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2020 NADC 16th Annual Member Conference April 26-28, 2020



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IRS Issues Proposed Final Regulations on Bonus Depreciation and Floorplan Indebtedness

By Zach Wimberger, *Rosenfield & Company*

On September 13, 2019, the IRS issues proposed regulations on the outstanding issues as they related to section 163(j) of the Tax Cuts and Jobs Act of 2017 (TCJA). Section 163(j) introduced a new limitation on business interest expense that only allowed for the deduction of 30 percent of a business's adjusted taxable income. Any interest expense over this amount was disallowed and carried forward into the next taxable year. NADA lobbied heavily to have dealer floorplan interest expense be exempt from this new limitation under the premise that it was an ordinary and necessary business expense due to the unique nature in dealership operations. The IRS reviewed and agreed to put in place an exception on floorplan interest expense, allowing it to be 100 percent deductible as an ordinary expense. The tradeoff, however, was that the newly allowed 100 percent bonus depreciation on new and used fixed asset additions would not be applicable for any trade or business that had excluded floorplan interest from limitation.

The Joint Committee on Taxation Blue Book, released late in 2018, gave an interpretation, and numerous examples, including an option on taking this floorplan interest exclusion. The

Blue Book gave examples that if a business had adequate taxable income and did not need to take the floorplan interest exception, they could treat this interest as ordinary subject to the 30 percent limitation and could take advantage of the 100 percent bonus depreciation for that year. However, once the business decided to use the exception, the election was considered permanent, and that business entity could not take bonus depreciation in any subsequent tax year. Additionally, a taxpayer could decide to not use the floorplan exception, even if they did not have enough taxable income to cover the 30 percent threshold listed above. That decision enabled them to use the 100 percent



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bonus depreciation expense in current and future years, and disallowed interest expense would be carried over to 2019 and so forth.

As part of the recently passed IRS proposed regulations, the floorplan interest exception has now become an annual calculation. If the dealership takes this exception in 2019, for example, bonus depreciation cannot be claimed and deducted. In 2020 it can still claim bonus depreciation if taxable income is enough to treat floorplan interest as business interest subject to the 30 percent threshold. However, the IRS does not view the floorplan interest exception as optional, meaning that once a businesses floorplan interest exceeds the 30 percent taxable income limitation in any given year, the exception must be taken and the dealership cannot claim bonus depreciation. This drills down to dealerships having one of two paths in each taxable year:

- If a dealership has enough taxable income in any given year to cover all the floorplan interest expense without limitation, full bonus depreciation is allowed for any fixed assets including service equipment and furniture, as well as any specified real estate placed in service for that year, as a tax deduction.
- If a dealership does not have enough taxable income in any given year to cover all the floorplan interest expense, then the dealership must take the floorplan interest exception and applicable bonus depreciation is not allowable for that tax year.

This is a significant change from the Blue Book examples that many accounting firms used as guidance in the preparation of their dealership clients on 2018 tax returns. Due to the timing of these proposed regulations, the IRS noted that a large amount of returns had already been filed following the Blue Book's guidance. The IRS is currently determining how to address filed tax returns where there was not enough taxable income, but the dealer voluntarily chose to not take the exception, treating floorplan interest as ordinary (to take advantage of bonus depreciation), creating a disallowed interest limitation carry forward to 2019.

In instances where 2018 tax returns have been filed where the floorplan exception was taken, even if combining floorplan and regular business interest together did not exceed the 30 percent limitation, a dealer may want to consider amending to take advantage of allowable bonus depreciation, if applicable. Please have your clients consult their tax advisors. Additionally, when the TCJA was passed, there was a question whether lessors who lease real estate to a business with floorplan indebtedness would be able to take advantage of the bonus depreciation if the business had used the floorplan exception for the tax year. The current proposed regulations provide that the lessor is not prohibited from taking bonus depreciation in the scenario where it leases property or equipment to a business with floorplan indebtedness.

The IRS has also addressed qualified improvement property placed in service after December 31, 2017. Historically, the three classes of qualified improvement property (leasehold, restaurant, and retail)

Updated Member Contact Information

Please make sure to notify NADC Staff (info@dealercounsel.com) if your contact information has changed so that your records can be updated accordingly. We list updated contact information in *The Defender* so all members can be aware of the change.

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were all classified as having a fifteen-year recovery period. With the passing of the TCJA, these three classes of property were replaced by one overarching category of qualified leasehold improvement. The provision to have this newly defined category be fifteen-year property and eligible for bonus depreciation was inadvertently omitted by the drafters of the TCJA. Consequently, all qualified property placed in service in 2018 and beyond is now classified as thirty-nine-year property, ineligible for bonus depreciation. In the proposed regulations, the IRS has noted that a technical correction would have to be made by Congress to allow for a fifteen-year recovery period and the use of the bonus depreciation provision.

