APPRECIATION FOR DEPRECIATION

Bonus Depreciation Makes LHPH a Compelling Model in Unpredictable Times

With a new administration in Washington, the BHPH/LHPH industry is facing significant uncertainty in what the future holds from a regulatory and tax liability perspective.

Innovation and adaptability are the driving forces of companies that have been successful throughout the past year, and of those that will continue to flourish through an unpredictable future.

How can a Buy Here-Pay Here dealer become more resilient during this unprecedented time?

One way is by introducing leasing to the dealership.

BHPH enables you to profit off the cars you bought at auction, sold and financed through your related finance company.

Leasing allows you to maintain ownership of that vehicle and maximize profits through two or three customer cycles – *and* receive tax benefits in the process.

Welcome to the world of Lease Here-Pay Here.

The sales tax advantage piece of Lease Here-Pay Here is one of its most well-known benefits for dealers located in "pay-as-you-go" states.

But the LHPH business model also allows for many other benefits, including (but not limited to) improved profitability, competitive advantage, residual cash flow, customer retention and a federal income tax deferment.

The 2018 Tax Cuts and Jobs Act gave LHPH a significant advantage by allowing dealers to claim 100 percent bonus depreciation during the first year on used vehicle purchases for leasing until 2023.

Post-2023, bonus depreciation will decrease by 20 percent each year. That makes it an incredible tax-saving opportunity for the next seven years.

Depreciation from the assets in your LHPH portfolio is reported as an expense on your federal income tax return.

That expense can offset taxable income and often generate a net operating loss for LHPH dealers, allowing them to defer their annual income tax liability for subsequent years, depending on the size of their portfolio.

For example, if you purchase and lease 15 cars a month for one year with an average actual cash value of $8,000, with bonus depreciation you could depreciate 100 percent of the 180 vehicles in your portfolio.

That would result in a total deduction of $1.44 million against whatever profits you made from your dealership that year, and would possibly offset other entity income depending on the structure of your business.

That's a benefit of LHPH that often goes overlooked by dealers considering making the transition from BHPH, and it represents a substantial opportunity.

There is uncertainty as to whether the 2018 Tax Cuts and Jobs Act will remain intact or whether it will be amended or dramatically altered by the new administration. But even if changes are made, standard asset depreciation will likely remain available to LHPH dealers in the form it has taken for decades, and it's worth exploring with a qualified CPA.

Leasing is a great opportunity to elevate your dealership and maximize profits on your assets while deferring tax liability, even in year one.

As an example of the impact of the standard straight-line depreciation method for an LHPH dealer, let's imagine a dealer with 300 accounts in his portfolio and an average ACV of $6,000 per vehicle.

If we use a simple, five-year depreciation rate down to zero (20 percent per year), the dealer has $1.8 million in assets in the portfolio and the depreciation available to claim each year will be $360,000 to offset net income.

That's still a significant tax benefit for the dealership on an ongoing basis, even without bonus depreciation.

While the sales tax advantage is the best known benefit of LHPH for cash flow purposes, depreciation and the income tax benefit is often cited by new LHPH dealers as a major reason they made the switch from BHPH.

Leasing is a great opportunity to elevate your dealership and maximize profits on your assets while deferring tax liability, even in year one.

That benefit – along with differentiating yourself from other dealers by being able to offer your customers a newer, more reliable vehicle for a payment they can still afford – makes leasing a compelling model in today's environment. ▪

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