax loophole is something that benefits the other guy. If it benefits you, it is tax reform.”

—Russell B. Long, former U.S. Senator



## Corporation AMT

- The corporate AMT would be repealed for tax years beginning after 2017
- Taxpayers with AMT credit carryforwards would be allowed to claim a refund of 50% of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning in 2018, 2019 and 2020
- In 2022, taxpayers would be able to claim a refund of any remaining credits



# Business Interest Expense Limitations

## **GREAT NEWS for MOST Dealers**

- **For years beginning after 2017**, every business, regardless of its form, would be subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income
- The net interest expense disallowance would be determined at the tax filer level
  - It would be determined at the partnership level rather than the partner level
  - The limitation would be determined at the S corporation level



# Business Interest Expense Limitations

**“Adjusted taxable income” is a businesses taxable income computed without regard to business interest expense, business interest income, net operating losses (NOLs), and depreciation, amortization and depletion**





# Business Interest Expense Limitations

- The business interest limitation provisions would not apply to:
  - **Floor plan financing for dealers of automobiles and trucks, farm equipment, recreational vehicles, motorcycles and boats for both lease and acquisition**
  - **NOTE: Not good news for Construction Equipment Dealers**
  - Real property trades or businesses, which would not be ineligible for full expensing
- Businesses with average gross receipts of \$25 million or less would be exempt from the interest deduction limitations **(previous 3 year averages & attribution applies)**



## Depreciation and Cost Recovery

- **The Act allows taxpayers to immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 instead of 50% bonus depreciation for qualified property**
- **Also allows new and used property**, repealing the current requirement that the original use of the property begin with the taxpayer



## Depreciation and Cost Recovery

- **After 2022, a phased-out bonus depreciation percentage will be allowed over the next five years:**
  - 80% for property placed in service after December 31, 2022 and before January 1, 2024
  - 60% for property placed in service after December 31, 2023 and before January 1, 2025
  - 40% for property placed in service after December 31, 2024 and before January 1, 2026
  - 20% for property placed in service after December 31, 2025 and before January 1, 2027



## Depreciation and Cost Recovery

- Qualified property would not include property used by the following businesses allowed to fully deduct business interest:
  - **Dealers of automobiles and trucks, farm equipment, recreational vehicles, motorcycles and boats with floor plan financing – inventory must secure the floor plan**
  - **Good News: Construction Equipment Dealers are permitted to use 100% expensing.**
  - Real property trades or businesses
  - Certain regulated public utilities
- **The Act does not allow for both the option of 100% expensing and full deductibility of interest expense**



# Depreciation and Cost Recovery

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  - Real property traded or business uses
  - Certain regulated public utilities
- The Act does not allow for both the option of 100% expensing and full deductibility of interest expense

Not So Fast... Great News:  
IRS Issued Favorable Ruling  
in September of 2019.





## Depreciation and Cost Recovery

- **In summary –**
  - New or used property placed in service after September 27, 2017 and before 2018 is eligible for 100% expensing.
  - If the dealership is under \$25 million in gross receipts for the previous 3 year average, then they could use both 100% expensing and not be subject to interest deduction limits.



# Depreciation of Automobiles

- The Act would sharply increase the depreciation limitations for passenger autos (under 6k pounds) placed in service after December 31, 2017
- The maximum amount of allowable depreciation would be increased:
  - First year from \$3,160 to \$10,000
  - Second year from \$4,100 to \$16,000
  - Third year from \$2,450 to \$9,600, and
  - Fourth and later years from \$1,475 to \$5,760
- These dollar limits would be indexed after 2018
- For passenger autos eligible for bonus first year depreciation, the maximum first year depreciation allowance would be increased by \$8,000
- **Therefore, first year depreciation on a passenger auto at 100% business use could be as high as \$18,000.**
- **NOTE: Retail automotive dealers are not subject to this limitation with regards to loaners and rental vehicles.**



## Section 179 Expensing

- The § 179 limitation on the amount that could be expensed would be increased for eligible property **placed in service for tax years beginning after December 31, 2017 from the current \$500,000 to \$1 million**
- The phase-out amount would be increased from current \$2 million to \$2.5 million
- **There is still a \$25,000 § 179 limit on SUVs between 6k and 14k GVW**
- All amounts would be indexed for inflation after 2018



## Section 179 Expensing

- The definition of eligible property is expanded to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:
  - Roofs
  - Heating, ventilation, and air-conditioning property
  - Fire protection and alarm systems
  - Security systems
- **There is not a provision to preclude businesses using floor plan indebtedness from using § 179 up to \$1 million. Therefore, this will allow for some relief in that regard for fixed asset additions otherwise qualifying.**



# Real Estate Depreciation

- **The current provisions for depreciating nonresidential commercial property at 39 years and residential at 27.5 years remains in effect**
- **The separate definitions for qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant property are all eliminated and provisions apply to qualified improvement property**
- **Although not included in the final bill it is anticipated that a technical corrections amendment will be issued so that Qualified improvement property follows a 15 year MACRS recovery period**





# Real Estate Depreciation

- **Qualified improvement property is**
  - Any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service
  - Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building
- **NO 3 year requirement or pursuant to a lease requirement**



## Real Estate Depreciation

- Thus, for example, the provision allows § 179 expensing for improvement property without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or subject to a qualifying lease
- Again, many dealers may not get 100% expensing on this property, but will be able to utilize § 179
- The provision also requires a real property trade or business electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property

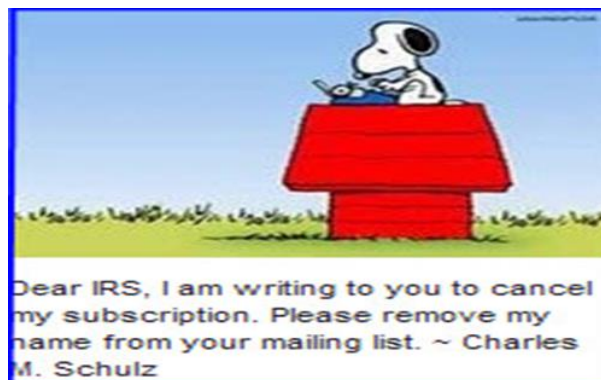


## Like Kind Exchanges

- For transfers after 2017, like-kind exchanges would only be allowed for real property
- **Like-kind exchanges for personal property including franchise costs would no longer be available. This is a tremendous blow to dealers with lease and rental operations. (e.g., Heavy Truck dealers) and any dealer looking to sell a franchise and acquire a replacement franchise.**
- A transition rule would allow like-kind exchanges of personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017

# Like Kind Exchanges

- Only allowing like-kind treatment for real estate is a significant change to the tax law
- **Customers of auto and equipment dealers may be adversely affected but with the increase in bonus depreciation, increased passenger auto limits, and Section 179 the impact may be mitigated.**





## Cash Method of Accounting - Inventories

- Uniform capitalization rules (UNICAP) would be exempt for the businesses with average gross receipts of \$25 million or less
- **Many dealers have little to no UNICAP costs under Rev. Proc. 2010-44 so this is of little consequence**



## LIFO

- **GREAT NEWS.**
- **LIFO inventory method is not eliminated**



# Net Operating Loss Deduction

- The NOL deduction **would be limited to 80% of taxable income** for losses **arising in taxable years beginning after 2017**
- Instead of the current 20-year limit on carryforwards, businesses with excess NOLs would be able to carry them forward indefinitely for losses arising in tax years beginning after 2017
- Carrybacks, currently allowed to the two previous tax years except for losses arising in a farming business



## Should I Switch to a C Corp?

- This is the one of the most common questions we receive from dealers.
- The answer is in most cases no, see the example attached on the next slide.





