

**\*\*\* Year-End Preparation and Tax Planning Strategies \*\*\***

We hope your holidays will be enjoyable. To make your holidays the most enjoyable, it is helpful to complete your year-end planning as early as possible. With the end of 2009 approaching, it is appropriate to review your particular situation with these tax planning strategies in mind. Some of these strategies may require action by year-end while others may require that you postpone actions until after year-end.

**New vehicle inventory planning**

Dealerships that use the last in, first out (LIFO) inventory accounting method should closely monitor how much new vehicle inventory they will have in stock at year-end along with what type of vehicles they have in stock at year-end. Many dealers this year will have low inventory levels either due to the Cash for Clunkers (CARS) program or due to reduced inventory planning with the past year's sluggish economy. Although this may save you floor plan interest costs, this could result in an unexpected LIFO income recapture. You should consult your accountant to estimate the potential cost to your dealership and plan what inventory levels and types of inventory will be the most advantageous to have at year-end.

If your LIFO recapture will be significant this year, there may be situations in which you want to consider adopting off of LIFO to receive a four year spread on the income tax repayment.

**Corporation and personal operating loss carrybacks**

Last year congress allowed losses generated in 2008 to be carried back to the five previous years to offset income in prior years. Unfortunately, they didn't allow this for businesses with gross receipts over 15 million dollars. This cap effectively shut most dealers out of any benefit. The good news is that effective for 2009 losses generated will likely be available for carryback to the prior 5 years. These losses will not be limited as the gross receipts cap of \$15 million has been eliminated for 2009 losses.

Based on this, you should consider what benefits are available by carrying back losses and consider trying to bunch expenses and/or reduce income where possible to increase 2009 losses.

**Section 263A (UNICAP)**

This area has received a tremendous amount of publicity from the IRS and NADA this year. Section 263A (UNICAP) regulations require that retailers add certain costs to inventory. Based on interpretations made by the IRS this year, the costs required to be added to inventory (and not expensed) could increase significantly. You should consult with your tax advisor regarding the potential effects of this position and what position your dealership should take this or next year regarding the IRS position.

**Possible S corporation opportunity**

With the significant losses dealers have incurred this year, some C corporation dealerships may find themselves with large enough loss carryovers to allow them to convert to S corporations without a tax effect.

### **Recognize income in 2009 or 2010**

Based on the current budget deficits, it is only a matter of time until income tax rates are increased. Most advisors believe rates will increase by a minimum of approximately five percent up to ten percent or higher in 2010 or 2011. Based on this, there are situations in which it may make sense to recognize income in 2009 or 2010 at lower rates, before tax rates increase.

### **S corporation or partnership losses**

If you own an interest in a partnership or S corporation, you may need to increase your basis in the entity so you can deduct a loss from it for this year. If you are reporting losses, you should review your dealership's tax basis to determine that you have the tax basis needed to deduct this loss on this year's personal income tax returns.

### **Self-rental income**

Do you lease real estate to your own business entity? If so, the passive activity loss rules present a significant threat. If your 1040 has a mix of positive and negative rental activities, the passive loss risk needs to be carefully assessed. Grouping rules may allow you to offset your rental losses with your dealership profits to avoid them being disallowed.

### **Used vehicle write downs to market and LIFO**

Assuming that your dealership is not on used vehicle LIFO, you may be able to adjust your used vehicle inventories down from cost to market value. To do so, requires that you made the correct elections in prior year returns. Such market value adjustments should be based on industry guidelines and market value guides.

For the past several years, used vehicle LIFO made little sense and many dealers elected off. For those dealers that have not been on used LIFO or elected off over five years ago, benefits may be received this year. At some point, we all knew used vehicle prices would have to start climbing again; 2009 appears to be a year of inflation in used vehicle prices. Some estimates of inflation in used vehicles could be as high as seven percent. Remember, LIFO generally reduces income by the rate of inflation, so five percent inflation could generate savings of five percent of your used vehicle inventory value.

