



BDO Driving Profits
NEWSLETTER

INSIGHTS FROM THE BDO AUTO DEALERSHIPS PRACTICE

Sales Tax: Common Risks, Overlooked Deductions and Refund Opportunities for Dealerships

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Dealerships are no strangers to sales tax audits. Although some sales tax matters, such as potential sales tax exemptions, may be top of mind for a dealership's management, complications can arise when factoring in multiple state requirements associated with deductions, refunds or incentives. This article summarizes some common risk areas, overlooked deductions, and refund opportunities.

MISSED OR MISCALCULATED BAD DEBT DEDUCTIONS

With each return, a retailer must report and pay sales tax applicable to the period in which sales occur, even when the purchaser finances the amount due at the time of sale. If the purchaser defaults on the amount financed, the dealership may generally claim a refund of sales tax related to the resulting bad debt. Additional considerations are reviewing requirements when there is a lender or financing company as part of the transaction and determining which partner has written off the bad debt for purposes of [Section 166 of the IRC/Internal Revenue Code](#). States that are part of the Streamlined Sales Tax Agreement also require review.

Special rules may apply when there is a repossession. For example, California allows a bad debt deduction only if the dealership sustains a net loss of gross receipts on which tax has been collected and paid. If faced with this scenario, dealerships should be aware of any special payment application rules that may apply. For instance, the California Department of Tax and Fee Administration (CDTFA), the agency that administers California's sales and use tax system, allows dealerships to apply payments using one of the following methods:

- ▶ The pro rata method may be used in a scenario where a bad debt is available when the wholesale value of the repossessed vehicle is less than the net contract balance (after excluding unearned insurance and finance charges) at the date of repossession.
- ▶ The contract method may be used in a scenario where a bad debt deduction is available when the wholesale value of the repossessed vehicle is less than the net contract balance at the date of repossession.
- ▶ Other methods negotiated with and preapproved by the CDTFA.

MISSED REFUNDS UNDER APPLICABLE LEMON LAWS

A manufacturer that repurchases goods may be eligible for a refund of the amount of sales tax it refunds to the consumer, lien holder or lessor. For example, if an automobile manufacturer repurchases an automobile because it cannot repair or correct a nonconformity after a reasonable number of attempts – meaning the repurchase is made pursuant to the state's lemon law warranty provisions– the Florida Department of Revenue will refund to the manufacturer any sales tax the manufacturer refunds to the consumer, lien holder or lessor.

APPLICATION OF INCORRECT RATES

Generally, a retailer must collect sales tax based on the applicable rate in the jurisdiction where the customer takes delivery of the purchased item. Some states, however, have special rate rules for dealerships. For example, in California, dealerships must assess and collect sales tax based on the rate that applies in the jurisdiction where the vehicle will be registered. Given that California allows localities to charge local rate surcharges in addition to the state rate, this differential can make sales tax collection and reporting more complicated.

MISSED EXEMPTIONS

Some vehicle sales, including sales to government agencies and military personnel and sales of vehicles used in interstate or foreign commerce, may be exempt from sales tax.

Sales made pursuant to government purchase orders are often nontaxable. These exemptions are often limited to sales made to the federal government, but dealerships should review state rules to see if the exemptions extend to state, county and

city agencies. Dealerships should obtain and retain copies of purchase orders to support the nontaxable nature of the sales.

Sales to active-duty military members are often nontaxable. Dealerships should ensure they are obtaining and retaining applicable documentation under their states' laws.

Sales of some new, used or remanufactured vehicles may be exempt if the vehicles are removed from the state of sale and used exclusively in interstate or foreign commerce. Dealerships should ensure they are obtaining and retaining applicable documentation under their states' laws.

While more limited, a review of a state's nontraditional application of their manufacturing exemption to retailers including auto dealers. Michigan, for example, would allow its manufacturing exemption to apply to activities such as reconditioning of used vehicles and performing original warranty repairs. Other states could be reviewed as well to maximize exemption opportunities.

SPECIALS AND INCENTIVES

Special rules may apply to pricing offsets and other incentives, including discounts, trade-ins, dealer and factory incentives, other special charges and gas incentives.

Discounts and trade-ins are often treated differently. Dealerships are generally required to assess and collect tax on the total vehicle selling price and should be aware of how their

states require them to calculate that price. For example, many states allow dealerships to deduct discounts from the selling price but do not allow deductions for trade-in allowances. In anticipation of potential abuse in this area, states often prohibit dealerships from treating a trade-in allowance that exceeds a vehicle's fair market value as a discount of the selling price. To further (potentially) complicate things, discounts that involve third parties (e.g., rebates) may be taxable.