# S versus C Example

	S Corp - reform	C Corp – reform
Business income	\$2,000,000	\$2,000,000
Less: 199A deduction	<u>(400,000)</u>	<u>0</u>
Taxable inc.	\$1,600,000	\$2,000,000
Federal Tax	\$531,379	\$382,872
State Tax	\$246,000	\$176,800
Tax rate	38.87%	27.98%
Tax on dividend (36.1%)	\$0	\$519,958
Tax rate overall	38.87%	53.98%

# Estate & Gift Tax Changes Impacting Dealerships



## Current Estate Tax Law

- **Unified Exemption** = \$11,580,000 per person for 2020
  - Increases for inflation each year
  - Increased to \$11,700,000 for 2021
  - Set to decrease to \$5 million, adjusted for inflation, in 2026
- **Annual Exclusion** = \$15,000 per donee (for 2020 and 2021)
- **Tax Rate** = 40% for estate exceeding the unified exemption
- **Portability** = if a deceased spouse's exemption is not fully used, the surviving spouse can file Form 706 to “port” or transfer the unused exemption to the surviving spouse



## Biden Estate Tax Proposals

- **Unified Exemption** = revert to \$3,500,000 per person, which was proposed by former President Obama
- **Tax Rate** = unrealized capital gains would be subject to income tax for decedents whose income is above \$400,000; then a 45% estate tax would be applied
- **Basis Step-Up** = elimination of step-up in basis to fair market value as of the date of death



# Tax Issues and Opportunities Relating to the Dealership



## Qualified Business Income Deduction

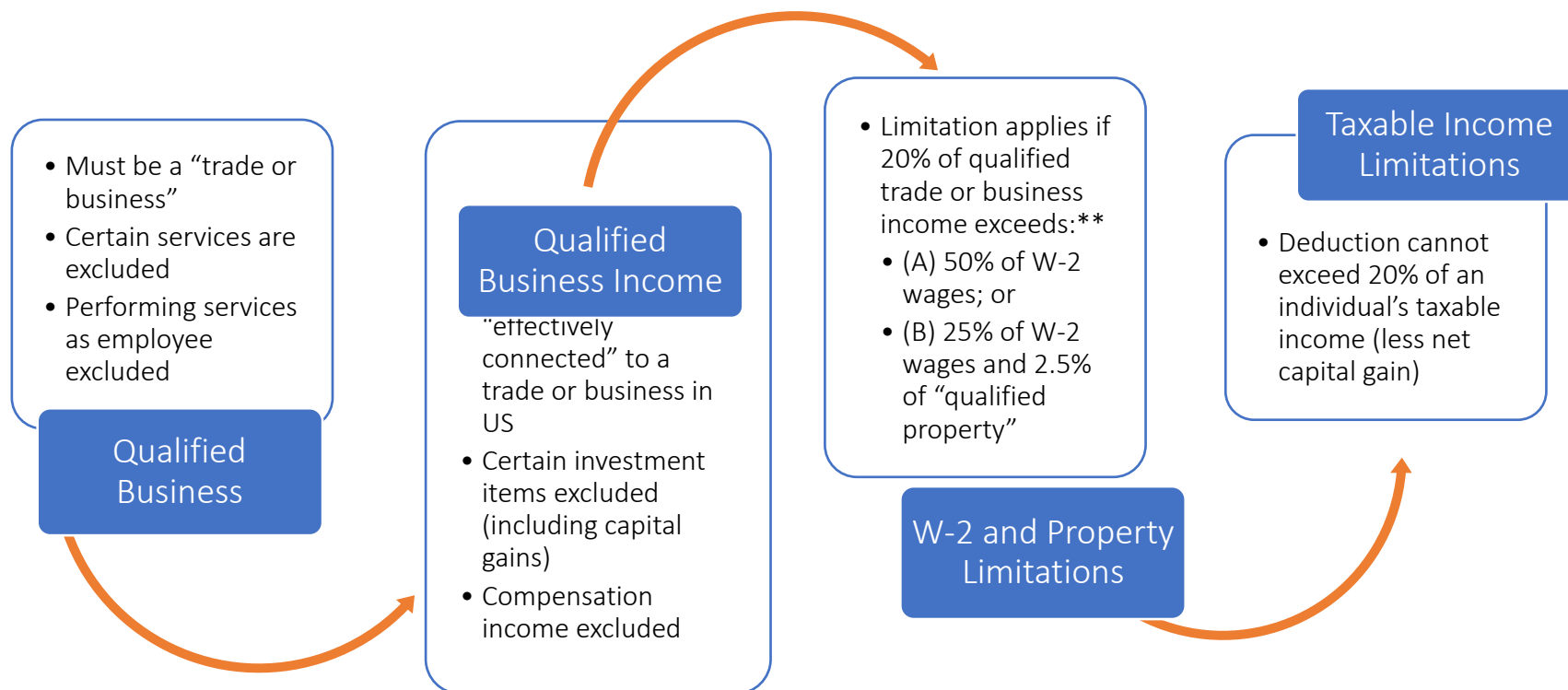
- One of the most significant changes of the new tax law for pass-through businesses is the new Section 199A deduction.
- The 20% QBI deduction applies to certain pass-through businesses such as sole proprietorships, S-corporations and partnerships including trusts and estates as well as dividend income from REITs.
- Most privately held dealerships should be eligible for this deduction (except for those with businesses held in C corporations). The IRS has yet to issue guidance on this new law, and there are a lot of questions regarding how this law applies to dealer groups who are currently treating multiple stores and real estate properties as one economic unit.



# Qualified Business Income Deduction

- Specific service industries, such as health, law, accounting, actuaries, performing arts, consulting, athletics, financial, brokerage and other professional services as well as traders/dealers in securities, partnership interests, or commodities cannot take the deduction unless they meet the small taxpayers exception. However, the deduction is available for engineering and architecture services.
- Does not apply to tax on net investment income or self-employment taxes.
- QBI deduction will expire for tax year beginning after 12/31/2025.

# 20% Deduction on Qualified Business Income





# What Are the Limitations?

## Not included in income:

- Investment income such as interest income, dividends, investment short-term and long-term capital gain/loss are excluded. Earned income received from salaries and/or guaranteed payments from partnerships are also excluded.