### **S corporation owner's health insurance deduction**

Based on a 2008 directive from the IRS, it is important to have the health insurance premiums of an S corp. shareholder either paid directly or reimbursed by the corporation. Further, those premium payments must be added as income to the owner's W-2. This allows the individual owner to then claim a 100% offsetting 1040 deduction for the health insurance costs. Please let us know if your S corporation will need assistance in complying with this W-2 reporting mandate. The income added on forms W-2 for this will not require FICA/Medicare withholding.

### **Capital gains**

Presently, capital gains and dividends are taxed at a favorable rate of 15%. But based on the results of the recent federal elections, we share the view of most tax analysts that these rates will increase in 2010 or 2011 to most likely 20% or higher. If this occurs, capital gain sales and dividends that are accelerated into the final

days of 2009 or made early in 2010 may avoid this rate increase. Sales of real estate and closely-held corporate stock to family members are examples of transactions that would be better placed in 2008 or early 2009 than in the next few years. For those receiving payments on older installment sales, we should discuss strategies to take before year-end that can accelerate the remaining gain into 2009 or 2010.

### **Cost Segregation of buildings or improvements**

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 methods and shorten the useful life categories which can accelerate your tax deduction for depreciation in excess of your book depreciation methods used for your financial statements.

### **Dividends**

Many C or S corporation shareholders that own dealerships generating taxable losses in 2009 and are also employees of the corporation may want to consider reducing their wages and taking the balance needed to maintain an appropriate lifestyle as dividends. If the wages being paid to the shareholder are not benefiting the corporation in the way of expense, shifting the type of payment from wages to dividends reduces the current year income tax and also lowers social security taxes. It is necessary to continue paying "reasonable" wages for the work being done.

### **Parts inventory adjustments**

Make sure to reconcile your parts inventory balances on your books with your parts inventory counter pad. This is normally done if a physical parts inventory is taken but does not require a physical parts inventory. Often reconciling the two inventory balances can result in decreased taxable income.

### **Receivable write-offs**

Review past due customer accounts receivables and determine those that appear to be uncollectible. Write-off such accounts to bad debt expense. Remember that uncollectible factory incentives, rebates, and other receivables also can be written off.

### **Meals and entertainment expense**

Many dealerships lump all meal and entertainment expenses into one account. As a result, most of these expenses will only have one-half of the expense deducted on the company's tax return. Such expenses should be reviewed by dealership personnel to determine those that are 100%, 80%, and 50% deductible. If you would like further information on which expenses qualify for the different deduction amounts, please give us a call.

### **Watch out for officer note payable repayments**

If the dealership, or another business, has generated taxable losses in the past, review current year loan repayments made to shareholders. If prior year losses have been taken based on money loaned by shareholders, the repayment of such loans may create taxable income to the shareholder in the year of

repayment. You should review your loan activity in 2009 and consult with your tax advisor to determine if an unwelcome tax surprise may result.

**Review January expenses and other chargebacks**

Care should be taken to assure that finance, service contract, and other chargebacks received in January next year are recorded in 2009. Such chargebacks and other expenses may not be received until after the financial statement and month-end are closed, but should be recorded in completing your income tax returns so that you receive the deduction in the current year, not 2010. In 2009, it may also be possible to deduct employment taxes which will not be paid until 2010 on bonuses and other salary accrued for the 2009 tax year.

**Maximize contributions to your 401k and other retirement plans**

Many dealerships have retirement plans setup so employees can make contributions that are not included as income. Most of these plans have limits on the amounts that officers and owners of the dealership may contribute (and sometimes require that such contributions are returned at end of year); however, frequently we find that owners are not contributing as much as they are allowed to and miss opportunities to make this up after the year ends. You should be contacting your retirement plan administrator to find out if you can contribute additional funds to these accounts

**Gift and estate taxes**

You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before year-end. You may give \$13,000 in 2009 to an unlimited number of individuals to reduce the costs of an onerous 45% federal estate tax to your heirs, but you cannot carry over unused gift exclusions from one year to the next. For those with children or grandchildren that may be facing future higher education costs, we can assist in designing a gift strategy that uses tax-free Section 529 college savings plans.

These are only a few of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a specific plan that will work best for you.

Sincerely,

***LarsonAllen Dealership Group***  
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