These clarifications and updates of bonus depreciation in the proposed regulations are generally considered taxpayer friendly, as the opportunity for dealers to still be able to take advantage of bonus depreciation is now available. As part of the TCJA, both dealership entities and real estate entities that held the dealership properties were not eligible for bonus depreciation. These proposed regulations have not been made final yet, and public hearings are scheduled for any comments. Until then, dealerships can rely on them for as they relate to qualified fixed assets and properties. ■

Zach Wimberger joined Rosenfield and Company as part of the firm's successful internship program in 2014 and transitioned to a full time member of the Tax Services Team in 2016. Zach has a passion for the Automotive Industry and works with some of the firm's largest automotive clients. He specializes in Cost Segregation Studies, LIFO and Dealership



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“Remembering the Past, but Always Looking Forward”

After completing the 2019 Fall Conference, I encourage us to take the time to reflect on the beginnings of the National Association of Dealer Counsel (NADC). In the Spring of 2020, we will have our 16th Annual Conference. The first annual conference was held in 2005. We should always recognize Jonathan Harvey's vision to create this Association with a small group of lawyers from around the country. I was not present at the initial annual conference, as I did not learn of the NADC's existence until its second year, and I immediately joined. I remember attending workshops and meetings in such areas as Baltimore and Dallas, where forty to fifty members were present. The NADC quickly grew from its humble beginnings of less than ten original members. By 2009 membership had grown to approximately 300 members. The 2009 bankruptcy proceedings, which harmed our motor vehicles dealers, cemented the need for this organization. Now, we exceed 650 members. Our recent 2019 Fall Conference had approximately 240 members attend, which I believe to be a record for a Fall Conference. While we should always remember our founding members, and thank those who started this great organization, one of the great strengths of the NADC is that it is always looking forward to better serve its members.

We take your suggestions and comments about NADC conferences quite seriously. We experimented with dual tracks for the first time this Conference, and are looking forward to seeing your thoughts on this new schedule.

This past summer, the NADC completed a survey of our members and engaged in strategic planning with the Board of Directors and a Strategic Planning Committee. We are well on our way to shaping the NADC's strategic plan for the coming years.

The primary strength of the NADC has always been its members tremendous knowledge and their willingness to share. In turn, NADC members are able to most effectively represent our dealer clients and protect them from the legal challenges of their quickly involving industry. Have no doubt, the Strategic Planning Committee realizes that this is the primary goal and strength of this Association. Our

challenge looking forward is to how to make this Association even better for you. We will continue to experiment and explore ways to better present and disseminate knowledge about current and timely issues. Please don't hesitate to offer comments and constructive criticisms so that we can assure that this primary goal is achieved at the highest level.

New members, I encourage you to become involved. Please don't hesitate to offer an article to our *Defender* magazine. Our fearless editor Jami Farris, has been serving in this capacity for many years overseeing our newsletter. These articles do not need to be scholarly but address timely issues that you are experiencing. Reading about other's experiences provide insight to our ever-changing legal challenges. Please submit those articles.

Because it is so important, I will again repeat that the great strength of this association is its members and their willingness to share. Unless you are willing to contribute the way you have in the past, this Association's influence will be lessened. Please continue to submit the presentation proposals for our conferences and your learned comments on the NADC list-serve.

Amazingly, the Planning Committee is now receiving almost thirty submissions for presentations for each conference. The Planning Committee works very hard attempting to find the most-timely and beneficial presentations we can offer. No doubt, many great presentations are not chosen only because we do not have enough time to present all. If your submission has not been selected at a conference, please don't be offended. We may select the submission for perhaps a later conference. It is a difficult job to narrow thirty submissions to eight or nine.

As we approach our 15th anniversary, we do not forget the past, but wish to express to you, the members, that the Board of Directors is only looking forward to better serve you, and continue to make the NADC the singular organization best situated to represent the dealer client in their daily legal challenges. ■



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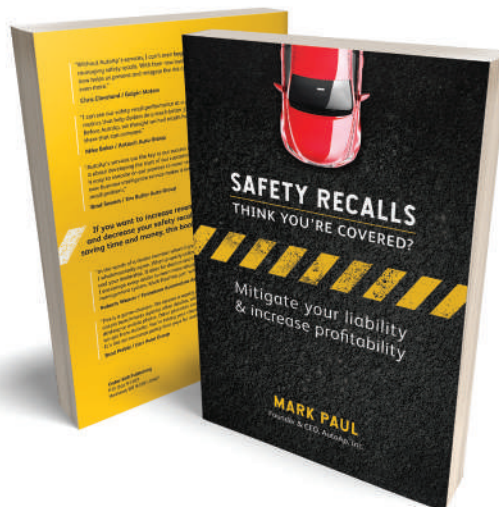
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Cognitive Bias and the Law: *Using Technology to Improve Legal Decision Making Under Risk**

By Oren Tasini, *Killgore, Pearlman, Semanie, Denius & Squires, P.A.*

What is Cognitive Bias?

