Manufacturer Assistance Payments to Automobile Dealerships for Facility Improvements & Image Upgrades

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- The many different programs introduced in recent years by manufacturers to encourage their dealers to expand or completely rebuild their facilities have raised an assortment of legal, tax, accounting and practical issues for dealers and their advisors.
- In interacting with their dealership constituencies, the manufacturers have never done anything without expecting an equal, if not greater, benefit in return. Accordingly, it does not seem to be unreasonable to conclude that dealers are providing services to the manufacturers in return for their receipt of assistance payments under these programs.
  - It is difficult to imagine circumstances - or manufacturer plan specifics - that could possibly support any treatment to the contrary. Has any manufacturer … Ford, Chrysler, General Motors, or any other … ever done anything that was not in its own best business interests … or without exacting (at a minimum) a *quid pro quo*?
- There is an extensive body of case law dealing with taxpayers' attempts to treat various payments received from manufacturers, distributors and other sources as non-taxable reductions in cost basis or as contributions to corporate capital under Section 118. There is also extensive IRS guidance - some precedential and some not precedential - on this issue. This case law … and related IRS guidance … extend far back to many years before Section 118 came into the law in 1954.
- The *John B. White, Inc.* case (decided in 1971 by the Tax Court and upheld on appeal in 1972) and the *Detroit Edison* case present the most formidable barriers against dealerships successfully sustaining the position that payments they receive from manufacturers for facility improvements and upgrades can be excluded from taxable income.
- Some dealership advisors believe the argument can be made for excluding payments under some manufacturers' programs from dealership taxable income. In part, they may be placing reliance on the favorable outcomes taxpayers obtained in the (1) *James Brown*, (2) *Freedom Newspapers* and (3) *GM/GMAC* cases.
  - However, upon careful analysis, there is a common denominator in these cases which makes them inapplicable to factory facility upgrade payments.
  - In essence, after receiving a payment to induce them to purchase an asset, the taxpayers involved in these cases simply netted back to not being out-of-pocket for an amount in excess of the fair market value or market value of the asset that was being purchased (i.e., (1) the minority interest in a closely-held corporation in the *James Brown* case, (2) the *Floridian* tabloid that the taxpayer in *Freedom Newspapers* acquired, or (3) the retail installment sales contracts (RISCs) that GMAC was acquiring from GM dealers).
  - This difference clearly distinguishes the fact patterns in these three cases from the receipt of payments by many dealerships under various and sundry Factory facility upgrade program(s).
  - This difference also distinguishes them (1) from the Tax Court's decision in *John B. White* which held that the payments from a manufacturer (Ford) to a dealer were taxable upon receipt and (2) from the fact patterns in LTR 9452003 and in the IRS Coordinated Issue Paper (1996) and Settlement Guidelines (1998) on tenant allowances paid to retail store operators by shopping mall developers.
  - Therefore, it may be extremely difficult for a dealership to successfully sustain the position - against the IRS - that payments under a manufacturer's facilities improvement or image upgrade program should not be treated as ordinary income when received.

- The position of the IRS is that the exclusion from income for contributions to the capital of a corporation which is allowed by Section 118 applies ***only to corporations***.
  - This would exclude from Section 118 many dealerships that conduct operations in non-corporate form (i.e., as disregarded entities electing to be taxed as partnerships or LLCs).
  - The IRS is actively monitoring and challenging partnerships that are trying to secure the non-taxable treatment benefits of Section 118. The Service describes these non-corporate entities trying to fit under Section 118 as attempting something which the IRS considers to be ***abusive***.
- Some Programs, to a lesser or a greater degree, contain repayment obligations and/or forfeiture provisions that would require the dealership to repay funds provided by the manufacturer either in full or according to a sliding scale over time if the dealership fails to satisfy some or all of the conditions of the Program.
  - Some CPAs contend that amounts received under these Programs may be characterized or treated as non-taxable loans (rather than as taxable income immediately upon receipt).
  - This contention has been addressed in analogous factual situations in both case law (*Colombo*, 1975) and in IRS guidance (LTR 9308001) … with results unfavorable to the taxpayer.
- In filing income tax returns for years in which manufacturer assistance payments have been offset against basis (i.e., charged against either fixed asset and/or goodwill or other accounts) in reliance on the position that these payments are Section 118 contributions to capital or on some other theory, consideration should be given to adequate disclosure in the tax returns and to potential accuracy-related penalties against the preparer and other penalties against the taxpayer that the IRS may allege should be imposed.
  - This involves Schedule M-1, M-3 and/or Schedule UTP disclosure matters and/or whether Forms 8275 should be filed with the tax return.
  - There are also change in accounting method implications and statute of limitation considerations because different depreciation deductions will result from treating manufacturer payments as reductions of cost basis under Sections 118, 1012, 1016 or some other common law theory.
- At this time, there is no specific precedential "guidance" from the IRS on the proper tax treatment by dealerships for payments received from the manufacturers under their various and sundry facility improvement and image upgrade programs.
  - These programs and the difficult tax issues they raise should become a new priority item requiring published guidance if the IRS hopes to enforce any degree of consistent treatment by dealerships.
  - In this respect, one other important (and yet unaddressed) question is: Should the present fair market value of payments to be received be included as income, at a discounted amount, when the dealership begins to participate (or agrees to participate) in a manufacturer's Program? This is especially relevant to per car bonus incentive arrangements where dealer participation in a Factory image upgrade program results in payments to the dealership which are applied (in the very near future) against inventory purchased from the Factory.
- In interpreting the new Tangibles Regulations effective Jan. 1, 2012, many practitioners are of the opinion that … as a matter of proper "risk management" by the dealership … the adverse effect of reporting manufacturer payments as income can be mitigated (to some extent) by complying with provisions in the new tangibles Regulations.
  - However, practitioners should approach the interpretation of the new T-Regs expecting that it may be very difficult to avoid capitalizing substantial amounts of expenditures unless unusually favorable extenuating "facts and circumstances" override the detailed rules.

Source: ***"Taxation of Manufacturer / Factory Upgrade Program Payments to Automobile Dealers"*** **presented by Willard J. De Filipps, CPA for De Filipps University on Sept. 19, 2012.**