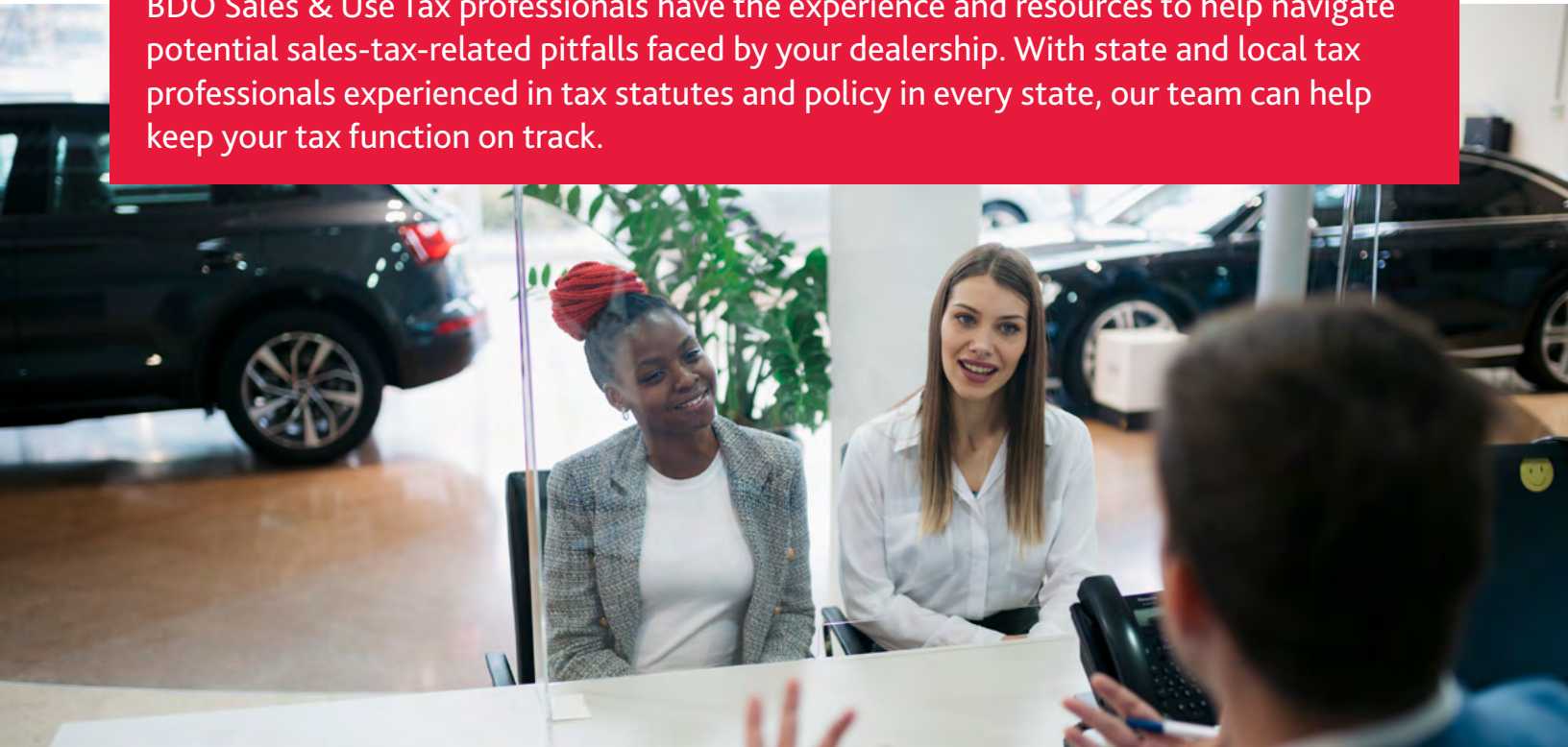
Dealer and factory incentives are subject to different tax rules. The treatment of an incentive varies depending on who offers the incentive and what the nature of the incentive is. Tax generally applies to incentives that involve dealer-purchased supplies; however, manufacturer incentives may be excluded from the sales price.

Special charges might be taxable in some states. Dealerships should understand when charges such as documentation fees, finance charges, and emissions certifications are taxable.

Dealerships often turn over vehicles to purchasers with full tanks of gas. Whether the gasoline charge is taxable depends on how it is presented to the purchaser – that is, whether it is itemized or included in the price of the vehicle – so dealerships should be mindful of the tax implications of their invoicing methods. Because there may be documentation requirements to support the exempt nature of gasoline sales, it is important for dealerships to maintain sales documentation, provide resale certificates to fuel vendors, and the like.

HOW BDO CAN HELP

BDO Sales & Use Tax professionals have the experience and resources to help navigate potential sales-tax-related pitfalls faced by your dealership. With state and local tax professionals experienced in tax statutes and policy in every state, our team can help keep your tax function on track.





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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.

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