In a well-known fable, a king was so grateful to the inventor of chess, he asked the inventor what reward he desired. The inventor asked to be given grains of rice, the amount of which would double for each of the 64 squares on the chessboard, 1, 2, 4, 8, etc. The king agreed. The king was not pleased when he learned the inventor would receive 9,223,372,036,854,775,808 grains of rice.

The king had fallen victim to the cognitive biases of overconfidence and the misperception of exponential growth. Estimating exponential growth is not optimal. With few exceptions, we cannot do large math problems in our head. Moreover, the sum of the first ten squares of the series (1, 2, 4, 8, 16, 32, 64, 128, 256, 512) is a sequence of small numbers. This creates a misperception that the total sum is not large. This cognitive bias is “framing”—the way information is presented greatly influences cognition.

Cognitive bias is the deviation from rationality in decision making. This deviation occurs because of how our brains process information. The first type of processing is instinctive and reflexive—fight or flight is a well-known example. This is called System 1 thinking. The second type of processing is more deliberative. The information that is received is analyzed using well thought out processes of human intelligence—we apply the tools we have to analyze the problem.

The influence of System 1 thinking is very powerful. Cognitive bias appears in many ways to influence decision making:

Overconfidence Bias

Overconfidence bias results from someone’s false sense of their skill, talent, or self-belief. This includes the illusion of control, timing optimism, and belief an outcome will occur because it is the desired outcome.

Self-Serving Bias

Self-serving bias is the tendency to attribute positive outcomes to skill and negative outcomes to luck. We view decisions in a way that will benefit us, even when it is not optimal.

Loss Aversion and the Endowment Effect

Loss aversion is the tendency to avoid losses and pursue gains, even when the opposite behavior would be more beneficial. In addition, we tend to value items we possess more than items we seek to acquire, placing an inflated value, an “endowment,” on the items we possess.

Framing

Framing is decision making based on how information is presented, rather than based on the objective facts. We pick heads over tails in a coin flip, because the choice of heads is presented first (“heads or tails”), even though the outcome is equal.

Anchoring Bias

Anchoring bias is the fixing of a decision based on how the information is presented, and then refusing to deviate from the anchor. This is similar to framing but involves a long lasting fixation on the anchor. In negotiations, the tendency to stick to an initial offer is anchoring.

Confirmation Bias

Confirmation bias is the tendency to seek out information and data that confirms pre-existing ideas. We ignore or reject any information that is contrary to our pre-existing ideas, even when the contrary information is objectively correct.

Hindsight Bias

Hindsight bias is the tendency of people to assert that they knew the outcome, even when their decision making before the outcome occurs shows they expected a different outcome.

Because cognitive biases are unconscious and involuntary, they are very difficult to overcome. Studies of techniques to counteract cognitive bias, such as “considering the opposite,” “sleeping on it,” and a team approach, show them to be ineffective.

Advances in Technology and Artificial Intelligence

So, how does one overcome the influence of cognitive bias which is part of the very nature of human behavior? The answer is simple—by using machines. A machine objectively analyzes data and provides an optimal decision. A machine’s cognition is not affected by bias. Machines are unemotional. Machines do not need food, rest, or fresh

* This is the last of three articles in the *Defender* regarding cognitive bias and the law. The first two articles can be found in the *Defender*, September 2019 and October 2019 editions at www.dealercounsel.com.

air. Machines can process a vast amount of data, far beyond what the human mind can process, with one hundred percent accuracy. And Artificial intelligence “AI” is the machine that can gather, process, and analyze the information.

AI encompasses any machine that can perform human task. It included calculators and photocopiers. The term “AI” is used as shorthand to refer to both the machines and the software used in AI. The AI that has recently been developed is far more advanced than a simple machine. The creation of AI that would be “human” was thought to be imminent in the 1950s. The task was harder than expected. There was no significant advancement in AI from the 1950s to 1990s. This period is referred to as the AI Winter.

Since the turn of this century, and especially in the last five years, there have been enormous advances in AI. The effort to create machines that equal or exceed human intelligence has yielded remarkable results—machines that think like humans, the “cognition,” but are free from the deviation from rational decision making, the “bias”.

The development of AI to play complex games at a level far in excess of human performance illustrates the advances in AI. In 2016 the AlphaGo program developed by Google’s Deep Mind division beat the world’s best Go player. This was a major advance from IBM’s effort in 1997, developing its Deep Blue computer to beat the world’s best chess player. Deep Blue selected its moves by analyzing all the possible moves (two hundred million), fourteen moves ahead. No human could perform such a computation so quickly; however, Deep Blue was just a very big calculator and no different than existing computers.

