

INSIGHTS FROM THE BDO AUTO DEALERSHIPS PRACTICE

PROPOSED RELIEF FOR DEALERSHIPS USING LIFO

The supply chain for many U.S. companies was disrupted due to the global COVID-19 pandemic, and inventory levels at the end of 2020 and 2021 were significantly reduced. As a result, many companies using the last in, first out (LIFO) inventory method experienced an involuntary liquidation of their LIFO layers.

A LIFO liquidation occurs when sales of inventory exceed purchases and a company must accelerate lower costs from prior years into costs of goods sold in the liquidation year, which results in recognition of previously deferred gain. This increased taxable income may hamper companies' recovery from the pandemic, and for some companies, poses cash constraints to cover the additional tax due. Further, when companies restore inventory to its normal level, the liquidated LIFO layers will be replaced with an increment valued at current-year costs; therefore, income resulting from the involuntary liquidation of the LIFO inventory will be permanently recaptured.

Internal Revenue Code Section 473 gives the Treasury Department the authority to grant relief for qualified inventory interruptions under Section 473(c), which includes a "major foreign trade interruption [that] has made difficult or impossible the replacement during the liquidation year of any class of goods for any class of taxpayers." However, Treasury has to date declined to do so, despite intense lobbying by the auto industry, the American Institute of Certified Public Accountants (AICPA) and many members of the House and Senate.

On April 4, 2022, House Ways and Means Committee members Daniel T. Kildee, D-MI and Jodey Arrington, R-TX introduced new bipartisan legislation (the Supply

Chain Disruptions Relief Act) to provide tax relief to auto dealerships impacted by the pandemic and the global semiconductor shortage.

As proposed, the bill would deem the auto dealers experiencing qualified liquidations of new motor vehicle inventory to have satisfied the requirements for a qualified liquidation of LIFO inventory under Section 473(c). Auto dealers with a qualified liquidation of new motor vehicles can make an irrevocable election to not recognize any income that is solely attributable to such qualified liquidation for liquidation years ending after March 12, 2020, and before January 1, 2022, if the liquidated inventory is totally replaced during the replacement period.

Under the proposed bill, the replacement period begins with the first taxable year after the liquidation occurs (liquidation years ending after March 12, 2020, and before January 1, 2022), and ends with the earlier of: a) the last taxable year ending before January 1, 2026, or b) the first taxable year after such liquidation with respect to which such dealer does not inventory new motor vehicles under the LIFO method (i.e., the replacement period ends if a dealer changes from the LIFO inventory method).

If an auto dealer fails to fully replace liquidated new vehicles during the replacement period described above, the auto dealer would be required to increase gross income in the last taxable year of the replacement period by the amount of income attributable to the qualified liquidation that would have been recognized in the liquidation year plus underpayment interest.

An election to apply the provisions of this bill for taxable years ending after March 12, 2020, and before January 1, 2022, would have to be made by the applicable tax return due date (including extensions) for such taxable year. Once made, the election would be irrevocable. For a taxable year for which the return has already been filed before the bill is enacted, the election would be treated as a change in method of accounting under the IRS automatic consent procedures. In that case, the election for a specified taxable year would be made by making an accounting method change on the tax return for the first taxable year ending after the bill's enactment date.

The bill is in the early stages of the legislative process — it has been referred to the House Committee on Ways and Means — but for affected taxpayers, the introduction of a bill represents

movement in the right direction. The bill must be approved by the the Ways and Means committee, and then it would go before the full House.

If the House passes the bill, it would move to the Senate for their approval process, and if passed, it would go to the President for signing. Note that at the end of April the Senate introduced a similar piece of legislation that mirrors the House bill — a further positive sign.

While the proposed Supply Chain Disruptions Relief Act applies only to new car dealers, the AICPA in a comment letter dated April 27, 2021, requested Section 473 relief for all taxpayers using LIFO that experienced a qualified liquidation for a liquidation year. The AICPA further recommended providing a safe harbor method under which a taxpayer would not recognize income attributable to the liquidation of these LIFO layers if the taxpayer completely replaces the inventory by the end of the replacement period. Taxpayers in other industries may wish to consider contacting their industry organization or their congressional members to attempt to obtain similar potential relief.

HOW BDO CAN HELP

BDO has a wealth of experience providing guidance to Dealership and Automotive Retailers like yourself when legislative changes occur. If you need advice on how maximize the value for your business, please reach out to one of the authors or Auto Dealerships team members listed.

CONTACT:

JORDAN ARGIZ, CPA

Audit Partner, Auto Dealerships Practice Co-Leader
305-503-1039 / jargiz@bdo.com

MEGAN CONDON, CPA

Tax Partner, Auto Dealerships Practice Co-Leader
206-382-7825 / mcondon@bdo.com

PETER PENTLAND

Tax Partner, STS Accounting Methods
312-730-1421 / ppentland@bdo.com

KAREN MESSNER

Tax Managing Director, National Tax Office, Accounting Methods
203-905-6259 / kmessner@bdo.com

LINA GEORGIEVA-IVANOVA

Tax Manager, National Tax Office, Accounting Methods
804-614-1171 / lgeorgieva-ivanova@bdo.com

ABOUT BDO'S AUTO DEALERSHIPS PRACTICE

BDO is a valued business advisor for auto dealerships, bringing a wealth of experience on traditional and emerging accounting, tax, and advisory issues. The firm's Auto Dealerships industry practice works with a variety of companies across the dealership sector, including automotive, motorcycle, marine, RV, rental equipment and more. We help dealerships of all sizes achieve their desired business outcomes.

ABOUT BDO

BDO USA, LLP is a professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 70 offices and over 750 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 95,000 people working out of more than 1,700 offices across 164 countries and territories.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. www.bdo.com

Material discussed in this publication is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2022 BDO USA, LLP. All rights reserved.