### W-2 Limitation - General Rule:

- The deduction is limited to 50% of W-2 compensation paid by the qualified trade or business during the taxable year. Example:
- Taxable Income: \$1,000,000, wages must be at least \$400,000 to get the \$200,000 deduction



## Alternative Asset Calculation for 20% Deduction:

- The alternate rule provides a deduction for interests in entities that are capital intensive, but do not have significant wage expenses (e.g. real estate partnerships which holds land for the store).
- Calculation is: 25% of W-2 wages plus 2.5% of unadjusted basis of all qualified property
- Qualified property is any property used in a trade or business subject to depreciation and the depreciable period (or 10 years from date placed-in-service) has not ended before the end of the taxable year – so this includes buildings and short life assets but not land.
- Important to note that we get 2.5% of unadjusted basis- so depreciation does not come income into play here

# Qualified Business Income Limitations

## Small Taxpayers Exception

You can still take advantage of the 20% deduction regardless of wages or assets or type of business as long as your income is below the thresholds below. There is a phaseout that maxes out at \$415,000 MFJ.

Filing Status	Threshold
Married Filing Jointly	\$315,000
Other filers	\$157,500



## QBI Deduction Example

- Bill & Joan have \$450,000 of pass-through income from three qualified trades or businesses. Their QBI Deduction Calculation is as follows:

Activity	QBI	Wages	Property	20% QBI	50% Wages	Alternative Limitation	QBI Deduction
A	500,000	50,000	3,000,000	100,000	25,000	87,500	87,500
B	250,000	300,000	300,000	50,000	150,000	92,500	50,000
C	<u>(300,000)</u>	<u>3,000,000</u>	<u>50,000,000</u>	<u>(60,000)</u>	<u>1,500,000</u>	<u>2,000,000</u>	<u>(60,000)</u>
Total	<u>450,000</u>	<u>3,350,000</u>	<u>53,700,000</u>	<u>90,000</u>	<u>1,675,000</u>	<u>2,180,000</u>	<u>77,500</u>

- Bill & Joan's QBI deduction would be \$77,500. They are not able to "pool" wages and property to arrive at an overall QBI deduction limitation. QBI calculation is done on an activity-by-activity basis.

# Excess Business Loss Provision

- Non-passive business loss is limited

Filing Status	Current Limitation	New Limitation
MFJ	Amount of business loss	\$500,000
Single	Amount of business loss	\$250,000

- The limitation is applied at the individual taxpayer level rather than entity or business level and the calculation is applied after determining allowable passive income/loss.
- Any disallowed loss is carried forward and treated as part of the taxpayer's net operating loss which they can use the following year.



## Excess Business Loss Provision

- Business losses in excess cannot offset non-business income in the year incurred. Suspended losses can be used in subsequent years subject to the 80% taxable income limitation for NOLs.
- If you have a large loss as a result of a factory refresh, you might not get the entire taxable loss in the year of the refresh if you are treating your store and real estate as one economic unit. You may have to wait until the following year to take the loss.
- We need to think carefully about the losses being generated in one year and plan accordingly.



# Net Operating Losses

New NOL Rules	Old NOL Rules	Effective Dates
Indefinite carryover period	Carryback 2 years	80% limitation applies to NOLs arising in years <u>beginning</u> after 12/31/17
Limited to 80% of taxable income	Carryover 20 years	Carryover/back to NOLs arising for years <u>ending</u> after 12/31/17
Special rules for farming and non-life insurance businesses	No 80% limitation (although limited by AMT)	

# Tax Issues and Opportunities Relating to the Dealers Reinsurance Companies



## The 6 Major Structures for F&I Insurance/Reinsurance

- **ARC – Allied Reinsurance Companies**
- **DOWC – Dealer Owner Warranty Companies**
- **CFC – Controlled Foreign Companies**
- **NCFC – Non-Controlled Foreign Companies**
- **Retrospective Arrangements**
- **Self-Insured Plans**



## Changes to ARC Taxation

- **C Corp Taxation applies to ARCs**
  - 21% rate – Breakeven point is \$90,384 compared to pre – TJCA
  - The dividend received deduction exemption lowered from 70% to 50%
- **Small insurance company ceded premium limit increases to \$2.3MM annually**



## Changes to DOWC Taxation

- **C Corp Taxation applies to DOWCs**
  - Net Operating Loss rule changes do **not** apply to property and casualty insurance companies



## Changes to CFC Taxation

- US Shareholder definition change to 10% of vote **or** value
- Some NCFCs may become CFCs
- Repatriation Tax generally not applicable
  - CFC had to exist on December 31, 2017

**No Longer Available**



# Changes to NCFC Taxation

- **The Passive Foreign Investment Company (PFIC) problem**
  - Not new – PFIC tax law originated in 1986
  - Effectively eliminates the US tax deferral previously afforded NCFC-PFICs
  - CFC-PFICs are taxed as CFCs, not PFICs
  - Introduction of the applicable insurance liabilities 25% test to continue to get a “pass” from PFIC taxation
    - Based upon a hierarchy of financial statements available to use for the test



# Changes to NCFC Taxation

- The PFIC Tax Regime
  - The NCFCs earnings are taxed at the highest marginal rate
    - Taxation occurs annually when earned or when a distribution occurs
      - Annual taxation is afforded those US shareholders making a Qualified Electing Fund (QEF) election
  - 1. QEF elected in first PFIC year
  - 2. Preserves capital gain treatment on stock sales
  - 3. Pre-PFIC earnings are distributed first



## Changes to NCFC Taxation

- **Taxation when distributions occur is afforded to those US Shareholders not making a QEF election**
  1. Conversion of pre-PFIC potential capital gain to ordinary income
  2. “Excess Distributions” are seen as being distributed from all years of earnings
  3. Interest is added to taxes paid currently that are attributed to PFIC earnings from prior years



## Changes to Retrospective Arrangement Taxation

- **Applicability of the new 20% reduction in taxable income for non-C Corporation entities**
- Dependent upon the structure set up by the recipient

## Changes to Self Insured Plans

- **Generally eligible for the 20% reduction in taxable income for non-C Corporation entity**



# Tax Issues and Opportunities Relating to the Dealer's Personal Return



## Individual Tax Reform

- Most of the changes are effective for tax years beginning after Dec 31, 2017
- All changes to individual taxation are temporary and expire on Dec 31, 2025 (unless specifically noted otherwise)



# Tax Rates and Adjustments

- 7 brackets
  - Top rate of 37% on income earned in excess of \$500k (single) or \$600k (MFJ)

2018 Tax Brackets					
Single Filers			Married Filers		
10%	-	9,525	10%	-	19,050
12%	9,526	38,700	12%	19,051	77,400
22%	38,701	82,500	22%	77,401	165,000
24%	82,501	157,500	24%	165,001	315,000
32%	157,501	200,000	32%	315,001	400,000
35%	200,001	500,000	35%	400,001	600,000
37%	500,001	or more	37%	600,001	or more



# Tax Rates and Adjustments

- No personal exemption
- Increased Standard Deductions
  - \$12k single, \$18k HOH, \$24k MFJ

2018 Tax Brackets					
Single Filers			Married Filers		
10%	-	9,525	10%	-	19,050
12%	9,526	38,700	12%	19,051	77,400
22%	38,701	82,500	22%	77,401	165,000
24%	82,501	157,500	24%	165,001	315,000
32%	157,501	200,000	32%	315,001	400,000
35%	200,001	500,000	35%	400,001	600,000
37%	500,001	or more	37%	600,001	or more



