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LIFO for Auto Dealerships Video Transcript

Chad Martin, CPA, CFE
Chris Burnham, CPA

Chad Martin (00:10):

Hello, I'm Chad Martin, a Director here with Barnes Dennig. We work with auto dealership groups in southwest Ohio, Northern Kentucky, and Southeast Indiana. We have been for about 30 years. I'm here with Chris today and we're gonna talk about some issues with auto dealerships.

Chris Burnham (00:27):

How's it going?

Chad Martin (00:28):

So one item that we've been noticing with auto dealerships and, and you probably have as well since last year, is the inventory levels. The amount of cars on lots of dealerships. You know, we've seen a decline in the, the number of cars they have for sale, predominantly in their new cars. But we've also seen that some in the used car area as well.

You know, the manufacturers really slowed down during the pandemic and, and manufacturing those vehicles and then getting those to the auto dealers' lots. This has caused a lot of concern among buyers being able to find the car that they're looking for and the color and the options, those kinds of things. In some cases, even being able to find a car, the model car that they're looking for, has been rather difficult. So this has caused some of the pricing to increase on vehicles.

(01:22):

We've seen a lot of the rebate programs for manufacturers really go by the wayside during the pandemic, during this shortage. And auto dealers as well are trying to find that inventory to get their allotment of, of cars on the ground to be able to sell to their customers.

This has caused an increase in profit margins for auto dealers because with the shortage of supply and there's a high amount of demands as people weren't buying as many cars early in the pandemic. This has caused that, that pricing and the gross profit for dealerships to, to increase.

We've seen that in the new vehicles. We've also seen that in used vehicles to some degree as well as the, the service and the finance and insurance portions of their, the auto dealerships operations. So next I'm gonna turn it over to Chris and let him talk about the LIFO aspect of inventory.

Chris Burnham (02:18):

Yeah. So, you know, what Chad was stating is, you see it all over and with, with your dealerships you're driving by, , you know, there's used cars that they have displayed in the very front and that's not common because you know, getting new cars was not an issue before.

So with the challenges of having a much lower volume of new cars, uh, has caused a lot of these dealerships that have been on LIFO to recognize a big LIFO capture. So what we're noticing with our dealerships is they had to take in all of that into income this past year and they have thrown around the idea, and this is the NADA that is talking with Treasury, just trying to get relief for these dealerships that can't replenish the new inventory.

(03:12):

And it really is out of their control due to the microchip shortage that I know is a big big thing going on. That is a big driver for this, pandemic-driven. And they are trying to get relief for these dealerships. So their plan as they're talking to Congress is they want to file under section 4 73, which is your foreign trade interruptions. And essentially they will give dealerships a few years to replenish their inventory. So with that relief, they've thrown around the idea that they could have a retroactive adjustment to their return so you don't have to amend a return. Essentially, what would happen is the extra tax that they paid on that life over capture would be a prepayment of taxes for the following year. So our dealerships have already filed because they had a 9-15 deadline.

(04:11):

So we can't make that change now. But the welcome news for the dealerships is that we wouldn't have to go back and amend, and they would have time to replenish their inventory. The hope is that there will be more microchips and they will have other sources of, you know, ways that they can make those even domestically and they could supply those to the dealerships. But as of now they're still working with Treasury. The NADA is really fighting on the dealerships' behalf to try to get that relief for them. So we're keeping an eye out on that, letting our dealerships know too. But that has been a pretty big issue.

So, one thing I thought was very interesting too is just how resilient the dealerships have been through just all these market indicators that, you would think with high inflation, high interest rates, GDP that has gone down the past two quarters that consumers would steer away from getting cars things like that that they can do without and hold onto their old car.

(05:33):

But we haven't really been seeing that with, with our clients and it seems like nationwide has not been the case.

Chad Martin (05:39):

Yeah, there seems to have been, during the early part of the pandemic, a lot of people were not buying, replacing their vehicles, they weren't buying new cars. And then coming out of the pandemic there's just a lot of pent-up demand for purchasing or replacing their cars. One one statistic that's tracked is the

average age of used cars on the roads in our country and the average age has been climbing up there because they have not been replacing those vehicles. So, good point.

Chris Burnham (06:09):

Yeah. And what we're noticing as he's mentioning the average age is as these consumers cannot find the new cars that they typically would have in the past, they're holding onto their used cars a lot longer. And we're noticing their fixed operations, their body shop, their service departments, they're, they're at record levels right now.

And it makes sense just because the average age of the car is a lot longer than it has been in the past. So the dealerships have been very creative in finding ways to be profitable and they continue to be very profitable. It's just coming from different sources than it would have in the past.

Chad Martin (06:47):

So, Chris, tell me a little bit about, as we talked about LIFO, if a dealership group has not been on LIFO in the past and are thinking about electing to be on the LIFO inventory method for their vehicles. What are some things they need to think about there?

Chris Burnham (07:07):

So one of the main things we will keep in mind, if they're thinking of electing LIFO is, do they plan on selling the dealership anytime soon? Is there going be a change in ownership in the near future? If that's the case, then it wouldn't make sense for them to elect LIFO because they're going to have to take back all of the tax savings that they had over the, let's just say three to five years that they were in existence before switching owners. So we'll kind of steer away from telling clients, Hey, you need to go on LIFO. But if you have a younger owner that really plans on growing the dealerships, it is really an easy way to, find ways to save on taxes by electing LIFO.

Yes, there's a little more work involved in adopting LIFO for all these dealerships, but they will more than make up for it with the taxes, deductions, that they're getting year after year. On top of that, they're electing it when inventories are at an all-time low. So it, it really would be beneficial for a lot of the dealerships to just explore the option. It can't hurt to ask the question. If the answer's no, we can at least ascertain as to why. But there are instances that it would work out that electing LIFO would be the right choice.

Chad Martin (08:33):

Yeah. So a lot of our dealership groups and a lot of dealerships around the country are on LIFO inventory method and it's, for a lot of them, it makes a lot of sense and they've been able to defer a lot of income tax, because of that inventory method. So consider that if you're not on LIFO, reach out to us. We can certainly talk through that with you. You thank you for joining us today and we'll see you next time. Thanks.