



TAX ALERT

Vendor Money Program Payments are Gross Income to Auto Dealers

Vendor money arrangements are customary in the retail industry, and due largely to the fact specific nature of the programs and agreement terms, frequently result in inconsistent treatment by taxpayers and significant controversy with the IRS on examination.

The IRS National Tax Office has recently issued an advice memorandum outlining their position on the taxability of amounts received by dealers from automobile manufacturers to pay for store improvements. Based on this ruling the IRS will classify monies received from manufacturers under facility image upgrade programs as gross income. In the past, some dealers have argued that these amounts represent a contribution of capital, a purchase price adjustment to vehicles (e.g. a trade discount) or a reimbursement of improvement costs, and are therefore a reduction of the improvement costs and not gross income. The IRS has now gone on record to disagree with these arguments. The IRS defends its position by stating the manufacturers are paying for improvements to dealer-owned property and as a result the dealers benefit economically from the incentive payments. As worded in the advice memorandum, "...the dealerships have an accession of wealth... accordingly the dealerships must recognize

gross income." The IRS also reasons that the reimbursements are taxable income because the dealers are being compensated by manufacturers for making the improvements with the manufacturer's objective of selling more cars to the dealers, making the payments a direct benefit for the manufacturers thus meriting that the dealers be compensated.

Although the guidance states that it "should not be used or cited as legal precedent," retailers with similar vendor money arrangements in place (that are currently excluding the program payments from income) should be aware of the Service's contrary position and may want to consider filing Form 3115 to obtain the Service's consent to change their method of accounting for these payments. Additionally, the guidance serves as a general reminder to taxpayers that receive significant vendor money payments to periodically review the terms of their arrangements and ensure their current accounting methods for these payments are compliant and optimal under current tax law.

If you have questions related to this or other tax matters please contact your GBQ tax advisor.