## Itemized Deductions

- Pease limitation is suspended
- SALT limited to \$10,000
- Mortgage Interest limitation
  - \$750k of principle debt, on debt acquired after Dec 15, 2017
  - No deduction for home equity lines
- Medical expenses, 7.5% for 2017 & 2018
- All 2% Misc. deductions are suspended
- Increased Charitable Contributions limit, 60% of AGI



## Family Tax Credits

- Child tax credit is increased to \$2,000 per qualifying child
  - Phase out begins at \$200k single or \$400k MFJ





## AMT

- Individual AMT was not repealed
- The exemption is increased to \$70,300 (single) or \$109,400 (MFJ)
- The phase out is adjusted to \$500k (single) or \$600k (MFJ)



## Alimony

- Payor will no longer be allowed to deduct alimony payments
- Payee will no longer have to claim alimony payments as income
- Only applicable to divorce decrees or modifications after December 31, 2018





## 529 Plans

- Up to \$10k per year can be used to pay for public, private, and religious elementary and secondary schools
- Homeschool costs are also allowed





## Individual Mandate

- ACA is still in place, no changes
- The penalty for not having health insurance is amended to \$0

Coverage Year	Penalty Applies
2017 – <i>filing taxes in 2018</i>	YES
2018 – <i>filing taxes in 2019</i>	YES
2019 – <i>filing taxes in 2020</i>	NO



# Biden Tax Plan

## Individual taxes:

- A 12.4 percent social security (payroll) tax on income earned above \$400,000, evenly split between employers and employees. The current cap is at \$137,700, creating a “donut hole” in social security taxes.
- Increase to the top tax rate to 39.6% for Taxpayers making more than \$400,000.
- Tax long-term capital gains and qualified dividends at ordinary income tax rate of 39.6 percent on income above \$1 million.
- Elimination of SALT cap from TCJA, and cap itemized deductions at 28%.
- Restore the Pease limitation on itemized deductions for taxable income above \$400,000 (3% of every dollar capped at 80%)



# Biden Tax Plan

## Individual taxes:

- Expands the Child and Dependent Care Tax Credit (CDCTC) from a maximum of \$3,000 in qualified expenses to \$8,000 (\$16,000 for multiple dependents) and increases the maximum reimbursement rate from 35 percent to 50 percent.
- Reestablishes the First-Time Homebuyers' Tax Credit, which was originally created during the Great Recession to help the housing market. Biden's homebuyers' credit would provide up to \$15,000 for first-time homebuyers.



# Biden Tax Plan

## Business taxes:

- Increases the corporate income tax rate from 21 percent to 28 percent.
- Creates a minimum tax on corporations with book profits of \$100 million or higher. The minimum tax is structured as an alternative minimum tax—corporations will pay the greater of their regular corporate income tax or the 15 percent minimum tax while still allowing for net operating loss (NOL) and foreign tax credits.
- Expansion of the work opportunity credit to include military spouses; additional 10% “Made in America” tax credit available to companies that create jobs for American workers or revitalize closed or nearly closed facilities or expand.
- Reversal of TCJA provisions regarding depreciation deductions.
- Modification of Qualified Business Income Deduction rules created under the TCJA including rules for real estate investors.
- Repeal of Section 1031 exchanges



## Biden Tax Plan

- **Estate Tax**
  - Elimination of step-up basis provisions allowing capital gains to be passed to heirs after death without tax.
- **Current estate/gift exemption \$11.58MM (\$23.16MM for a married couple)**
- **Planning?**



# COVID-19 Legislation Payroll Credits/Benefits

## Families First Corona Response Act (FFCRA)

- Paid Sick Leave
  - Either full or 2/3 pays for up to 80 hours
  - Limited to \$511/ day if full pay, \$200 if 2/3
- Expanded FMLA
  - 2/3 pay for additional 10 weeks
  - Limited to \$200 per day

## Coronavirus Aid, Relief, and Economic Security Act (CARES)

- Employee Retention Credit
  - 50% credit for qualified wages up to \$10,000 per employee
- Employer Payroll Tax Deferral





# Who is Eligible to Claim the Credit/Benefit?

## FFCRA Credits:

- Any business paying employees under the sick leave or expanded FMLA coverage provided by the FFCRA. Generally, all employers with under 500 employees are covered by the FFCRA.
- See the following Department of Labor FAQ for specific questions on eligibility and benefits: [DOL FFCRA FAQ](#)

## Employee Retention Credit:

- Those that carry on a trade or business during calendar year 2020, including a tax-exempt organization, that either:
  - Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; or
  - Experiences a significant decline in gross receipts during the calendar quarter.

## Employer Payroll Tax Deferral:

- Every business even those receiving loan forgiveness under Sections 1106 and 1109 of the CARES Act.





## When Can an Employer Get the Credit/Benefit?

### FFCRA

- Starting April 1, employers can claim the 100% tax credit against employment taxes for benefits.
- Employers will claim the credit when filing their quarterly Form 941.
- Employers may receive an advanced credit by taking it out of their otherwise required payroll deposits.
- If the total credit exceeds their payroll deposit, they can file new Form 7200 to claim a refund.
- Below is a link to the IRS FAQ on the FFCRA benefits and tax credits including examples regarding claiming the credit.
  - [IRS FFCRA FAQ](#)



## When Can an Employer Get the Credit/Benefit?

### Employee Retention Credit

- The employee retention tax credit applies to wages paid after March 12, 2020 and before January 1, 2021.
- IRS published brief guidance, stating the 1st quarter credits earned for pay between March 13 and March 31 will be claimed on a second quarter Form 941.
- The credit will not be claimed on the first quarter payroll return.
- Employers may receive an advanced credit by taking it out of their otherwise required payroll deposits.
- If the total credit exceeds their payroll deposit, they can file new Form 7200 to claim a refund.
- Below is a link to the IRS FAQ on the employee retention credit which includes examples regarding claiming the credit.
  - [IRS Employee Retention Credit FAQ](#)



## When Can an Employer Get the Credit/Benefit?

### Employer Payroll Tax Deferral

- The deferral period starts March 27, 2020 and ends December 31, 2020.
- Deferral applies to all payroll deposits starting March 27th.



## PPP Loan Expenses Non-Deductible

- IRS issued Notice 2020-32 stating no deduction is allowed for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan pursuant to section 1106(b) of the CARES Act.
- The CARES Act makes loan forgiveness non-taxable but is silent on the deductibility of expenses.
- The net result likely puts taxpayers in the same position as if the forgiveness was taxable.
- We may (hopefully) see a legislative change.
- **State issues for taxation**



## SBA Loan Subsidy

- In addition to PPP loans, the CARES Act also covered principal and interest payments on existing SBA loans for 6 months.
- This loan forgiveness will be taxable to the recipient, with no loss of deductions.



