Year End Tax Planning and Accounting Update

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Topics to Cover

- LIFO
- Recent and Proposed Legislation
- Sunsetting Provisions of TCJA in 2022 and 2023
- Other Inventory Deferrals
- NJ BAIT Tax
- Electric Charging Infrastructure and Tax Credits

It is coming …

Perfect Storm...
RECORD PROFITS
LIFO RECAPTURE
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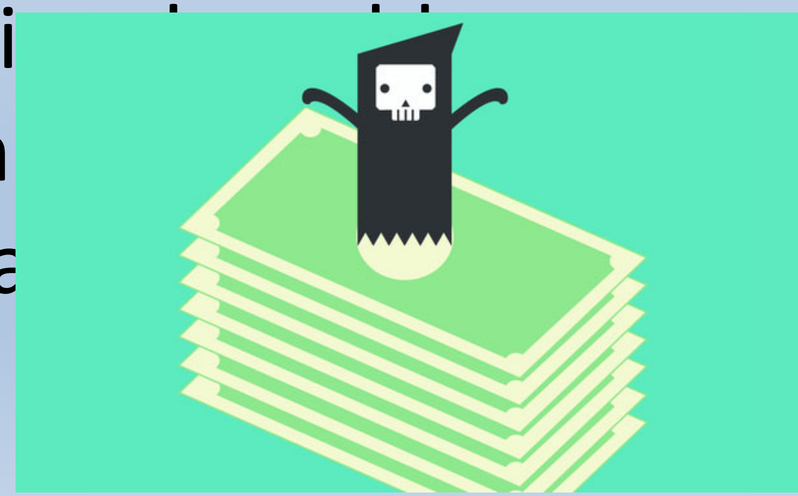
The perfect storm

- Chip shortage, production capacity, allocation and inventory shortages.
- Approximately 40% of dealers use the LIFO method for new vehicle inventory
- The scarcity of vehicles is driving up gross over 50% on average. (2021 8.7%; 2020 5.7%)
- There's cash in the bank

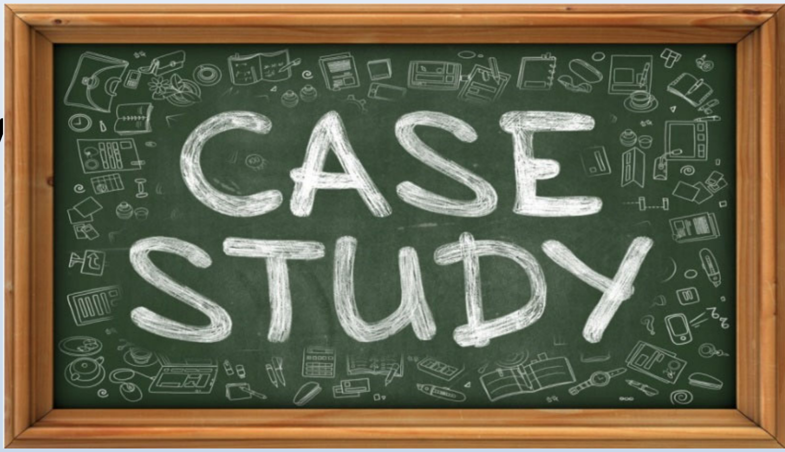
Income without the cash

- The significant decline in new vehicle inventory quantities will very likely cause a significant decline in a dealer's LIFO inventory reserve.
- This translates into "phantom income" to the dealer as there will be additi income without a correspon cash to pay the associated ta



One dealership's situation

- Dec. 31, 2020
  $20million in new inventory
  $2.5million in LIFO reserve



- Sep. 20, 2021
  $8.6million in new inventory
- Forecasted $1.4million LIFO recapture
- Estimated tax liability $550,000
- 57% reduction in inventory lead to 56% recapture.

Another dealership's situation

- Dec. 31, 2020
  - 11.8million in new inventory
  - 2.5million in LIFO reserve
- November 20, 2021
  - 6million in new inventory
  - Forecasted 550K LIFO recapture
- Estimated tax liability $214,500
- 49% reduction in inventory lead to 22% recapture
- Dealership 2's reserve is much older.

Options for mitigation

- Include all vehicles in-transit for your estimate
- Change to IPIC (Inventory Price Index Computation)
- Acquire more inventory – good luck
- Section 473 – will it happen? Possible, not likely.

qualified inventory interruption

(2) Qualified inventory interruption defined (A) In general The term “qualified inventory interruption” means a regulation, request, or interruption described in subparagraph (B) but only to the extent provided in the notice published pursuant to subparagraph (B). (B) Determination by Secretary Whenever the Secretary, after consultation with the appropriate Federal officers, determines— (i) that— (I) any Department of Energy regulation or request with respect to energy supplies, or (II) any embargo, international boycott, or other major foreign trade interruption, has made difficult or impossible the replacement during the liquidation year of any class of goods for any class of taxpayers, and (ii) that the application of this section to that class of goods and taxpayers is necessary to carry out the purposes of this section, he shall publish a notice of such determinations in the Federal Register, together with the period to be affected by such notice.

Best choice of bad options

- Take the hit.
- Election to go off LIFO – string out with a 4-year recapture.

LIFO recapture

- Example: Dealer with $2.5m LIFO reserve is at 43% 12/31/20 inventory. They could elect off and only recapture $625,000 this year. Or, maybe take the $1.4m income hit and the tax liability (effective Federal rate with QBI, etc. of 29.6%)

Take the hit

Tax Rate	Year	Recapture	Tax
29.60%	2021	$ 1,400,000	$ 414,400

Elect off LIFO

Tax Rate	Year	Recapture	Tax
29.60%	2021	$ 625,000	$ 185,000
32.60%	2022	$ 625,000	$ 203,750
32.60%	2023	$ 625,000	$ 203,750
32.60%	2024	$ 625,000	$ 203,750
			$796,250

Blend the two options

- Take the big hit this year while taxes are low and cash is available, then opt out.