The game of Go is far more complex than chess. The game of Go has many more possible moves than a game of chess. Go also requires recognition of subtle patterns and strategies. A traditional computer, such as IBM’s Deep Blue, cannot win at Go by using brute force to calculate the possible moves.

Google’s AlphaGo computer utilized machine learning to master the game of Go. In machine learning the machine is not programmed in the traditional sense. The machine is instructed more broadly about a goal. The machine is then given samples of the data to be analyzed using the broad goal. For the AlphaGo computer, the dataset/training set was thirty million moves in actual games played by the world’s best Go players. After learning how to play from the training set, the computer then played games against itself to improve its performance. When matched against a human player AlphaGo beat the world’s best player 5-0.

From 2016 to 2018, DeepMind improved AlphaGo, with AlphaGo Zero and AlphaZero. AlphaGo Zero and AlphaZero used deep learning. Deep learning is the design of computers to mimic the processes in the human brain, by combining millions of nodes (“perceptrons”) with programming (“algorithm”). Deep Learning allows the computer to solve problems that are not explicitly coded. Each perceptron is like a human neuron in the brain. It takes in information and then passes it along to the next neuron, ultimately resulting in a response or a decision. Using deep learning and the neural network, the AlphaZero

played millions of games against itself. The AlphaZero computer initially played randomly and at a very unskilled level. Within three days, it beat the original AlphaGo computer 100-0. Within forty days, it acquired the cumulative knowledge of all known players who had ever played Go. AlphaZero also uses far less computing power—one tenth of AlphaGo.

AI as a Tool to Aid in Legal Decision Making Under Risk

The advances in AI have yielded real world solutions for lawyers. Across the broad depth of legal practice, AI is available to help lawyers make better decisions. By using these tools, lawyer can mitigate the influence of cognitive bias. A look into a sample day of a lawyer shows the breadth and depth of AI:

- In the morning a client calls to discuss a recent EEOC claim against her company filed by a former employee for gender discrimination. The client is concerned, as she has been reading numerous news accounts of a “wave” of Title VII lawsuits and “skyrocketing awards” to plaintiffs. She sends you a link to several articles. She asks if the company should settle and settle fast. You tell her that, based upon the technology the firm uses, the actual statistics on Title VII cases refutes the headlines. Claims are not skyrocketing—employers win over 70 percent of Title VII cases and the average dollar award to employees is quite low. You discuss the EEOC process and advise her that if the employee files a lawsuit it is likely to be in federal district court. You tell her that the firm uses a program that evaluates specific judges, how they rule in Title VII cases, what kinds of motions and pleadings are successful or unsuccessful before each judge. Before ending the call, you also tell her that the software can draft pleadings that are likely to be well received by the judge assigned to the case based on his prior rulings.
- Just before lunch a client calls you about a contract that needs to be prepared to provide construction services to a commercial developer. Time is of the essence, he tells you, because the developer wants the bid package, including the form of contract, by the close of business the following day. You tell the client not to be concerned. You remind him that the firm uses a contract extraction and assembly program. All of the client’s contracts have been coded based on the type of services provided by the client, so producing a new agreement takes seconds. The “AI” has also created contract templates that contain the terms most favorable to the client by assessing the material provisions of similar agreements which ended up in litigation and the outcomes in those litigations.
- Late in the afternoon, you have a telephone conference with a client and the firm’s lawyers handling the client’s acquisition. The sixty-day due diligence period has just started. The client wants to wrap up the due diligence as soon as possible. The firm’s lawyer heading up the deal team tells the client that by using AI all of the due diligence materials requested were digitized and analyzed within the first three days of the due diligence period. The AI extracted all the business terms of all the contracts and provided an analysis of

the terms and conditions of the contracts, including any provisions that vary from what is considered an industry standard.

- Before you leave for home, you receive an email, generated by the firm's AI that writes legal briefs in response to your request for a draft brief. Your client needs to file a reply brief in opposition to a motion for summary judgment. Your AI has analyzed your opponents brief, mined all known prior decisions in similar cases, and produced a comprehensive legal memo with all citations. The AI also finds case law that the other side's memorandum did not discover or failed to cite and the legal arguments to support the omitted case law.

Conclusion

Cognitive bias causes suboptimal decision making. Lawyers are continually faced with making decisions that have consequences. Because bias is hard wired into the process of acting on cognition, it is extremely difficult to overcome. Advances in technology, and artificial intelligence, provide tools to combat cognitive bias. These machines, properly utilized by their human makers, provide better decision making under risk. ■

Oren Tasini is a Partner with Killgore Pearlman. He was one of the founding members of the National Association of Dealer Counsel.

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