# NOL Carryback Period Expanded

- Taxpayers may elect to carry-back NOLs 5 years.
- 5-year elective carryback applies to taxable years beginning after 12/31/17 and before 1/1/2021.
  - Generally 2018, 2019, and 2020 tax years
- Taxpayers may elect to forego the entire 5-year carryback with respect to a specific year's NOL.
  - Irrevocable once made
- The 80% limitation on NOL deductions is suspended for losses generated in 2018, 2019, and 2020.
- Special rules apply to NOL carrybacks to years where a taxpayer had GILTI income.



## Section 163(j) Amended

- **For taxable years beginning in 2019 and 2020 taxpayers, except for partnerships, from 30% to 50% of ATI.**
  - Taxpayers may elect to use 30%.
- **For taxable years beginning in 2020, a taxpayer may elect to use its 2019 ATI for purposes of computing its 2020 §163(j) limitation.**
  - This should benefit taxpayers facing reduced 2020 earnings.
- **For partnerships, the increase to 50% of ATI applies only to years beginning in 2020.**
- **However, if a partner is allocated excess business interest expense in 2019, they may deduct 50% of that excess business interest in 2020 with the remainder subject to the same limits.**
  - Example: Partner is allocated \$10,000 of excess business interest expense in 2019, the partner may deduct \$5,000 of that interest in 2020, and the remaining \$5,000 will be subject to the normal limits.



# What's coming for §163j?

The calculation of adjusted taxable income changes following 2021

Taxable Income	Before 2022	2022
Subtract		
Business interest income	YES	YES
Business interest income and floor plan financing interest expense	YES	YES
Depreciation recapture from gains	YES	<b>NO</b>
Add Back		
Business interest expense	YES	YES
NOLs	YES	YES
199A	YES	YES
Add depreciation, amortization and depletion (including bonus depreciation)	YES	<b>NO</b>
= ATI	EBITDA	EBIT





# Bonus Depreciation Final Regulations

- The TCJA disallows bonus depreciation if the floor plan financing exception applies.
- What happens if a dealership does not need to use the floor plan financing exception? (Interest expense is less than 30% or 50% of ATI?)
- The final regulations adopt the dealer friendly provisions of the proposed regulations, concluding that dealers not utilizing the floor plan financing exception are permitted to use bonus depreciation.
- **Bonus Depreciation %'s**
  - 100% - Through 2022
  - 80% - 2023
  - 60% - 2024
  - 40% - 2025
  - 20% - 2026
  - 0% - 2027



## Technical Correction to QIP

- What is **Qualified Improvement Property (QIP)**?
  - Internal, non-structural improvements to property, made after the building is placed in service.
- **QIP now has a 15-year life and is eligible for bonus depreciation**
- **Fix is in place retroactive to 2018**
- **What to do for 2018 returns, or 2019 if filed?**
  - Amend
  - File a method change (Form 3115)



## Qualified Disaster Relief Payments

- Exclusion from gross income for amounts received by taxpayers that are “qualified disaster relief payments”.
- Employers can make tax-free payments to employees that are deductible to employers.
- Qualifying expenses:
  - Medical expenses not compensated for by insurance
  - Over the counter medicine and hand sanitizer
  - Funeral costs
  - Costs associated with enabling an employee to work from home
  - Cost of childcare or tutoring
- Payment of wages, or disguised wages will not count



## Accelerating Disaster Losses

**Certain deductible financial losses caused by Federally declared disasters (COVID-19) may be accelerated to the 2019 tax return.**

- **What qualifies:**
  - Abandoned leaseholds
  - Capitalized costs from abandoned business deals
  - Contract termination payments
  - Prepaid expenses that will not be refunded
- **What does not qualify:**
  - Declines in FMV
  - Lost revenue
  - Goodwill impairment

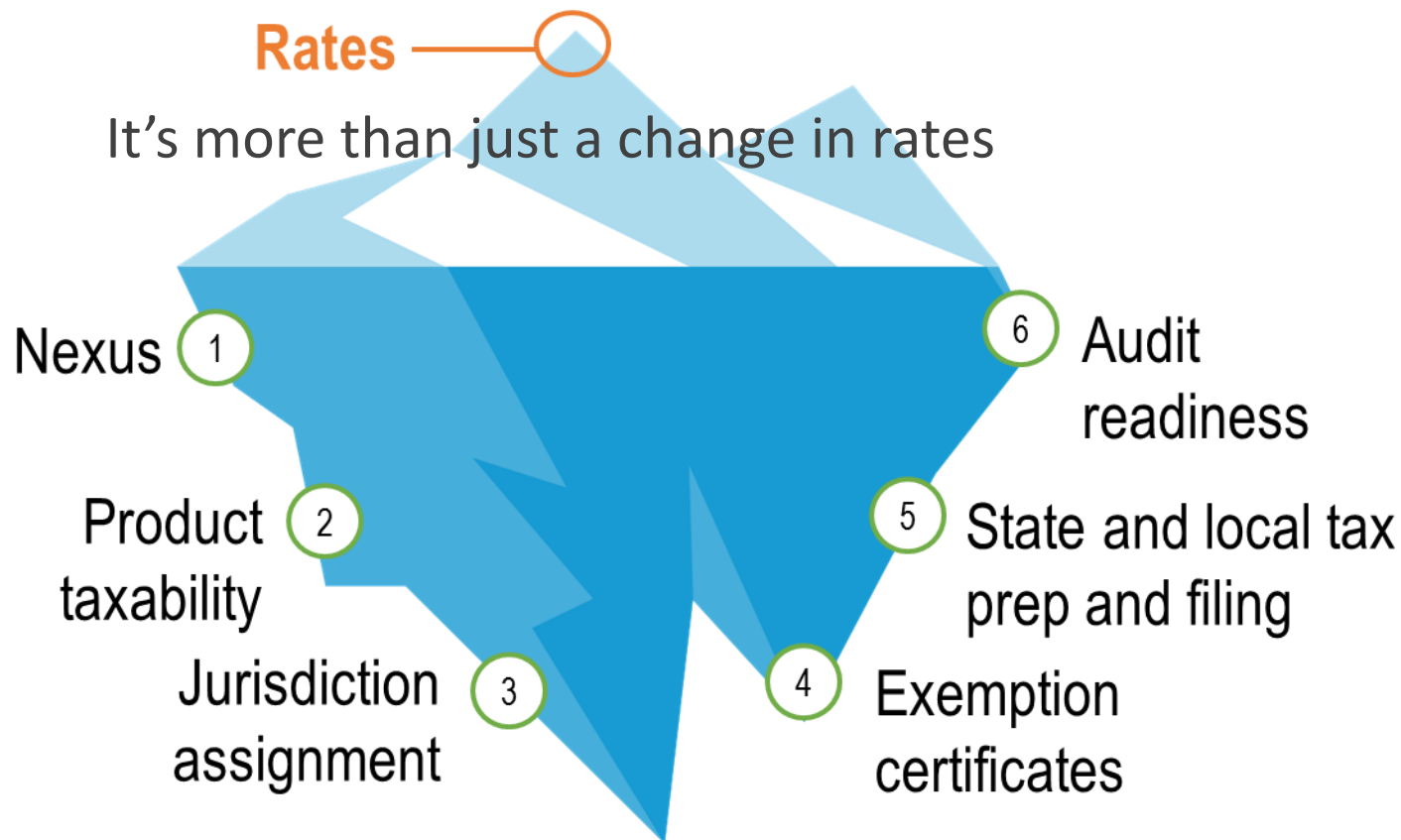


# Business Loss Limitation

- **Background.** The Tax Cuts and Jobs Act of 2017 (TCJA) added a limitation on business losses, requiring business losses in excess of \$250,000 for single filers and \$500,000 for married filers to be carried forward as part of a net operating loss.
- **CARES Act Changes.**
  - Eliminated the limitation for farm losses for tax years beginning after December 31, 2017 and before January 1, 2026.
  - Eliminated the limitation for all other business losses of noncorporate taxpayers for tax years beginning after December 31, 2017 and before January 1, 2021.
- **Planning Opportunity.** The elimination of this business loss limitation allows taxpayers to amend their 2018 (and 2019, if filed) income tax returns if their business losses were limited.