Take the hit, then elect off LIFO

Tax Rate	Year	Recapture	Tax
29.60%	2021	$ 1,400,000	$ 414,400
32.60%	2022	$ 275,000	$ 89,650
32.60%	2023	$ 275,000	$ 89,650
32.60%	2024	$ 275,000	$ 89,650
32.60%	2025	$ 275,000	$ 89,650
			$ 773,000

Elect off LIFO

Tax Rate	Year	Recapture	Tax
29.60%	2021	$ 625,000	$ 185,000
32.60%	2022	$ 625,000	$ 203,750
32.60%	2023	$ 625,000	$ 203,750
32.60%	2024	$ 625,000	$ 203,750
			$ 796,250

Final LIFO Points

- Not every situation is the same. Consult your tax professionals to model out scenarios and weigh the impacts.
- Tax deferrals are designed to defer income at higher rates.
- The age of your LIFO reserve, inflation rates on manufacturer models and when you elected LIFO all matter.

Other Inventory Deferrals Impacted

- Inventory Capitalization – 263A
- Used Car Write Down Reserves
- Trade Discounts
- Parts Adjustments

Recent Legislation

- $1 Trillion infrastructure bill was passed in early November.
- Included the end of the ERTC for the fourth quarter of 2021. Qualifying dealers can still claim credit going back to Q2 of 2020.
- Crypto Asset reporting. A part of the legislation imposes new information reporting requirements on brokers of cryptocurrency
- Long term items include extension of various highway related taxes and modification of superfund excise taxes.

Proposed Legislation

- Budget reconciliation bill would be for fiscal year 2022. It would include several of the proposals that were sought after in the original infrastructure bill.

- **Individual Tax**
  - Increase of the State and Local Tax deduction to $80,000. Senator Bernie Sanders (D-VT) has already come out against this except for taxpayers making less than $400K
  - Addition of new tax rate surcharges for individuals making more than $10M (5%) and more than $25M (another 3%) starting in 2022.
  - Elimination of QSBS exclusion rates for taxpayers with AGI >$400K.
  - Expansion of net investment income tax (NII) 3.8% to include income derived in the ordinary course of a trade or business.

Proposed Legislation Continued..

- Permanent limitation of excess business losses (e. net business deductions in excess of business income) for non-corporate taxpayers.
- Exclusion of Federal Pell grants from gross income through 2025.

Business Tax

- 15% corporate alternative minimum tax on adjusted book income of corporations with 3-year average annual income over 1B.
- 1% stock buyback excise tax applicable to publicly traded US Corporations
- International tax reform including interest expense disallowance.

Sunsetting Provisions of TCJA

- QBI Deduction will be eliminated starting in 2026.
- For 163(j) interest expense limitation, addback for depreciation and amortization in calculating ATI ends after 2021. In addition, interest expense limitation returns to 30% (was 50% in 2020 and 2021 because of CARES Act)
- Changes to immediate expensing of qualified property via bonus depreciation ends after 2022.

Schedule of Bonus Depreciation Phase Out

- 100 Percent through 2022
- 80 Percent through 2023
- 60 Percent through 2024
- 40 Percent through 2025
- 20 Percent through 2026
- None after 2027

NJ BAIT

- Elections must be made before March 15, 2022, but -
- Payments are due before the end of the tax year (December 31, 2021) to be deductible (and you need to make the election before you can make payments).
- Pass through entity pays the NJ tax, which is deductible against federal taxable income and also generates a NJ credit.

Electric Charging Stations and Infrastructure Tax Credits Federal

- FEDERAL
  - Alternative Fuels Vehicle Refueling Property Credit (Expires December 31, 2021)
    - Tax credit – **<u>per location</u>**
      - Commercial – lesser of $30,000 or 30% of credit base
      - Residential - lesser of $1,000 or 30% of credit base
    - Credit base is reduced by Section 179 depreciation and rebates
  - May qualify for 100% expensing under 168(k) – Bonus Depreciation

Electric Charging Stations and Infrastructure Tax Credits NJ

- New Jersey
  - Currently NJ does not provide for a specific tax credit
  - However, “It Pay$ to Plug In” grants may be available to offset some costs (https://www.drivegreen.nj.gov/plugin.html)

Other Tax Planning Considerations

- Where are tax rates going?
- Consider finishing up projects in 2021 and 2022 in order to avoid any potential negative impact of decreased bonus depreciation and potentially in 2021 to avoid interest expense limitations if they exist.
- Consider rental fleet additions and disposals and plan accordingly.
- LIFO
- Excess cash strategies – pay down debt; registered investment advisor;
- Deferring revenue
- Accelerating/ prepaying some expenses
- Tax credit – EV charging, Solar, WOTC
- Cost segregation studies
- Employee benefits –
  - Profit sharing contributions
  - Employee student loan repayment - $5,250
- Donor advised funds and Charitable lead annuity trusts "CLAT"
- Qualified Opportunity Zone investment "deadline" – December 31, 2021
- Residency planning

Conclusion

- Planning is critical in the next few years.
- Legislation significantly altering the tax code is unknown at this time but should be monitored.
- Take advantage of Local and Federal tax credits on EV Charging Stations and Infrastructure.
- Talk to your accountants about running scenarios for your specific situation.

Questions?

- Feel free to call or email us as well.

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