# **Economic Nexus: Dealers are Struggling to Comply with the 2018 Supreme Court Ruling**

## Wayfair v. South Dakota





## Economic Nexus

*A recent study found that sales and use taxes paid by businesses on purchases and capital equipment represented 22% of all state and local business taxes, while corporate income taxes represented 8% of total state and local business taxes*



Washington  
Oregon  
Idaho  
Montana  
North Dakota  
Minnesota  
Wisconsin  
Michigan  
South Dakota  
Wyoming  
Nebraska  
Iowa  
Illinois  
Indiana  
Ohio  
Kentucky  
Tennessee  
Mississippi  
Alabama  
Georgia  
Florida  
Texas  
New Mexico  
Arizona  
Nevada  
California  
Alaska  
Hawaii  
New York  
Pennsylvania  
Virginia  
North Carolina  
South Carolina  
Louisiana  
Arkansas  
Missouri  
Kansas  
Colorado  
Utah  
Arizona  
New Mexico  
Texas  
Alaska  
Hawaii  
Maine  
New Hampshire  
Vermont  
Massachusetts  
Rhode Island  
Connecticut  
New Jersey  
Delaware  
Maryland  
West Virginia



# Economic Nexus

## Nexus

- Before a state taxing jurisdiction can require an out-of-state company to charge, collect and remit sales tax, the company must have some connection with the taxing jurisdiction
  - We call this connection, “nexus”



# Economic Nexus

## Physical Presence Nexus

- Having an office
- Having an employee
  - Home office for sales professional
- Having a warehouse
- Having an affiliate/engaging a 3<sup>rd</sup> party for services
  - Construction, maintenance, repairs and warranties
- Storing inventory
- Drop shipping from a 3<sup>rd</sup> party provider
- Temporarily doing physical business in a state for a limited amount of time, such as at a trade show or craft fair



## Economic Nexus

- Physical Presence STILL triggers filing and registration obligations for sales tax and CIT
  - Be mindful of in state activities such as:
    - Servicing vehicles through employees or 1099 contractors in other states
    - Warranty services out of state
    - Vehicle pick up's or delivery out of state



## Economic Nexus

### Goodbye Quill

- Quill Corporation, a mail-order company sold more than \$1M of office products to North Dakota customers by soliciting sales through catalogs and flyers.
- Products were shipped to North Dakota customers by mail or common carrier by out-of-state locations.
- The U.S. Supreme Court found that North Dakota was unable to require Quill to collect use tax because it lacked physical presence.

# Economic Nexus

- **1967 National Bellas Hess v. Illinois**
  - Use tax cannot be imposed by a state on out of state taxpayers with no direct or indirect physical presence
    - Bellas Hess was one of the big five merchandise catalogs that thrived during the 20<sup>th</sup> century along with Sears, Alden's, Roebuck, Spiegel and Montgomery Ward.
    - Their argument was that they only sell direct from their catalog, they had no agents or branch stores.
    - IL attempted to force Bellas Hess to collect state sales tax/remit use tax however the Court in a 6-3 majority started what we now know as the “physical presence” test affirmed by Quill.





## Economic Nexus

- **1992 Quill Corp. v. North Dakota**
  - Extremely similar fact pattern, Quill was however distributing ads, catalogs, flyers, making telephone calls and sending floppy disks in state.
  - North Dakota attempted to claim that Quill's "regular or systematic solicitation of a consumer market within the state" made it a North Dakota retailer and thus subject to sales tax.
  - The Court cemented the physical presence standard, saying it was not only sufficient under the Due Process Clause but also necessary.





## Economic Nexus

- Quill was affirmed before the internet or the boom of e-commerce.
- Without physical presence an internet purchaser has not been required to charge sales tax on purchases within the states where they lack sufficient nexus.
  - Some see this as unfair to the states, leaving a large gap in the states ability to effectively tax the e-commerce market.





# Economic Nexus

## Wayfair v. South Dakota

- South Dakota passed a law that required companies with over \$100,000 in sales to collect the states 4.5% sales tax on purchases made by in state residents.
- WayFair, NewEgg and Overstock (all big players in the history of physical presence court cases) all opposed the legislation.
  - Lower courts sided with these retailers, based on the precedent set by Quill.
- Physical presence requirement was eliminated for sales tax nexus.
- Quill and National Bellas Hess are overruled
- Arguably the most significant state and local tax (SALT) case in decades.
- The U.S. Supreme Court rejected arguments against South Dakota that imposes sales tax collection requirement without physical presence (i.e. economic nexus).





## Economic Nexus

- **The U.S. Supreme Court determined that physical presence test is “unsound and incorrect” because:**
  - It creates marketplace distortions.
  - Favors remote sellers over local brick and mortar.
  - The substantial nexus requirement of the 1977 Complete Auto case does not require physical presence.
  - The Quill decision acknowledged that due process does not require physical presence.
  - 41 states and the District of Columbia asked the U.S. Supreme Court to reject the physical presence test.



## Economic Nexus

- **The U.S. Supreme Court noted the following when holding in favor of the South Dakota law:**
  - There is a safe harbor provision for limited in-state activity (e.g., nexus only if in-state delivery of more than \$100k of sales or 200 separate transactions for delivery of goods within state).
  - There is no retroactive obligation to remit sales tax.
  - South Dakota is one of 20 states that have adopted the Streamlined Sales and Use Tax Agreement (a standardized system to reduce accounting costs and confusion).



## Economic Nexus

### Reporting Requirement States

- **Prior to Wayfair, more than 10 states required remote sellers to report who their customers were and the monetary value of annual purchases to a state as well as inform their customers their purchases were subject to consumers use tax.**
  - Failure to report the information would subject the remote seller to hefty penalties.
  - Alabama, Colorado, George, Iowa, Kentucky, Louisiana, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Vermont and Washington reporting for sales as low as \$10,000 to as high as \$250,000.



## Economic Nexus

- **“Remote Sellers” are often believed to be companies who sell goods and services over the internet**
- **However, this term applies to any company that makes sales into a state where they do not maintain physical presence:**
  - Online Sales
  - Purchase Orders
  - Drop Shipping
  - Telephone Orders
  - Automatic Replenishment Orders



# Economic Nexus

## Shipping & Freight

- Sales tax is a tricky subject, and it gets even more confusing when all the different state governments set their own rules for how it is applied and when. It becomes an even foggier subject when you get to small subjects like whether or not sales tax is applicable to shipping charges.
- The following states usually consider charging shipping that is part of an order a taxable activity, regardless of whether sales tax is part of the price or not:
  - Arkansas, Connecticut, District of Columbia, Florida, Georgia, Hawaii, **Indiana**, Kansas, Kentucky, **Michigan**, Minnesota, Mississippi, Nebraska, **New Jersey**, New Mexico, **New York**, North Carolina, North Dakota, **Ohio**, **Pennsylvania**, South Carolina, South Dakota, Tennessee, Texas, **Vermont**, Washington, West Virginia, Wyoming.
- **Conversely, the following states say shipping charges are not taxable if included in the price:**
  - Alabama, Arizona, California, Colorado, Idaho, **Illinois**, Iowa, Louisiana, **Maine**, Maryland (noted exceptions), **Massachusetts**, Missouri, Nevada, Oklahoma, **Rhode Island**, Utah, Virginia, Wisconsin.



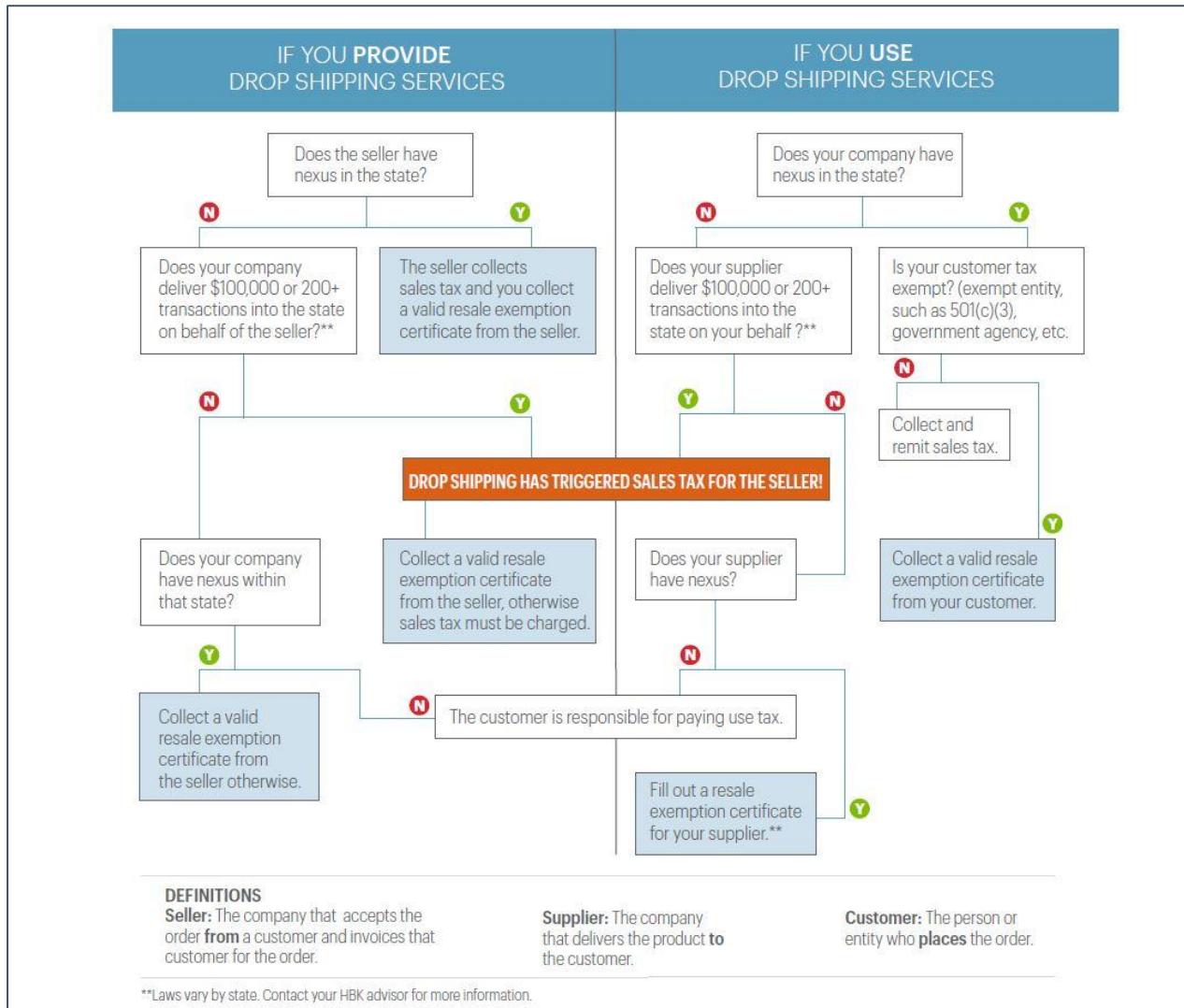
# Economic Nexus

## Shipping & Freight

- Tax on freight typically follows the transaction.
- If the goods you sell are exempt, the freight/delivery or handling charges are exempt. If taxable, the converse applies.
- Freight is typically a nontaxable service, **UNLESS** it is considered a “necessary part of the sale.” In other words, it becomes taxable when you pay for the service and then charge your customer for it as part of the sale.
- **Freight or delivery is NOT taxable when the:**
  - Customer pays the carrier directly. Freight charges are showed separately from handling. Freight is delivered using a common carrier like the postal service (versus the company’s truck).
- **States often tax freight depending on the taxability of bundled items.**
  - When taxable and nontaxable products are bundled into the same shipment, some states tax freight based on this ratio.
    - For example: If a customer purchases a \$60 exempt item and a \$120 taxable item and both goods are bundled into one shipment, only the shipping costs associated with the \$120 item are taxable.



# Economic Nexus







# Economic Nexus

How do I apply these thresholds?

- **Measurement Period:**
  - Typically the current or preceding calendar year, some states have a rolling 12 month period and some use the prior calendar year
- **Taxable Sales vs. Gross Sales:**
  - Typically the states look at your gross sales into that state, many states do not have this clearly written in their provisions and the SST and MTC have asked for clarification. States where threshold is taxable sales:
    - New Mexico
    - North Dakota
    - Oklahoma
    - Rhode Island
    - Utah
- **Agricultural Exemption:** not immune from Gross Sales thresholds even if sales are made to Ag Exempt customers

## Economic Nexus

State	Enforcement date	Type of threshold
Alabama	Oct. 1, 2018	\$250,000 in sales
Alaska <sup>1</sup>	N/A	N/A
Arizona	Oct. 1, 2019	\$200,000 in sales in 2019; \$150,000 in sales in 2020; \$100,000 in sales in 2021 and beyond
Arkansas	July 1, 2019	\$100,000 in sales or 200 separate transactions
California	April 1, 2019	\$500,000 in sales
Colorado	Dec. 1, 2018	\$100,000 in sales
Connecticut	Dec. 1, 2018	\$100,000 in sales and 200 separate transactions
Delaware <sup>1</sup>	N/A	N/A
District of Columbia	Jan. 1, 2019	\$100,000 in sales or 200 separate transactions
Florida	Proposed	\$100,000 in sales or 200 separate transactions
Georgia	Jan. 1, 2019	\$250,000 in sales or 200 separate transactions
Hawaii	July 1, 2018	\$100,000 in sales or 200 separate transactions
Idaho	June 1, 2019	\$100,000 in sales
Illinois	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Indiana	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Iowa	Jan. 1, 2019	\$100,000 in sales
Kansas	Oct. 1, 2019	No sales or transaction test

State	Enforcement date	Type of threshold
Kentucky	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Louisiana	TBD (no later than July 1, 2020)	\$100,000 in sales or 200 separate transactions
Maine	July 1, 2018	\$100,000 in sales or 200 separate transactions
Maryland	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Massachusetts <sup>2</sup>	Oct. 1, 2017	\$500,000 in sales and 100 separate transactions
Michigan	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Minnesota	Oct. 1, 2018	100 or more retail sales or 10 or more retail sales totaling \$100,000
Mississippi	Sept. 1, 2018	\$250,000 in sales
Missouri	Proposed	\$100,000 in sales or 200 separate transactions
Montana <sup>1</sup>	N/A	N/A
Nebraska	April 1, 2019	\$100,000 in sales or 200 separate transactions
Nevada	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
New Hampshire <sup>1</sup>	N/A	N/A
New Jersey	Nov. 1, 2018	\$100,000 in sales or 200 separate transactions
New Mexico	July 1, 2019	\$100,000 in sales
New York	Jan. 1, 2019	\$500,000 in sales and 100 separate transactions
North Carolina	Nov. 1, 2018	\$100,000 in sales or 200 separate transactions

State	Enforcement date	Type of threshold
North Dakota	Oct. 1, 2018	\$100,000 in sales
Ohio	Aug. 1, 2019	\$100,000 in sales or 200 separate transactions
Oklahoma	Nov. 1, 2019	\$100,000 in sales
Oregon <sup>1</sup>	N/A	N/A
Pennsylvania	July 1, 2019	\$100,000 in sales
Rhode Island	July 1, 2019	\$100,000 in sales or 200 separate transactions
South Carolina	Nov. 1, 2018	\$100,000 in sales
South Dakota	Nov. 1, 2018	\$100,000 in sales or 200 separate transactions
Tennessee	July 1, 2019	\$500,000 in sales
Texas	Oct. 1, 2019	\$500,000 in sales
Utah	Jan. 1, 2019	\$100,000 in sales or 200 separate transactions
Vermont	July 1, 2018	\$100,000 in sales or 200 separate transactions
Virginia	July 1, 2019	\$100,000 in sales or 200 separate transactions
Washington	Oct. 1, 2018	\$100,000 in sales
West Virginia	Jan. 1, 2019	\$100,000 in sales or 200 separate transactions
Wisconsin	Oct. 1, 2018	\$100,000 in sales or 200 separate transactions
Wyoming	Feb. 1, 2019	\$100,000 in sales or 200 separate transactions

<sup>1</sup> State does not impose a state sales or use tax.<sup>2</sup> Massachusetts' economic nexus is only applicable for "internet vendors" with physical presence (cookies/apps/in-state servers) effective Oct. 1, 2017: \$500,000 in sales and 100 transactions

In the past few weeks Tennessee went from \$500k to \$100k



## Economic Nexus

**Once you are registered in a state you must keep in mind not only the difference in product and service taxability but also:**

- Additional registration fees
- Licensing fees for dealers
- Bond and prepayment of tax requirements
- Annual minimum taxes (CA minimum Tax, PA franchise tax)
- Local municipalities (CO and AK)



## Economic Nexus

**Remember: if you have a sales division that has not been set up as a separate EIN those sales impact the nexus of the dealership as a whole**

- Seeing this a lot with online parts divisions, the sales of the parts website is triggering nexus for the entire dealership



# Economic Nexus

- **Exemption Certificates:**

- Crack down on acceptance and use of Exemption Certificates from vendors/manufacturers
- Ag Exemptions:
  - Scenario: Equipment Dealer told under audit from state of Wyoming that they would not be permitted to make exempt purchases if they are from out of state, essentially that only Wyoming farmers and agricultural taxpayers were permitted to purchase items exempt in the state of Wyoming, even when possession of the equipment takes place in Wyoming.
    - **THIS WAS INCORRECT INFORMATION FROM THE AUDITOR**
    - State does permit out of state farmers and agricultural taxpayers to make exempt purchases so long as they provide either 1. Wyoming Exemption Certificate 2. Streamlined Sales And Use Tax Exemption Certificate 2. Home State Exemption Certificate
    - SOME STATES HAVE STRICT EXEMPTION CERTIFICATE RULES i.e.: Florida does NOT accept out of state exemption certificates and does NOT accept multistate or streamlined exemption certificates so this issue might come up in other states





# Economic Nexus

## Questions for Dealers

- **Do you know your footprint?**
  - Gross sales or number of transactions in states on top of your traditional physical footprint?
- **What tools do you have to identify states where immediate registration and compliance is required by the decision v. states with alternate nexus rules?**
- **Do you know the taxable status of your goods and services in all of your customer states?**
- **Will you need to separately state sales of goods and services on your invoices?**
- **Do you need to collect exemption or resale certificates in states where historically you had not been required?**

# Economic Nexus

- **Issue in Maine:**
  - Scenario: Dealer went through a sales tax audit where they were told that they were not adjusting their bonuses and manufacturers rebates the correct way. Dealer was charging sales tax **after taking off the rebates and State said sales tax needed to be applied before the rebates.**
  - The state of Maine is trying to say Dealer customers should have to pay sales tax on bonuses we don't pass on to them.
- **Scenario 1: Retailer offers the \$300 manufacturer rebate to the consumer on a \$3,000 tractor.**
  - Sale price of tractor - \$3,000
  - Sales tax of 5.5% on \$3,000 sale - \$165
  - Total: \$3,165
  - Less Manufacturer Rebate of \$300
  - Total paid by customer is \$2,865 (\$3,165-\$300)
- **Scenario 2: Retailer does not offer the \$300 manufacturer rebate to the consumer on a \$3,000 tractor. This is how Maine Revenue Services is saying the sales tax SHOULD be calculated and is at the root of the appeal.**
  - Sale price of tractor - \$3,000
  - **Rebate not offered to customer - \$300**
  - Taxable price - \$3,300 (instead of \$3,000)
  - Sales tax of 5.5% - \$181.50
  - Total paid by customer is \$3,181.50 instead of \$3,165.00.
- **Auditors don't understand the Dealership industry, this issue is a broad decision by Maine that has a detrimental impact to how Dealership rebates work!**
  - Decision in Maine to rule this way is based on TWO cases in Maine law that sets this precedent, and both have to do with credit cards (store cards) and incentive bonuses/rebates

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**December 10<sup>th</sup> 11:00 – 12:00 EDT**

*Link to register will be provided after this webinar.*



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